

Exhibit  
Staff 26  
10-23-07

**STATE OF VERMONT  
PUBLIC SERVICE BOARD**

Docket No. 7270

Joint Petition of Verizon New England, Inc.            )  
d/b/a Verizon Vermont, Certain Affiliates            )  
Thereof, and FairPoint Communications, Inc.        )  
for approval of an asset transfer, acquisition        )  
of control by merger and associated transactions    )

INITIAL BRIEF  
OF THE  
VERMONT DEPARTMENT OF PUBLIC SERVICE

October 17, 2007

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## INTRODUCTION

The Joint Petitioners have sought review of a transaction that would transfer ownership and control to FairPoint of the landline assets of Verizon New England, Vermont's most significant telecommunications service provider.

Judging the value and merits of the proposed transaction is no academic exercise. To deny this petition means retaining Verizon in Vermont – a telecommunications company which has made no secret of its desire to shift its strategic focus and priorities out of the state. The Department believes that the best outcomes for Vermonters are difficult to achieve when a key telecommunications player such as Verizon does not see Vermont as central to its business.

But nor do Vermonters have much to gain from a decision to approve this change of ownership, should it later prove that FairPoint could not deliver better value for the state, it's best intentions and good faith efforts notwithstanding.

After nine months of careful review and consideration, the Department on balance has concluded that the transaction as defined by the Joint Petitioners should not be approved by the Vermont Public Service Board. It is only with the addition of the conditions detailed in this brief that the Department is able to conclude that a modified version of the transaction would serve the public good and longterm interests of Vermont.

## PROCEDURAL HISTORY

### Petition

The petition (hereinafter the “Joint Petition” or the “Proposed Transaction”) in this docket was filed jointly on January 31, 2007 by Verizon New England Inc.<sup>1</sup> and FairPoint Communications, Inc. (hereinafter the “Joint Petitioners” or “Verizon” and “FairPoint” respectively).

A prehearing conference was held on February 23, 2007.

### Interventions

The Board granted permissive intervention to the following parties:

- The Communications Workers of America (“CWA”) and the International Brotherhood of Electrical Workers (“IBEW”) (collectively “the Labor Intervenors”);
- The Eight Independent Telephone Companies (collectively the “Eight Independents,” consisting of Shoreham Telephone Company, Inc. Topsham Telephone Company, Inc., Waitsfield-Fayston Telephone Company, Inc., d/b/a Waitsfield Telecom and d/b/a Champlain Valley Telecom; Northfield Telephone Company; Perkinsville Telephone Company; Ludlow Telephone Company; Franklin Telephone Company; and Vermont Telephone Company, Inc., d/b/a VTel));
- New England Cable and Telecommunications, Inc. and Comcast Phone of Vermont, LLC (collectively “Comcast/NECTA”);
- segTEL, Inc.
- Sovernet, Inc.

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<sup>1</sup> Joining Verizon New England Inc. in this petition are also the following affiliates: NYNEX Long Distance Company, Verizon Select Services Inc. (“VSSI”), Bell Atlantic Communications, Inc. (“BACI”), Northern New England Spinco, Inc. (“Spinco”), Northern New England Telephone Operations Inc. (“Telco”), and Enhanced Communications of Northern New England, Inc. (“Newco”).

- Vermont Electric Cooperative
- Burlington Electric Department
- Green Mountain Power
- One Communications Corp.
- Level 3 Communications, LLC

On August 14, 2007, the Board granted the motion of Level 3 Communications to withdraw from the case.

### **Discovery and Testimony**

The Petitioners filed direct testimony on March 23, 2007.

After two rounds of discovery, the Department and Intervenors filed direct testimony on May 24, 2007.

After one round of discovery, the Petitioners filed rebuttal testimony on June 27, 2007.

After one round of discovery, the Department and Intervenors filed surrebuttal testimony on August 10, 2007.

### **Hearings, Witnesses and Briefs**

Public hearings were held on:

- May 3, 2007, using the Vermont Interactive Television (“VIT”) network sites at Bennington, Castleton, Johnson, Lyndonville, Middlebury, Montpelier, Randolph Center, Springfield, St. Albans, White River Junction and Williston;
- June 13, 2007, in Cabot, Vermont;
- August 1, 2007 using the VIT sites at Brattleboro, Rutland, Johnson and Waterbury.

Technical hearings were convened in Montpelier on September 5-7 and September 17-21, 2007, at which the following witnesses appeared for cross-examination:

**For FairPoint:**

Peter Nixon (filed direct and rebuttal)  
Walter Leach (filed direct and rebuttal)  
Michael Haga (filed direct and rebuttal)  
Arthur Kurtze (filed rebuttal)  
Michael L. Harrington (filed direct)  
Michael S. Brown (filed rebuttal)  
John Smee (filed rebuttal)  
Brian Lippold (filed rebuttal)  
Michael J. Balhoff (filed direct and rebuttal)  
Michael T. Skrivan (filed rebuttal)  
Dr. Douglas C. Sicker (filed rebuttal)  
William E. King (filed rebuttal)

**For Verizon:**

Stephen Smith (filed direct and rebuttal)  
Pamela Porrell (filed rebuttal)

**For the Department:**

Christopher Campbell (filed direct and surrebuttal)  
Tamera Pariseau (filed direct and surrebuttal)  
Hans Mertens (filed direct and surrebuttal)  
F. Wayne Lafferty (filed direct and surrebuttal)  
Perry Wheaton (filed direct and surrebuttal)  
Curtis W. Mills, Jr. (filed direct and surrebuttal)

Scott Wierson (filed direct and surrebuttal)

Joel F. Jeanson (filed surrebuttal)

Ronald Behrns (filed surrebuttal)

By consent of the parties and with leave from the Board, Department witness Dr. Michael Ileo filed surrebuttal testimony but was excused from appearing for cross-examination.

**For Labor:**

Dr. Kenneth Peres (filed direct and surrebuttal)

Randy Barber (filed direct and surrebuttal)

**For NECTA/Comcast:**

Dr. Michael Pelcovits (filed direct and surrebuttal)

**For Sovernet/SegTel:**

Gary J. Ball (filed direct and surrebuttal)

**For Vermont Electric Cooperative:**

David Hallquist (filed direct and surrebuttal)

Direct briefs were filed on October 17, 2007. Reply briefs were filed on November 2, 2007.

**Motion Practice and Board Queries**

On March 23, 2007, FairPoint filed a motion for confidential treatment of certain prefiled testimony.

On March 23, 2007, Verizon filed a motion for confidential treatment of certain prefiled testimony.

On March 28, 2007, the Board issued an order approving a protective agreement that was executed by all of the parties.

On April 27, 2007, the Board granted the March 23, 2007 motions by FairPoint and Verizon for confidential treatment of certain prefiled testimony.



On May 23, 2007, Verizon filed a second motion for confidential treatment of certain prefiled testimony.

On May 24, 2007, FairPoint filed a second motion for confidential treatment of certain prefiled testimony.

On May 29, 2007, FairPoint filed a third motion for confidential treatment of certain prefiled testimony.

On June 5, 2007, the Board requested comments from the parties concerning the several motions filed by FairPoint and Verizon for confidential treatment of testimony.

On June 15, 2007, the Department responded, noting concerns about the adequacy of the averments filed by FairPoint and Verizon in support of their respective confidentiality motions. On August 10, 2007, the Department submitted a letter to the Board stating that its specific concerns regarding the Verizon averments had been addressed satisfactorily by Verizon, but continuing to express concerns about the logistical difficulties posed in this docket due to the volume of information for which Petitioners were seeking confidential treatment.

On August 17, 2007, Verizon filed a third motion for confidential treatment of certain prefiled testimony.

On August 22, 2007, the Board issued a memorandum noting that a large portion of the testimony and exhibits in this docket has been filed under the Protective Agreement as Allegedly Confidential. In some cases, motions had been made to protect specific elements of prefiled testimony. In other cases, motions had been filed referring to underlying discovery materials, but do not list specific lines in testimony or specific exhibits attached to testimony. The Board instructed Verizon and FairPoint to provide a complete listing of the elements of prefiled testimony, filed by any party, to which Verizon or FairPoint wished to allege confidentiality during the technical hearings. Both Verizon and FairPoint subsequently made these filings.

On August 23, FairPoint filed a fourth motion for confidential treatment of certain information.

### **FairPoint Motion to Exclude Testimony**

On June 25, 2007, FairPoint moved to exclude on hearsay grounds certain portions of the direct testimony of Dr. Kenneth Peres, an expert witness for the Labor Intervenors. On June 29, 2007, Labor objected, arguing that the testimony at issue was admissible through certain hearsay exceptions. The Board took the motion under advisement on July 12, 2007, and declined to rule in advance of the technical hearings. Ultimately, FairPoint consented to the admission of Dr. Peres direct testimony in full during the technical hearings on September 5, 2007.

### **Board request for comments re: Alternative Regulation Plan**

On July 12, 2007, the Board requested comments from the parties as to the necessity for broadening the scope of this proceeding to include 30 V.S.A. §226b or whether the Board should reopen Verizon's alternative regulation plan for further review pursuant to 30 V.S.A. §226b(i). On August 1, 2007, having received, reviewed and considered comments from Verizon, FairPoint and the Department, the Board decided against expanding the scope of this proceeding or reopening the alternative regulation plan.

### **Labor Motion to Remove Confidential Seal**

On September 17, the Labor Intervenors made a motion to unseal a portion of the evidentiary record. On September 18, 2007, FairPoint filed a response to the Labor Intervenors' motion. After oral argument later in the afternoon, the Board indicated on the record that it would stay its ruling until the next day to give FairPoint and the Labor Intervenors a further opportunity to reach a mutually agreeable solution. On September 19, 2007, FairPoint and the Labor Intervenors reported on the record that they were able to settle their differences. A portion of the record thereafter was removed from under seal.

## STANDARD OF REVIEW

The Board's jurisdiction to approve or disapprove the Proposed Transaction arises under two statutes:

Title 30, Section 107, which requires advance approval of the Board whenever a "company" acquires a "controlling interest" in a regulated utility, upon due notice and opportunity for hearing, and upon finding by the Board that the proposed transaction "will promote the public good." 30 V.S.A. §107(a) and (b);

Title 30, Section 311, which requires Board approval for certain mergers, upon finding by the Board that the merger "will not result in obstructing or preventing competition." 30 V.S.A. §311.

Accordingly, the Department has reviewed the pending transaction with emphasis on whether approving it would (1) promote the public good; and (2) not obstruct or prevent competition.

The Department's analysis has been guided by the fifteen considerations that the Board previously has used to examine other change of control transactions under 30 V.S.A. §107. These fifteen criteria are:

1. Legal authority for the transaction from the Federal Communications Commission;
2. Availability of emergency services;
3. Compatibility with neighboring systems;
4. Terms and conditions of service would be just and reasonable;
5. Service quality;
6. Customer Service;
7. Quality of the facilities;
8. Rate of capital investment;
9. Financial stability and soundness;
10. Control of affiliate interests;
11. Competence of management;
12. Technical knowledge, experience and ability;
13. Business reputation;
14. Transaction should produce efficiencies;
15. Transition should not impair competition

*Docket 5900, Joint Petition of New England Telephone & Telegraph Company d/b/a NYNEX, NYNEX Corporation, and Bell Atlantic Corporation for approval of a merger of*

*a wholly-owned subsidiary of Bell Atlantic Corporation into NYNEX Corporation, Order dated 02/26/97 at p.8-9.*<sup>2</sup>

The Joint Petitioners have also petitioned for review of the proposed transaction pursuant to 30 V.S.A. §311, which provides as follows:

A consolidation or merger under the provisions of this chapter shall not become effective without the approval of the public service board after due notice and opportunity for hearing, and the finding on its part that such consolidation or merger will not result in obstructing or preventing competition in the purchase or sale of any product, service or commodity, in the sale, purchase or manufacture of which such corporations are engaged.

In construing §311, the Board has previously determined that analysis performed for the fifteenth criterion of the §107 review will also suffice to address the standard under § 311. Docket 5900, Order of 02/26/97 at p.20 n.21.

Finally, in light of FairPoint's proposal to adopt and abide by the terms of Verizon's existing Alternative Regulation Plan ("ARP"), the Department believes it is appropriate for the Board to consider how this transaction would affect the public good interests presently secured through the mechanisms of Verizon's alternative regulation

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<sup>2</sup> The Joint Petition also seeks review of the transaction pursuant to 30 V.S.A. §109, which requires advance approval from the Board whenever a regulated company sells a significant portion of its property or merges or consolidates with another entity. The Board has previously determined that the substantive review of a petition pursuant to §109 "is the same as the standard under section 107, promotion of the public good." Docket 5900, Order of 02/26/97 at p.1 n.2.

The Joint Petition also requests that the Board issue Certificates of Public Good pursuant to 30 V.S.A. §231 respectively to Newco and Telco. The §231 test requires the Board to determine that the operation of Newco and Telco "will promote the general good of the state." The Board has established a set of criteria to be used as guidelines when determining whether to issue a §231CPG. These criteria are: technical expertise; adequate service; facility maintenance; balance between customers and shareholders; financial stability; company's ability to obtain financing; business regulation and relationship with customers. See Docket 6833, *Petition of Dalton Hydro, LCC for certificate of public good to own and operate certain hydroelectric generating facilities located at the Gilman Dam in the Town of Gilman, Vermont, and for de minimis regulation*, Order dated 07/17/03 at p. 4-5. In the context of the instant docket, given the searching §107 review that has been undertaken, the Department believes that the §231 review may be deemed to be subsumed into the §107 analysis. Accordingly, should the Board determine that the Joint Petitioners have made the requisite showing under §107, then that same determination will serve to support issuance of the requested CPGs.

plan, as established in Docket 6959.<sup>3</sup> The Department's legal theory concerning the standard for review for the proposed ARP transfer is discussed later in this brief.<sup>4</sup>

### Proposed Findings and Conclusions

#### General Findings:

1. FairPoint is a publicly-traded telecommunications company, incorporated in Delaware. Joint Petition at 3.
2. FairPoint, through its local exchange carrier operating subsidiaries, provides wireline local exchange service and exchange access service to approximately 308,000 access line equivalents in 18 states, including Vermont, New Hampshire and Maine. Joint Petition at 3.
3. FairPoint's interexchange carrier subsidiaries provide domestic and international long-distance toll services in 18 states, including Vermont, New Hampshire and Maine. Joint Petition at 3.
4. A subsidiary of FairPoint, FairPoint Vermont Inc. (hereinafter "Classic FairPoint") presently has a Certificate of Public Good and provides intrastate telecommunications service in Vermont. Joint Petition at 3.
5. Verizon New England is a New York corporation that is an indirect, wholly-owned subsidiary of Verizon Communications Inc. Verizon New England provides regulated telecommunications services in Vermont, including local exchange service and exchange access service to approximately 330,000 access line equivalents in the state. Joint Petition at 3.
6. NYNEX Long Distance and VSSI are indirect, wholly-owned subsidiaries, and BACI is a direct, wholly-owned subsidiary, of Verizon Communications. NYNEX Long Distance, BACI and VSSI are Delaware corporations and provide interexchange services in Vermont. Joint Petition at 3.
7. Spinco, Telco and Newco are Delaware corporations formed for the purpose of the Proposed Transaction. Spinco is a direct, wholly-owned subsidiary of Verizon Communications, and Telco is a direct, wholly-owned subsidiary of Verizon New England. Newco is a direct, wholly-owned subsidiary of Spinco. Joint Petition at 3.

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<sup>3</sup> Docket 6959/7142 *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, Orders dated 09/26/07 and 04/27/06 (amendment).

<sup>4</sup> Please see discussion *infra* pp. 88-89.

8. FairPoint has identified numerous risk factors associated with the Proposed Transaction. These risk factors are most recently described in the Form S-4/A filed by FairPoint with the Securities and Exchange Commission (SEC) on July 10, 2007. Ex. DPS-Cross-19.

The risk factors described in this SEC filing include:

- The integration of FairPoint's and Spinco's businesses may not be successful. Ex. DPS-Cross-19 at 25.
- The integration of FairPoint's and Spinco's businesses may present significant systems integration risks. Ex. DPS-Cross-19 at 26.
- If the assets transferred to Spinco by Verizon are insufficient to operate the combined company's business, it could adversely affect the combined company's business, financial condition, and results of operations. Ex. DPS-Cross-19 at 27.
- FairPoint's or the combined company's spending in excess of the budgeted amounts on infrastructure and network systems integration and planning related to the merger could adversely affect FairPoint's or the combined company's business, financial condition and results of operation. Ex. DPS-Cross-19 at 28.
- FairPoint or the combined company may not realize anticipated synergies, cost savings and growth opportunities from the transaction. Ex. DPS-Cross-19 at 26.
- After closing, sales of FairPoint stock may negatively affect its market price. Ex. DPS-Cross-19 at 27.
- FairPoint and Spinco provide services to customers over access lines, and if the combined company loses access lines, its business, financial condition and results of operations may be adversely affected. Ex. DPS-Cross-19 at 32.
- The combined company may not be able to successfully integrate new technologies, respond effectively to customer requirements or provide new services. Ex. DPS-Cross-19 at 34.
- The combined company's business, financial condition and results of operations could be adversely affected if the combined company fails to maintain satisfactory labor relations. Ex. DPS-Cross-19 at 28.
- The combined company may face significant future liabilities or compliance costs in connection with environmental and worker health and safety matters. Ex. DPS-Cross-19 at 41.

- Regulatory changes in the communications industry could adversely affect the combined company's business by facilitating greater competition, reducing potential revenues or raising its costs. Ex. DPS-Cross-19 at 45.
- The combined company will be subject to competition that may adversely impact its business, financial condition and results of operation. Verizon has notified FairPoint that Verizon intends to compete with FairPoint in New England. Ex. DPS-Cross-19 at 32.
- The combined company's operations and expansion plans and dividend payouts depend on its ability to generate cash flow, which is subject to many factors beyond the company's control. Ex. DPS-Cross-19 at 34.
- The combined company's substantial indebtedness could restrict its ability to pay dividends on its common stock and have an adverse impact on its financing options and liquidity position. Ex. DPS-Cross-19 at 36.
- FairPoint Communications, Inc. is a holding company and relies on dividends, interest and other payments, advances and transfers of funds from its operating subsidiaries and investments to meet its debt service and other obligations. Ex. DPS-Cross-19 at 37.

### **Criterion 1: Legal Authority From the Federal Communications Commission**

#### **Findings:**

9. FairPoint and Verizon also have filed an application with the Federal Communications Commission (FCC) for the transfer of licenses under section 310(d) of the FCC's rules and the section 214 authorizations for Maine, New Hampshire and Vermont (FCC Applications). The section 214 authorizations cover both domestic and international operating authorities for the acquired properties. Lafferty Dir. at 8.
10. The Proposed Transaction must be approved by several other regulatory bodies in addition to the Vermont Public Service Board, including the FCC, the New Hampshire Public Utilities Commission and the Main Public Utilities Commission. Joint Petition at 8.
11. The Proposed Transaction also requires a filing with the U.S. Department of Justice and the Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. Joint Petition at 8.

12. Various state and FCC approvals are still pending. Lafferty Dir. at 8.
13. FairPoint has requested a waiver of sections 61.41 (b) and (c) of the FCC's rules – the "All or Nothing Rule." The purpose of this request is to allow FairPoint to continue operating its existing "classic" operations pursuant to rate of return regulation for federal regulatory purposes. Lafferty Dir. at 9.
14. Since the acquired Verizon properties are subject to the FCC's price cap rules, absent the waiver the FCC rules would require FairPoint to convert its classic properties to price cap regulation. Lafferty Dir. at 9.
15. In the alternative, FairPoint could make a one-time election to withdraw the acquired properties from price cap regulation. However, in its waiver filing with the FCC, FairPoint has stated that it intends to operate the Verizon properties under the price cap rules. Lafferty Dir. at 9.
16. If FairPoint is required to file price cap tariffs for its "classic" properties, it is possible the price cap mechanism would reduce the Company's revenues. Lafferty Dir. at 9.
17. To date FairPoint has been able to invest significant funds in broadband technology and service quality for its "classic" properties. The rate of return mechanism has allowed FairPoint to receive a reasonable return on some of these investments, which, given the low density of the territories and associated higher costs, may not have been possible under price cap regulation. Lafferty Dir. at 9.
18. The current level of universal service support available to price cap companies might be insufficient if the "classic" FairPoint properties came under the price cap rules. Lafferty Dir. at 10.
19. If universal support is reduced, it is possible investments in broadband deployment and service improvements in rural markets would be reduced which could harm customers in Vermont and elsewhere. Lafferty Dir. at 10.

**Discussion:**

The record evidence shows that while many of the Joint Petitioners' extra-jurisdictional requests for permission to close the Proposed Transaction are still pending, they have taken all measures within their power to obtain these requisite authorizations.

It is not necessary for the Board to take any specific action with regard to the issues related to this docket that are pending before the FCC. Rather, as in the case of



the Verizon - MCI merger, the Board should require FairPoint to obtain the necessary authorizations to provide service from the FCC. See Docket 7056, *Joint Petition of Verizon Communications, Inc. and MCI, Inc. for approval of an Agreement and Plan of Merger resulting in MCI becoming a wholly-owned subsidiary of Verizon*, Order of 11/29/05 at p.5.

The Board should require FairPoint to keep it informed on the status of the FCC's investigations. Specifically, FairPoint should provide formal notice to the Board and the Department of FCC action on the Section 214/310(d) application and the "All or Nothing Rule" waiver.

**Criterion 2: Availability of emergency services**

**Findings:**

20. The Joint Petitioners are proposing to transfer ownership and operational control of Verizon New England's network in Vermont to FairPoint. Nixon Dir. at 9. Campbell Dir. at 8.
21. Verizon has one of the largest telephone operations in the country and provides service to millions of customers, with a commensurately large workforce. This provides the ability for Verizon to bring to bear in Vermont a larger number of company workers than FairPoint would be capable of mobilizing in an emergency such as a natural disaster. Campbell Dir. at 9.
22. In the event of a widespread emergency or natural disaster, resources would be available from other FairPoint companies and additional resources would be available through the TANE Emergency Resource Book. Campbell Surreb. at 40.
23. It is reasonable to expect that FairPoint will provision Enhanced 911 services to an extent and in a manner comparable to Verizon New England. Campbell Dir. at 8.
24. FairPoint proposes to wait until six months after closing to formalize its emergency response protocols. Nixon Reb. at 37.
25. According to the Department, allowing emergency procedures for restoration after a pole incident to be developed "following the closing" is unwise. FairPoint's request for a six month delay is unnecessary and potentially detrimental to system reliability. The Department agrees that formal improved procedures can be

developed over time, but a fully functional Day-One plan needs to be in place and actionable as well. Mertens Surreb. at 3.

**Discussion:**

The petitioners have not specifically demonstrated that emergency services would be available. Nevertheless, because the petitioners are proposing essentially to transfer control of Verizon's network in Vermont to FairPoint, it is reasonable to expect that most aspects of Verizon's provisioning of Enhanced 911 service would not change.

One area in which the Department does have a concern, however, is the potential for disruptions or errors in the provisioning of information to Vermont's Enhanced 911 system because of the transition from legacy Verizon systems to the new systems FairPoint will be using after ceasing to take services under the Transition Services Agreement (TSA). This is one aspect of the Department's larger concerns with the potential for disruption or degradation of service due to the systems development which FairPoint will be required to perform as a result of the transaction.

The Department also has some concerns about the ability of FairPoint to restore and continue service in a widespread emergency, such as a natural disaster. Verizon has one of the largest telephone operations in the country and provides service to millions of customers, with a commensurately large workforce. This allows Verizon to respond to an emergency in Vermont such as a natural disaster by mobilizing more remedial personnel than FairPoint would be capable of fielding. While it is somewhat reassuring that FairPoint will be able to draw on its other companies and seek agreements with other companies within Northern New England to provide aid in an emergency, this does not provide the same level of resource that is currently available to Verizon. If this transaction is approved, northern New England will be by far Fairpoint's largest operation, and Fairpoint will have far more employees than it could potentially call upon from other companies in the region (not to mention that those smaller companies might also be impacted by a widespread emergency).

It may very well be possible for FairPoint to adequately prepare for such contingencies, but to date it has not stated how it plans to do so. Therefore, the Board

should require FairPoint to demonstrate in a compliance filing six months after closing that it has used best efforts to enter into mutual aid agreements with comparably-sized or larger carriers in case of a natural disaster or other widespread emergency.

### **Criterion 3: Compatibility with neighboring systems**

#### **Findings:**

26. Seamless interconnection with neighboring telecommunications networks, both incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs), as well as with inter-exchange carriers (IXCs) and wireless carriers is critical to the seamless operation of the public telecommunications network regardless of the technology which is used. Lafferty Dir. at 12-13.
27. Verizon's network in Vermont connects together most of the state for telecommunications purposes. Lafferty Dir. at 13.
28. Verizon's network is currently interconnected with other ILECs and CLECs, IXCs and wireless carriers (both affiliated and non-affiliated) in Vermont. As the largest incumbent LEC in the state, Verizon has deployed a network allowing inter-connection and transport to most parts of the state. Lafferty Dir. at 12-13.
29. The public interest requires FairPoint to provide the same level of connectivity to other carriers, using comparable technology and at the same prices and terms as Verizon. Lafferty Dir. at 14.
30. Customers and other carriers should not be adversely impacted by the Proposed Transaction. Network compatibility and connectivity should not change. Lafferty Dir. at 13.
31. In most cases, the Proposed Transaction will not change the compatibility of networks and operations with neighboring systems. Lafferty Dir. at 13.
32. FairPoint will assume Verizon's obligations under applicable interconnection and traffic exchange agreements with other carriers. Nixon Dir. at 28.
33. If any of the agreements include Verizon operations outside of the three-state Northern New England market (Maine, New Hampshire and Vermont), the agreement may have to be modified by Verizon and FairPoint to segregate the three states. Nixon Dir. at 28-29.

34. In that case FairPoint has committed to mirroring the Verizon agreements wherever possible. Nixon Dir. at 28-29.
35. The public interest is best served if, from the point of view of the other carriers, interconnection with FairPoint is no different than with Verizon. Lafferty Dir. at 14.
36. FairPoint is undertaking an extremely complex, risky and aggressive system conversion process. Every customer facing system, both for retail and wholesale operations must be converted from Verizon's platform to newly developed FairPoint systems. Lafferty Dir. at 14.
37. FairPoint currently plans to cut to the new system platforms three to six months after the closing occurs. Among the systems being developed and converted will be the service order systems which many competitors and other carriers interface with electronically to process orders. Lafferty Dir. at 14.
38. Competitors may be forced to incur expenses to adjustment their systems to be able to communicate with the new FairPoint systems. Lafferty Dir. at 15.
39. FairPoint should clearly communicate all the requirements for interconnection to all other carriers which interconnect in any way with Verizon in Vermont. Lafferty Dir. at 15.
40. FairPoint will charge the same rates for access and other interconnection services as Verizon. Lafferty Dir. at 15-16.

**Discussion:**

Verizon's network currently provides a critical means of interconnection between a wide range of telecommunications carriers in Vermont. A transition from Verizon to FairPoint has the potential to create disruption in these relationships. In general, FairPoint appears poised to ensure the requisite compatibility with neighboring systems. However, to guard against the risk of serious disruption to the compatibility of neighboring systems, the Board should require FairPoint to provide interconnection with all neighboring systems in the same manner as Verizon. If modifications to the method of inter-connection are required, FairPoint should compensate the neighboring system for any costs associated with the modifications required for the neighboring system to interconnect with FairPoint.

**Criterion 4: Terms and conditions of service would be just and reasonable****Findings:**

41. FairPoint has agreed to adopt all Verizon retail service obligations in Vermont. Nixon Dir. at 27. Lafferty Dir. at 18.
42. This commitment protects retail customers from any changes in the terms of service and should ensure customers receive the same services and at least the same prices as provided by Verizon which are just and reasonable at this time. Lafferty Dir. at 18.
43. FairPoint will adopt virtually all of Verizon's access tariff and wholesale service requirements. Lafferty Dir. at 18.
44. Verizon currently operates under an alternative regulation plan in Vermont which replaces rate-of-return regulation through 2010. FairPoint proposes to assume Verizon's rights and obligations under the terms of the Amended Incentive Regulatory Plan. Nixon Dir. at 25.
45. The ARP currently precludes Verizon -- and hence FairPoint -- from raising basic service rates for existing services during the term of the plan. FairPoint's agreement to continue Verizon's obligations under the ARP will help to minimize the impact of the Acquisition on the rate aspects of the terms of service. Lafferty Dir. at 19.
46. In the order approving the Amended ARP, the Board noted that absent an agreement to adopt the new ARP, Verizon would have been required to implement rate reductions totaling \$11.24 million over a little more than two years. Docket 6959/7142, Order of 04/27/07 at 2. Lafferty Dir. at 19.
47. The Department believes that FairPoint should be expected to retain this same requirement should it not fulfill the terms of the ARP. To ensure FairPoint has the ability to fund its operations and investments in Vermont, should the Board approve the acquisition, the Board should require FairPoint to freeze dividend or other payments from the acquired Vermont property to the FairPoint Parent Company if the targets in the ARP are not being met. Lafferty Dir. at 20. Behrns Surreb. at 14-15, 21, 24.
48. FairPoint has committed that it will not seek to recover through rates the transaction costs or any acquisition premium associated with this transaction. Nixon Dir. at 27.

49. In any event, if this transaction is approved, then FairPoint should be barred from attempting to recover any expenses related to the transaction or the transition from Verizon to FairPoint in any future rate proceeding. Moreover, any increased costs which are due to FairPoint's need to develop and transition to new systems currently supported by Verizon, or which are incurred as a result of continued reliance on Verizon under the Transition Services Agreement ("TSA"), should also not be recoverable from ratepayers in any future ratemaking proceeding. Campbell Dir. at 16 and 47.

**Discussion:**

It is difficult to judge that Verizon's current rates, which FairPoint proposes to adopt, are just and reasonable but for the offsetting value which Verizon is obliged to deliver through the broadband commitment and the other benefits of the plan.

FairPoint proposes to assume Verizon's existing terms and conditions of service are set according to the terms of an alternative regulation plan.<sup>5</sup> In Docket 6959/7142, the Board found that Verizon's initial rates exceeded just and reasonable levels by \$8.18 million annually. The Board ordered Verizon to reduce rates by that amount at the commencement of the plan, and to further reduce rates by \$1.26 million effective July 1, 2007, and \$1.80 million effective July 1, 2007, unless Verizon delivered an offsetting benefit to Vermont telecommunications consumers. Unlike in the prior alternative regulation plan under which Verizon operated, which left the form that the benefit might take relatively open-ended, the Board adopted in Docket 6959 a mechanism through which Verizon could offset scheduled rate reductions through increased investment. After the Board adopted this mechanism, the Department and Verizon negotiated a specific broadband commitment in lieu of implementing the required rate reductions over the life of the plan. The Board approved this negotiated settlement. Therefore, it would be difficult to judge that Verizon's current rates, which FairPoint proposes to adopt, are just and reasonable but for the offsetting value which is delivered through the broadband commitment and the other benefits of the plan.

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<sup>5</sup> Docket 6959/7142 *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, Orders dated 09/26/07 and 04/27/06 (amendment).

If FairPoint complied with the terms of Verizon's alternative regulation plan, Verizon's rates under the plan could be presumed just and reasonable for FairPoint as well.<sup>6</sup> However, the judgment of the justness and reasonableness of Verizon's present rates presumes that a level of public good can be and is being delivered by Verizon. To the extent that the Proposed Transaction diminishes or places at risk important public benefits (for example improvements in service quality and reliability) that have been secured by Verizon's legal obligation to deliver them, then the justness and reasonableness of the company's terms and conditions of service could also be called into question.

Nor can the present rates offered by Verizon necessarily be deemed just and reasonable if adopted by FairPoint, and continued at historical levels in the future. Assume for the sake of example that FairPoint's regulated revenues and costs were to remain the same as Verizon's were at the time that the Board performed its analysis in Docket 6959, and the Board considers a successor to the present alternative regulation plan that FairPoint would inherit from Verizon. Assume further that competition remains sufficiently limited such that the Board does not find a reason to substantially deregulate large portions of the operation's rates. The Board might find that FairPoint's rates exceed just and reasonable levels by approximately \$11.24 million per year, unless FairPoint were delivering some comparable value in another form.<sup>7</sup> While FairPoint has spoken in general terms of benefits such as broadband expansions, more locally-focused service, and new bundled service offerings, it has not identified consumer benefits with enough specificity for the Board to rely upon.

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<sup>6</sup> As is discussed *infra* at pp.90-97, at least some specific modifications to Verizon's present alternative regulation plan would be necessary for practical reasons or to meet the public good related to this and other considerations. Additionally, given the projected synergies and the different capital structure, FairPoint's costs are likely to be less than Verizon's as contemplated under the existing alternative regulation plan.

<sup>7</sup> In making this point, the Department does not mean to foreclose the possibility that a regulatory proceeding in 2010 might lead the Board to a different conclusion. The Department would expect that any just and reasonable rate determination would be made upon due consideration of (1) the company's prices relative to the value of the services it provides to its customers; (2) reasonable needs for revenues to facilitate appropriate network investment and maintenance; (3) the degree of broadband deployment achieved under the expired alternative regulation plan and what remaining need may exist for additional deployment.

It is not necessary to determine at this time whether FairPoint's terms and conditions of service would be just and reasonable under a future alternative regulation plan or after a future rate case. But it is important to determine whether or not there is a substantial risk that approving the transaction would preclude the Board from taking actions necessary to establish just and reasonable terms and conditions in the future. FairPoint's ability to reduce costs while maintaining revenue, and thus achieving a desired level of cash flow, appears to be critical to its ability to achieve financial stability and soundness. The risk is that state regulators might determine that rate reductions were necessary to meet the public good but would not have an option to implement warranted reductions to FairPoint's regulated rates in the future without endangering the financial stability of the company, due to the way the company has chosen to structure and finance the Proposed Transaction. FairPoint has not adequately explained why this would not happen if the Board is to approve this transaction.

FairPoint projects that it will reduce capital and operating expenses. If these projections prove correct, this could have an impact as well on the justness and reasonableness of FairPoint's rates, if they were to remain at the levels Verizon currently has. If FairPoint were able to reduce expenses while maintaining regulated revenue, this would only increase any difference between FairPoint's rates and their cost-based level.

If FairPoint were to earn more than their costs would justify under traditional ratemaking, by itself this would not necessarily be inconsistent with Vermont regulation. As the Board has previously explained:

Our goal in adopting an incentive regulation plan and delineating its terms and conditions has never been solely to force rate reductions or require that rates remain cost-based during the term of such a plan. The rate levels certainly are a relevant consideration, particularly at the outset of the plan; such a review at the outset is necessary to assure that the rewards derived from incentive regulation are based upon the company's efforts and are not the result of starting rates that produce excessive revenue.



If FairPoint is able to achieve efficiencies greater than Verizon could while maintaining or improving service, that would be desirable, and the Department would not object if FairPoint were to benefit financially because of those efficiencies. Indeed, one of the criteria that the Board has used in evaluating these transactions is that they should produce efficiencies. However, the Board has also noted that ““consumer benefit is the overarching goal of 30 V.S.A. § 226b’ [the alternative regulation statute for telecommunications companies in Vermont.]” While the Department certainly sees that alternative regulation is intended to permit the regulated company to realize benefits for more efficient behavior, consumers should also see some of the benefits of that efficiency, either through lower rates or other improvements in the services that they can receive.

In any event, if this transaction is approved, then FairPoint should be barred from attempting to recover any expenses related to the transaction or the transition from Verizon to FairPoint in any future rate proceeding. Moreover, any increased costs which are due to FairPoint’s need to develop and transition to new systems currently supported by Verizon, or which are incurred as a result of continued reliance on Verizon under the Transition Services Agreement (TSA), should also not be recoverable from ratepayers in any future ratemaking proceeding.

#### **Criterion 5: Service Quality**

##### **Findings:**

50. An Amended Service Quality Reliability Plan (Amended SQRP) is incorporated into Verizon’s ARP. This plan establishes the process under which the Board monitors Verizon’s service quality commitments. The Amended SQRP tracks many standard industry performance metrics and includes a service quality compensation payment mechanism under which customers receive compensation for Verizon’s failure to meet the baseline standard for any of the performance areas in the plan. Lafferty Dir. at 21.

##### **Verizon’s Service Quality Record in Vermont**

51. Verizon has not consistently met all of the standards resulting in service quality compensation payments to customers for non-compliance over the past several years. Pariseau Dir. at 2. Lafferty Dir. at 21 . Wierson Dir. at 4-5.

52. While performance on several standards has been problematic, residential trouble report clearing has consistently been below the baseline standard. Little improvement in this metric has been demonstrated. Pariseau Dir. at 2. Lafferty Dir. at 21.
53. Verizon views the benchmark for Residential Troubles Not Cleared in 24 hours as an unobtainable measurement. Pariseau Dir. at 2-3.
54. Verizon has also indicated that it was unable to meet the measurement for Residence Troubles Not Cleared in 24 hours due to inadequate staffing levels in Vermont. Pariseau Dir. at 3.
55. Staffing issues may have contributed to Verizon's inability to meet service quality and delivery deadlines. Such issues can include understaffing (especially when working with aging equipment), outdated procedures, poor planning, competing agendas disconnected reward system, lack of measurement, bad data and misaligned goals. Wierson Dir. at 14.
56. While Verizon claims that the standard for Residential Trouble Not Cleared in 24 Hours is too stringent, in 2001 Verizon was reporting an annual rolling average of 24.3%, well below the baseline of 30%, and in 2000, Verizon reported an annual rolling average of 20%. Pariseau Surreb. at 5.
57. Verizon's performance in a number of other measurements has shown a decline rather than an improvement. Pariseau Surreb. at 13.
58. Non-compliance has cost Verizon ██████████ since 2003; however, the compensation payments appear to have been too small to have much of an impact on Verizon. Lafferty Dir. at 21.
59. For Verizon, the Amended SQRP does not appear to have been a good deterrent for poor service quality. There are no indications Verizon has a solid plan to correct these costly service problems. Lafferty Dir. 21. Pariseau Surreb. at 8.
60. Should FairPoint become liable for service quality compensation payments, these will have a more significant financial impact on FairPoint overall than Verizon. Lafferty Dir. at 21.
61. Competition is beginning to provide alternatives to certain customer groups which can impact FairPoint's top line in the form of reduced customer lines, services and revenues. Unlike for Verizon, the acquired Vermont operation will be one of the largest properties for FairPoint overall; lost customers and revenues in Vermont

- will have a more material impact on the Company's ability to continue growing and paying the dividends its investors expect to receive. Lafferty Dir. at 20.
62. Verizon has outlined and undertaken several service improvement projects to address shortfalls in its reported service quality results. Lafferty Surreb. at 33-34.
  63. The Department has identified the following areas that may be experiencing, or may have experienced, chronic problems with the delivery of service: Dover/East Dover, Windham, Vershire, Fairfield and Worcester. Pariseau Dir. at 4.
  64. In each area identified, the problems have consisted of static on the line and frequent loss of dial tone service. Pariseau Dir. at 4.
  65. Verizon concurs these are problem areas and are related to poor quality of the network. Corrective action taken by Verizon has included replacement of copper cable and/or replacement of copper-fed remote terminal. Pariseau Dir. at 4.
  66. FairPoint proposes to assume Verizon's rights and obligations under the terms of the Amended Incentive Regulation Plan and has committed to comply with service quality standards, consumer protection standards, and requirements set forth in the relevant Board Orders. Nixon Dir. at 25.
  67. FairPoint has had service problems in Maine where it is the second largest ILEC. Lafferty Dir. at 26 and 28.
  68. Verizon currently utilizes a INTEGrated Results Information System (Integris) to track and report Network Trouble Report Rate in accordance with the Retail Service Quality Plan. Pariseau Surreb. at 14.

**Discussion:**

Vermont customers have not received their due from Verizon when it comes to service quality. The company's performance has been dismal, and the resulting penalties evidently have done little to deter Verizon from continuing to shortchange its customers, never mind improve the quality of its service.

FairPoint's experience in its "classic" properties and its commitments in testimony combined with the increased significance of the potential financial compensation to customers should provide FairPoint incentives to meet the Amended SQRP requirements that currently apply to Verizon. In addition, as FairPoint designs and implements its own systems, it should have an opportunity to include state of the art

process for tracking and resolving service quality challenges. However, FairPoint is untested as the largest incumbent operator in a state or even as an operator of large telecommunications properties. Therefore, at least initially FairPoint must be provided significant incentives to meet the requirements of the Amended SQRP.

If the Board decides to approve the Proposed Transaction, then it should include a requirement that FairPoint adopt as minimum requirements all aspects of the ARP including the Amended SQRP and associated service quality compensation payments. In addition, given the recent service problems in Maine and Vermont and concerns raised by some parties about FairPoint's ability to fund its operations, the Board should require FairPoint to freeze dividend or other payments from its acquired Vermont property to the FairPoint Parent Company if the service quality standards in the Amended SQRP are not being met. This restriction will increase the incentive to meet the standards in the Amended SQRP.

The process the Department envisions for pursuing such a dividend freeze is quantifiable and predictable, thus serving the goal of regulatory clarity: If FairPoint, like Verizon, falls chronically short on its service quality metrics, the Department would petition the Board for an order to show cause why FairPoint's dividends should not be frozen pending demonstrable and substantial improvement. The Department would present its case to the Board, and FairPoint would have an opportunity to explain its performance. The Board would then decide whether a dividend freeze was warranted, and to what degree.

FairPoint has outlined a variety of capital investment programs and spending plans in its testimony, discovery responses and media advertisements. Given the size and scope of FairPoint's announced plans, it is possible these specific service improvement projects cited by Verizon could get overlooked. The Board therefore should ensure that FairPoint makes it a priority to complete any portions of these projects which have not been completed as of the closing date.

Thus, if the Board decides to approve the acquisition, it should require FairPoint to complete any of the Verizon remedial projects presently underway which have not been completed by the closing date.

Finally, Verizon currently utilizes a INTEGrated Results Information System to track and report Network Trouble Report Rate in accordance with the Retail Service Quality Plan. With FairPoint implementing a new system for tracking this important measurement, the Department would like to review the codes to be used with the new system to ensure that (1) the codes will provide the same information as reported by Verizon; (2) the codes map to Verizon system used as a basis for the report, and (3) the new system will provide the required measurements for full and accurate reporting.

#### **FairPoint's Service Quality Record in Vermont**

##### **Findings:**

69. The Department has concerns about the service quality in the current FairPoint territory. Pariseau Dir. at 4-5.
70. An analysis of the service quality reporting by FairPoint for the period 2002 through 2006 demonstrates FairPoint has not missed a baseline or action level benchmark. However, FairPoint's SQRP reporting to the Department has shown that FairPoint is obliged to but has not been reporting on Performance Measurement #3, Calls Not Answered within 20 seconds, Residence. Pariseau Dir. at 4.
71. FairPoint has met the modest service quality standards to which it is subject in Vermont. Campbell Dir. at 21.
72. However, FairPoint's reported service quality metric does not compare favorably to other Vermont companies similarly situated to FairPoint and regulated under the same standard. Pariseau Dir. at 5-6.
73. The Department's Consumer Affairs Division does not believe that FairPoint in the past has demonstrated a commitment to a high level of service quality for Vermont consumers that would translate into improved service quality for Verizon customers. Pariseau Dir. at 5.
74. The Department's Telecommunications Director reports having favorable regulatory interactions with FairPoint in an effort to define and resolve problems relating to its trouble report rate and incidents of central office isolation.

FairPoint has been responsive to the concerns raised in a series of meetings that took place in the summer and fall of 2006. FairPoint has taken corrective actions designed to improve its reported service quality metrics. However, it is too soon to judge whether these actions have been effective. Campbell Dir. at 21-21.

75. In discovery, FairPoint stated that it was “generally aware of any purported service quality issues Verizon has in Vermont.” Ex. DPS-TSP-DIR-4.

**Discussion:**

FairPoint is proposing to become a much larger company by buying Verizon’s landline assets in Vermont. Because FairPoint has not been able to match the performance of companies the size of WCVT and Vermont Telephone, the Department is concerned that FairPoint may not have the experience necessary to improve upon the performance of Verizon, a much larger company. But this is the issue that is paramount to Vermonters.

Moreover, FairPoint has not persuasively exhibited a full and thorough knowledge of Verizon’s failure to meet service quality metrics. Nor has FairPoint specifically identified the corrective actions that will be necessary to improve service quality to Verizon customers. This point is underscored by FairPoint’s claim in discovery to be “generally aware of any purported service quality issues Verizon has in Vermont.” Verizon’s service quality problems are not “purported” – they are documented and very real to Vermont consumers.

FairPoint has an opportunity to put in place better systems and processes for monitoring and reacting to the factors which impact service quality and reliability. That said, the Department is not confident about FairPoint’s readiness to deliver on this potential. The substantial systems development and conversion challenges FairPoint will require, if not handled successfully, provide numerous opportunities for customer-impacting malfunctions. It is operating on limited information about the state of the Verizon network and the reasons for past service quality problems. It must absorb and re-orient a large number of existing workers while hiring and training a substantial number of new workers. It must create a management team and management policies to oversee service quality and customer service.

Moreover, FairPoint is projecting that it will be reducing capital spending compared to Verizon's historical levels. Given the level of uncertainty about the quality and quantity of information FairPoint has about the operation it proposes to acquire from Verizon, it is enough to question whether FairPoint's assumptions about the level of spending which will be required to maintain and improve service quality in Vermont are durable. This is one of the several reasons why the Department has proposed a dividend restriction safeguard that is tied to the quantifiable and verifiable standards of service quality metrics and broadband deployment rates. This allows FairPoint an opportunity to execute on its projections of reduced capital spending. If FairPoint succeeds in delivering the service quality and broadband deployment that is due its Vermont customers, then that falls rightly to the good for the company, its ratepayers and Vermonter at larger. And if the company fails to deliver, then the dividend safeguards will send a clear message of accountability to FairPoint and will make it in their financial interests to meet their obligations. In essence, this establishes parity between service quality and financial performance of the company.

### **Hot Spots**

#### **Findings:**

76. "Hot Spots" are service quality issues which may affect a geographically contained customer base. Because this type of service quality problem is not tracked and reported as part of the service quality performance standards, the problems are not easily identified and have often continued for years, with the affected consumers suffering from frequent interruptions of service which may last hours or days. Pariseau Surreb. at 6-7.
77. Often a consumer has had to notify Verizon and the Department numerous times before the problem is identified and remedied. In the meantime, many of the prior trouble tickets have been cleared by Verizon as "suspected CPE" referring to the Customer Provided (or Premises) Equipment, leaving the consumer frustrated and without resolution to their complaint of poor telephone service. Pariseau Surreb. at 7.
78. Verizon has represented that approximately 367 customers were served by the five remote terminals located in the five communities that have been identified as

hot spots, and that this number constitutes only one tenth of one percent of Verizon VT's access lines. Pariseau Surreb. at 14-15.

**Discussion:**

Verizon acknowledges that 367 customers are served in areas that are recognized as hot spots. In Verizon's view, this is not a substantial number of customers at risk for poor quality service – the number constitutes only one tenth of one percent of Verizon's access lines in Vermont. The Department, however, believes that the impact of inadequate or repeated loss of service for a period of time over many years for no matter how many customers should be an unacceptable business practice for any Vermont telecommunications company that is doing business in good faith.

Because hot spots have been difficult to identify in the past, and to facilitate timely repair so as to minimize any negative impact on customers, the Board should require FairPoint to use their new system, currently under development, to track on a monthly basis, Trouble Report Rates and Troubles Not Cleared in 24 Hours by exchange. Further, FairPoint should be required to ensure that no exchange has a rate on any of these measures that exceeds twice the statewide standard. FairPoint should be required to provide this report to the Department upon request, but would not have to provide a monthly submission of the report to the Department.

**The Proposed Quality Assurance Plan**

**Findings:**

79. The cutover carries with it potential quality control and quality assurance risks. Wierson Dir. at 19.
80. The transition of Verizon wireline assets in Vermont along with New Hampshire and Maine is a complex and detailed operation. Tasks of extracting data have been outlined in the Verizon cutover plan . All databases and other information delivered to FairPoint must be integrated into their systems and checked or audited prior to the full operational cutover. Many opportunities exist for failure, including the following:



- Missing files or records from incomplete transfer
- Verification of Verizon databases prior to transfer
- Software incompatibility and database configuration mismatch
- Data extracts done in multiple stages containing conflicting data
- Data verification incomplete
- Testing databases in FairPoint systems
- Operational cutover with mismatched data between Verizon and FairPoint
- Field operations policies and procedures cutover from Verizon to FairPoint
- Establishment of new processes for daily operations in COs and outside plant.

Wierson Dir. at 19.

81. There are risks associated with the integration of the Operating Service System (“OSS”) with the network elements. Wierson Dir. at 20.
82. FairPoint will not receive any of the Element Managers used by Verizon to manage the equipment in their network. The Element Manager provides the interface between the Network Management System in the OSS and the equipment in the network. Wierson Dir. at 20.
83. No provisioning or monitoring can take place unless specialized applications are developed for each equipment type in the Network Management System. This can be costly, and configuration control (especially software) could become unmanageable as network elements are upgraded. Wierson Dir. at 20.
84. FairPoint will have to acquire the Network Element Managers from each major vendor used in the legacy network. They will also lose any special tools Verizon developed in the Element Manager to assist them in monitoring and provisioning their network elements. Wierson Dir. at 20.
85. FairPoint has not produced for review a Management Plan or Quality Control Plan that addresses Quality Assurance (QA) and Quality Control (QC). Wierson Surreb. at 8.
86. The reporting structure is not clear on how focus will be directed to resolve many of the existing service issues today and how the company will minimize service problems in the future. System metrics are not defined. The quality team is not defined, nor how they will establish over-site or control over the quality of the network. Wierson Surreb. at 8.

87. The Department recommends that FairPoint be required to produce and file with the Board and Department for review before closing of the Proposed Transaction a detailed management plan that addresses the following issues:

- Organizational Structure and responsibility
- Implementing a regimented approach to the inspection of work
- Quality policies and metrics
- Process flow – engineering, construction, testing, service provisioning
- Reducing error rate
- On time completion rate
- Training employees
- Analysis of data and improvement.

Wierson Surreb. at 8-9. Ex. DPS-CJC-5 at 2.

**Discussion:**

In order to ensure there is a fully operational telephone system the day after FairPoint's assumption of operational responsibility from Verizon, several quality control initiatives must be established and adhered to. To date, as far as the Department has been able to determine, none of these initiatives have been adequately developed and implemented by FairPoint. For this reason, the Department recommends that FairPoint provide to the Board and Department a QA/QC plan for review prior to approval of the Proposed Transaction that addresses all of the quality issues and management concerns discussed in the findings above. The Department's precise proposed condition is detailed on page 2 of Ex. DPS-CJC-5.

**Criterion 6: Customer Service**

**Findings:**

88. FairPoint has made adequate provisions to fund the system development and conversion process. FairPoint has budgeted \$200 million to fund the system development and conversion process for all three states. Wheaton Dir. at 5.
89. FairPoint has \$ [REDACTED] in additional lines of credit it could conceivably use to cover any potential cost overruns after 2008. Wheaton Dir. at 5.

90. In 2009, FairPoint's annual free cash flow after dividend payments becomes positive. Its contract with CapGemini also provides protection in the case of schedule delays and cost overruns. Wheaton Dir. at 5.
91. FairPoint also could reduce its annual dividend payments which are projected at \$ [REDACTED] per year if it needed additional cash flow. Wheaton Dir. at 5. Attachment DPS-PLW-DIR-2 (A.DPS:FP.1-86).
92. Even if FairPoint had to eliminate its dividends, the firm would not be insolvent, when insolvency is defined as not having sufficient cash flow to cover ongoing expenses and required capital expenditures and debt repayments. Wheaton Dir. at 5.

### **Verizon's Customer Service Record in Vermont**

#### **Findings:**

93. During the period of 2002 through 2006, consumers have experienced increasingly serious problems with Verizon in the areas of repairs, delivery of service and line extensions. Pariseau Dir. at 7.
94. The most dramatic increase in consumer complaints against Verizon has come in the area of repair, where complaints jumped over 100% in the period of 2002 through 2006. Pariseau Dir. at 7.
95. Consumer complaints to the Department have also shed light on the long wait time customers experience in some geographic areas due to a lack of facilities. Consumers have also experienced delays in line extensions, sometimes resulting in consumers waiting months for the installation. Pariseau Dir. at 8.
96. During the period of 2002 through 2006, the Department has seen a steady increase in the number of complaints regarding poles and line extensions against Verizon. In some instances, consumers have been required to pay for the installation of new service, with poles and lines, only to have the installation delayed up to 6 months or longer. Pariseau Dir. at 8.

### **FairPoint's Customer Service Record in Vermont**

#### **Findings:**

97. During the period 2002 through 2006, FairPoint's complaint rate has shown a pattern similar to Verizon in terms of the increase in consumer complaints handled by the Department. Pariseau Dir. at 10

98. Complaints in specific categories, such as arrangement, deposit, and change order have remained relatively unchanged, and complaints in the area of rate have actually decreased, complaints in the areas of billing, delivery of service, and repairs have seen a sharp increase during the period of 2002 through 2006. Billing complaints have seen a 200% increase, delivery of service has seen a 500% increase, and repairs have seen a 200% increase. Pariseau Dir. at 10.
99. Consumers are increasingly experiencing problems with FairPoint, specifically in the areas of billing, delivery of service and repairs. Pariseau Dir. at 10-11.
100. The Department's Consumer Affairs division currently has three complaints under investigation in regard to Fairpoint's billing. While a determination has yet to be made in those complaints, the number of open complaints examining FairPoint's billing is, at this time, almost equal to the number of total complaints received in the entire 2001 and 2003 calendar years. Pariseau Surreb. at 17.
101. FairPoint's current handling of consumer complaints in Vermont is inadequate and requires, at a minimum, additional training, tighter controls over procedures, improvement in systems and additional staffing. Pariseau Dir. at 11.
102. FairPoint has made efforts to improve its service quality in Vermont, but it has not demonstrated a commitment to providing a high level of service to the consumers of Vermont. Pariseau Dir. at 12.

### **FairPoint's Prior Billing Conversion Difficulties in Vermont**

#### **Findings:**

103. An earlier FairPoint conversion of their embedded Maine property to a new customer billing system resulted in numerous customer complaints. This system was subsequently replaced. Mills Dir. at 9.
104. FairPoint undertook two billing conversions in Vermont in 2005 and 2006 respectively. During both billing conversions, Local Measured Service ("LMS") billing became a persistent problem for FairPoint consumers. Pariseau Dir. 6-12. Ex. DPS-TSP-DIR-5. Pariseau Surreb. at 15-17.
105. Among other problems, in some instances, bills did not provide a breakdown of LMS, bills contained duplicate billing for LMS charges, or consumers were charged at an incorrect rate for the LMS charges. Pariseau Dir. at 9.
106. The ramifications of FairPoint's latest billing conversion can be seen in the spike in billing related complaints received by the Department. The increase in

complaints was a direct result of the billing conversion and FairPoint's inability to identify and remedy the underlying causes of the billing errors. Pariseau Surreb. at 15.

107. These two difficult billing conversions, each of which resulted in months of billing inaccuracies for Vermont consumers and a higher than average demand on FairPoint's customer service staff -- a demand FairPoint was not equipped to deal with as witnessed by the excessively long wait times experienced by consumers attempting to contact FairPoint. Pariseau Dir. at 9-10.
108. FairPoint will have to address service quality issues while absorbing outside plant staff and creating new policies and procedures. FairPoint will have an additional burden of expanding DSL service in the Verizon territory while addressing these service quality issues. This effort places an extra burden on the newly acquired supervisors and first level managers who must manage daily operations, DSL expansion projects and improve service quality. Wierson Dir. at 9-10.

**Discussion:**

The Department has significant concerns about FairPoint's service quality track record in the past in Vermont, and in particular with the level of complaints. Vermont's experience with FairPoint's 2005 and 2006 system conversions led to an increase in the number of consumer complaints and exposed challenges that FairPoint had either not anticipated or was not equipped to handle. During each of the conversions, consumers experienced a high number of billing errors, extremely long wait times in their efforts to contact a customer service representative who, once contacted, was often unable to resolve the consumer's complaint, resulting in a complaint filed with the Department. As recently as January 2007, the Department has received complaints from consumers about billing errors which are ongoing and which FairPoint has been unable to resolve. Based on FairPoint's past level of performance in Vermont, the Department remains concerned about FairPoint's ability to improve service quality and customer service while undergoing a systems conversion on a much larger scale than the two previous conversions, occurring in 2005 and 2006.

While FairPoint has made efforts to improve aspects of its service quality and customer service, the evidence to date does not reflect that FairPoint has the sound overall understanding necessary to implement changes which will adequately address its

own weaknesses in these areas, in addition to the weaknesses it stands to inherit from Verizon.

To ensure consumers are protected from the negative impact an unsuccessful conversion may have, if the transaction is approved, the Board should require FairPoint to hold customers harmless from billing errors resulting from the conversion, prohibiting FairPoint from collecting on any underbilling which may occur on consumer accounts.

To further ensure consumer protections with regard to billing, the Board should require FairPoint to provide consumers with a billing accuracy guarantee, providing a billing accuracy credit of \$5.00 per month for every month the bill provided to the consumer from FairPoint contains an inaccuracy that is the result of a FairPoint error.

### **The Proposed Conversion from Verizon to FairPoint**

#### **Findings:**

109. The term “conversion” —also referred to by Verizon and FairPoint as “cut-over”- means the transfer of all data and business processes from the Verizon systems to their counterpart systems at FairPoint. This involves a complex mapping of each source data element in Verizon’s systems to the corresponding required data elements in FairPoint’s systems, the development of conversion programs to automate the translation and loading of data to FairPoint’s systems, and the confirmation that the FairPoint systems would operate accurately and responsively with the new data. Mills Dir. at 5.
110. The conversion contemplated by FairPoint entails the replacement of most or all operational and business systems simultaneous with the integration and conversion of over 1,500,000 new customers. Mills Dir. at 5-6.
111. FairPoint plans to convert all three state operations at one time. Although there are efficiencies and economies related to a single effort, the risk of surprise and customer impact is increased. Mills Dir. at 10.
112. According to Verizon and FairPoint a “flash cut,” or single conversion, would be the only practical way to convert the Verizon Northern New England customer base; any type of phased conversion is overly complex, excessively expensive, and could actually increase of the risk of customer impact in the event of problems. Smith Reb. at 13. Haga Reb. at 29; Kurtze Reb. at 29.
113. According to the Department, a phased, “one-state-first” cutover is both possible and a preferable approach to cutover as it means that a smaller, much more easily

- manageable group of customers would be exposed to potential disruption while the systems are proven in production after the cutover. Following successful initial conversion of the first state, both remaining states could be converted together with much higher confidence. Mills Surreb. at 4. Trans. 09/19/07 at 173-175 and 177-180 (Mills Cross).
114. However, there will be no way to “fall-back” to Verizon systems after the actual cutover. Since the new FairPoint systems would be in production for the first time after the cutover, all of the more than 1,500,000 access lines and related customers would be exposed to impact if there are unanticipated data, system, or business process problems. Mills Surreb. at 3.
  115. FairPoint intends to replace their existing applications at the same time as they integrate the new business. These include most customer, inside and outside plant, provisioning, network related, and wholesale systems. The most notable and difficult systems to be replaced are the customer relationship management (CRM) and customer billing systems. Mills Dir. at 5.
  116. Among other reasons, ILEC and customer conversion projects are difficult due to the wide variety of data involved, the disparate nature of the data on multiple source legacy systems, data integration requirements on target systems, differing data content and formats between the source and target systems, and often incorrect or incomplete source data. Mills Dir. at 8.
  117. Implementing a new CRM (service order processing, sales, order management, billing adjustments, billing inquiry, and other functions) system is difficult for ILECs since commercially available CRM software is largely unproven in high volume residential call centers. They involve a fundamental change in call center business processes, and must be integrated with unrelated systems to share customer data, product data, plant inventory, etc. The difficulty to implement new CRM systems in ILEC high volume residential call centers is evidenced by the fact that no large ILECs or Regional Bell Operating Companies have implemented new commercial CRM software systems for their high-volume regulated mass market businesses. Mills Dir. at 9.
  118. Customer Billing System implementation projects for ILECs are difficult since significant customizations are required for commercial software to meet state specific business requirements. Specific requirements vary by state, but each state typically has unique regulatory or legacy functionality requirements. The difficulty in implementing new customer billing systems is evidenced by the fact that most large ILECs and Regional Bell Operating Companies continue to use older legacy customer billing systems for regulated ILEC processing, rather than replacing them with newer technology. Mills Dir. at 9.

119. FairPoint's conversion will not proceed in a manner that is typical for the industry. The conversion of a large customer base to existing in-house systems is generally viewed as a high risk effort by itself. Additional simultaneous systems projects are usually avoided to focus all attention on the conversion effort. There are many examples of project delays and customer service impacts from ILEC conversions when no legacy systems have been replaced at the same time. Mills Dir. at 6.
120. Replacement of ILEC operational and business systems, CRM and Customer Billing in particular, are also viewed as high risk projects. There are many examples of failed or delayed system replacement projects when no external conversions were involved. The combination of these efforts into simultaneous projects would increase the project risk above that of any single project. Mills Dir. at 6.
121. The term "project risk" is defined as the relative likelihood of any or all of the following occurrences:
  - Customer service or accuracy problems negatively impacting retail customers,
  - Service, performance, or accuracy problems negatively affecting wholesale customers,
  - Project delivery schedules exceeded,
  - Project cost budgets exceeded, or
  - System quality compromises from rushing to meet deadlines or inadequate testing. System quality affects application stability (which can affect customer service) and accuracy.

All of these risks attend FairPoint's proposed conversion. Mills Dir. at 6.

122. When a project is referred to as "high-risk," it does not imply that these potential issues are certainties. Rather, that there is a higher than normal possibility that problems could occur. This must be recognized, planned for, and managed accordingly. Mills Dir. at 6.
123. Each project type involves aspects or shared components of the others. It is difficult to coordinate simultaneous development with each project area changing during the process. A recent similar project at Hawaiian Telecom where new systems were selected and implemented, and the 600,000 access line Hawaiian properties acquired from Verizon were converted was considered unsuccessful. There were project delays and serious customer impacts after conversion. The Systems Integrator responsible for the system implementations and conversion is a large international firm with significant experience in the telecommunications industry. They recently settled a legal dispute with Hawaiian Telecom by paying them approximately \$90,000,000. Mills Dir. at 10.



124. FairPoint has done a commendable job of risk sharing and creating incentives for Verizon and CapGemini, effectively creating a partnership with a vested interest in the timely success of the transition and conversion. The risk sharing limits the cost to FairPoint and provides incentives for each stakeholder to complete the projects expeditiously without endangering customer service to save money. Verizon shareholders' significant equity stake in the new entity creates an incentive for the conversion to occur smoothly. Although Verizon would benefit from extended TSA payments, this could be at least partially offset by the increased equity value created in the new entity if the transition occurred quickly and without business disruption. Mills Dir. at 12.
125. In general, the scope of FairPoint's project plan appears to be appropriately addressed. It includes business and systems integration and cut-over from Verizon to FairPoint systems and operations. The plan contains over 8,000 task items and is 175 pages long. Mills Dir. at 14.
126. However, in spite of the size and length of the plan, many of the project areas will require additional detail to validate estimates and for execution. The existing plans lack detail necessary to confirm that task estimates are valid and provide adequate direction for actual work to be performed. A conversion work plan for a similar project would typically contain a significant amount of more detail. Other important tasks appear to be underestimated. Mills Dir. at 15.
127. The project schedule is aggressive. An overly aggressive development and delivery schedules can increase project risk by increasing the possibility of quality problems due to potentially hurried sub-task completion. Mills Dir. at 16.
128. CapGemini – FairPoint's conversion consultants -- intends to employ a team of up to 500 people on this project. Many of these will be system developers and many will be managed "off-shore." The large staff level is intended to accelerate development and delivery. However, a team of this size and in multiple locations is difficult to manage effectively, and integration of numerous systems developed concurrently by separate large teams can be problematic. In addition, "off-shore" development may not involve adequate understanding of ILEC telecommunications business and operations, and can result in mis-implemented customizations to the software applications. Mills Dir. at 17.
129. However, an aggressive schedule does not mean that it is not achievable. Mills Dir. at 16.
130. One of the critical success factors for any large business affecting system implementation is a dedicated executive sponsor with commitment to make the project successful. The level of commitment and investment that FairPoint has

- made in this area is exemplary. FairPoint has dedicated Mr. Peter Nixon, FairPoint's President, to oversee the overall business integration project on a full time basis. In addition, key senior management personnel representing each area of the business have been assigned to the team and report to Mr. Nixon on a full time basis. Mills Dir. at 17-18.
131. Although this level of senior management dedication to the success of the integration is a critical factor in project success, the FairPoint leadership team responsible for management and oversight of the CapGemini contract and relationship does not appear to have prior experience managing an outsourced vendor effort of this cost and magnitude. Mills Dir. at 18.
  132. It is common to find invalid or inaccurate legacy system data during conversion processes. Mills Dir. at 11.
  133. CapGemini has dedicated a series of senior consultants to manage this project. They are experienced in large project management and experienced in the telecommunications industry. The full-time program manager is experienced in managing large complex projects. Although they are experienced in related areas, the assigned CapGemini senior management do not have personal experience implementing or converting ILEC customer systems for regulated mass market telephone service. This experience is an important determinant in successfully managing like projects. Mills Dir. at 18.
  134. A "switch-to-bill-to-tariff" comparison allows verification of the degree to which products that are provisioned on the switch are actually being billed to the customer, and that the products that are being billed to the customer meet the tariff requirements. Such reviews of ILEC and RBOC data have been known to reveal billing discrepancies ranging from 8% to 27%. Mills Surreb. at 7-8.
  135. The odds of a successful conversion could be improved if FairPoint undertook measures such as: (1) a "switch-to-bill-to-tariff" comparison, which can help determine the accuracy of the switch profile set-up and converted billing records; (2) a billing audit conducted six months after cut-over; and (3) adding a conversion audit task to the conversion plans to confirm conversion data accuracy for important data. Mills Surreb. at 10.

**Discussion:**

Integration and sharing of important customer information is a challenge when combining new systems for the first time. Incomplete or poorly synchronized integration of customer information can cause delays in service and safety risks. Conversions have

been successfully completed combining multiple states in one effort and with large customer bases as FairPoint would be converting, but the number of customers involved for FairPoint and the fact that they would be converting to a new set of systems that is unproven in production suggest that separating the states into two or three separate conversions might be a more prudent approach. Completing a smaller conversion first on new systems often affects and improves the remaining conversions, and reduces the potential for customer impact.

It is common to find invalid or inaccurate legacy system data during conversion processes. FairPoint's conversion plans do not appear to include an "audit" of the accuracy of the Verizon customer service, plant, and billing records. Moreover, CapGemini [REDACTED] Verizon's source data. If invalid or inaccurate data is present in the Verizon systems and is not corrected during conversion, customer service could be affected and FairPoint will be called to account for poor records created by Verizon.

### **The Proposed Independent Monitor**

#### **Findings:**

136. The Department has called for the appointment of an independent third party monitor (TPM) to observe the planning, testing and execution of the conversion to ensure quality and readiness. The TPM would be selected by the Department. The TPM's role would be to provide an unbiased view of project status and readiness for conversion with a focus on quality assurance. This independent oversight approach is frequently employed on nuclear power plant construction projects and is referred to as "the owner's engineer." Mills Dir. at 19. Mills Surreb. at 8-10.
137. FairPoint initially opposed the TPM proposal as unnecessary since the company is open to sharing status and testing reports. FairPoint is concerned that a TPM might impede progress. Haga & Kurtze Reb. at 36.
138. FairPoint is now amenable to the appointment of a TPM, but not on the terms recommended by the Department. FairPoint outlined the terms it would be comfortable with in testimony that it filed in the parallel proceeding New Hampshire on September 10, 2007. Trans. 09/20/07 at 146 (Nixon Cross). Ex.NECTA/CPVT-Cross-53.

139. The basis for the recommendation of a TPM is to reduce the potential for impact to Vermont customers given the risk related to a completely new set of business systems prior to a large conversion. Mills Surreb. at 7.
140. The Department has outlined the details of the mission it has proposed for the TPS as a condition for the approval of the Proposed Transaction, as well as other important data verification tasks. An additional responsibility for the TPM could be to ensure that the new systems are developed and implemented to comply with the competitive market opening requirements of the 1996 Act. Ex. DPS-CJC-5 at 3. Lafferty Surreb. at 21-22.
141. The TPM would work more closely with the team than simply reviewing delivered project and test status reports. The TPM would participate in test reviews and status meetings to review detailed project and test status results, and regularly report back to both FairPoint management and the Department. The independent nature of the TPM would remove any bias from status reporting and increase confidence that the project was progressing as planned and prepared for the cutover. Mills Surreb. at 7.
142. According to the Department, the TPM's involvement could be defined so as not to impede progress or create extra work for any part of the project team. Mills Surreb. at 7.
143. Should Verizon have any concerns about FairPoint's state of readiness for cutover, it Verizon has no obligation to notify the regulators of Vermont, New Hampshire and Maine of these concerns. Trans. 09/07/07 at 76 (Smith).

**Discussion:**

FairPoint is undertaking significant efforts at great expense to replace their existing business systems with state of the art "next generation" applications that are intended to improve customer service for all of their customers. FairPoint has employed CapGemini, an international consulting and outsourcing firm, to execute the systems replacement and conversion for them. The implementation of these new systems concurrently with the planned conversion of the Vermont, New Hampshire, and Maine Verizon properties is a high-risk combined project. Commercial "off the shelf" software for retail customer systems does not exist for regulated local exchange carriers, and software packages must be substantially modified to meet each new state's regulatory and

business requirements. In addition, the planned delivery schedule is aggressive for the amount of work that must be simultaneously completed on related applications, which further increases the project risk. These risks could result in delayed delivery, cost overruns, and / or customer service impacts.

FairPoint has taken several measures to improve the likelihood that the project would be successful. They have dedicated a team of their senior management to manage the overall business integration of the Verizon properties. This level of executive commitment and sponsorship is critical for project success. FairPoint has also created a risk sharing partnership with Verizon and CapGemini where each party has a vested interest in the timely success of the integration.

Nonetheless, the public interest in managing the risk of conversion and cut-over would be substantially served by the appointment of a TPM and requiring FairPoint to perform the other data verification tasks recommended by the Department: key data audit during conversion planning; “switch-to-bill-to-tariff” comparison after conversion; billing audit six months after conversion.

### **Conversion Issues Affecting Competitors**

#### **Findings:**

144. FairPoint plans to provide wholesale customers notice of the new systems six months in advance of cutover. Lafferty Surreb. at 28.
145. Once FairPoint converts to its new system platform, competitors will no longer have the security of the previous testing work or the proven Verizon system capabilities. Lafferty Surreb. at 20.
146. FairPoint has plans for developing its systems, training its employees, testing systems, training wholesale customers which FairPoint believes provides a robust plan to ensure competitors and other wholesale customers are treated fairly, service orders are processed properly and billing is accurate among other things. Lafferty Surreb. at 21.
147. All else being equal FairPoint’s plans to ensure wholesale customers are treated fairly are inadequate as no independent third-party review is proposed by FairPoint. Lafferty Surreb. at 21.

148. Assuming the TPM is ordered by the Board, one of the TPM criteria for moving forward with conversion could be that verification that FairPoint's new systems are developed and implemented in a manner which is consistent with the requirements established for Verizon's systems during the Section 271 approval process. Lafferty Surreb. at 21.
149. Compliance with the market opening requirements of the 1996 Act is critical to FairPoint's wholesale customers that will use the company's OSS for pre-ordering, ordering, provisioning, billing and other functions. Lafferty Surreb. at 21-22.
150. In addition, the Board should require FairPoint to assume all Verizon Interconnection Agreements or develop mirror agreements. Most, if not all, of these agreements will contain notice periods which can be enforced to ensure CLECs are kept informed of all relevant changes stemming from conversion and cut-over planning. Lafferty Surreb. at 22-23.
151. FairPoint has also offered training for wholesale customers. Lafferty Surreb. at 27-28.
152. The Department believes the Board should require FairPoint to provide this training and bear the related expense, while the decision whether to attend and the associated costs of attending should be left up to each specific wholesale customer. Lafferty Sureb. at 28.

**Discussion:**

FairPoint acknowledges that wholesale customers will experience some changes as a result of the acquisition to FairPoint's OSS. FairPoint plans to provide wholesale customers notice of the new systems six months in advance of cutover. This is an appropriate condition for the Board to order, provided the notice requirement is extended to include CLECs and neighboring systems at least six months notice of the planned conversion. Assuming the Board orders the appointment of a TPM, one of the monitoring criteria should be that FairPoint's system meets the market opening requirements of the 1996 Act. However, should the Board not order a TPM, then additional safeguards for wholesale customers concerning the cutover would be necessary, such as formal written confirmation of readiness from each wholesale customer.

**The need for a consolidated Cutover Plan****Findings:**

153. FairPoint does not have a consolidated Cutover Plan that covers all cutover tasks in a single document with consistent format and content. FairPoint claims that it would be too expensive to create such an integrated document, for little benefit. Wierson Surreb. at 5-7.
154. In a project of this size there is too much risk and chance for misunderstanding without such a working plan. This plan can consist of multiple documents. However, they should easily track each other and be consistent leading to an executable plan. Wierson Surreb. at 5-7. Ex. DPS-CJC-5 at 3.
155. While Verizon and FairPoint have made progress toward demonstrating that they have an adequate Cutover Plan for the network, the entire plan provided for review thus far is inconsistent and confusing. Wierson Surreb. at 5-7.

**Discussion:**

Verizon and FairPoint should be required to provide an updated Cutover Plan, Task Index, and other related documentation to the Board for review prior to the approval of the acquisition. It should include the integration of the newly acquired Network Element Managers during the TSA period and with the newly developed OSS. This updated Cutover Plan should be consistent, more equitable and agreed too, at least in principal, by Verizon and FairPoint. Some type of tracking system between the various documents should be incorporated if it is not already. If there are areas that are not defined or agreed too they should be identified as "open items." Providing this information should not require any appreciable additional work for either FairPoint or Verizon.

## **Criterion 7: Quality of the Facilities**

### **The Proposed Plant Audit**

#### **Findings:**

156. The rural telephone properties in Rural Bell Operating Company regions are often found to be less adequate than in the rural independent operator's territories. Trans. 09/07/07 at 95 (Balhoff Cross).
157. In his review of a number of acquisitions, FairPoint witness Balhoff found that the plant, as reported by the managements of the companies, was underinvested and required upgrading loop facilities and some of the switching facilities. Trans. 09/07/07 at 96 (Balhoff Cross).
158. In the case of particular acquisitions of GTE properties, for example, in Wisconsin, the switches were found to be very old switches and required updating to digital switching. In certain cases in Texas, again GTE properties, the loop plant was insufficient and when it rained the plant went out. Trans. 09/07/07 at 96 (Balhoff Cross).
159. The service quality issues Verizon has been experiencing could likely be due to the condition of its fiber, copper, and power plant. A plant audit could identify the need for significant investment in upgrades, replacement and/or repair. Wierson Dir. at 11, 23-24. Wierson Surreb. at 4 and 7.
160. It is customary for a buyer to perform a reliable audit on at least portions of a seller's network before final purchase. The buyer should be allowed to randomly select what they want to audit. Wierson Dir. at 10 and 23. Wierson Surreb. at 3.
161. FairPoint's plant audit has consisted mostly of analyzing records and data about Verizon's plant. Wierson Dir. at 22. Trans. 09/17/07 at 214-15 (Smee, Brown, Harrington).
162. For instance, FairPoint has not physically examined any of the copper infrastructure where Verizon has not implemented DSL service. Trans. 09/17/07 at 211 (Smee, Brown, Harrington Cross).
163. FairPoint's conclusions regarding the state of Verizon's plant rest on FairPoint's inferences from data contained in system reports from Verizon. Trans. 09/17/07 at 216 (Smee, Brown, Harrington).
164. There are 8 central office switches in Vermont and 77 remote switches. Trans. 09/17/07 at 201 (Smee, Brown, Harrington Cross).



165. FairPoint conducted only limited visual inspections at 3 central office sites chosen by Verizon based on a set of criteria from FairPoint. These sites were in Burlington, Montpelier and White River Junction, Trans. 09/17/07 at 201 (Smee, Brown Harrington Cross).
166. In inspecting the remote terminal sites, FairPoint only conducted an outside visual inspection, as it had no access to undertake an internal visual inspection. Verizon knew in advance that these inspections would take place. Trans. 09/17/07 at 200 and 202. (Smee, Brown Harrington Cross).
167. FairPoint has not done enough due diligence on the outside plant from the central office to the end of the network. Trans. 09/21/07 at 82 (Wierson Redirect).
168. AFL was contracted by FairPoint to do an assessment of the Verizon network including some portion of the outside plant condition, alarm history and outstanding alarms being generated by the network. The AFL report samples FairPoint has provided for review to date by the Department have not been extensive or informative. Wierson Dir. at 10.
169. FairPoint expects to receive all relevant reports at closing; however they hired AFL to study the outside plant and audit trouble reports and a report was generated. Wierson Dir. at 22; Trans. 09/17/07 at 215 (Smee, Brown, Harrington).
170. A physical plant audit can reveal service affecting issues. For example, the audit can lead to the discovery of an old or un-serviced battery plant that needs repair or replacement, or backup generators that require repair or have not gone through the manufactures recommended maintenance cycle. Wierson Surreb. at 7-9.
171. FairPoint does not appear to have examined all sources of relevant data available to gain a sound understanding of Verizon's outside plant network. The company has not demonstrated adequate knowledge of the existing Verizon network from the Central Offices (COs) to the network edge regarding the condition of the Outside Plant (fiber and copper infrastructure), Power Plant, Remote Switch facilities, Remote Terminal facilities and the associated equipment. Wierson Dir. at 22-26; Wierson Surreb. at 3-5.
172. Normally a spot audit of plant is done prior to purchase. This consists of a random audit of one or more of each type of facility in a network selected at random by the buyer. Usually this audit consists of a site survey where the actual configuration is compared to the documentation provided by the seller. The general condition of the network is also evaluated. Repair records especially on items needing periodic maintenance are audited as well. This is done for various

Point-of-Presences (POPs) and on the copper and fiber facilities also. Wierson Dir. at 23.

173. FairPoint is courting significant risks in developing a DSL overlay with limited knowledge of the outside plant network and local loop makeup. FairPoint runs the risk of deploying DSL overlay systems that will either under perform or require additional capital to extend fiber and add new remote terminal cabinets. Wierson Dir. at 23-24.
174. Both capital budgets and deployment schedules will be impacted should any of these risks come to pass. The cost and schedule impact could be significant depending on the actual copper plant loop profile. Deployment schedules could easily double with the discovery of non-favorable cable data. Moreover, a more thorough knowledge of the Verizon Vermont copper plant could lead to alternate technologies or serving areas. Wierson Dir. at 24.
175. A case in point is the unknown amount of fiber needed to build out the network. FairPoint had identified 44 miles of fiber that must be built and has indicated that 90% of this would be aerial fiber. This alone could cost around \$60k per mile (or more) or \$2.6M. Not knowing what additional fiber is required to build out to the Remote Terminals or to close fiber rings, which is part of FairPoint's plan to improve the reliability of the network, could significantly impact FairPoint's ability to provide their service level commitments. Wierson Dir. at 25.
176. The estimated average capital cost of FairPoint's initially-proposed broadband expansion is \$169 per additional addressable line. Wierson Dir. at 26
177. Using per line deployment cost estimates from a California PUC Broadband report, the cost per line is somewhere between \$700 for reaching 75% of the unserved population and \$1300 for reaching 100% penetration per connected line including equipment, deployment costs, core network, and outside plant. Wierson Dir. at 26.
178. The California PUC study raises some concerns about the FairPoint capital estimates to meet its stated 80% DSL addressability target. Wierson Dir. at 26.
179. The Department recommends that if the Proposed Transaction is approved, then two audits should be performed in two phases. The results of each audit should be presented to the Board. The details of the proposed audit are set forth in Exhibit DPS-CJC-5 at p. 2. Wierson Surreb. at 3-5.

**Discussion:**

FairPoint does not appear to have made adequate provision for the quality of the facilities that it would be receiving in this transaction. There is good reason to doubt that FairPoint has enough information about the quality of Verizon's facilities to fully understand what steps will be required to maintain and improve the quality of Verizon's facilities after closing. This introduces risk that improvements to the quality of Verizon's facilities to provide service quality improvement and broadband deployment will be more costly or time consuming than FairPoint has forecasted. Because FairPoint is a company with fewer resources than Verizon, it is important to test if FairPoint would be able to provide a quality network even if its assumptions do not ultimately prove correct. For this reason, the Department recommends that FairPoint be required to undertake the audits outlined in Exhibit DPS-CJC-5 at p. 2. Specifically:

FairPoint should be required in advance of closing to perform a network reliability analysis and provide the Board with the following information:

- The entire AFL report (Note: If the AFL report is not adequate then a new and more in depth audit should be performed)
- A Fairport reliability report showing results from the reliability audit with a gap analysis highlighting areas of deficiency in the existing network and a plan to rectify all identified potential service affecting issues.

The process of generating these reports will ensure that FairPoint develops a deeper understanding of the scope of the existing service quality issues Verizon faces in Vermont and condition of Verizon's outside plant.

Finally, FairPoint should also be required to conduct a complete outside plant audit within 12 months of closing to catalog the current plant condition and help further determine the root cause of present and potential service effecting problems in the state.

The extent of the audit should focus on the following:

- Outside plant areas where service quality issues dominate.
- Outside plant (fiber, copper infrastructure) over which Verizon has not implemented DSL services.

A copy of the audit report should be provided to the Board along with a similar action plan to rectify all remaining service issues and plant conditions discovered in the audit. The plan should address how newly discovered service affecting issues will be rectified along with how potential service problems will be circumvented.

## **Poles**

### **Findings:**

180. Verizon and electric utilities have inter-company agreements in place that address a variety of joint operations issues. One area of the agreement addresses pole setting territories. Utilities share the responsibility of setting poles and then both attach to it in accordance with their agreement. Mertens Dir. at 2.
181. Long lead times – as much as six months – have been common to process a new customer service application in Verizon pole setting service territories. Since electric utilities rely on attaching to the same pole that Verizon sets for its use, this resulted in long delays to some customers in receiving basic services. Mertens Dir. at 2.
182. Similarly, during emergencies and storm restoration the owners of various poles have the first responsibility to repair or replace damaged facilities. In some cases, Verizon would need to dispatch a crew from a distant “garage” – from Rutland to White River Junction for example, to repair a pole hit by a car. This can and has resulted in long delays in restoring electric and telecom service to customers. Mertens Dir. at 2.
183. Another area of great concern to municipalities is the dual pole issue. Numerous examples of Verizon failing to remove their old poles after other utilities transferred their facilities to the new poles were reported. In such cases, either some facilities remain on both poles, or the vacant poles remain as an aesthetic distraction in the neighborhood. Old poles also pose a potential safety hazard. In some towns, utilities have been denied permission to set new poles because of this condition. Mertens Dir. at 3.
184. Numerous customer complaints and inquiries from several electric utilities regarding Verizon practices caused the Department to convene workshops at the end of 2006. Very quickly, the group agreed on problematic areas and root causes for all the major concerns were identified. More importantly, broad corrective action plans were agreed to by the participants. The short term focus was on resolving a) line extension delays and b) improving utility-AOT coordination in response to highway projects. Mertens Dir. at 2.

185. There has been progress in resolving these issues, but what is needed is a continued focus and commitment to clear the backlog while implementing improved and effective coordination. Mertens Dir. at 4.
186. FairPoint has proposed to rely on “communications fostered through the joint pole coordinators” as a solution to these issues. Nixon Reb. at 36.
187. In the Department’s view, FairPoint’s approach carries the risk of achieving clear understanding the problem but making no progress. It also does nothing to address the backlog for pole removal due to past failure to address equipment transfers from old poles to new poles in a timely manner. Mertens Surreb. at 2.
188. The backlog for pole removal has created unsightly, obstructive and dangerous conditions in Vermont. A systematic inventory followed by an efficient and organized remediation plan is needed to correct the problem. Mertens Surreb. at 2.
189. FairPoint has exhibited a constructive view toward resolving identified pole problems, but it is still necessary to objectively measure progress rather than rely on good intentions. Establishing appropriate metrics, combined with periodic reporting will provide needed focus and urgency for resolving issues. Mertens Surreb. at 2.
190. It would be reasonable to afford FairPoint six months to perform this inventory and develop a remediation strategy. The Department believes that such a strategy should include establishing performance expectations and making periodic progress reports. Mertens Surreb. at 3.
191. The DPS believes it is important that utility pole operators provide access to their poles in an expeditious manner for all qualified applicants. Unnecessary encumbrances may have been sought by Verizon – this practice should not continue. The Department believes it would be productive if FairPoint and the Vermont Agency of Transportation crafted a term sheet to overcome any obstacles the parties face so they may be predictably resolved after closing if the Board approves the Proposed Transaction. Mertens Surreb. at 3.

**Discussion:**

The proper maintenance of the land-line infrastructure is a matter of great importance to the residents of Vermont. Coordination failures among Verizon and various electric utilities regarding their joint ownership and operation of utility poles has resulted in a deterioration of service quality and customer complaints. It is vital that

excellent coordination and communications exists among the telecom and electric utilities. In the event the Board approves the Proposed Transaction, the Department believes a commitment by Fairpoint to continue enhancing inter-company cooperation and honoring the spirit of past commitments is needed.

The Department urges the Board to require as a condition of any approval for the Proposed Transaction that FairPoint engage their electric utility partners in upgrading response to customer service requests and pursue improvements in joint operations. To objectively measure the success of these efforts, The Department believes a tracking report measuring the time required to serve new customers be maintained and a target goal reflecting good service be established. Also, the Department recommends that all dual poles be inventoried and a remediation plan be established. Further, joint protocols for responding during emergencies should be formalized to facilitate timely customer restorations. Finally, the Department recommends that FairPoint commit to globally clarifying responsibilities and perform root cause analysis for most of the joint operational areas identified during the 2006 workshops.

#### **Criterion 8: Rate of capital investment**

##### **Findings:**

192. A comparison of Verizon's aggregate capital expenditures for the three New England states with FairPoint's aggregate projections shows that FairPoint will actually be spending ██████ than Verizon spent. Wheaton Dir. at 6. Campbell Surreb. at 33.
193. A comparison of Verizon's actual operating expense (not including depreciation expense) levels for Vermont, New Hampshire and Maine combined, for 2003 to 2006, to Verizon's estimated operating expense levels for the three states for 2007, and FairPoint's estimated operating expense levels for the three states for 2008 to 2012 indicates that FairPoint projects spending less money. This reduction in spending levels is primarily due to merger synergies which FairPoint expects to attain. Wheaton Dir. at 8. Wheaton Surreb. at 4.
194. FairPoint has approximately \$██████████ per year in free cash flow (before dividends) available to fund contingencies. FairPoint will not have positive cumulative free cash flow after payment of dividends until 2011. The negative

cash flow after dividends in 2008 is expected to be funded by borrowings from the Company's revolving credit facility and / or delayed draw term loan. Wheaton Dir. at 9.

195. FairPoint projects it will have a negative equity position. This should not inhibit its ability to fund its capital program. Wheaton Dir. at 9.
196. FairPoint's projected level of free cash flow ensures that it will still have access to equity and debt capital markets if needed to fund capital expenditures. Wheaton Dir. at 9.
197. FairPoint's financial projections reflect the funding of future capital expenditures on a pay-as-you-go basis; that is, all will be funded from internally generated funds and none will be funded by additional borrowing or through the issuance of additional shares of common stock. Wheaton Dir. at 14-15.
198. FairPoint expects to implement an aggressive dividend policy. Wheaton Dir. at 21.
199. Standard & Poor's (S&P) assigned FairPoint a qualitative risk assessment of "high" in its March 24, 2007 stock report. S&P's "risk assessment reflects a balance sheet that we view as relatively weak and the company's commitment to pay a large quarterly dividend out of what we consider its somewhat limited cash reserves, which we believe is partially offset by the rural nature of its operations." Wheaton Dir. at 21.
200. As a result of the Proposed Transaction, FairPoint's dividend payout ratio as a percent of free cash flow is expected to decrease from 87 percent pre-merger to 60-70 percent post-merger while keeping the dividend rate per share unchanged. As a result, FairPoint's ability to fund its capital program and its operations should improve. Wheaton Dir. at 21.
201. Morningstar adds that they "expect FairPoint to begin paying full taxes in 2010, which may strain its ability to maintain dividend payments and make necessary capital expenditures." Wheaton Dir. at 21.
202. FairPoint's ability to fund its capital program is based on projected cash flows, which should be sufficient to cover both capital expenditures and dividend payments.
203. FairPoint's projected level of free cash flow ensures that it will still have access to equity and debt capital markets if needed to fund capital expenditures. Wheaton Dir. at 9.

204. The union contract's provision that requires only union employees to install new technology and network facilities may act as a cap that will limit, delay or reduce FairPoint's investment in DSL facilities in Vermont as projected. Wheaton Dir. at 8-9.

**Discussion:**

FairPoint has not persuasively demonstrated that its proposed rate of capital investment is adequate for Vermont.

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The Board has required a capital spending condition as part of past transactions involving predecessors of Verizon. For instance, when the Board reviewed the merger of Bell Atlantic and NYNEX, it imposed a condition that NYNEX continue to invest in telecommunications infrastructure within the state at a rate comparable to the average rate of investment for the last four years. Docket 5900, Order dated 02/26/97 at 43. Similarly, when the Board reviewed the merger of Bell Atlantic and GTE, it chose to require a minimum investment of \$47 million per year and found that in 1998, Bell Atlantic-Vermont's investment had been \$50.9 million. The Board renewed the investment condition through the end of 2003. Docket 6150, Order dated 09/13/99 at 17-18.

However, Verizon as a company obviously has the resources to spend whatever amounts might be necessary in Vermont. As a smaller company, FairPoint must show how the capital expenditures it expects to make in Vermont would be adequate to provide for needed investments to maintain and improve service quality and expand broadband, especially if it were not to have a minimum capital investment requirement. It must demonstrate that it will have the resources to deal with contingencies which require additional capital, and that it will have the ability not only to meet investment requirements through the end of the alternative regulation plan in 2010, but to support an upgrade path for a network that will support increasing levels of broadband service capability.



While the evidence may show that FairPoint has adequate capital expenditure resources at its disposal, the Department is not able to conclude that FairPoint has made an adequate commitment to deploy those resources to maintain an appropriate rate of capital investment in Vermont. The desire to ensure an enforceable commitment from FairPoint on this point is just one of the reasons why the Department has advocated for the establishment of a separate subsidiary and certain contingent cash flow transfer restraints.<sup>8</sup>

### **Criterion 9: Financial stability and soundness**

#### **Findings:**

205. FairPoint has disclosed to its investors in its SEC S-4 statement numerous risks associated with the Proposed Transaction that could materially affect the company's financial stability and soundness. Ex. DPS-Cross-19.
206. FairPoint's capital structure has been described by Standard & Poor's as aggressive and is considered to be a weakness of the company. Ex. DPS-Cross-18 at 3. Trans. 09/06/07 at 185 (King Cross).
207. FairPoint's stock is not presently and never has been rated as investment grade. Trans. 09/05/07 at 31 (Leach Cross).
208. FairPoint has no plans for its stock to become investment grade. The company does not see being investment grade as a critical factor in grading shareholder value. Trans. 09/05/07 at 32-33 (Leach Cross).
209. Standard & Poor's has characterized FairPoint's "shareholder-oriented financial policy" as a weakness as well. Ex. DPS-Cross-18 at 3.
210. Most of FairPoint's peer telecommunications companies are also rated below investment grade. Trans. 09/06/07 at (King cross).
211. Like FairPoint, none of these peer telecommunications companies have a lengthy history of operating or trading successfully while rated below investment grade. Trans. 09/06/07 at 178 and 182-3 (King Cross).

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<sup>8</sup> The findings and discussion dealing with the proposed separate subsidiary and cash flow restraints are set forth *infra* at pp. 60-67.

212. FairPoint perceives advantages in being below investment grade; it allows a different mix of debt and equity that creates different shareholder returns. Trans. 09/05/07 at 34 (Leach Cross).
213. In order to become an investment grade company, FairPoint would have to attain a book value of shareholders equity of \$1 billion. Wheaton Dir. at 14.
214. However, the investment community and the rating agencies are more concerned with FairPoint's free cash flow than with its book value. The investment community believes that FairPoint's cash flow projections will ensure that it has sufficient cash flow to fund its capital program and its ongoing operations. Wheaton Dir. at 15.
215. The fact that FairPoint will not be an investment grade company at the close of the Proposed Transaction will not inhibit its ability to fund its capital program and provide an acceptable level of customer service to its Vermont customers. Wheaton Dir. at 12-13.
216. FairPoint's financial projections indicate that it will have sufficient cash flows to fund its capital program and provide an acceptable level of customer service for the period from 2008 to 2015. FairPoint's projected cash flows are independent of its book equity position. Wheaton Dir. at 9.
217. The Reverse Morris Trust approach that Verizon and FairPoint propose to use will enable FairPoint to acquire the Verizon New England properties at a lower price. Wheaton Dir. at 11.
218. The RMT results in a tax-free transaction for the shareholders of Verizon. As a result, Verizon is willing to accept a lower price for the properties offered for sale than it would if the transaction were not tax-free. Wheaton Dir. at 11.
219. The RMT is an appropriate method for acquiring and capitalizing a regulated utility. Wheaton Dir. at 11.
220. Other telecommunications companies have recently completed similar tax-free transactions. Wheaton Dir. at 12.
221. However, an issue with using the RMT vehicle to accomplish the Proposed Transaction is that the regulated utility could end up with negative book equity, thereby causing a conflict with the traditional rate of return ratemaking used in the utility industry. Wheaton Dir. at 12-13; Behrms Surreb. at 7-9.
222. Rate of return ratemaking is based on earning a return on one's rate base book value. In a rate of return environment, FairPoint might become insolvent unless it

receives an imputed value for the price paid to acquire the properties. Wheaton Dir. at 12-13; Behrns Surreb. at 7-9 and 11-13.

223. Currently, Verizon's Vermont rates are based on an alternative regulation plan. The ARP was originally based on a traditional cost of service/revenue requirement consisting of earning a rate of return on net book value (original cost less depreciation), taxes and operating expenses. However, this plan is scheduled to end in 2010 and there is no guarantee that Vermont regulators will extend the plan. Wheaton Dir. at 12-13. Behrns Surreb. at 4-7.
224. If rate of return regulation were to be resumed post-transaction, FairPoint's Vermont properties are unlikely to be financially viable, unless FairPoint's premium above net book value investment in the properties and a capital structure that included some level of equity were imputed in the rate base. Wheaton Dir. at 12-13.
225. In modeling its financial projections through 2015, FairPoint failed to consider the possibility that the ARP might not be extended in 2010 and that its rates could become subject to traditional cost-of-service based ratemaking. Nor did FairPoint's financial analysis recognize that in a proceeding concerning any extension of the ARP beyond 2010, the company may be required to make a traditional cost-of-service filing. Trans. 09/06/07 at 173 and 180 (King Cross); Trans. 09/07/07 at 117 (Balhoff Cross); Trans. 09/05/07 at 38 (Leach Cross); Behrns Surreb. at 4.
226. The Department conducted a sensitivity analysis, using seven scenarios to test the sensitivity of FairPoint's financial capacity to changes in costs and revenues. These scenarios included increases in operating expenses, increases in capital expenditures, increases in interest rates, and reductions in revenues. Jeanson Surreb. at 3.
227. The results of the sensitivity analysis indicate that FairPoint has financial capacity to absorb certain levels of cost increases, both on-going and one-time, conversion-related increases, and revenue decreases. Some scenarios indicate that a reduction in cash dividends paid to common shareholders will be required to stay in compliance with debt coverage ratios required by FairPoint's debt covenants. Two of the scenarios indicate that elimination of the dividend will not suffice to meet the company's debt coverage requirements. Jeanson Surreb. at 3.
228. It is reasonable to expect that at some time during the forecast period that FairPoint will have to reduce dividend payments for one or more years in order to remain in compliance with its debt coverage ratios. Jeanson Surreb. at 3.

229. Financial cushion represents the ability for FairPoint to absorb cost increases or revenue decreases due to unanticipated events or transactions or assumptions that prove to be inaccurate and still meet the needs of its various stakeholders. Jeanson Surreb. at 7.
230. The amount of cushion available is constrained by FairPoint’s debt covenant in the form of two separate debt coverage ratios and by the total amount of debt capacity available to FairPoint. EBITDA Cushion represents the amount by which operating expenses can increase or revenues decrease (or some combination of the two) and still satisfy the debt coverage ratio specified in the debt covenants. This coverage ratio is defined as Adjusted EBITDA divided by Interest Expense, and must exceed 2.25. Jeanson Surreb. at 6.

Long-term Debt Cushion represents the amount of additional borrowing capacity available to FairPoint while satisfying the debt coverage ratio defined as Net Long-term Debt divided by Adjusted EBITDA. This coverage ratio must be not exceed 5.75 in 2008 and must not exceed 5.50 each year thereafter.

In the base case, FairPoint has financial cushion available by year (in million dollars) as shown in the following table:

	2008	2009	2010	2011	2012	2013	2014	2015
EBITDA Cushion	\$145.8	\$170.5	\$168.8	\$149.3	\$140.8	\$128.8	\$119.8	\$110.5
Net Long-term Debt Cushion	\$213.0	\$279.0	\$341.0	\$391.0	\$430.0	\$461.0	\$472.0	\$472.0

Jeanson Surreb. at 7.

**Discussion:**

The Department’s sensitivity analysis clearly indicates that FairPoint’s financial viability is very sensitive to changes in revenue. These changes could occur as a result of competition or changes in regulatory treatment, or some combination of both.

FairPoint’s cash flow projections have been enough to convince many in the financial community that the company is and will continue to be financially stable and sound. The Department’s sensitivity analysis for the most part has confirmed this investor perspective except if revenues were to decrease 5% per year as may be the case

given competition, Vermont regulation and FairPoint's optimism regarding line losses or if operating expenses and capital expenses were to increase by \$50 million per year.

But the Department is not as comfortable with FairPoint's financial projections when these are viewed from a regulatory perspective. FairPoint's financial planning has exhibited little or no familiarity with the regulatory ratemaking terrain it must cover in doing business in Vermont. By way of example, FairPoint appears not to have considered the traditional ratemaking implications of executing a business model that plans for incurring and maintaining a negative book equity position. There is no evidence to suggest that FairPoint understands the degree to which it may be depending on the Board to impute (1) a rate base that includes an acquisition premium and (b) a capital structure that includes some hypothetical level of non-existent equity. FairPoint seems disturbingly uncurious about whether this expectation comports with the Board's past practices in the regulation of Vermont utilities.

If FairPoint were unable to include the premium paid in acquiring the properties in its rate base, it would have to look for ways to increase revenues, decrease costs, and reduce capital expenditures to pay interest and dividends. If none of these options were sufficient to create the needed cash flows to cover both interest and dividends, then FairPoint would be forced to first reduce dividend payments and then beyond that risk default on its debt before finally declaring insolvency.

While FairPoint management has assured regulators that a dividend reduction would be considered if necessary to meet operating and capital expenditure cash requirements, this would have the effect of reducing share prices and contributing to a further decline in their credit metrics, making the sale of equity or raising additional debt even more problematic. If unable to sell additional common equity or to raise reasonably priced debt in the future to fund operations and capital expenditures, FairPoint might be forced to issue a higher level of junk bond debt at higher rates or yields. FairPoint's capacity to issue debt, in turn, would be limited by its need to maintain certain coverage ratios and reasonable credit metrics.

In pointing out this potential downward financial spiral, the Department does not mean to suggest that FairPoint's business model is doomed to fail, or that FairPoint must necessarily be judged to be financial unstable and unsound. Rather, the Department wishes to emphasize that FairPoint's business model must be rugged enough to survive regulator scrutiny on Main Street as well as investor scrutiny on Wall Street. At this time, FairPoint's highly leveraged capital structure houses the debt risk at the parent level. The operations at the state level are projected to be healthy, generating substantial free cash flow. It is important to protect these healthy operations from the risk of their free cash flow being diverted from service quality and capital expenditure initiatives to satisfy FairPoint's aggressive leverage and investor dividend payout policy.

When viewed through the regulatory paradigm to which FairPoint's Vermont operations will be subject should the Proposed Transaction be approved, the Department is forced to conclude that FairPoint's financial stability and soundness cannot be assured for Vermonters and their purposes absent the safeguards for which the Department has advocated in this proceeding. Accordingly, the Department strongly recommends that the Board take steps to give comfort to ratepayers and Vermonters at large that if necessary, the cash flow they generate for FairPoint in fact will be used to give appropriate precedence to their needs for improved service quality and capital expenditures that deliver on the promises FairPoint is making to obtain approval of the Proposed Transaction. To this end, the Department urges conditions requiring FairPoint to establish a separate Vermont subsidiary, as this will facilitate transparency in monitoring FairPoint's use of its free cash flow relative to its expenditures on improving service quality and capital investments.

#### **Criterion 10: Control of affiliate interests**

##### **Findings:**

##### **Separate Vermont Entity and Other Safeguards**

231. For holding companies such as FairPoint, it is common practice for operating subsidiaries to provide cash dividends to the parent in order to pay shareholder

- dividends and for other corporate purposes. Wheaton Dir. at 22. Ex. DPS-Cross-19 at 37.
232. FairPoint intends to transfer cash out of its Vermont properties in an amount in excess of its book net income but less than the amount of its free cash flow before dividends. Wheaton Dir. at 22.
233. It is a common practice for utilities to have separate legal entities for operations at a state level. FairPoint has given no evidence that the cost of establishing and maintaining a separate legal entity for Vermont would be prohibitive. Wheaton Surreb. at 3.
234. Verizon does not currently have a separate legal entity for its Vermont properties. Wheaton Dir. at 22.
235. FairPoint plans to operate multiple affiliates should the Proposed Transaction be approved. Lafferty Surreb. at 17.
236. Even if the Board does not require FairPoint to operate the acquired Verizon Vermont property as a separate affiliate from the acquired New Hampshire and Maine operations, FairPoint will have at least two operations in Vermont – its embedded (i.e. classic) property and the former Verizon exchanges. It also has operating companies in many other states. Lafferty Surreb. at 17.
237. FairPoint dismisses the need for a separate legal entity or any additional affiliate transactions requirements. Lafferty Surreb. at 17.
238. The Department recommends that the Board require FairPoint to establish a separate legal entity within the State of Vermont to segment all Vermont related assets and liabilities, if any, from the assets and liabilities of other FairPoint regulated, non-regulated and classic operations. Wheaton Dir. at 29. Behrns Surreb. at 17-20.
239. Vermont's ability to monitor the financial performance of FairPoint's Vermont properties would be enhanced by establishing a separate legal entity for these properties and requiring FairPoint to provide certified financial statements for them to the Board on an annual basis. Wheaton Dir. at 22. Behrns Surreb. at 17-20.
240. According to the Department, the Board should also establish safeguards regarding the outflow and transfer of cash including dividends and loans of any form from the separate Vermont Corporation related to Vermont FairPoint regulated operations to FairPoint corporate or other affiliates. These cash flow related safeguards would ensure that adequate funds (cash) were available to meet

the needs of providing state-of-the-art telecommunications networks and services throughout FairPoint's Vermont serving territory. Behrns Surreb. at 20.

241. Such safeguards could include thirty day advanced notification to the Department and the Board of all planned loans, dividends and cash transfers of any kind from FairPoint - Vermont to FairPoint parent and affiliates. Suspension of the cash transfers, dividend payments and loans could then be initiated by the Board if it were determined that FairPoint was not consistently meeting its commitments related to:
- Service quality minimum standards.
  - Meeting the broadband build-out commitments established under Verizon's Alternative Regulation Plan.

Wheaton Dir. at 23; Behrns Surreb. at 20-21.

242. In addition, all contracts between FairPoint's parent and Vermont affiliate should be competitively priced. The Board should require FairPoint to file copies of all affiliate-related contracts and service agreements over \$25,000 with the Department and the Board for review. Wheaton Dir. 23. Behrns Surreb. at 25.

#### **Affiliate Allocation Issues**

243. To protect ratepayer interests, the allocation of support service costs to individual jurisdictions is typically governed by a cost allocation process approved by regulators - including the FCC - and subject to audit. Cost allocation policies and procedures are documented in a Cost Allocation Manual, or CAM. CAMs are filed with the FCC and updated annually. Wheaton Dir. at 22.
244. FairPoint acknowledges that it is subject to the FCC's cost allocation rules between regulated and deregulated operations. Skrivan Reb. at 17.
245. The Department believes the Board should impose a condition that requires FairPoint to follow Section 272(e) non-discrimination requirements which are applicable to BOCs. Lafferty Surreb. at 18.
246. FairPoint does not think this condition is necessary because it will voluntarily follow Verizon practices as defined in its CAM. Skrivan Reb. at 17-18. Lafferty Surreb. at 17.
247. FairPoint plans to provide both traditional regulated and deregulated services in Vermont. Lafferty Surreb. at 18.



248. Initially, with the exception of bundles including wireless services, FairPoint plans to offer all the same services and bundles currently available from Verizon. Some of these bundles include services provided by Verizon as a Bell Operating Company (“BOC”) through more than one affiliate. Lafferty Surreb. at 18.
249. FairPoint also has announced its intention of introducing additional bundles and pursuing a wireless product partnership. New services and bundles are designed to provide choice to customers and should be encouraged. However, the Board must ensure that customers purchasing mainly traditional regulated services do not unwillingly subsidize customers purchasing bundles of regulated and deregulated services. Lafferty Surreb. at 18.
250. To guard against such unwilling subsidization, the Department believes the Board should apply to FairPoint the Section 272(e) BOC affiliate requirements found in 47 U. S.C. §272(e). Lafferty Surreb. at 18.
251. Applying the BOC affiliate requirements to FairPoint would have the effect of ensuring that FairPoint complies with the affiliate transactions requirements in the same manner as Verizon. Lafferty Surreb. at 19.
252. If the Board does not require FairPoint to establish a separate legal entity for Vermont, these requirements are even more important to ensure costs and investments are properly allocated among FairPoint’s operations especially in the northern New England states. Lafferty Surreb. at 18.

**Discussion:**

In short order, FairPoint will need to recruit experienced senior level management and executive talent, execute a massive systems conversion, initiate construction projects across three states, improve service quality and make substantial capital expenditures to deploy broadband, while simultaneously maintaining a highly leveraged financial structure and an aggressive dividend payout policy. It would be a formidable undertaking for any company, even a large company. It is even more formidable when considering FairPoint’s size and talent pool.

In general, the Department believes that the affiliate transaction controls FairPoint proposes to implement are acceptable. However, given the combination of circumstances that FairPoint will need to contend with should the Proposed Transaction be approved, the Department has identified some important safeguards to ensure that FairPoint will

conduct its affiliate transactions in a manner that does not compromise the interests of Vermont ratepayers.

These safeguards include: (1) requiring the establishment of a separate legal entity for FairPoint's Vermont operations; (2) creating a mechanism to restrict the ability of FairPoint to move cash from its Vermont operation to the parent corporation should FairPoint be unable to demonstrate that it is meeting service quality standards, and achieving broadband expansion milestones.

There is sound Vermont precedent for the safeguards the Department is seeking. In Docket 7213, when the Board approved the acquisition of Green Mountain Power by Gaz Metro, the Board imposed a condition that GMP provide notice of, and file copies upon request, all contracts with affiliates other than contracts of less than \$25,000 and contracts with existing affiliates. Docket 7213, *Joint Petition of Green Mountain Power Corp., Northern New England Energy Corp. (NNEEC), a subsidiary of Gaz Metro of Quebec, and Northstars Merger Subsidiary Corporation (Northstars) for approval of the merger of Northstars into and with Green Mountain Power, etc.*, Order dated 03/26/07 at 32. The Board required all such contracts to be based upon arms-length negotiations. *Id.* The Department believes a similar condition would be appropriate in this case.

Nor are such safeguards unknown to FairPoint. Similar measures were ordered by the commission in Illinois in 2004 and in New York State in 2005. In the Illinois case, FairPoint petitioned jointly with several of its subsidiaries for state regulatory approval of a recapitalization connected with FairPoint's eventual initial public offering in 2005. *FairPoint Comm. Inc., et al., Joint Application for approval of the Recapitalization of FairPoint Comm., Inc.*, 2004 Ill PUC LEXIS 278, \*3. As a condition of approval and to ensure the delivery of sound service quality, the Illinois Commission restricted each petitioning FairPoint subsidiary

from paying dividends to FairPoint Communications, Inc. or from otherwise transferring cash to FairPoint Communications, Inc. through loans, advances, investments or other means that would divert their moneys, property or other resources that is not essentially or directly connected with the provision of non-competitive telecommunications service if [the subsidiaries] fails to meet or exceed the standard, set herein, for a majority of the service quality measures...

Id. at \*13-\*14.

In the New York case, FairPoint petitioned jointly with Berkshire Telephone Corporation for state regulatory approval of their merger. *Joint Petition of Berkshire Telephone Corp., FairPoint Communications, Inc. et al. for Approval of the Merger of FairPoint Berkshire Corp. with and into Berkshire Telephone Corp.*, 2005 N.Y. PUC LEXIS 124. The commission noted the “significant financial pressures” FairPoint could face in the future due to its “non-investment grade bond rating and relatively weak overall financial condition.” Id. at \*7. Thus, to ensure the continuation of high quality service and Berkshire’s ability to complete necessary capital and maintenance expenditures, the Commission conditioned its approval of the merger by imposing restrictions on the dividends Berkshire could distribute to FairPoint. Id. at \*14. The effect of the restrictions was “to require that an amount of cash, equal to 100% of that year’s depreciation expense, will be available for Berkshire’s capital expenditures.” Id. The commission also prohibited Berkshire and its subsidiaries from “making any loans or financial advances to FairPoint.” Id.

The safeguards proposed by the Department are very similar to those FairPoint has come to terms with in doing business in Illinois and New York. The effect of the safeguards proposed by the Department will be to create full transparency for Vermont regulators over the financial activities of FairPoint’s operations in the state. These safeguards will provide additional comfort for the public that, when necessary, regulators can act to ensure that the free cash flow generated by FairPoint in Vermont will be applied first for the benefit of Vermont ratepayers.

In addition to the foregoing proposed financial safeguards, the Board should also require FairPoint to follow the BOC requirements of Section 272(e) of the 1996 Act.<sup>9</sup>

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<sup>9</sup> Section 272(e) requires BOCs to afford equal treatment to affiliated and unaffiliated entities alike for (1) requests for telephone exchange service and exchange access; (2) provisioning on identical terms and conditions of facilities, services and information concerning these matters; (3) access charges for telephone exchange service and exchange access; and (4) provisioning of interLATA or intraLATA facilities or services at same rates and terms and conditions, with appropriate cost allocation. 47 U.S.C. §272(e)(1)-(4).

This condition will give customers a level of certainty that affiliates and non-affiliates are treated the same will help avoid confusion and related disputes concerning FairPoint's obligations in the future.

In opposing the Department's proposed condition requiring 30 day notice of affiliate transactions in excess of 25,000, FairPoint argues that it is already subject to the FCC's Part 32 and 64 rules which address among other things affiliate transactions. FairPoint believes the FCC rules are adequate to control FairPoint's affiliate transactions and claims it is unnecessary for the Board to place any specific restrictions on FairPoint's affiliate relationships. However, §272(a) – (e) and §272 (g) of the 1996 Act provide specific affiliate transactions safeguards for BOCs. While §272(f) provides a sunset for many of the Section 272 requirements, which has occurred in Vermont, the Section 272(e) non-discrimination requirements applicable to BOCs continue for Verizon in the state and should apply to FairPoint.

It is not necessary for the Board to first determine whether FairPoint as a matter of law will be a BOC as a result of the Proposed Transaction before then deciding whether BOC requirements should be imposed upon FairPoint to the extent permissible under state law authority.<sup>10</sup> The Board may use its broad supervisory powers pursuant to 30 V.S.A. §209 to simply treat FairPoint as if it were a BOC by applying the BOC requirements of the 1996 Act to FairPoint See, e.g. In re Verizon New England, Inc., 173 Vt. 327, 335 (2002)(sustaining Vermont Public Service Board ruling that it had broad authority under §209(a)(3) “ to regulate telecommunications companies to further competition in Vermont's local exchange market.”) Nor is there anything in the 1996 Telecommunications Act that prohibits the Board from adopting as Vermont regulatory policy the same rules as the FCC. For example, as Department witness Lafferty testified, many states require ILECs to follow the FCC's Part 32 rules, which FairPoint

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<sup>10</sup> The question of FairPoint's BOC status appears simple enough to resolve by a straightforward reading of 4 U.S.C. §153(4)(B), which plainly states that the term “Bell operating company” includes the “successor or assign” of a BOC. However, this statutory construction exercise would appear to lie beyond the jurisdiction of this Board, at least in this proceeding. As it is, the question is now pending before the FCC, where it has been raised by One Communications Corp. in a petition to deny the applications filed by Verizon and FairPoint to transfer certain spectrum licenses and Section 214 authorizations. See WC Docket No. 07-22, Petition of One Communications Corp. dated April 27, 2007 at 6 n.7 (citing cases).

acknowledges it will follow in Vermont. Treating FairPoint as if it were a BOC will ensure that Vermont retains the competitive and regulatory safeguards inherent in the §272(e) obligations that Verizon has been required to observe in doing business as a BOC in Vermont.

FairPoint has multiple affiliates which provide services in Vermont and plans to offer bundles which will likely include regulated and non-regulated services and services which can be provided by multiple affiliates. FairPoint already recognizes the importance of following the FCC's affiliate transactions and cost allocations rules. Therefore, the Board can apply the BOC requirements to FairPoint without adding any administrative burdens to FairPoint, and customers and regulatory authorities will be assured that FairPoint operates in the same manner as Verizon.

Finally, with regard to the allocation issue, as Mr. Lafferty testified, all ILECs are required to follow the FCC's Part 64 cost allocation rules to allocate expenses and investments between regulated and deregulated operations and among affiliates. Thus, FairPoint should be required to develop and provide to the Board its cost allocation manual, plans, processes and reporting practices. Where such costs are allocated or assigned among affiliates, such costs should be charged based upon arms-length contractual agreements that can be competitively verified as lower-of-cost or market.

**Criteria 11 & 12: Managerial competence, technical knowledge, experience, ability.**

**Findings:**

253. FairPoint does not yet have sufficient management strength to operate the Verizon-New England properties effectively. Wheaton Dir. at 24. Trans. 09/21/07 at 115 (Wheaton Cross).
254. FairPoint has designated its President to serve as the full-time chief executive for the Verizon-New England properties. This individual has substantial operating experience in the telecommunications industry, with FairPoint and with rural local exchange carriers. A top-level organization chart for the post-transaction properties in New England has been defined, and a significant effort is currently underway to fill those positions. Wheaton Dir. at 24.

255. FairPoint has defined an organization plan for the Verizon New England properties that is typical of the telecommunications industry. The plan also reflects FairPoint's experience in providing services to rural communities. Wheaton Dir. at 25.
256. However, it is unclear if FairPoint's organization plan reflects the regulatory demands that the Company will face when it is the prime provider of telecommunication services in each of the three New England states and is subject to greater scrutiny than it has faced previously in its legacy operations. Wheaton Dir. at 26.
257. FairPoint has executed a sound consulting contract with CapGemini to prepare for and execution the systems conversion and cut-over. However, FairPoint does not have a seasoned expert who has either managed or monitored a systems development and conversion effort of this magnitude and whose prime responsibility is to oversee and manage this relationship. Wheaton Dir. at 25.
258. Prior to the cutover, FairPoint appropriately plans to merge the conversion team with the permanent organization. FairPoint should take immediate steps to retain a third-party to oversee the CapGemini relationship or hire a seasoned expert who has the necessary background to perform that role. Wheaton Dir. at 25.
259. It is common practice in the utilities industry to have Boards of Directors whose membership reflects the geographical mix of its customer base. Since Vermont will have 17.7% of FairPoint's total access lines, it should have at least one representative included in the nine members on FairPoint's Board of Directors. Wheaton Dir. at 28.
260. FairPoint will work to nominate a Vermont representative to the Board of Directors, but cannot control such appointments. Trans. 09/05/07 at 25-26 (Leach Cross).
261. Since Vermont will have about 17.7 percent of FairPoint's total access lines, it should have at least one representative included in the nine members on FairPoint's Board of Directors. It is common practice in the utilities industry to have Boards of Directors whose membership reflects the geographical mix of its customer base. Wheaton Dir. at 28.

**Discussion:**

The evidence persuasively shows that FairPoint has financial management savvy and is appropriately adding to its ability to oversee the transition and the operations of the new company. However, the development of FairPoint's management team is still a

work in progress at this time, and it is still difficult to judge if it will be up to the task FairPoint has set for itself.

FairPoint faces the very significant management challenge of scaling up and putting together the team which is capable of effectively overseeing the very large system conversion and running the company apart from the support that Verizon provides for the Vermont operation. In the Department's opinion, FairPoint does not yet have in place adequate staff and to successfully complete this transition. Some of the delay no doubt is occasioned by the tentative nature of preparing for the execution of the Proposed Transaction without assurance that all regulatory approvals in fact will be forthcoming. In some key respects, FairPoint has exhibited an exemplary commitment to staffing the New England operations with a seasoned executive officer who is capable of marshalling FairPoint's management resources as warranted. But in other respects, FairPoint's ranks are noticeably thin, lacking in the expertise necessary to effectively supervise the activities of Cap Gemini.

Finally, given that the Vermont operations post-transaction will comprise a significant portion of FairPoint's access lines, steps should be taken to assure that Vermont has representation on FairPoint's Board of Directors.

### **The Proposed Management Plan Requirement**

#### **Findings:**

262. FairPoint is in the process of establishing a New England specific senior management team focused on the three States. This is a very positive indication that will help ensure service quality and delivery. Wierson Dir. at 12.
263. FairPoint does not have formal written policies and procedures that are critical for sound management of the transition and future operation of the New England Properties. Wierson Dir. at 15-16.

#### **Discussion:**

Before final approval of the Proposed Transaction, FairPoint should provide to the Board and the Department a detailed management plan that addresses:

- Organizational Structure and responsibility
- Implementing a regimented approach to the inspection of work
- Quality policies and metrics
- Process flow – engineering, construction, testing, service provisioning
- Reducing error rate
- On time completion rate
- Training employees
- Analysis of data and improvement

### **The Union Work Force**

#### **Findings:**

264. The integration of the Verizon employees into the new Fairpoint organization could give rise to staffing issues. Wierson Dir. at 15.
265. FairPoint is acquiring ex-Verizon employees who have worked under strict policies, practices and procedures in the past. FairPoint does not intend to carry Verizon's practices forward. Wierson Dir. at 16 .
266. FairPoint has little management experience in working with union personnel on the scale associated with this acquisition. This could lead to friction between employees and management. Wierson at 17.
267. The union contract prohibits the use of non-union resources to install new plant. Wierson at 17.

#### **Discussion:**

If the Board approves this acquisition, it is recommended that FairPoint create a plan within 10-12 months after closing to transition and train Verizon employees who are accustomed to Verizon's procedures into FairPoint's operational processes. It is recommended that FairPoint establish their own written policies and procedures and provide those along with the plan.

FairPoint should acquire expertise in the area of operations experience with union labor. While this expertise could be in the form of transition consultants, it is highly recommended that some of the permanent senior and mid-level management have direct experience with CWA and IBEW employees. It is clear the CWA has major concerns



about the FairPoint/Verizon transaction and FairPoint must address these concerns directly with experienced upper-level management expertise.

FairPoint must develop a management plan and organization structure to address staffing issues that may arise post-transaction. FairPoint will need to implement service delivery assessment programs focused on meeting customer commitment dates and deadlines. These programs need to incorporate quantitative assessment tools focused on establishing the root cause of the failures.

Any issues delineated previously can lead to friction between management and staff. To avoid this friction, it is recommended that a plan be devised for the incorporation of operational metrics and training for all employees as well as the establishment of employee incentive programs to eliminate possible network failures and improve delivery performance.

### **Criterion 13: Business reputation**

#### **Findings:**

#### **FairPoint's Reputation in the Financial Community**

268. The financial community believes that FairPoint' senior management has a proven track record in acquiring properties and operating them effectively. It believes that FairPoint has the financial acumen, discipline, experience and savvy to acquire the Verizon New England properties and to operate them effectively. Wheaton Dir. at 24-25.
269. The investment community points to FairPoint's use of the RMT, how it managed its negotiations with Verizon, its experience in successfully completing numerous acquisitions in the past, its selection of CapGemini as a partner, and its use of lessons learned both from its own experience as well as others, as evidence it will be successful in completing this transaction and managing the newly acquired properties successfully. Wheaton Dir. at 24-25.
270. The investment community also believes that Verizon will provide the necessary assistance and cooperation to FairPoint since it is important to Verizon that this sale and the system conversion be successfully completed. It is commonly known that Verizon would like to dispose of its other rural properties and needs to demonstrate that such a sale and transition can be successfully executed financially and operationally. Wheaton Dir. at 26.

### **FairPoint's Reputation in the Regulatory Community**

271. The Department's consultants conducted a "Business Reputation Survey" of FairPoint. Lafferty Dir. at 23.
272. In general, due to its small size FairPoint has received little attention by most regulatory and other governmental agencies, consumer advocates or Attorneys General (collectively "Agencies"). Lafferty Dir. at 23.
273. In most cases, respondents who reported interaction with FairPoint personnel had favorable experiences. Lafferty Dir. at 23.
274. With the exception of Maine, to the extent regulators and other government agencies have had opportunities to work with FairPoint, they report chiefly positive experiences. FairPoint's quality of service, broadband service and accessibility and knowledge of personnel are rated above average in most cases. Lafferty Dir. at 23.
275. However, in Maine where FairPoint is currently a relatively large carrier serving approximately 60,000 customer access lines, regulators reported significant concerns with the Company's service quality and level of complaints. Lafferty Dir. at 23.
276. Based on the number of reported complaints, FairPoint has had recent service problems in Maine. In 2005 and 2006, complaint levels increased significantly. In 2004 FairPoint only had 31 complaints; however, in 2005 and 2007 the number increased to 76 and 70 respectively. While the trend in complaints appears to be lower in 2007, the recent increases are notable, and the Consumer Assistance Division of the Maine PUC claims that FairPoint's level of complaints is above the level for other carriers. Lafferty Dir. at 23.
277. In Maine FairPoint is the second largest local telecommunications service provider. Since FairPoint's proposed acquisition of the Verizon Vermont properties will make it the largest incumbent local telephone company in Vermont, FairPoint's experiences in Maine are probably more indicative of what might be expected in Vermont. Lafferty Dir. at 23.
278. At least some of the service concerns in Maine stem from problems with the conversion of a customer care and billing system. In recent years FairPoint appears to have had significant service complaints and problems in Maine and Vermont stemming at least partially from challenges associated with system conversions. Lafferty Dir. at 23.

279. In Vermont, FairPoint will be required to convert all the customer service, billing and many other system platforms from the Verizon systems to a new platform after close for the acquired Verizon Vermont (and Maine and New Hampshire) properties. Lafferty Dir. at 23.
280. There is a similarity of challenges between the Maine situation in 2005 and 2006 and the upcoming conversions in Vermont which suggests FairPoint's experiences in Maine must be carefully considered. Lafferty Dir. at 23.
281. Frequent and open communication between customers, the Board, Department and FairPoint will be critical to managing customer service. Lafferty Dir. at 23.
282. FairPoint has not demonstrated a commitment to providing a high level of service to the consumers of Vermont. Pariseau Dir. at 5.

**Discussion:**

The financial agencies interviewed by the Department all reported confidence in FairPoint's ability to manage the acquired operations and remain financially stable in the process. The management team is respected and the company is expected to generate significant cash flow to meet capital investment and dividend requirements.

FairPoint operates relatively small operations in its other states with the exception of Maine. Where FairPoint provides service today, state regulators, consumer advocates and attorneys general report little interaction with the company. With the exception of Maine and Vermont, where regulatory interactions are reported, FairPoint has a generally strong reputation for delivering good service quality and responsiveness. Thus, the Board should understand that FairPoint is perceived well by the regulators, the consumer advocates and the attorneys general in most of other states where the Company operates. Therefore, the Department concludes that FairPoint has a sound business reputation in the investment community, and, for the most part in the regulatory jurisdictions in which it operates.

Unfortunately, the same cannot be said of FairPoint's business reputation in Maine and Vermont – two jurisdictions that happen to have experiences with FairPoint that are highly relevant to the judgment call the Board must make about whether it is in the public good for the Proposed Transaction to be approved. Since Maine represents

FairPoint's largest current operation and has experienced recent challenges with system conversions, the Board should give FairPoint's past experiences in Maine more weight than its experiences in the other states. Moreover, these issues find additional resonance in FairPoint's Vermont record for service quality and customer service.<sup>11</sup>

The Department would observe that FairPoint's conduct throughout this review docket has suggested that the company wishes to cooperate and to be responsive to its regulators. For instance, as Mr. Campbell noted in his direct testimony, FairPoint deserves high marks for the openness it has exhibited in communicating and responding to concerns the Department has voiced about the information that the company has provided in discovery and otherwise. This would lead the Department to conclude that while FairPoint's service quality record for its classic Vermont operations may not be optimal, the company has the best of intentions of improving its performance should this Proposed Transaction be approved.

To ensure that FairPoint good intentions translate into a reality of quality service to customers, the Board should ensure that FairPoint appoints a senior level person with responsibility for communicating with the Board and other regulatory agencies in the state. This person should be located in Vermont to be readily accessible by the Board and Department. Furthermore, with the imposition of recommended service quality performance and conversion safeguards outlined earlier,<sup>12</sup> the Department would interpret FairPoint's business reputation at large to mean there is good cause to think that FairPoint would be a good corporate citizen in Vermont if the Proposed Transaction were approved.

**Criterion 14: Transaction should produce efficiencies**

**Findings:**

283. FairPoint expects to achieve net cost savings as a result of merger synergies of \$71 million per year. Wheaton Dir. at 26.

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<sup>11</sup> Please see earlier service quality and customer service discussion *infra* pp. 26-33.

<sup>12</sup> Please see *infra* pp. 34-44.

284. Of this amount, \$ [REDACTED] relates to software depreciation which, when eliminated as an operating expense post-merger will be replaced by additional depreciation related to new systems being developed. Wheaton Dir. at 26. Ex. DPS-Cross-10.
285. Most of the cost savings relate to FairPoint projections of back office costs which are less than those same costs currently allocated to the New England properties by Verizon. Wheaton Dir. at 26.
286. Morningstar, in its report dated March 9, 2007, states “we are skeptical of management’s claim that it can eke out annual cost savings of \$60-75 million following the integration, equaling a 7%-8% reduction in operating expenses. Remarkably, FairPoint is not planning any job reductions, as are typical in deals of this nature. In fact, the combined company plans to grow its employee head count by 20% to accommodate bringing previously outsourced work in-house.” Wheaton Dir. at 27.
287. In modeling its projections for synergy savings, there are several substantial financial items FairPoint chose not to include in its projection calculations. These include a recommended \$45 million rate reduction for Verizon in Maine, a \$23 million ratebase imputation for Verizon in New Hampshire, and a \$ [REDACTED] depreciation expense that FairPoint wishes to reclassify as an operations expense. Trans. 09/05/07 at 111-115 (Leach Cross). Ex. DPS-Cross-10. Ex. DPS-Cross-11. Ex. DPS-Cross-12.

**Discussion:**

FairPoint asserts that it will be able to achieve operating efficiencies of \$60 million to \$75 million dollars by running operations less expensively than what Verizon allocates internally for functions like network monitoring, customer care, and back office support. However, FairPoint’s claims have been received with some skepticism on Wall Street. The complexity and scale of this Proposed Transaction make projecting costs and synergies difficult. Moreover, FairPoint appears to have been highly selective in omitting substantial potential adjustments from its process of modeling synergistic savings. In any event, for consumers, the benefit of FairPoint’s greater efficiency, if true, should be the ability to share in the benefits, whether through reduced rates or better services.

## **Criterion 15: Transition should not impair competition**

### **Findings**

288. The Department recommends that the Board require FairPoint to establish business rules and processes and train its personnel to ensure parity in the treatment of wholesale CLEC and retail customers in all aspects of service. Lafferty Surreb. 28-29.

### **The Section 271 Checklist**

289. As a Bell Operating Company (“BOC”), Verizon is required to follow several of the market opening provisions of the 1996 Telecommunications Act (the “1996 Act”). 47 U.S.C. §271; Lafferty Surreb. at 8-9.
290. Through the course of several proceedings before the Vermont Public Service Board, Verizon became subject to certain market opening obligations in Vermont. These obligations are commonly referred to as the “Section 271 Checklist.” Lafferty Dir. at 29. Docket 5900, *Joint Petition of New England Telephone & Telegraph Co. d/b/a NYNEX, NYNEX Corp., and Bell Atlantic Corp. for approval of a merger of a wholly-owned subsidiary of Bell Atlantic Corp. into NYNEX Corp.* Order dated 02/26/97.
291. Subsequent to the closing of the Proposed Transaction, FairPoint will have the same market power in Vermont as Verizon. FairPoint will be the incumbent LEC in the same fashion as Verizon and use the same network with the same scale throughout the state as Verizon. It will operate the only network in Vermont which reaches all parts of the current Verizon territory and will maintain carrier of last resort obligations. Lafferty Surreb. at 10.
292. Previous Rural Local Exchange Carrier (RLEC) acquisitions of BOC assets have been limited to relatively small groups of exchanges within a state. Lafferty Surreb. at 12.
293. Unlike Verizon (the successor of the New England Telephone and Telegraph Company), FairPoint is not identified as a BOC in the 1996 Act. 47 U.S.C. §153(4)(A). Lafferty Surreb. at 9.
294. The parties do not agree on the need for the Board to impose the Section 271 Checklist requirements on FairPoint. Lafferty Surreb. at 10-11. Ball Dir. at 22. Skrivan Reb. at 29.
295. FairPoint’s position is that there is no need for the Board to impose BOC obligations because FairPoint will voluntarily meet all of the regulatory

obligations that apply to Verizon in Vermont. FairPoint asserts that in the past no non-BOC has been deemed subject to Section 271 as a result of an acquisition. Lafferty Surreb. at 12. Skrivan Reb. at 28.

296. The Department's position is that as a condition of approval for the Proposed Transaction, the Board should require FairPoint to abide by the Section 271 Checklist obligations that have applied to Verizon in Vermont. This will ensure that competitors and consumers in Vermont continue to enjoy the same level of service after close of the Proposed Transaction as they presently have with Verizon. It will also ensure continuity of oversight for Vermont regulators. Lafferty Dir. at 31. Lafferty Surreb. at 10.
297. Absent Section 271, FairPoint's obligations to provide certain UNEs will be limited to those available under the FCC's impairment analysis conducted in the TRO and TRRO. The FCC in the TRO has ruled that, even if a UNE is no longer required based upon the 251 necessary and impair standard, it still may be required under Section 271. Ball Dir. at 18. Lafferty Surreb. at 11.

### **Discussion**

Almost all of the parties have commented on the unique aspects of this acquisition. Never before has a small rural incumbent local exchange carrier such as FairPoint acquired all of the access lines and operations of an incumbent BOC in a state, much less in three states. If this Proposed Transaction closes, overnight FairPoint will become the largest and most dominant LEC in all of northern New England. Previous rural local exchange carrier acquisitions of BOC assets have been limited to groups of exchanges within a state. In all of these past situations the BOC has continued to be the dominant LEC in the state. Therefore this type of situation and some of the associated consequences faced by the Board in this case have never been addressed in prior acquisitions.

All incumbent local exchange carriers (ILECs) -- including BOCs -- are subject to most of the market opening provisions of §251 and §252 of the 1996 Act. Among other things, these statutes require ILECs to interconnect with other carriers and provide unbundled network elements at cost-based rates in a nondiscriminatory manner.

However, the 1996 Act also has several provisions which do not necessarily apply to non-BOC entities. For example, in return for the ability to obtain approval to enter the

interLATA long distance market, §271 of the 1996 Act requires BOCs to comply with additional market opening requirements known as the “Section 271 Checklist” set forth in §271(c)(2)(B) of the 1996 Act.

On January 16, 2002, the Board acknowledged Verizon’s compliance with the requirements of §271 in Vermont. The Board stated:

The record shows that Verizon VT has developed the tariffs, the Statement of Generally Available Terms ("SGAT"), interconnection agreements, processes, and procedures necessary for a competitive market in Vermont. At this time, Verizon VT has taken the appropriate steps to open the local exchange and exchange access markets in Vermont to competition in accordance with standards set forth in the Act. We base this decision on the evidence presented during our review of Verizon's filing in this docket, as well as consideration of our decisions in prior dockets in which we have taken active steps to ensure that we have established a framework that allows effective and fair competition. Therefore, we conclude that, upon satisfaction of the conditions specified below, Verizon VT has demonstrated its compliance with the requirements of Section 271.

As a successor to Verizon, it is important for FairPoint to be held to the requirements of the 21271 Checklist because competition for many telecommunications customers and services is still in the early stages of development. While §§ 251, 252 and 271 of the 1996 Act established the broad requirements for opening the local exchange telecommunications marketplace to competition, as the Board’s cited remarks indicate, state regulators have invested countless hours to develop the specific rules to foster and allow competition to take root.

Verizon has participated in many regulatory proceedings in Vermont and in other states to establish the rules associated with competitive entry. In these proceedings state regulators have implemented specific rules for Verizon, many of which have been memorialized in interconnection agreements (ICAs) between Verizon and competitors after years of negotiations and regulatory proceedings. The Board, Verizon, and Verizon’s competitors have made significant investments of time, systems, plant and/or other resources to ensure a competitive marketplace can develop. Without these rules and ICAs, competitors would not be able to compete on anything close to a level playing



field with Verizon. FairPoint's acquisition of the Verizon Vermont wireline properties should not alter this hard won competitive landscape.

Unlike Verizon, FairPoint is not listed as a BOC in the 1996 Act. Therefore, if FairPoint is going to fully "step into Verizon's shoes," then the Board must take action to ensure that FairPoint continues to meet the market opening commitments made by Verizon in earlier Board proceedings. These are the only means by which the Board can ensure that FairPoint in fact will assume all of Verizon's commitments to existing competitors and ensure a competitive marketplace continues to evolve consistent with state and federal requirements.

### **The 2% exemption of Section 251**

#### **Findings:**

298. Section 251(f)(2) of the 1996 Act provides ILECs serving less than 2% of the access lines in the United States in the aggregate with the right to petition the state commission for a suspension or modification of some or all of the requirements of subsections b or c of §251. 47 U.S.C. §251(f)(2).
299. Since it serves more than 2% of the aggregate access lines in the country, Verizon does not qualify as a 2% Company; however, FairPoint currently qualifies and will continue to be a 2% Company after the acquisition closes. Lafferty Surreb. at 13.
300. The 2% exemption would provide FairPoint an opportunity to potentially avoid certain competitive market opening obligations which Verizon currently is required to meet. Lafferty Surreb. at 13.

#### **Discussion:**

FairPoint's existing Vermont property and all of its other properties are considered rural for regulatory purposes. Section 251(f)(1) of the 1996 Act provides rural incumbent local exchange carriers certain exemptions from interconnection requirements. Currently the Verizon Vermont properties are considered non-rural for regulatory purposes meaning Section 251(f)(1) does not apply. However, it is possible in the future FairPoint could try to claim the acquired Verizon Vermont properties are rural and obtain an exemption.

Section 251(f)(2) provides local exchange carriers with fewer than 2% of the nations access lines in the aggregate the ability to seek a waiver of certain interconnection requirements from state commissions. FairPoint's acquired Verizon Vermont (and total acquired New England properties) will be less than 2% of the nation's access lines in the aggregate. Therefore, even if FairPoint was unable to meet the definition of a "rural" company, it could still seek a waiver of certain interconnection requirements.

To address this competitive concern, the Board must order FairPoint to continue to meet all of Verizon's current interconnection requirements in Vermont. Furthermore, as a condition for approval, the Board must require FairPoint to waive any claim any exemptions under Section 251(f) for the acquired Verizon Vermont properties.

The 2% exemption would provide FairPoint an opportunity to potentially avoid certain competitive market opening obligations which Verizon currently is required to meet. The Proposed Transaction should not be used as a tool to change the competitive and regulatory safeguards appropriate for competitors and consumers in Vermont. The public interest is best served by applying all necessary safeguards to ensure the acquisition does not decrease competition in the future. This will reassure competitors and consumers that the Proposed Transaction will maintain the status quo for the competitive landscape.

## **The SGAT**

### **Findings:**

301. The Statement of Generally Available Terms ("SGAT") provides wholesale customers a single source of terms, rates and other information concerning all wholesale services an ILEC offers to competitors. Lafferty Surreb. at 14.
302. BOCs developed, filed and obtained approval of SGATs usually in conjunction with the review by state regulators of their potential to obtain Section 271 interLATA long distance authority. Verizon has an approved SGAT in Vermont. Lafferty Surreb. at 14.
303. The Board has previously recognized the importance of Verizon Vermont's SGAT in opening the local exchange market to competition in accordance with the 1996 Act. Lafferty Surreb. at 14-15.

304. SGATs are similar to tariffs. However, the format and approval process for changes can be different. Lafferty Surreb. at 15.
305. One option would be to convert the existing SGAT to a state wholesale services tariff. Lafferty Surreb. at 15.
306. Another option would be for the Board to require FairPoint to adopt Verizon's SGAT and maintain it on a going-forward basis in the same manner as Verizon does today. Lafferty Surreb. at 15.
307. FairPoint has agreed to assume or replicate Verizon's interconnection and traffic exchange agreements, as well as to honor Verizon's ICAs and to comply with the obligations of Section 251 of the 1996 Act. Skrivan Reb. at 4.
308. FairPoint and individual CLECs or groups of competitors can negotiate different requirements as part of an ICA. Thus, FairPoint (and competitors) do not lose any flexibility to customize solutions to individual circumstances. Lafferty Surreb. at 16.

### **Interconnection Agreements**

#### **Findings:**

309. FairPoint plans to assume Verizon's obligations under applicable traffic exchange and interconnection agreements ("ICAs") with other carriers. Lippold Reb. at 18.
310. If an ICA is not assignable, then FairPoint would propose to enter into a mirror agreement with such CLECs. Lippold Reb. at 18.
311. FairPoint should adopt the same interconnection obligations as Verizon. Lafferty Dir. at 35.
312. Unless mutually agreed by both parties, the process of adopting or obtaining the required ICAs for existing competitors to continue to compete in Vermont should not open the door for FairPoint or competitors to attempt to renegotiate any aspect of an existing ICA. Most ICAs contain term limitations and renegotiation processes which should continue to apply should FairPoint be approved to purchase the Verizon properties in Vermont. Lafferty Dir. at 35. Lafferty Surreb. at 29. Lippold Reb. at 24.

**Discussion:**

The Board should require FairPoint to meet its commitment to adopt all of Verizon's existing ICAs and related obligations in Vermont. This condition will provide clarity to competitors, customers and regulators and will ensure competitors have the same opportunities with FairPoint as they did with Verizon in Vermont. If FairPoint is not able to adopt a specific existing ICA for any reason, it should implement its own agreement exactly mirroring Verizon's requirements. It is possible that competitors might have to make system or process changes to interconnect with FairPoint as opposed to Verizon. While ideally the transition should be transparent to all competitors, if a competitor must make any changes, FairPoint should compensate the competitor for any costs incurred specifically as a result of changing its systems to accommodate interconnection with FairPoint.

**Interconnection Services Tariffs and Special Access Prices**

**Findings:**

313. Verizon offers Special Access volume and term plans to its access customers. Customers can pay a lower price by purchasing a larger number of circuits or services and committing to a longer term. Requiring FairPoint to prorate the volume requirements to allow customers to receive the same benefits as prior to the Proposed Transaction will ensure that customers are treated the same as with Verizon. Lafferty Dir. at 17.
314. Intrastate Special Access prices are capped under Verizon's Alternative Regulation Plan in Vermont. In addition, the majority of Special Access services are purchased through an interstate access tariff. Lafferty Dir. at 17.
315. The transfer of ownership to Verizon may reduce the total volume of access services purchased by another carrier (or even an end-user customer) from FairPoint or Verizon, resulting in an increased price for the same services purchased from Verizon before the transaction. Lafferty Dir. at 17.
316. This situation could apply to both customer accounts acquired by FairPoint and customer accounts remaining with Verizon. If the volume decreases, the price per circuit or service paid by customers could increase. Lafferty Dir. at 17.

**Discussion:**

The Board should ensure that FairPoint does not change any aspects of the tariffs, pricing or terms and conditions associated with access and other tariff interconnection services regardless of the method FairPoint chooses to use to deliver the services. If FairPoint must change the tariff or pricing, terms or conditions associated with interconnection services in any way, FairPoint should be required to compensate the customers for any system modification costs associated with the change and avoid making the change until the customer(s) has had the opportunity to make the required modifications. This requirement should remain in place until the Board has an opportunity to review the ARP in 2010.

In addition to requiring FairPoint to honor Verizon's ARP requirements and access tariffs, the Board should require FairPoint and Verizon to price individual Vermont customer intrastate Special Access services as though the services were being provided by FairPoint and Verizon collectively. To the extent the volume of intrastate access circuits is included in a total volume of circuits for pricing purposes, intrastate access circuit costs to customers should not increase. Until customers make a decision to purchase different services or choose a different carrier, they should continue to get the benefit of the volume arrangement in place for intrastate access services with Verizon prior to the Acquisition. This requirement should be reviewed in 2010 when the Board addresses the future of the ARP.

Finally, from a regulatory standpoint FairPoint should adopt and follow the terms of the ARP for tariff changes and introduction of new services and bundles. FairPoint should not be restricted from offering new bundles or packages as long as it follows the parameters of the ARP. The Board should adopt FairPoint's agreement to prorate the volume for special access and other services to ensure its customers receive the same pricing treatment available from Verizon before the closing.

## Wholesale Cutover Issues

### Findings:

317. FairPoint's Operations Support System ("OSS") will provide wholesale customers the same level of service as Verizon's systems. Lafferty Surreb. at 24. Lippold Reb. at 3-6.
318. From a purely regulatory policy standpoint, the acquisition of the Verizon Vermont operations by FairPoint should not change any OSS requirements for competitors. Lafferty Surreb. at 24.
319. FairPoint contends that it should not bear any costs for changes to CLEC systems which are required due to the new FairPoint systems because FairPoint's new systems will comply with current industry standards. Lippold Reb. at p. 19-20.
320. The Department believes FairPoint should still be required to compensate CLECs for any system change expenses if the only cause of a CLEC incurring expenses to modify its systems is the acquisition of the Verizon New England properties by FairPoint. Lafferty Dir. at 30. Lafferty Surreb. at 26.
321. When Verizon introduces new systems or makes changes to existing systems, Verizon usually leaves the old system in place to provide CLECs time to adopt the changes. Lafferty Surreb. at 25.
322. In all previous acquisitions involving BOC access lines, the BOC has continued to be the dominant ILEC in the state and few changes by neighboring carriers have been required. Lafferty Surreb. at 12-13.
323. FairPoint will not offer its wholesale customers the same alternatives for billing as Verizon. FairPoint will only support paper statements and on-line statements. Lafferty Surreb. at 26.
324. Neighboring carriers are at risk for incurring expenses to adapt to OSS changes FairPoint makes to implement the Proposed Transaction. Some of these neighboring carriers are relatively small companies. Lafferty Surreb. at 26.
325. FairPoint opposes any requirement for the company to compensate owners of neighboring systems for costs to modify their systems due solely to the Proposed Transaction. Lippold Reb. at 20.

**Discussion:**

From a regulatory standpoint, the mechanics of the changeover should be transparent for competitors and neighboring systems. And where the mechanics breakdown, FairPoint should bear the cost of the fix.

The situation facing neighboring carriers, wholesale customers and regulators as a result of the Proposed Transaction is unique. In all previous acquisitions involving BOC access lines, the BOC has continued to be the dominant ILEC in the state and few changes by neighboring carriers have been required. In this situation, however, it is a new entity that will become the dominant ILEC operating legacy BOC access lines using mostly new, unproven systems to deliver services such as billing and interconnection. The owners of neighboring systems, some of which are relatively small companies, should be able to expect FairPoint to compensate them for any expenses associated with OSS changes which result solely from FairPoint's execution of its decision to acquire Verizon's wireline footprint in Vermont. FairPoint has promised to step into Verizon's shoes as part of this Proposed Transaction.

Unless a wholesale customer agrees to the change, FairPoint should be required to offer the same billing options as Verizon. Given the apparent plans for FairPoint to reduce the number of billing alternatives, the Board should establish a condition that FairPoint will provide CLECs the opportunity to receive bills in the same manner as Verizon. Wholesale customers can agree to make a change, but they should not be forced to do so.

**The Rapid Response Team**

326. The Department believes it would be useful for FairPoint to form a "rapid response" team similar to one that was created in Maine. Lippold Reb. at 27. Lafferty Surreb. at 30.
327. A "rapid response" team is designed to provide a mechanism for dealing with interconnection disputes quickly and without resorting to "full blown" litigation. Trans. 09/21/07 at 196 (Campbell Cross).

328. The unique aspect of this acquisition and the challenges faced by FairPoint becoming the largest ILEC in several states as well as converting to an entirely new OSS platform raise the potential for more disputes than normal. The rapid response team would be a vehicle to quickly respond to problems which could not have been foreseen. Lafferty Surreb. at 30.
329. FairPoint initially indicated an interest in forming a rapid response team for Vermont. Lippold Reb. at 27. However, during the technical hearings, FairPoint witness Lippold testified that such a team was not needed. Trans. 09/17/07 at 79 (Lippold Cross).
330. FairPoint should be required to work with its wholesale customers to jointly develop a proposal for a rapid response team and report back to the Board within six months of the closing. Lafferty Surreb. at 30.

### **Wholesale PAP Issues**

#### **Findings:**

331. Verizon has specific wholesale service quality obligations in Vermont. Lafferty Dir. at 32.
332. In Vermont Verizon is subject to a performance assurance plan (PAP) which is similar to and references requirements in other northeastern Verizon states. Lafferty Dir. at 32.
333. For purposes of the immediate future following closing of the Proposed Transaction, FairPoint should be required to follow the existing Verizon PAP. Lafferty Dir. at 33.

#### **Discussion: Overall Impact on Competition**

There are a number of potential legal and practical ways in which the transfer of ownership from Verizon to FairPoint could impair competition in Vermont, and against which the Board should guard. The primary concern is how the transaction would affect the relationship that Verizon now has with its wholesale customers.

That said, setting aside the regulatory requirements under Sections 251, 252 and 271 of the 1996 Act, and assuming FairPoint adopts all of Verizon's interconnection requirements in Vermont, the Department does not expect the Proposed Transaction to have any other significant effects the competitive landscape in Vermont.



For the business market, FairPoint is merely replacing Verizon as the operating entity. FairPoint and Verizon were not prior competitors in the acquired properties, so the level of competition should not change. In fact, for the largest business customers, sometimes referred to as the enterprise market, Verizon may continue to provide some services in the marketplace as it is not transferring to FairPoint the former MCI operations. To the extent this Verizon entity continues to compete in Vermont, enterprise customers will continue to have this alternative to the Verizon local exchange services being acquired by FairPoint.

The mass market, which represents most of the customer access lines in Vermont to be acquired by FairPoint, should see no change either from a competitive standpoint. FairPoint will merely replace Verizon. Assuming the transition of the interconnection requirements from Verizon to FairPoint is transparent to competitors and end-user customers, the available choices to customers should not change. Cable companies, non-network VoIP providers and other mass market competitors will continue to operate as in the past. To the extent wireless is viewed as an option to basic local wireline service, the Proposed Transaction will not on its own have an impact on the ability of existing wireless companies to continue offering service in Vermont, since Verizon Wireless will become an unaffiliated (as opposed to an affiliated) carrier for the incumbent LEC which could increase the independence of its services.

### **Proposed Transfer of Verizon's Alternative Regulation Plan to FairPoint**

#### **Legal Standard:**

Verizon's existing ARP was reviewed and authorized pursuant to 30 V.S. A. § 226(b), Vermont's alternative regulation statute for telecommunications carriers. Section 226(b) does not expressly contain a standard governing the transfer of an alternative regulation plan. Therefore, the Board's review of FairPoint's proposal to stand in Verizon's shoes for ARP purposes is best viewed as an exercise of the Board's "incidental powers ... necessarily implied" in order for the Board to fully exercise the powers it was expressly granted with the enactment of 30 V.S.A. §§ 107, 109, 231 and

311. See Green Mountain Power Corp. v Sprint Comm., 172 Vt. 416, 419 ((2001) (citing Trybulski v. Bellows Falls Hydro-Electric Corp., 112 Vt. 1, 9 (1941))). Accordingly, the Board should treat the review of the proposed ARP transfer as one component among many to be analyzed in the Board's overarching review to determine whether granting the Docket 7270 petition will promote the public good.

Section 226(b) contains eleven criteria that the Board is required to apply in making findings to support approval of a proposed alternative regulation plan. The Board must find that a proposed plan:

- (1) promotes the general good of the state;
- (2) is consistent with the state telecommunications purposes established under section 202c of this title;
- (3) is consistent with the state telecommunications plan adopted by the department of public service under section 202d of this title, or there exists good cause to approve alternative forms of regulation notwithstanding this inconsistency;
- (4) is consistent with the public's interests relating to appropriate quality telecommunications services;
- (5) is consistent with the goal of protecting or promoting universal service to residential users of telecommunications;
- (6) provides reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies;
- (7) reasonably supports economic development in the affected service territory;
- (8) adequately protects consumer privacy interests;
- (9) supports reasonable competition;
- (10) includes adequate safeguards to insure that charges for noncompetitive services do not subsidize competitive services; and
- (11) is just and reasonable and would not produce unjust discrimination between users of the public switched network in the pricing, quality, or availability of the network functions or services offered.

30 V.S.A. §226b(c).

As in the case of the §231 analysis in this case, the Department believes the §226(b) criteria have been subsumed into the review of the fifteen criteria of §107. Accordingly, the Department respectfully submits that the Board's ultimate determination pursuant to §107 will also satisfy any legal determination that is required concerning whether transfer of the ARP from Verizon to FairPoint will serve the public good.

**Findings:**

334. FairPoint has pledged to initially offer substantially the same retail services as customers receive today. Nixon Dir. at 27.
335. A condition that “re-sets” the point in time from which services are considered “new” for alternative regulation purposes would make this promise binding on FairPoint and would give the assurance that FairPoint would not be able raise the price of services which Verizon has been offering or alter their terms and availability without Board approval. Campbell Dir. at 37.

**“New Services” Limitation**

336. The current alternative regulation plan allows Verizon to call a new service any product or service designated as such and introduced since the inception of the alternative regulation plan approved by the Board in Dockets 6167/6189. Verizon enjoys enhanced pricing flexibility, including upward pricing flexibility, on these services and the ability to withdraw those services. Campbell Dir. at 36.
337. Verizon is a company that markets its services across multiple states, and Vermont benefits to a degree from that, as services, packages, bundles, and prices which are offered in other states are introduced into Vermont as part of their spread more or less consistently across the Verizon footprint. Campbell Dir. at 36.

**Discussion**

FairPoint may choose to exploit different marketing opportunities from Verizon’s, and might even eventually offer new services which are more attractive to some than their Verizon counterparts. But there is no guarantee that this will happen. At the very least, FairPoint will be constrained in its ability to introduce new services during its new systems development. Vermont consumers should not have reduced or less attractive choices for service from FairPoint than Verizon, if the proposed transaction is to be found to be in the public good.

**Investment Standards and Service Quality Measurement for “Classic” FairPoint**

338. Under the current alternative regulation plan, Verizon is required to maintain at all times a level of infrastructure investment and operating expenditures sufficient to maintain the ongoing reliability of its network and the reliability and availability of its services. Campbell Dir. at 38.

339. The service quality standards under Verizon's alternative regulation plan are more stringent than the generic service quality standard set under Docket 5903, and also carry an explicit financial consequence for noncompliance. Campbell Dir. at 37.
340. According to the Department, the classic FairPoint operations should be included, at least in part, in the measurements of FairPoint's service quality under the alternative regulation plan. Classic FairPoint operations should also be subject to the infrastructure investment and operating expenditure standards that have been set under the alternative regulation plan. Campbell Dir. at 38.
341. The Board's decision in Docket 5903 reflected the concern that the service quality standards approved in that docket might not be sufficiently stringent to reflect reasonable consumer expectations. Campbell Dir. at 37. Docket 5903, *Investigation into Service Quality Standards, Privacy Protections, and other Consumer Safeguards for Retail Telecommunications Service*, Order of 07/02/99 at 17.

## **Discussion**

If FairPoint were to operate two service territories in Vermont under two different sets of performance standards, the result for consumers could be the unfairness of disparate treatment. For example, there is no good reason why FairPoint consumers in Montgomery should experience any lower service quality than consumers in Troy. Furthermore, two different standards could create a perverse incentive for FairPoint to remedy service quality issues in the acquired Verizon territory in part by shifting capital, staff, or other resources from its classic territory, at the expense of service quality in that territory. The same reasoning applies as well to the requirements for infrastructure investment and operating expenditures. If this Proposed Transaction is to be deemed to be in the public interest, it must foreclose all risk of giving rise to a tier of second class citizens in FairPoint's consumer population. The way to achieve this is to bring FairPoint's classic operations under a similar set of regulatory expectations as are applied to the operations it proposes to take over from Verizon, to the extent practical.

**Performance Benchmark Report**

342. According to the Department, the public good must be secured by FairPoint demonstrating that it has obtained legally binding commitments from Verizon to continue to provide the state-specific information for the states which would not become part of FairPoint operations, contained in the Performance Benchmark Report. Campbell Dir. at 38-39.
343. One of the statutory requirements for the Board in approving, modifying, or renewing an alternative regulation plan is to establish “standards and procedures by which the effectiveness of the alternative form of regulation can be determined.” 30 V.S.A. § 226b(d)). Campbell Dir. at 39.
344. The Performance Benchmark Report provides the Board and Department with comparative information about how well Verizon is performing on a number of measures compared to a number of other states in which it operates. Campbell Dir. at 39.

**Discussion:**

The state operations against which Verizon compares its Vermont performance are diverse in size, level of competition, level of urbanization, and form of regulation. These states provide a good basis for comparison. If Verizon were to not continue to provide FairPoint with this data, the Department and the Board would be less well equipped to evaluate the effectiveness of the plan, using a consistent time series of information. Furthermore, the ability to compare FairPoint’s performance in Vermont and in the other New England states against Verizon’s operations in other states would provide a useful indicator of whether or not FairPoint had improved the relative value to Vermont consumers.

**“Classic” FairPoint Broadband Deployment**

345. The Department recommends excluding the classic FairPoint operation in Vermont when measuring the progress toward the broadband deployment milestones in Verizon’s alternative regulation plan. Campbell Dir. at 39-40.
346. In the Department’s view, this would be most consistent with the purpose of including the broadband deployment milestones in the alternative regulation plan, namely, to ensure improvements in the availability of broadband service. Campbell Dir. at 39-40.

347. FairPoint's DSL availability in Vermont already exceeds the 80% broadband availability that Verizon would be required to achieve over the life of the plan. Campbell Dir. at 40.
348. If the broadband-qualified lines that are already in FairPoint's territory were included in the calculation, it would reduce the total number of additional lines that FairPoint would be required to qualify, compared to Verizon. Campbell Dir. at 40.

### **"Broadband-qualified" Line Characteristics**

#### **Findings:**

349. The lines which FairPoint may validly count as broadband-qualified under the alternative regulation plan should be linked to the characteristics of broadband services offered by Verizon in Massachusetts, Rhode Island, and New York. Campbell Dir. at 41.
350. Verizon's current alternative regulation plan does not contain any requirements related to the price of the broadband service offered. However, Verizon has a history of offering DSL packages and prices uniformly across its footprint where it makes DSL service available. Campbell Dir. at 40.
351. FairPoint's present practice is to offer higher prices for slower-speed DSL services than Verizon does in Vermont. Exhibit DPS-CJC-4.
352. Additional lines or line equivalents qualified for broadband service in the territory served out of the Burlington Central Office after July 1, 2005, should be excluded from the number of additional line counted as qualified for broadband service for purposes of the calculations under the alternative regulation plan. Campbell Dir. at 41.

#### **Discussion:**

The price at which FairPoint offers broadband services is important to the degree of value Vermont consumers would receive through the broadband commitments contained in the alternative regulation plan. If broadband services are expanded in Vermont, and those services are expensive, it is less valuable than if the services are priced more affordably.

Benchmarking the services that count toward the fulfillment of the alternative regulation plan obligation to the pricing and performance offered by Verizon in nearby states would help to ensure that FairPoint's broadband services offered at least equal value to what the state might reasonably have expected from Verizon. FairPoint should provide broadband service offerings which have the same or better price/performance combinations as similar Verizon broadband services in these nearby states.

In an agreement dated March 2, 2006 in Docket 6959/7142 concerning certain modifications to Verizon's alternative regulation plan, Verizon represented "that it [did] not intend to meet the additional broadband service milestones through qualifying additional lines or line equivalents in the territory served by its Burlington Central Office." This agreement is not technically part of the amended plan that was ordered by the Board in Docket 6959/7142. Rather, this assurance from Verizon was set forth in a legally enforceable Memorandum of Understanding between Verizon and the Department. It was this assurance that induced the Department to support the settlement in Docket 6959/7142, as the Department was primarily concerned with expansions of broadband service in unserved areas, as opposed to Burlington, which already had ubiquitous service. In sum, if FairPoint means to step into Verizon's shoes, then that means FairPoint must also assume responsibility for the representations Verizon made and upon which the Department relied in entering into the settlement of Docket 6959/7142. Thus, the Department believes the public interest requires that FairPoint offer comparable assurances about the qualifying lines it intends to count to meet broadband service milestones if FairPoint means to assume Verizon's obligations under the plan.

#### **Termination of "Classic" FairPoint §227d regulation**

##### **Findings:**

353. If the Proposed transaction is approved, the classic FairPoint company will be controlled by the same corporate parent as the entity comprising the former Verizon territory. Campbell Dir. at 42.

354. As a result of the Proposed Transaction, FairPoint would control more than ten percent of the subscriber lines installed in Vermont. Campbell Dir. at 42.

**Discussion:**

Section 227d applies to carriers which serve fewer than ten percent of subscriber lines installed in the aggregate statewide. As a result of the Proposed Transaction, FairPoint would control more than ten percent of the subscriber lines installed in Vermont. Campbell Dir. at . Thus, classic FairPoint's operations in Vermont would no longer be eligible for regulation under 30 V.S.A 227d, and the Board would have to terminate the company's election to be regulated under that statute.

If classic FairPoint were not regulated under Section 227d, it would revert to traditional rate-of-return regulation unless it was included in the alternative regulation plan. Including classic FairPoint in the provisions of the plan related to changes in pricing, terms, and conditions of service would have the effect of placing classic FairPoint under a form of price cap regulation, as Section 227d is a form of price cap regulation, but one which would be more consistent with the regulation governing the rest of FairPoint's operation. It would protect classic FairPoint customers from price increases and provide FairPoint the same pricing incentives to introduce new services in its classic territory as it would have in its new territory. Using this form of regulation would be a better and more efficient use of company and regulatory resources than would be, for example, a potential rate case to adjust rates for classic FairPoint's approximately 6,000 customers. This would be especially true as FairPoint would be in the midst of transitions which could have a potentially much greater impact on a much larger set of consumers in Vermont, and which should command the first attention of the company and the regulatory oversight on the company.

**Universal Service Funding**

355. The current Verizon alternative regulation plan limits the ability of the Board or Department to propose reductions in rates for existing services due to revenue-neutral rate restructurings or specified exogenous events. Campbell Dir. at 43.



356. The specified exogenous events do not include a change in federal universal service funding due to a change in ownership, as this possibility was not considered when Verizon's alternative regulation plan underwent regulatory review. Campbell Dir. at 43.
357. The Board should impose a condition requiring FairPoint to accrue any potential increases in universal service funding for the benefit of consumers, either through demonstrable increases in investment which benefit consumers, or otherwise in the form of lower rates. Campbell Dir. at 43-44.

### **Summary of Recommended Alternative Regulation Adjustments**

As the findings stated and related discussion sections above indicate, if FairPoint were to assume control of the Verizon's operation in Vermont, there are several terms of Verizon's current alternative regulation plan that the Department believes should be modified to fit FairPoint as the successor to that plan. These include:

- No regulated intrastate telecommunications product or service offered by Verizon under tariff when the transaction closes should be considered a "new service" under the alternative regulation plan.
- Where classic FairPoint currently reports a Service Quality Performance Area under the requirements of Docket 5903, and there is a Performance Area standard under the alternative regulation plan which is essentially the same, the performance of classic FairPoint should be included in the measurement of the alternative regulation performance area standard.
- The classic FairPoint operation in Vermont should be required to comply with the Annual Investment requirement of the alternative regulation plan.
- FairPoint should be required to demonstrate that it has obtained legally binding commitments from Verizon to continue to provide the state-specific information for the states which would not become part of FairPoint operations, contained in the Performance Benchmark Report which Verizon is currently required to provide annually.
- The classic FairPoint operation in Vermont should be excluded from measurements of progress toward the alternative regulation plan's broadband deployment milestones.
- Lines should be considered broadband-qualified for the purposes of the alternative regulation plan only in locations where FairPoint offers broadband service plans

which provide upload and download speeds which are not less than those offered by Verizon in Massachusetts, Rhode Island, and New York for prices which are not greater than those offered by Verizon in those states.

- Additional lines or line equivalents qualified for broadband service in the territory served out of the Burlington Central Office after July 1, 2005, should be excluded from the number of additional lines the qualified broadband service for purposes of the calculations under the alternative regulation plan.
- The classic FairPoint operation in Vermont should be included in the provisions of the plan related to changes in pricing, terms, and conditions of service.
- Notwithstanding any other provision of the alternative regulation plan, the Board or the Department should have the ability to seek rate reductions commensurate with any increase in Federal Universal Service Funding which the Vermont operation may be eligible to receive as a direct or indirect result of the transaction.
- FairPoint must perform on all of Verizon's obligations under the settlement in Docket 6957, in which Verizon was allowed to make specific investments to improve network reliability in lieu of refunds to customers which were due for failure to meet service quality standards. Verizon has not completed all of the projects it is obligated to perform under the order in that Docket, and it is unlikely that they will all be completed at the time of closing, if the transaction is approved. These investments are intended to be incremental investments, over and above ordinary investments.

### **Designation of FairPoint as an Eligible Telecommunications Carrier**

FairPoint has requested designation as an ETC in the territory currently served by Verizon-Vermont. Consequently, the Board must determine whether FairPoint has met the standards for ETC designation in Vermont.

#### **Legal standard:**

A carrier seeking ETC designation pursuant to 47 U.S.C. §254(e) and §214(e)(2) must demonstrate the following:

- That the carrier provides:
  - voice grade access to the public switched network,
  - local usage,
  - touch-tone service,

single-party service,  
access to emergency services,  
access to operator services,  
access to interexchange service,  
access to directory assistance,  
toll limitation;

- That the designation is in the public interest, convenience and necessity;
- That the carrier offers qualifying low-income customers access to Lifeline and Link-Up; and
- That the carrier advertises and publishes to the public the availability of and prices for each of the required services.

**Findings:**

358. There are Vermonters in the territory served by Verizon for whom Verizon and Verizon's network is still the only option for receiving affordable, reliable telephone service. Campbell Dir. at 44.
359. Verizon New England was certified by the Board as an ETC in Docket 5918, *In re: Designation of Eligible Telecommunications Carriers Under the Telecommunications Act of 1996(In re: RCC Atlantic, Inc. d/b/a Unicel)*, Order dated 12/05/02 at 6.
360. Should the transaction be approved, Telco will offer the services that are supported by the federal "universal service support" mechanism throughout the territory formerly served by Verizon New England using its own facilities or a combination of its own facilities and resold facilities and will advertise the availability of those services using media of general distribution. Joint Petition at 7-8.
361. Telco has committed to use federal high-cost support in compliance with 47 U.S.C. Sec. 254(e) of the Telecommunications Act of 1996. Joint Petition at 8.
362. Verizon is presently the only wireline ETC in its territory. Campbell Dir. at 44-45.
363. Should the Joint Petition be approved by the Board, then FairPoint would become the only wireline ETC. Campbell Dir. at 44-45.
364. It would be important for FairPoint to step into Verizon's shoes as an ETC if it were to assume control of Verizon's operation in Vermont. Campbell Dir. at 45.

365. FairPoint has committed to provide all of the services necessary to qualify as an ETC under the federal Communications Act. Nixon Dir. at 30.
366. It is reasonable to conclude that FairPoint, if it were to take over Verizon's telephone operation in Vermont in total, would in fact continue to provide the required nine services as Verizon does today. Campbell Dir. at 44-45.

**Discussion:**

Designation of FairPoint as an ETC in the territory of Verizon in Vermont would serve the public interest, convenience, and necessity.

**The Public Benefits of the Proposed Transaction**

**1. The Price Freeze**

**Findings:**

367. FairPoint contends that the Proposed Transaction delivers the public benefit of ensuring there will be no increase in prices. Joint Petition at 10. Nixon Dir. at 27.
368. Verizon's ability to raise prices on services which do not qualify as "new services" as defined under the alternative regulation plan is already constrained. This is the same Alternative Regulation Plan that FairPoint has committed to assume. Campbell Surreb. at 6-7.
369. Verizon has the right under the Alternative Regulation Plan to raise prices on "new services," but FairPoint has indicated that it declines to limit price increases on "new services" which FairPoint inherits from Verizon. Skrivan Reb. at 10-11.
370. FairPoint's proposal on prices is nothing more than the status quo, not an enhancement. Campbell Surreb. at 6-7.

**2. Service Quality Improvement**

**Findings:**

371. FairPoint contends that the Proposed Transaction delivers the public benefit of ensuring the delivery of good service quality. Nixon Dir. at 23.
372. Fairpoint has not committed to higher specific and enforceable service quality standards than Verizon. Campbell Surreb. at 7-8.

373. Fairpoint has promised to remedy Verizon's repeated failure to meet its residential troubles not cleared within 24 hours standard. However, FairPoint has not shown a plan for doing so. Campbell Surreb. at 7-8.

**Discussion:**

The Department believes that the Board could require Verizon to remedy service quality failures (and should if it does not approve this transaction), and that, if so required, Verizon has the ability to do so. The fact that FairPoint has agreed that it will need to take steps to remedy Verizon's repeated failure to meet a key service quality metric is certainly a good thing. The Department would certainly expect it. It would be a serious mistake if FairPoint were to simply claim, as Verizon has, that the standard is simply too difficult to meet. However, on this issue it seems that FairPoint is trying to claim extra credit for offering to meet the base service quality standards that any utility in good standing would be expected to deliver in Vermont.

If FairPoint had a long track record of delivering excellent customer service in Vermont, then the Board could take that as evidence that FairPoint is likely to deliver similar results in this larger undertaking. But the record shows that FairPoint's track record on service quality is mixed at best. It is commendable that FairPoint wants to commit to delivering better quality service, and the Department does not question the sincerity of any such expressed intentions. But that is not enough to warrant the assumption that it will necessarily be so. Accordingly, the Department is unable to agree with FairPoint that the Proposed Transaction necessarily will deliver the public benefit of improved service quality.

**3. Employment**

**Findings:**

374. FairPoint contends that its plans to increase employment in Vermont count as a public benefit attributable to the Proposed Transaction. Joint Petition at 11.

375. The increased employment that FairPoint states it will produce in and near Vermont can be counted a public benefit in the company's favor. Campbell Surreb. at 9. Ileo Surreb. at 12-14.
376. However, FairPoint cannot be held to its promise of increasing employment, and it is therefore not certain that these jobs will actually materialize in Vermont, or if they do, how long they will be here. Campbell Surreb. at 9.
377. FairPoint is projecting an annual employee attrition rate over the next few years of 4 to 4.5%. Ex. Labor 12.
378. The Board should not impose a condition that could prevent FairPoint from organizing its operations in a way that best provided the best, most cost-effective service to consumers. Campbell Surreb. at 8-10.

**Discussion:**

As tempting as it might be to impose a condition that guarantees the enhancement of the public good by ensuring increased employment, the number and location of jobs should be primarily driven by what best serves the interests of the consumers, and not driven by a regulatory condition that is not related to that consideration. Moreover, under cross examination during the technical hearings, FairPoint admitted that its own financial projections assume an employee attrition rate of 4-4.5% over the next several years. If the company itself is premising its business projections upon such an attrition rate, then it is difficult to conclude that the Proposed Transaction will necessarily net a real and enduring increase in employment in Vermont that can be counted as a public benefit accruing to Vermont from this transaction.

**FairPoint's Proposed Broadband Deployment**

**Findings:**

379. FairPoint cites its plans to increase broadband availability significantly withing the tri-state region relatively soon after completion of the Proposed as a public benefit attributable to the Proposed Transaction. Joint Petition at 11. Leach Dir. at 6.

380. FairPoint has submitted evidence of three broadband proposals in the course of this docket. Trans. 09/21/07 at 178-179 (Campbell Cross); Ex. HBS-1 (A.DPS:FP2-61 (3<sup>rd</sup> Supplemental Response).
381. Under one proposal, Fairpoint estimates that it will spend \$[REDACTED] on broadband deployment. Elements of this estimate appear to be expenditures that Verizon is already obligated to make and is presently undertaking. Campbell Surreb. at 21.
382. Put another way, the \$[REDACTED] that FairPoint has estimated it will spend (minus the amount for projects already underway that Verizon is obliged to undertake) is the price of Verizon's broadband commitment (to be assumed by FairPoint), that would have allowed Verizon (and now FairPoint) to avoid \$32.82 million in Board-ordered rate reductions over the period 2008-2010. Campbell Surreb. at 23.
383. FairPoint's collective testimony regarding its broadband commitments in this docket is not specific enough to permit an assessment of whether they are actually an improvement over Verizon's existing obligations. Campbell Dir. at 24. Trans. 09/21/07 at 178-181(Campbell Cross).
384. FairPoint has committed to what it characterizes as an acceleration of broadband investment in 2008. However, Verizon is already obliged to reach by the end of 2008 the milestone of 75% of its lines qualified for broadband, up from 56% at the beginning of the plan. Then, over the last two years of its Alternative Regulation Plan, Verizon is only obligated to achieve an additional five percentage points of additional broadband availability. Campbell Surreb. at 17-19.
385. FairPoint has asserted that it will exceed the level of broadband service availability promised by Verizon, but a close analysis shows that the size of the commitment is essentially the same, or at least not greatly larger, as that to which Verizon would be obligated to produce. Campbell Surreb. at 11. Trans. 09/21/07 at 181 (Campbell Cross).
386. FairPoint has not committed to providing more capable broadband service than Verizon. Campbell Surreb. at 19.
387. FairPoint has disclosed that while the network that FairPoint intends to deploy will be capable of greater speeds, but FairPoint intends to mirror Verizon's 3-Megabit service offering. Campbell Surreb. at 19. Brown Reb. at 28.

388. FairPoint has not committed to lower broadband service prices than Verizon. FairPoint intends to mirror the pricing offered by Verizon today. Campbell Surreb. at 19. Brown Reb. at 32.
389. FairPoint's DSL platform will be at least Verizon's equal and its pricing will mirror Verizon's (at least Verizon's current pricing). However, without a condition, these statements are unenforceable and could change at any time. Campbell Surreb. at 20.
390. FairPoint believes that it can deliver DSL less expensively and somewhat faster than Verizon. As commendable as this may be, much of the benefit appears to accrue only to FairPoint, and not to Vermont consumers. Campbell Surreb. at 20.
391. The Department does not believe that FairPoint has made any commitments to materially expand broadband service in Vermont beyond Verizon's present obligations. Campbell Dir. at 23. Campbell Surreb. at 20.
392. The availability of DSL varies significantly across the Verizon footprint today. Exhibit DPS-CJC-10 is a map illustrating information obtained from FairPoint in discovery about the percentage of broadband availability in Verizon exchanges currently. Campbell Surreb. at 26. Ex. DPS-CJC-10.
393. Under FairPoint's proposal, the pattern of varying coverage would differ from Verizon's, but would nonetheless persist. Campbell Surreb. at 26. Exhibit DPS-CJC-11.
394. The term "consistent coverage" means making broadband service available to everyone in a local area or region, not only to some. For the public, the most valuable way that FairPoint could improve on Verizon's commitment would be to provide consistent broadband coverage. Campbell Surreb. at 24.
395. The term "exchanges" refers to the areas that make up the 99 different Verizon rate centers in the state, including localities which are served by central offices in other states. Campbell Surreb. at 26.
396. In much of Vermont today, broadband service is not consistently available. There are very few regions of the state that are completely without broadband service. However, in most regions of the state, there are many pockets where broadband service is not available. These pockets are likely present to a greater degree than even is evident from this map, because they are masked by the scale of the map and because the extent of WISP service and Verizon DSL service availability is often estimated. Campbell Surreb. at 24. Ex. DPS-CJC-9.



397. Inconsistent coverage poses a serious challenge to Vermont's policy goal of extending broadband to all Vermonters. It is more difficult and expensive to reach customers in scattered and discontinuous areas. An existing provider might find it easier to fill gaps in its coverage, but a new provider may need to overbuild already covered areas to reach customers in uncovered areas when the existing pattern of coverage is not consistent. Campbell Surreb. at 25.
398. There are areas of the state that have a pattern of continuous coverage today. The most notable examples of consistent coverage are provided by some of the independent telephone companies in the state, companies like Waitsfield and Champlain Valley Telecom, Topsham Telephone, and Vermont Telephone. These companies provide 100% broadband availability across their service territories. FairPoint itself provides 100% DSL availability in some of its exchanges, such as Alburgh and Isle La Motte. Campbell Surreb. at 25-26.
399. FairPoint could deliver a significant public benefit by committing to achieve 100% broadband availability in 50% of its exchanges by the end of 2010, in addition to meeting Verizon's broadband commitment under the Alternative Regulation Plan. Campbell Surreb. at 26 and 30.
400. Exhibit DPS-CJC-12 is a map illustrating what 50 exchanges with continuous coverage might look like. This example is intended to be illustrative; it does not represent the only acceptable combination of 50 exchanges. Campbell Surreb. at 27. Ex. DPS-CJC-12

There are three other features that should be included in a consistent coverage plan:

- (1) FairPoint should determine which exchanges it will serve with 100% broadband availability, and publicly announce these areas as soon as possible after closing;
- (2) FairPoint should offer a broadband service plan with a data transmission rate of not less than 1.5 Mbps per second in at least one direction throughout these exchanges;
- (3) To further promote a pattern of consistent coverage the exchanges which are targeted for 100% broadband availability should be contiguous with at least one other exchange (served by FairPoint or another company) with actual or planned 100% broadband availability.

Campbell Surreb. at 28-29.

401. The standard for acceptable speed for a broadband service is increasing over time. It is possible to take a technology like DSL and push it over long loops, but the

- performance will decrease compared to shorter loops. There should be some minimum acceptable level of service. The 1.5 Mbps standard is found in 30 V.S.A., § 8077, which has to do with the establishment of minimum technical service objectives for broadband service in Vermont. Campbell Surreb. at 29-30.
402. Advance public announcement of broadband deployment plans is important. Between now and 2010, a substantial amount of public effort and possibly dollars will be expended in Vermont to reach the goal of 100% broadband availability. By announcing in advance what areas it would provide ubiquitous service, FairPoint would allow time, attention, and resources to be focused on those areas which would remain uncovered. This would also benefit FairPoint by directing publicly-assisted broadband deployment efforts away from areas in which they might compete with FairPoint's own efforts. Campbell Surreb. at 29.
403. DSL deployment in a rural area could cost as much as \$700 per line qualified. Campbell Surreb. at 28.
404. FairPoint has suggested that the \$700 per line qualified is too high. Campbell Surreb. at 28.
405. If providing 100% broadband availability across at least 50% of the exchanges in the Verizon footprint were to cost as much as \$700 per line, then the total cost for 40,000 lines qualified would be \$██████████, or still less than the \$32.82 million in foregone rate reductions under the alternative regulation plan for the 2008-2010 period. If a \$██████████ investment were made over a 3 year period, then the investment would be \$██████████ million per year. Campbell Surreb. at 28.

**Discussion:**

FairPoint has not outlined how its broadband services will be superior to Verizon's for consumers in Vermont. FairPoint has explained the advantages of its technology choices, especially cost savings. While the prospect of those savings is desirable, the benefits appear to accrue entirely to FairPoint. It does not seem that those savings translate into either greater availability or better prices for Vermonters. Nor are greater speeds and capabilities promised, at least for the foreseeable future.

The availability of broadband varies significantly across the Verizon footprint in Vermont. Consequently, many Vermonters live within sight of but not within reach of a broadband connection to their homes. Neighbors live in the same small town, but cannot communicate by email to organize community events – one person perhaps can send the

message, but the other cannot receive it. For the neighbor with email, the full potential of the service purchased cannot be realized. For the would-be recipient, the service is not an option at all. It is difficult to grasp that such is the condition of broadband availability in Vermont in 2007. The calendar might just as well read 1907.

The most valuable broadband service improvement FairPoint could offer as a public good to validate the Proposed Transaction would be a commitment to provide consistent coverage in its service territory. But this is not the public good FairPoint to date has proposed.

### **Verizon's Request For CPG Revocation**

406. Verizon has petitioned for revocation of its CPG effective upon consummation of the Proposed Transaction. Joint Petition at 7 and 13.
407. Verizon is currently subject to investigation in Dockets 7183 and 7192 for the alleged unlawful disclosure of protected Vermont customer information. Docket 7183, *Petition of Eight Ratepayers for an investigation of possible disclosure of private telephone records without customers' knowledge or consent by Verizon New England Inc., d/b/a Verizon Vermont* / Docket No. 7192 *Petition of Vermont Department of Public Service for an investigation into alleged unlawful customer records disclosure by Verizon New England Inc., d/b/a Verizon Vermont*, Order dated 09/18/06 (denying Verizon motion to dismiss).

### **Discussion:**

The Board should take appropriate steps to retain jurisdiction over Verizon so the Board may continue these other investigations in the event the Proposed Transaction is approved prior to the conclusion of these investigations.

The Department recommends that the Board either defer ruling on this part of the Petition until the pending investigations are complete. Alternatively, the Board could issue an order of revocation with the effective date suspended until such time as the pending investigations are resolved.

## CONCLUSION

Front and center in this case is the public good: will approval of the Proposed Transaction serve the public good or not?

Many Vermonters are presently paying good money to Verizon for the privilege of substandard service and inconsistent broadband access. Verizon has exhibited little, if any, interest in improving the lot of these customers. In so many words, Verizon chooses not to serve the public good of Vermont as it should, and as it could.

FairPoint says it can and will do better than Verizon, if given the chance. FairPoint is a motivated buyer who wants to serve Vermonters as they should and deserve to be served. If FairPoint succeeds in converting its stated good intentions into the tangible reality of sound service quality and achieved broadband milestones, then this would indeed serve the public good of Vermont. The inescapable fact remains, though, that there are serious questions about whether FairPoint can deliver. This is the judgment call the Board must make.

Any sale of Verizon's landline assets in Vermont will necessarily carry with it significant execution risk. The record in this case makes that much plain. Thus, the question becomes, if Vermonters and Verizon are ever to part ways, is there a way to shape this execution risk so that Vermonters can feel comfortable about taking it? The Department believes there is such a way, but it lies in FairPoint accepting in full the conditions and safeguards the Department has developed in the course of its review and assessment of the Petitioner's Proposed Transaction. These conditions are compiled in

Exhibit DPS-CJC-5.<sup>13</sup> Central to these conditions and safeguards is the Department's judgment that the public good will be served by linking FairPoint's service quality performance to its financial interests. FairPoint's boardroom deliberations should be just as focused on the quality of service that is delivered to FairPoint's Vermont customers as they are on the profit and loss statements generated by FairPoint's Vermont operations. If FairPoint were to observe this balance, that indeed would constitute a material improvement over the status quo.

The stakes are high for Vermonters and FairPoint. Without the conditions and safeguards the Department has proposed to the Board in this brief, the risks to the public good seem too high to justify approval of the deal. But with the Department's conditions and safeguards, the transaction risk becomes more manageable, and with that FairPoint's chances improve substantially for realizing the sizeable public good potential that this transaction appears to hold.

Dated at Montpelier, Vermont, this 17<sup>th</sup> day of October, 2007.

VERMONT DEPARTMENT OF PUBLIC SERVICE

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By: \_\_\_\_\_  
James H. Porter III, Esq.,  
Special Counsel

cc: Service list

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<sup>13</sup> For ease of reference, a copy of Exhibit DPS-CJC-5 is attached to the Department's brief. Please note, the Department no longer insists on bullet item 2 of condition 6 as this standard does not lend itself readily to quantification and verification, unlike service quality metrics and broadband deployment milestones.

