

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

Docket No. DT 07-011

**VERIZON NEW ENGLAND, INC. et alia
AND
FAIRPOINT COMMUNICATIONS, INC.**

JOINT PETITION FOR AUTHORITY TO TRANSFER ASSETS & FRANCHISE

**POST-HEARING BRIEF
OF THE
COMMISSION STAFF**

PUBLIC VERSION

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Dated: November 21, 2007

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Joint Petition for Authority
to Transfer Assets and Franchise

POST-HEARING BRIEF OF THE COMMISSION STAFF

I. INTRODUCTION

A. The Petitioners seek approval of both FairPoint's assumption of Verizon's regulatory obligations and Verizon's departure from the New Hampshire telephony market.

On January 31, 2007, Verizon New England, Inc.¹ (Verizon) and FairPoint Communications, Inc. (FairPoint) (Petitioners) jointly filed with the Commission a petition seeking approval of an agreement that ultimately would transfer Verizon's landline operations in New Hampshire to FairPoint.² Identical petitions were filed simultaneously with the Maine Public Utilities Commission and the Vermont Public Service Board. In their petition, Verizon and FairPoint request authority for the transfer of Verizon's local exchange and long distance businesses in New Hampshire to

¹ Verizon filed its petition on behalf of Verizon New England, Inc., Bell Atlantic Communications, Inc. ("BACI"), NYNEX Long Distance Company ("NYNEX Long Distance"), and Verizon Select Services, Inc. ("VSSI") (jointly "Verizon").

² Joint Application for Approval of the Transfer of Certain Assets by Verizon New England, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company and Verizon Select Services, Inc. and Associated Transactions (filed Jan. 31, 2007) ("Petition").

companies to be controlled by FairPoint and “for such other approvals as may be necessary to complete the transactions described herein.”³

The transaction proposed by Verizon and FairPoint entails the transfer of Verizon New England’s assets, business and franchise related to the provision of local exchange and intrastate toll service in New Hampshire and the transfer of certain assets of Verizon affiliates⁴ related to existing intrastate interexchange telecommunications business and customer accounts. Through a series of stock transfers and distribution, the transferred assets would be merged into FairPoint, with Verizon shareholders holding 60 percent of FairPoint’s stock.⁵

Upon conclusion of the transaction and approval under RSA 374:26, FairPoint would commence business as a local exchange and intrastate toll service provider within the portions of New Hampshire served by Verizon New England and provide intrastate toll services. At the same time, Verizon would discontinue service as a public utility in New Hampshire under RSA 374:28.⁶

The petitioners assert in their filing that the transaction would result in no net harm and would have no adverse effect on the services provided to customers in New Hampshire. They further assert that no existing retail service would be discontinued or interrupted, no rates would change, and existing wholesale arrangements would remain largely the same as a result of the proposed transaction.⁷ FairPoint proposes to assume all of the rights and obligations of Verizon in New Hampshire and to significantly increase broadband availability in the state while strengthening its operational presence through

³ Petition at 2.

⁴ BACI, NYNEX Long Distance and VSSI.

⁵ *Id.* at 7.

⁶ *Id.* at 4 and 8.

⁷ *Id.*

the creation of new local service centers within the three-state region. FairPoint further proposes to retain Verizon's existing employees, honor all current collective bargaining agreements with Verizon's union employees, offer comparable benefits, and add some six hundred positions to provide service across the three states.⁸

The petitioners seek Commission approval of the proposed transaction under RSA 374:26 and 374:30 with respect to the transfer of Verizon's New Hampshire assets, business and franchise to FairPoint, and under RSA 374:28 with respect to Verizon's discontinuance of operations in New Hampshire. The applicable statutes require a public good standard of review. To properly evaluate the "public good," the Commission should view the transaction within the context of the current telecommunications landscape in New Hampshire, assessing the legacy Verizon will leave behind as well as FairPoint's capability to assume Verizon's regulatory obligations in the state.

B. Approval of the proposed transaction will have widespread implications for New Hampshire telephone customers and the state's telecommunications landscape.

The wireline industry throughout the United States, including New Hampshire, is declining.⁹ The decline arises from the growth of alternative technologies, particularly in higher density and higher income regions.¹⁰ The existing trends of technological innovation and service bundling offer little prospect for recovery. Because rural and other smaller markets offer fewer incentives to competitors,¹¹ the decline of wireline operations is felt most severely in those areas.

⁸ *Id.* at 3.

⁹ *See, for example*, Tables 7.1 and 10.1 in *Trends in Telephone Service*, (Federal Communications Commission: February 2007); *see also* Staff Exh. 27.

¹⁰ *See, for example*, Direct Testimony of Balhoff at 5-7.

¹¹ *Id.* at 7 (lines 17-20).

With approximately 40 percent of its residents living outside metropolitan areas,¹² New Hampshire has a substantial rural population that remains vulnerable to the current trends in today's telecommunications market. That vulnerability is evidenced both by Verizon's lack of commitment to maintaining its network and providing adequate service quality,¹³ and the fact that New Hampshire ranks among the lowest in the country in terms of broadband penetration.¹⁴

Other regions of the country facing similar declines in the wireline business and quality of service have seen the growth of acquisition companies, or "consolidators," that focus on markets similar to New Hampshire.¹⁵ They, like FairPoint, focus on markets in which the largest incumbent, such as Verizon, has shown a lack of commitment to the local services market and propose to offer service quality improvement and increased access to services that require greater bandwidth availability, such as broadband. Indeed, such services are increasingly vital to assuring that New Hampshire can offer its residents the access to information and data that will allow its economy to be competitive in today's global marketplace.

Such consolidators are speculating on their ability to thrive in a shrinking business by replacing lost wireline revenues with growth in other areas, such as wireless and broadband, and with further acquisitions. In those areas they will compete not only with a variety of competitive local exchange carriers (CLECs) and cable operators, but - at least in FairPoint's case in New Hampshire where Verizon would retain its wireless

¹² http://www.nh.gov/oep/programs/DataCenter/Where_New_Hampshire_Ranks.htm. According to the 2000 Census data, 59.9 % of NH residents live inside metropolitan areas, compared to 80.3 % nationwide.

¹³ See, generally, NHPUC Docket No. DT 04-019. See also Direct Testimony of Baldwin at 57-58 and 67-74; and Direct Testimony of Falcone/King at 88 (lines 13-21).

¹⁴ See Staff Exh. 63, FCC Table on "Percentage of Residential End-User Premises with Access to High-Speed Services as of June 30, 2006."

¹⁵ Direct Testimony of Balhoff at 8 (lines 5 -13) and Direct Testimony of Vickroy at 11 (lines 13-16).

business and presence with large business customers¹⁶ - with the very entity that sold them the business. Moreover, they will do so with very slim financial cushions to take them through any rough spots occasioned by operating problems, accelerating rates of wireline loss, and smaller than expected returns on broadband investments.

The consolidators are far more thinly capitalized than the rock solid, century-old incumbents who are now seeking to exit the business that has served as the principal source of their growth and profitability over decades of service. FairPoint is even more thinly capitalized than comparable, peer members of this newer, riskier breed of wireline service provider.¹⁷

The dilemma this creates is that New Hampshire is being asked in this proceeding to allow the departure from the wireline business of a company that has the unshakeable financial foundation required to deal with an irreversible and accelerating loss of traditional business. Verizon's departure might be acceptable if the new entity coming to New Hampshire can be held to commitments that will halt declines in service quality and make advanced services available to more New Hampshire residents and businesses. Making those commitments meaningful, however will take an entity that can maintain its financial health in a declining market.

In evaluating the merits of the proposed transaction, therefore, the Commission must assess the financial structure proposed by FairPoint to sustain its long-term economic viability in difficult circumstances. Should the Commission determine that the transaction otherwise merits approval, protecting the public interest requires clear and

¹⁶ Direct Testimony of Smith at 10 (line 6) through 11 (line 6).

¹⁷ See Hearing Transcript of 10/23/07 ("10/23/07 Tr.") at 230 (lines 16-22).

enforceable conditions that ensure FairPoint's financial viability and its ability to assume the weighty responsibilities that Verizon seeks to leave in its past.

II. ARGUMENT

A. FairPoint's Financial Ability.

1. The immense profit Verizon's shareholders will gain from the transaction as currently structured will be augmented by substantial tax advantages.

The transaction price of the proposed transfer of Verizon's assets is \$2.715 billion,¹⁸ a figure which exceeds the book value of those assets by about \$1.1 billion.¹⁹ Verizon chose to structure the transfer as a Reverse Morris Trust transaction, thereby gaining tax-free treatment for the \$2.7 billion sale. To achieve tax-free treatment, Verizon needed to find a transaction partner significantly smaller than itself to gain the tax advantages that Mr. Balhoff estimates at as much as \$750 million.²⁰ The paucity of qualified small carriers willing to take on the financial burden of an expansion of the magnitude at issue here gave Verizon very few real options to sell to another party and realize the tax benefit for its shareholders.

2. The transaction as proposed would saddle FairPoint with a potentially crippling debt burden in a declining industry.

Verizon's planned transaction provides it significant financial gains, while leaving New Hampshire to shoulder the risks inherent in bringing to the state a small and relatively new carrier who is much weaker financially and whose operations will expand

¹⁸ FairPoint Exh. 8P at 16 (lines 1-2).

¹⁹ 10/23/07 Tr. at 138 (line 23) through 139 (line 2) (net book value of the Verizon Northern New England properties is \$1.6 billion) and 10/23/07 Tr. at 139 (lines 3-8) (difference between purchase price and net book value is \$1.1 billion).

²⁰ 10/24/07 Tr. at 91 (line 20) through 92 (line 8) (Balhoff estimate of savings of \$400 to \$500 per line, multiplied by 1.5 million lines).

by as much as six times its current size.²¹ Under the merger agreement, the purchase price will be financed by \$1.7 billion in new debt issued by FairPoint.²² An additional \$800 million debt will be acquired by Spinco, the Verizon entity to be merged with FairPoint, and ultimately assumed by FairPoint. As a result of this \$2.7 billion transaction, FairPoint will increase its debt to \$2.35 billion.²³ This would make FairPoint unusually highly leveraged for a New Hampshire utility.

Companies acquiring landline business operations today are no longer the progeny of the pre-divestiture AT&T, which are in the process of divesting themselves of assets, such as wireline operations, that are no longer profitable.²⁴ The entities buying up landline operations are known as “consolidators,” meaning that they make acquisition after acquisition of wireline businesses to offset now steady and continuing declines in wireline access line revenue.²⁵ By definition, consolidators cannot stay at the same size, let alone thrive in the wireline business without more acquisitions.

The consolidators can no longer rely on business growth through the provision of traditional wireline services, as they face a continuing decline in wireline customers in virtually every market they enter. They counter this decline by offering a variety of services, including high-speed broadband access, in particular, that will offset some of the revenue loss that credit analysts predict will continue, and probably at accelerating rates.²⁶

²¹ 10/23/07 Tr. at 90 (lines 15-18).

²² Staff Exh. 2P at 4 (line 22) through 5 (line 1).

²³ *Id.* at 5 (lines 6-12).

²⁴ *See, for example*, Staff Exh. 27-31.

²⁵ Direct Testimony of Vickroy at 11 (line 15) through 12 (line 11).

²⁶ Staff Exh. 43 at 2-5.

Consolidator companies, such as FairPoint, attract equity capital by offering large dividend pay-outs; they then combine that equity with high degrees of leverage.

According to Staff Exhibits 27-31, only two of FairPoint's consolidator peers, Embarq and CenturyTel, have been designated with corporate debt ratings of investment-grade, historically a hallmark of traditional utility capital structures.

Most of the consolidators, including FairPoint and some of its peers referred to earlier, have corporate debt ratings that fall in the non-investment grade range,²⁷ making them speculative – or close thereto - investments for debt holders. As noted, only two of them²⁸ have investment grade ratings, and those two have taken far less aggressive stances, structuring their capital structure with less debt than FairPoint and other comparable companies.

In its base case modeling, FairPoint projects that its leverage following the transaction, as measured by its debt-to-EBITDA²⁹ ratio, will range from 4.0 to 4.2 after year one.³⁰ In comparison, fiscal year 2006 ratios for Windstream, Embarq, Citizens, and CenturyTel,³¹ ranged from 2.3 to 4.1.³² FairPoint's year-two and beyond projection of its EBITDA-to-interest ratio, a measure of free-cash flow available to meet interest obligations, ranged from 3.3 to 3.4.³³ Compare this with the ratios of its peers, which

²⁷ Staff Exh. 28 at 6 and Staff Exh. 31 at 5. (For FY2006, S&P gave CenturyTel and Embarq corporate debt ratings of BBB, just one notch above speculative, while Citizens and Windstream received ratings of BB, or 'somewhat speculative'.)

²⁸ *Id.*

²⁹ "EBITDA" means Earnings Before Interest Taxes Depreciation and Amortization.

³⁰ 10/23/07 Tr. at 229 (lines 12-18). *See also* OCA Exh. 1HC at 54 (lines. 10-13) (FairPoint's financial projections show debt leverage measured by debt-to-EBITDA ranges from 4.3 to 4.4 in the period 2009 to 2015.)

³¹ 10/23/07 Tr. at 225 (lines 17-21). *See also* Staff Exh. 31 at 4-5 (Windstream/Embarq/Citizens) and Staff Exh. 28 at 6 (CenturyTel).

³² 10/23/07 Tr. at 229 (lines 12-18).

³³ 10/23/07 Tr. at 232 (lines 18-24).

ranged from 3.3 to 6.0 in fiscal year 2006.³⁴ These metrics reflect the level of confidence lenders have in the ability of a company to generate sufficient cash flow to provide a healthy cushion above debt payment requirements.³⁵ The ratios demonstrate that, even under what it suggests is its base case scenario, FairPoint's exposure to financial risk is forecasted to be far greater than that of its peers.

FairPoint's projected financial ratios moderately decline over time, even if the company achieves the optimistic assumptions and level of success it promises. The optimistic assumptions suggest that the decline in FairPoint's financial ratios is thus likely to be even worse than the company has assumed.

If FairPoint does not remain financially healthy, its commitments to improve service quality and expand broadband access will prove empty. A financially failing or even marginal company will not spend its capital on such things, if shareowners are deserting it and lenders are hounding it. While FairPoint suggests that it has the option to reduce dividends to provide a financial cushion,³⁶ it also concedes that reducing dividends would impair the price of its stock and inhibit its ability to raise capital³⁷ at reasonable terms. In the long run, reliance on dividend cuts as a source of financial cushion would reduce FairPoint's ability to provide adequate service, let alone improve it.³⁸ Where conformity to the public interest is paramount, proposed dividend cuts are far from satisfactory as a financial contingency plan.

³⁴ 10/23/07 Tr. at 231 (line 12) through 232 (line 12). *See also* Staff Exh. 31 at 5 and Staff Exh. 28 at 6.

³⁵ 10/23/07 Tr. at 216 (line 11) through 218 (line 20) (Leach cross by Staff).

³⁶ 10/23/2007 Tr. at 118-119.

³⁷ 10/23/2007 Tr. at 93 (lines 5-17).

³⁸ Direct Testimony of Leach at 6 (lines 12-22).

3. Financial safeguards are required to mitigate the relatively high degree of financial risk FairPoint would bring to New Hampshire.

Absent the improvements in service quality and broadband access that FairPoint promises to bring to New Hampshire, it would be unwise to substitute a financially vulnerable service provider for one with a 100-year record of service and proven financial strength without also imposing financial safeguards to ensure FairPoint's financial viability under uncertain circumstances.

As noted above, the new wave of companies acquiring traditional wireline businesses have introduced a much more aggressive and debt-laden financial structure into the industry as wireline losses continue. The pairing of a weak business model with high levels of debt has caused the credit ratings for wireline businesses to fall from the rock-solid AA levels of a Verizon to the speculative BB- of a FairPoint.³⁹

On top of its relative newness to the wireline business, FairPoint has been a publicly traded company only since February 2005, when it underwent an IPO of its shares, which now trade on the New York Stock Exchange.⁴⁰ Further, when we compare it to other utility service providers in the region, FairPoint's board size, structure, and composition do not command confidence.⁴¹ The challenge therefore is one of securing sufficient assurances that FairPoint will have the financial wherewithal to provide the benefits it promises.

While expressing optimism about FairPoint's business prospects, Verizon has offered nothing in the application before the Commission to back up that optimism. A commitment on the part of Verizon to backstop FairPoint's entry into the state is essential

³⁹ See Staff Exh. 27.

⁴⁰ FairPoint Exh. 39 at 21.

⁴¹ 10/30/07 Tr. at 47 (line 3) through 56 (line 20) (Nixon cross by Staff); *see also* Staff Exh. 18-23.

to assure New Hampshire customers and regulators alike that this deal is in the public interest.

4. The tax-free structure of the transaction provides Verizon with huge financial gains, while leaving FairPoint with limited ability to safeguard against undue financial stress.

In order for Verizon to conform to the requirements for a tax-free spin off under a reverse Morris Trust, and achieve tax savings of up to \$750 million on the gain, the deal had to be structured so that Verizon shareholders own greater than 50 percent of post-merger FairPoint's equity.⁴² However, while this structure for the transaction works favorably for Verizon, it is correspondingly detrimental to FairPoint, which, under the constraints of the Reverse Morris Trust, must finance itself mostly with debt so that pre-merger stockholders hold only a minority share of the merged company. As a result, on day-one, the "new" FairPoint emerges from the transaction not only with a host of regulatory and financial conditions and requirements, but also with a highly leveraged capital structure that carries a high level of financial risk. By its very nature, the transaction structure required for a Reverse Morris Trust ensures that Verizon's successor will be a relatively small consolidator saddled with high levels of debt.

In effect, the only safeguard FairPoint can offer to improve its projected financial performance and long-term viability is to cut dividends. There are limits on FairPoint's ability to cut dividends, however. Cutting dividends by too much, or in a non-predictive way, would undermine equity investors' confidence in FairPoint's future ability to maintain the anticipated high dividend payouts. A loss of investor confidence, in turn, would cause FairPoint's stock price to drop, thereby making too uncertain its continuing

⁴² Direct Testimony of Vickroy at 6 (line 11) through 7 (line 8).

ability to gain access to equity markets.⁴³ Any barrier to capital access is particularly troubling in light of the potential costs FairPoint will face to improve service quality and expand broadband access.

5. The key to FairPoint's financial viability lies in its ability to service debt.

A key factor in ensuring FairPoint's ability to service its debt is to guarantee more free cash flow to increase the financial cushion it would have in the event of financial difficulties in the future. An up-front 20 percent dividend cut, for example, would free up about \$28 million per year⁴⁴ to use to support interest payments in lean years and to pay down the massive \$1.7 billion in debt that FairPoint will have to carry to give Verizon the full purchase price it seeks through this transaction.⁴⁵ According to Mr. Leach, Valor, a similarly situated acquisition company, did not experience a reduction in stock price when it cut its dividend as part of a similar transaction.⁴⁶

Dividend cuts would free up cash flow to cover interest payments and pay down the principal, thereby lowering FairPoint's debt-to-EBITDA ratio and increasing its interest coverage ratio. The measurement of free cash flow used in both ratios is adjusted EBITDA. In examining these ratios, lenders look for assurance that total debt does not exceed an acceptable multiple of EBITDA (leverage ratio), and that EBITDA is enough of a multiple over interest payments to ensure that principal and interest will be repaid (interest coverage).⁴⁷

⁴³ *Id.*

⁴⁴ 10/23/07 Tr. at 118 (line 19) (Leach cross by OCA) (\$28 million = \$142 million dividend used in model x 20 percent).

⁴⁵ Direct Testimony of Vickroy at 5 (lines 19-23) (confidential).

⁴⁶ See 10/23/07 Tr at 95 (lines 1-13).

⁴⁷ *Id.* See also Direct Testimony of Vickroy at 14 (line 1) through 15 (line 2).

Debt leverage and interest coverage metrics are illuminating only as a floor, however, for purposes of this Commission's assessment of the transaction. To ensure FairPoint's financial viability in the long-term, the Commission should look for a great deal more assurance. New Hampshire customers and regulators are not lenders looking merely for debt repayment; they are stakeholders looking for a company healthy enough to thrive in an increasingly uncertain marketplace.

6. FairPoint's argument that the deal is sound because Wall Street has confidence in it is not relevant to the Commission's analysis.

FairPoint needs to demonstrate it will be financially viable and will continue to offer an attractive investment opportunity for stockholders. The question before the Commission is not whether FairPoint's projections show that it can stay under the financial benchmarks that its lenders have established. The more appropriate test is for FairPoint to demonstrate that it can maintain investor confidence and capital market access even if circumstances do not prove as rosy as it projects.

Some of the cross examination of FairPoint effectively invited the Commission to "take the word of Wall Street" that FairPoint is a good financial risk.⁴⁸ The fact that FairPoint has succeeded in arranging a debt financing package to finance the transaction does not equate to a seal of approval from the financial community. The credit rating agencies have taken a decidedly jaundiced view of FairPoint's ability to thrive and repay the debt, as reflected in Standard and Poor's assigning FairPoint a speculative-level BB- corporate credit rating.⁴⁹ The credit ratings indicate that FairPoint's ability to repay is

⁴⁸ See, for example, 10/23/07 Tr. at 95 (line 22) through 102 (line 16) (Leach cross by Staff), and 10/24/07 Tr. at 72 (lines 4-15) (King cross by Staff).

⁴⁹ 10/23/07 Tr. at 97 (lines 4-7) and 223 (lines 13-16).

significantly more doubtful than that of Verizon, or even that of three of the four peer companies whose business model FairPoint follows in acquiring wireline properties.⁵⁰

Furthermore, the ability to pay existing debt, not the ability to issue new debt, is the focus of the rating agencies. If FairPoint loses access to capital markets, the principal benefits of bringing it to New Hampshire will be threatened if FairPoint cannot fund network improvements and broadband expansion with external capital acquired from the marketplace.

7. FairPoint's performance forecasts are overly optimistic, given its limited track record.

That FairPoint is stretched thinner than its peer companies financially is troubling enough.⁵¹ Its lack of a proven track record in operating a business of the scale involved here significantly heightens concerns. FairPoint today is the product of many relatively small acquisitions and the transaction proposed here will increase FairPoint's existing operating presence by six times at closing.⁵² FairPoint has no experience operating a network as large as the one it proposes to assume from Verizon. Its performance forecasts provide projections for a business that it has not yet run, and, as the evidence shows, that it has not yet even investigated at a substantial depth.⁵³

Hawaiian Telcom provides the only other example of a transaction similar to this one where the buyer lacked an established track record. As the record evidence suggests, surviving long enough to reach a position of stable, predictable performance is no sure thing.

⁵⁰ 10/23/07 Tr. at 225 (line 22) through 226 (line 17). *See also* Staff Exh. 27 at 2.

⁵¹ *See, generally*, Staff Exh. 27-31, and 10/23/07 Tr. at 225 (line 17) through 234 (line 14) (Leach cross by Staff).

⁵² Supplemental Testimony of Antonuk at 5 (lines 9-11).

⁵³ Direct Testimony of Falcone/King at 24 (line 9) through 26 (line 18).

FairPoint's peers have actually operated the businesses that are measured by their financial metrics; FairPoint has yet to enter the market for which it forecasts its performance. FairPoint's *estimated* ratios, which are dependent on very optimistic assumptions, are slightly worse than Citizens, the next weakest of its consolidator peers. Even at FairPoint's own estimated cash flow levels, leverage ratios flatten and do not improve after the first few years of their forecast. Consequently, what are already unfavorable comparisons with its peers take on added uncertainty in light of the fact that FairPoint cannot back them up with any of its won operating experience.⁵⁴

8. The Transition Services Agreement is a major source of risk to FairPoint's meeting key ratios.

As noted below, until FairPoint is able to develop its own systems and processes to replace Verizon's, it will be purchasing services from Verizon to operate the business under a Transitions Services Agreement (TSA). The TSA requires expenditures from FairPoint averaging approximately \$16.5 million per month.⁵⁵ Although FairPoint optimistically projects that the TSA will last for only four months⁵⁶ the TSA is likely to extend well beyond that timeframe, as noted below. FairPoint has estimated the cost of the TSA in its financial model to be \$115 million.⁵⁷ If the TSA extends for 12 months, costs will amount to an additional \$110 million; at 15 months, costs will amount to an additional \$165 million; and at 18 months, the additional costs will amount to \$222

⁵⁴ 10/23/07 Tr. at 225 (line 22) through 226 (line 17) (*citing* Staff Exh. 27 at 2).

⁵⁵ 10/23/07 Tr. at 244 (line 13).

⁵⁶ 10/23/07 Tr. at 239 (line 20) through 240 (line 9) (Leach cross by Staff) (transition period could be no shorter than 4 months).

⁵⁷ 10/23/07 Tr. at 238 (lines 15-16 and 23).

million.⁵⁸ The Hawaiian Telcom experience suggests that an 18-month duration would be a more realistic assumption than FairPoint's four months.⁵⁹

The TSA's duration is not its only cause for concern. Its price is unreasonable. FairPoint justifies the high costs of the TSA by comparing them to the corporate overhead charges that Verizon has assigned to northern New England.⁶⁰ Those costs, however, go toward supporting all aspects of the business directly assigned to northern New England, not just the services Verizon will be providing during the transition.⁶¹

9. FairPoint's forecasted cost savings are not based on sound reasoning or experience.

FairPoint, itself less than one percent of Verizon's size,⁶² contends that it will produce cost savings of approximately \$71 million per year when it assumes Verizon's northern New England operations.⁶³ It is indicative that early in this case FairPoint referred to such costs savings as "synergies," but abandoned that term later in the proceeding.⁶⁴ Indeed, the transaction proposed here is not a true merger of companies in which economies of scale will increase and lead to cost savings; rather, it is a transfer of assets and a base of operations to a much smaller company. Thus, it can be expected to produce diseconomies of scale.

⁵⁸ Direct Testimony of Smith at Exh. SES-4 (the TSA).

⁵⁹ Direct Testimony of King/Falcone at 67 (line 14) through 659 (line 10) and Supplemental Testimony of Antonuk at 10 (lines 6-8)./

⁶⁰ 10/23/07 Tr. at 255 (line 13) through 256 (line 13) and 257 (line 20) through 258 (line 9) (Leach cross by Staff). *See also* Labor Exh. 11HC and 10/23/07 Tr. at 257 (lines 1-9) (Leach cross by Staff).

⁶¹ 10/23/07 Tr. at 253 (line 18) through 261 (line 2) (Leach cross by Staff).

⁶² Direct Testimony of Antonuk at 7 (lines 12-20).

⁶³ 10/23/07 Tr. at 235 (lines 7-13).

⁶⁴ *Compare* Direct Testimony of Leach at 37-38 (FairPoint Exh. 8) (referring to "cost savings or 'synergies'") and Rebuttal Testimony of Leach at 2 (line 1) (FairPoint Exh. 9) (referring to "expected operating cost savings").

To replace the services Verizon currently supports in northern New England, FairPoint must assemble a senior executive team, a middle management team, new operating support systems (OSS), and 675 people to operate those systems.⁶⁵ Only then will it be able to replicate the services that Verizon has been providing over many decades in New Hampshire across a base of access lines and other services that gives it immense economies of scale as compared with FairPoint.

Yet, FairPoint predicts that it will get the same productivity that Verizon has gotten from its employees.⁶⁶ [BEGIN HIGHLY CONFIDENTIAL] [REDACTED]
[REDACTED]⁶⁷ [END
HIGHLY CONFIDENTIAL] On the other hand, there has been no value assigned to the inevitable loss of efficiency that FairPoint will have, compared with Verizon, as it ramps up all these new executives, workers, and systems.

10. The required financial safeguards must come from Verizon.

It is contrary to the public interest for Verizon to walk away from its long-standing relationship with New Hampshire residents and businesses without providing assurances that the company it leaves behind can withstand the transitory and systemic issues that will challenge it.

FairPoint does not yet have the financial capability to assume Verizon's legacy of a large and deteriorating landline network requiring significant efforts to reach acceptable service standards. Dividend cuts alone as a source of funding to cover costs that exceed

⁶⁵ Supplemental Testimony of Antonuk at 9 (lines 3-16).

⁶⁶ 10/23/07 Tr. at 253 (lines 6-17).

⁶⁷ 10/23/07 Highly Confidential Tr. at 179 (line 4) through 182 (line 19).

FairPoint's model forecasts are not an acceptable solution.⁶⁸ To accept such a solution would undermine shareholder confidence and produce a company too financially weak to step into the position Verizon will vacate when it leaves the New Hampshire telecommunications market.

Verizon stands to enjoy enormous gains here, through a high purchase price combined with substantial income tax savings and a TSA that is clearly priced at well above its cost. The record shows that Verizon has the financial wherewithal to provide the financial assurances required to ensure that this transaction is in the public good. The Commission should require it to do so.

11. There are effective, practical measures by which Verizon can supplement means within FairPoint's power to establish a financial footing for FairPoint that is consistent with the public interest.

FairPoint's future financial viability requires that its forecasted leverage ratio, with no cost savings assumed and with an extended TSA, should fall comfortably below 4.5 times, in order to allow for the substantial risks and business uncertainties it faces. That its peer consolidators recorded leverage ratios ranging from 2.4 to 4.1 times in 2006 shows how much an outlier FairPoint is.

The rebuttal testimony of Walter Leach (at page 68) included the financial results of the Company's "MAC case" ("material adverse change," or worst case scenario), which removed all cost savings from the company's base forecast. The FairPoint MAC case produced financial ratio results of 4.8 to 5.3 times for the leverage ratio, and 2.5 to 2.8 times for the interest coverage ratio. However, these results still assume an unreasonably short TSA duration. Even without accounting for this added stress factor,

⁶⁸ See 10/23/07 Tr. at 118 (line 14) through 119 (line 2) (Leach cross by OCA) ("first line of defense would be the shareholders).

they demonstrate significantly greater financial weakness than does the peer group. The Commission needs to adopt means for reducing the leverage and financial risk to levels that do not require New Hampshire to accept the riskiest company in the business.

Staff has identified a direct and important set of financial measures that will bring this transaction into a range of financial viability that makes it consistent with the public interest:

- A FairPoint reduction of dividends (from the current per-share rate) at the maximum rate Staff considers consistent with its continuing ability to attract the equity capital needed to provide adequate service and expand broadband access; Staff considers this maximum reduction to be 20 percent, which will produce \$28.4 million annually that FairPoint must use to pay down debt on a quarterly basis.
- A Verizon reduction in the purchase price for SpinCo by \$200 million.
- A FairPoint reduction in the Term Loan B principal by that same \$200 million.
- A cap on TSA charges to FairPoint at the six-month total cost of \$131.5 million; i.e., Verizon has responsibility for providing TSA services at no cost if they continue.

The impacts of these measures on the key FairPoint financial ratios can be derived from the MAC Case forecast results presented on page 68 of Mr. Leach's rebuttal testimony. These measures will bring a material increase in FairPoint's cash availability, reduction in its debt, and improvement in the ratios critical to meeting the covenants of its debt agreement. Specifically,

- The FairPoint dividend cut of 20 percent provides additional cash availability for a cumulative paydown of debt of \$227 million over eight years.
- The \$200 million reduction in purchase price and related FairPoint debt reduction provides an immediate and substantial improvement in the leverage and interest coverage ratios.

- Limiting FairPoint's TSA cost exposure to 6 months and \$131.5 million provides protection against the company's most crucial immediate-term risk; *i.e.*, the duration and cost-increase exposures on the system conversion project.

Applying these measures to FairPoint's MAC-case financial projections from Mr. Leach's rebuttal testimony reduces FairPoint's total projected debt by about \$228 million in 2008. This already significant reduction grows to a total \$446 million reduction by 2015. The leverage ratio also improves significantly, ranging from 4.2 to 4.4 times after 2008. The interest coverage ratio also improves to forecasted levels of 3.0 to 3.2 times in all years. The measures also protect against a significant TSA extension, which is not accounted for in the FairPoint MAC case.

Please refer to Attachment A for a chart that summarizes the effects of these measures.

B. FairPoint's Managerial and Technical Abilities.

1. The proposed transaction raises a number of concerns regarding FairPoint's managerial and technical ability to operate Verizon's wireline business.

FairPoint claims that customers will be better off as a result of this transaction because of its greater focus on the needs of customers and its promise to provide increased broadband access.⁶⁹ However, this claim must be balanced against the reality that FairPoint's much smaller size and scope make its capabilities to provide service to customers significantly more limited than Verizon's.

Furthermore, there is another important reality to consider: this transaction does not provide for Verizon to turn over the business to FairPoint fully intact. While Verizon would transfer certain assets and employees to FairPoint through the terms of this

⁶⁹ Direct Testimony of Leach at 5 (lines 5-8) and 7 (line 20) through 8 (line 3); Direct Testimony of G. Nixon at 24 (lines 2-5).

proposed transaction, there are a number of functions Verizon currently performs that would not be included in the transaction and that FairPoint will need to completely rebuild. Not only will this necessitate FairPoint's creation of new work center operations and hiring and training an approximately 675 additional employees, but even more importantly, Verizon will be transferring to FairPoint almost none of the extensive support systems that are essential to the operation of the business.⁷⁰ Unless FairPoint is able to successfully replicate these missing systems and processes, the entire range of telephone operations will cease to function effectively, leading to poor responsiveness to customer service requests, inaccurate bills, and possible service disruptions.

These very problems occurred in the recent Hawaiian Telcom transaction case, which also involved Verizon.⁷¹ Compounding this problem is the fact that the best solution for mitigating any customer impact is for FairPoint to continue to purchase services from Verizon through a very expensive Transition Services Agreement (TSA) until the newly developed systems and business processes are thoroughly tested and fully operational, and all personnel are in place and fully trained. However, as noted above, the TSA cost for every month that passes until FairPoint is ready to cut over further worsens FairPoint's already tenuous financial condition.

Even if FairPoint is able to successfully weather the challenges associated with the cutover from the Verizon support, there are additional uncertainties about FairPoint's ability to address on-going challenges it will face. There is considerable evidence, for example, that service quality has been deteriorating under Verizon's stewardship.⁷²

⁷⁰ 10/22/07 Tr. at 159 (lines 1-4).

⁷¹ Direct Testimony of Falcone/King at 63-67.

⁷² *See, generally*, Commission Docket DT 04-019. *See also* 10/29/07 Tr. at 87 (lines 11-21); Direct Testimony of Baldwin at 57 -58 and 67-74; and Direct Testimony of Falcone/King at 88 (lines 13-21).

Although it would appear to be in the best interest of New Hampshire residents and businesses for ownership to change to a company that might be more inclined than Verizon to honor its service quality obligations, it is questionable whether FairPoint has the financial capability to do so. In fact, there is evidence that FairPoint has substantially underestimated the costs of service quality remediation, as noted below.

FairPoint has placed considerable emphasis on its promise to increase broadband access in New Hampshire. Again, on the surface, this would appear to be a substantial advantage, given the fact that New Hampshire has lagged behind almost all other states in ILEC DSL availability under Verizon's stewardship. However, it is questionable whether the promise of relief would be realized through this transaction as currently structured. In particular, as noted below, there is evidence that FairPoint has underestimated the cost of its DSL strategy, so it is not clear that the proposed transaction will improve rural customers' broadband access.

Finally, there are concerns that both retail and wholesale customers may be disadvantaged in the transaction and that FairPoint's proposed governance structure is flawed.

2. FairPoint underestimates the time and effort required to achieve operational transition and cutover readiness.

a. FairPoint's assumption of Verizon's business will require much more time and expense than provided for in the purchase agreement.

Successful operation of Verizon's current New Hampshire telecommunications business requires many separate and disparate components to coordinate efficiently. Although FairPoint will receive most of Verizon's physical assets and approximately 2,800 Verizon employees to manage the landline business in northern New England

under the proposed transfer, those assets and employees will be far from sufficient to operate the business without extensive additional investment on FairPoint's part. As FairPoint itself has acknowledged, it must develop a full suite of systems and processes, hire more employees, and train all employees on the newly developed systems.⁷³ FairPoint must replace all but a small subset of Verizon's existing operations support systems (OSS) functionality.⁷⁴ In addition to replacing extensive operating systems, FairPoint must also identify, hire and train approximately 675 new staff positions to assume the responsibility for the job functions being performed by Verizon under the TSA.⁷⁵ Furthermore, there are a number of network functions such as E911 service support, Advanced Intelligent Network (AIN) capabilities, and operator services and directory assistance, which Verizon will not provide to FairPoint as part of the transfer of network assets.⁷⁶ FairPoint must identify and arrange for replacements for each of these functions. While FairPoint is developing systems and hiring new employees and training all employees on its new systems, FairPoint will be purchasing the necessary services to operate the business from Verizon through the TSA at a monthly cost that will be a significant drain on FairPoint's limited resources.⁷⁷

In addition to being very expensive, the TSA is very complex, covering over 80 functional areas.⁷⁸ The monthly recurring cost of the TSA is \$16.5 million for the first

⁷³ See, for example, 10/30/07 Tr. at 25 (line 17) through 27 (line 11).

⁷⁴ Direct Testimony of Falcone/King at 38 (lines 15-22) (referencing Direct Testimony of Smith at 23 (lines 5-7) and Direct Testimony of Haga at 5 (lines 1-5)). See also 10/22/07 Tr. at 159 (lines 2-4).

⁷⁵ Direct Testimony of Falcone/King at 39 (lines 5-6) and 72 (lines 8-23) (referencing Direct Testimony of Haga at 10 (lines 10-11), and FairPoint Response to Staff 3-62 (Staff Exh. 44)). See also 10/30/07 Tr. at 15 (lines 1-23).

⁷⁶ Direct Testimony of Falcone/King at 34 (line 5) through 36 (line 12).

⁷⁷ Direct Testimony of Smith at 23 (lines 5-9); see also 10/23/07 Tr. at 237 (line 14) through 239 (line 2) and 244 (lines 8-16).

⁷⁸ Direct Testimony of Falcone/King at 40 (lines 21-22) and 41 (lines 1-16); see also TSA Schedules A, C and D provided as attachments to Direct Testimony of Smith.

eight months of the contract, reduced by \$500,000 per month for months nine to twelve and then increasing by \$500,000 per month from the original amount indefinitely for each and every month the TSA remains in effect.⁷⁹ There is also a one time TSA charge to FairPoint of \$34 million.⁸⁰ All TSA services with the exception of the employee benefits services provided under TSA Schedule C must be cut over simultaneously;⁸¹ FairPoint must provide Verizon with an irrevocable notice of cutover at least 60 days prior to its intended cutover date;⁸² and FairPoint can cutover only on the last Friday of an odd month. Thus, if FairPoint misses a cutover date, it must wait two months for the next cutover date, thereby incurring two more month's worth of TSA payments amounting to approximately \$33 million in additional payments to Verizon.⁸³ Furthermore, the next cutover date after its current projected date occurs near the time of the termination of its labor contract with the former Verizon employees.⁸⁴

b. The complexity of replacing the operations support systems (OSS) and the FairPoint team's limited experience with developing such systems are of grave concern.

FairPoint has limited experience with systems as complex as the OSS involved in this case; nor does it have experience with systems replacement and integration of this nature and scale.⁸⁵ Capgemini, whom FairPoint has hired to develop the necessary systems, has no experience in developing systems for a transition of this magnitude and

⁷⁹ Direct Testimony of Smith at 29 (line 6) through 30 (line 1). *See also* 10/23/07 Tr. at 244 (line 13) and Direct Testimony of Falcone/King at 45 (lines 4-22) (referencing confidential TSA Schedule D provided as an attachment to Direct Testimony of Smith).

⁸⁰ Direct Testimony of Smith at 29 (line 17) through 30 (line 1).

⁸¹ Direct Testimony of Falcone/King at 41 (line 21) through 42 (lines 5) (*referencing* Verizon Response to Staff 2-19 (Staff Exh. 52)).

⁸² Direct Testimony of Falcone/King at 41 (lines 17-20); *see also* 10/22/07 Tr. at 106 (line 22) through 107 (line 4).

⁸³ 10/30/07 Tr. at 28 (lines 5-6).

⁸⁴ 10/30/07 Tr. at 27 (line 12) through 29 (line 4).

⁸⁵ Direct Testimony of Falcone/King at 46 (line 13) through 49 (line 7) (*referencing* FairPoint Responses to Staff 3-2, 3-5, 3-7, 308, 2-112, and FDR III-1 (Staff Exh. 44)).

complexity.⁸⁶ The only other transition that has occurred in the industry on a scale similar to this one was the Hawaiian Telcom cutover from Verizon's systems in April 2006. As with the current proposed transaction, that transaction also required the new owner to replace the Verizon systems and involved a very expensive TSA, which motivated Hawaiian Telcom to cut over from the Verizon systems before its newly developed systems and processes were fully operational.⁸⁷ That cutover resulted in severe and continuing service quality problems, such as inaccurate bills and long waits for customer service for residential, business, and wholesale customers in Hawaii.⁸⁸ As a result, Hawaiian Telcom experienced significant loss of customers and increased expenses to hire temporary employees to staff manual processes required because it cut over with inadequate support systems.

The implementation of manual processes was one of the main reasons Hawaiian Telcom experienced the service quality issue it encountered.⁸⁹ In the event it finds that systems are not operating as expected after cutover in this case, FairPoint's "contingency plan" is to implement similar manual processes.⁹⁰ However, FairPoint has yet to identify which of the 80-plus processes it will have to handle manually.⁹¹

⁸⁶ Direct Testimony of Falcone/King at 49 (line 15) through 50 (line 7); *see also* 10/22/07 Tr. at 165 (line 20).

⁸⁷ Direct Testimony of Falcone/King at 70 (line 23) through 71 (line 9).

⁸⁸ Direct Testimony of Falcone/King at 62 (line 3) through 70 (line 16) (*referencing* Verizon Responses to Staff 2-15, 2-16, and 2-17 (Staff Exh. 52), *Honolulu Register* article (Staff Exh. 7), HI PUC Order No. 22,928 (Staff Exh. 58), and Hawaiian Telcom 10-K (Staff Exh. 11). *See also* 10/22/07 Tr. at 129 (lines 1-7).

⁸⁹ Direct Testimony of Falcone/King at 69 (line 11) through 70 (line 16) (*referencing* Hawaiian Telcom 10-K (Staff Exh. 11); *see also* Rebuttal Testimony of Haga/Kurtze at 34 (lines 10-12).

⁹⁰ Direct Testimony of Falcone/King at 43 (line 22) through 44 (line 6) (*referencing* FairPoint Response to Staff 3-65 (Staff Exh. 44); *see also* 10/22/07 Tr. at 169 (lines 2-8).

⁹¹ 10/22/07 Tr. at 176 (lines 15-24).

As was the case in Hawaii, the cost and timing requirements under the TSA create an incentive for FairPoint to cut over prematurely.⁹² If FairPoint decides to extend the TSA because systems and support are not ready for cutover, Verizon will effectively penalize FairPoint financially through the \$500,000 monthly increases in TSA costs.⁹³ In addition to the cost factors, the “all-or-nothing” structure to the TSA sets up the potential for premature cutover.⁹⁴ A premature cutover before all systems and processes are ready will adversely affect residential, business, and wholesale customers throughout New Hampshire.⁹⁵ Furthermore, a disaster in northern New England similar to that experienced in Hawaii would be devastating to FairPoint’s fragile financial condition.

c. FairPoint’s current cutover timeline is overly aggressive and unrealistic.⁹⁶

Aggressive timelines sometimes drive the wrong behavior among employees.⁹⁷ Because of the 60-day irrevocable notice of cutover readiness that FairPoint must provide to Verizon, based on its current schedule, FairPoint must determine that it is ready to cut over by the end of March, 2008, which is only two months from the anticipated close date.⁹⁸ In contrast, the Hawaiian Telcom TSA lasted 11 months from close in May 2005

⁹² Direct Testimony of Falcone/King at 55 (line 21) through 57 (line 15) (*referencing* Verizon Responses to Staff 2-23 and 2-24 (Staff Exh. 52) and FairPoint Response to OCA FDR III-6 (Staff Exh. 45). *See also* Supplemental Testimony of Antonuk at 6 (line 11) through 7 (line 13).

⁹³ Direct Testimony of Falcone/King at 55 (line 21) through 57 (line 15) (*referencing* Verizon Responses to Staff 2-23 and 2-24 (Staff Exh. 52) and FairPoint Response to OCA FDR III-6 (Staff Exh. 45); *see also* Supplemental Testimony of Antonuk at 6 (lines 11–22).

⁹⁴ Direct Testimony of Falcone/King at 54 (line 14) through 55 (line 13).

⁹⁵ Direct Testimony of Falcone/King at 58 (line 15) through 59 (line 12).

⁹⁶ Direct Testimony of Falcone/King at 59 (line 13) through 60 (line 8).

⁹⁷ Direct Testimony of Falcone/King at 61 (lines 11-23) (*referencing* FairPoint attachments CFPNH 0020-0040 (Staff Exh. 50C) and FairPoint Response to Staff FDR III-11 (Staff Exh. 49C).

⁹⁸ 10/22/07 Tr. at 161 (lines 18-22) and 106 (line 22) through 107 (line 4).

to cutover in April 2006.⁹⁹ FairPoint's current schedule will terminate the TSA in only four months - from close in January 2008 to the planned cutover in May 2008.¹⁰⁰

FairPoint agrees that staffing and training are essential elements to determine cutover readiness,¹⁰¹ yet it will need to identify and hire 590 of the 675 new employees needed to operate the business once the TSA is terminated and will need to train all 675 of these new employees on FairPoint's new operating systems and processes.¹⁰² In addition, FairPoint will need to train the approximately 2,800 employees transferring from Verizon on the new systems,¹⁰³ and yet training for those employees is not scheduled to begin until February 2008.¹⁰⁴ Moreover, on top of systems training, many of FairPoint's new employees will also need to be trained in the basic job functions for which they were hired.¹⁰⁵

Additional concerns are raised by the likelihood that not all of the Verizon employees identified to be transferred to FairPoint will, in fact, transfer. Those employees are still eligible to bid for other jobs within Verizon allowing them to remain with Verizon and thereby depriving FairPoint of their expertise.¹⁰⁶ The attrition rate of Verizon employees identified to be transferred to FairPoint has more than doubled over the same time period from previous years.¹⁰⁷ A significant percentage of the non-management and management Verizon employees identified to be transferred to

⁹⁹ Direct Testimony of Falcone/King at 63 (lines 13-16) (*referencing* Verizon Response to Staff 2-17 (Staff Exh. 52)).

¹⁰⁰ 10/22/07 Tr. at 106 (lines 19-21).

¹⁰¹ 10/22/07 Tr. at 111 (lines 3-5).

¹⁰² 10/30/07 Tr. at 15 (line 19) through 16 (line 2).

¹⁰³ 10/29/07 Tr. at 239 (lines 18-20).

¹⁰⁴ 10/29/07 Tr. at 239 (lines 11-17).

¹⁰⁵ 10/30/07 Tr. at 19 (lines 6-9).

¹⁰⁶ Direct Testimony of Falcone/King at 80 (line 21) through 81(line 6) (*referencing* Verizon Responses to Staff FDR I-2 (with attachment) and Staff FDR I-5 (Staff Exh. 52)).

¹⁰⁷ Direct Testimony of Falcone/King at 81 (lines 7-13) (*referencing* Verizon Responses to Staff FDR I-2 (with attachment) and Staff FDR I-5 (Staff Exh. 52)).

FairPoint are retirement eligible.¹⁰⁸ In addition, Verizon employees who are retirement eligible and remain with Verizon until January are entitled to their 2008 vacation, an added incentive for those employees to depart Verizon immediately prior to close.¹⁰⁹

As noted, FairPoint acknowledges that staffing and training are essential elements to determine cutover readiness. FairPoint further agrees that its business processes must be in place and fully operational before FairPoint is cutover ready.¹¹⁰ Given the obstacles it faces, FairPoint is underestimating the difficulty of the cutover effort when it claims that a cutover four months after close is not overly aggressive.¹¹¹

It is crucial for New Hampshire residents and businesses to be protected from a Hawaii-like disaster. The Commission should not approve this transaction without very strict conditions and protections to significantly reduce the likelihood of such an event.

3. Remediating the service quality issues that result from Verizon's legacy will require significant investment.

a. Inadequate due diligence efforts failed to expose the extent of service quality problems FairPoint will face.

If the proposed transaction is approved, Verizon will leave behind a deteriorating network and a legacy of poor service quality. In 2004, the Commission opened Docket No. DT 04-019 to investigate complaints about Verizon's service quality. Verizon's inability to meet critical quality service benchmarks has been and continues to be a widespread problem in New Hampshire.¹¹² In addition, major concerns have been raised

¹⁰⁸ Direct Testimony of Falcone/King at 83 (lines 4-7) (*referencing* Verizon Response to Staff 2-28 with confidential attachments GII 2-28 (Staff Exh. 53C)).

¹⁰⁹ 10/30/07 Tr. at 21 (line 21) through 22 (line 2).

¹¹⁰ 10/30/07 Tr. at 26 (line 17) through 27 (line 1).

¹¹¹ 10/30/07 Tr. at 29 (lines 5-21).

¹¹² Critical areas in which benchmarks are not being met include Orders Held Over 30 Days, Customer Trouble Reports per 100 Lines, Percent Out of Service Troubles Cleared in Less than 24 Hours, Average Hours for Repair Completion, Percent Repair Commitments Met, and Repair Service Answer Time. Direct Testimony of Falcone/King at 88 (lines 17-21); *see also* OCA Exh. 2C at 283-290 and OCA Exh. 77C..

regarding its maintenance of poles.¹¹³ Despite the fact that FairPoint was aware of the service quality issues addressed in Docket No. DT 04-019,¹¹⁴ its pre-sale due diligence was woefully inadequate to identify issues it may have to address upon the assumption of Verizon's operations in New Hampshire. FairPoint conducted its due diligence efforts with neither a checklist of which assets to inspect nor a plan for how it would inspect them.¹¹⁵

FairPoint left it to Verizon to select the central offices it was allowed to inspect.¹¹⁶ Accordingly, FairPoint inspected only four central offices in New Hampshire¹¹⁷ – all located in the most populous areas of the state. No rural offices were inspected.¹¹⁸ Moreover, of 96 remote switches in New Hampshire, FairPoint did not inspect a single one.¹¹⁹ And because Verizon did not accompany FairPoint on its outside plant inspections, FairPoint was limited to visual checks of outside facilities.¹²⁰ FairPoint's outside plant checks were also limited to the more populous areas of the state.¹²¹

FairPoint claims that it will be obtaining a “well-functioning and robust network in New Hampshire,” but admits that it conducted only a “high level review” of Verizon's documentation to make its assessment.¹²² The underlying details make clear that

¹¹³ See Direct Testimonies of Meissner and Hybsch; see also 10/31/07 Tr. at 125 (lines 5-14).

¹¹⁴ Direct Testimony of Falcone/King at 88 (line 22) through 89 (line 3) (referencing FairPoint Response to Staff 2-40 (Staff Exh. 44)). See also Direct Testimony of Harrington at 15 (lines 1-3).

¹¹⁵ Direct Testimony of Falcone/King at 25 (lines 11-22) (referencing FairPoint Response to Staff 2-74 (Staff Exh. 44)).

¹¹⁶ Direct Testimony of Falcone/King at 26 (lines 7-18) (referencing FairPoint Response to Staff 2-9 (Staff Exh. 44)).

¹¹⁷ Direct Testimony of Falcone/King at 26 (line 22) through 27 (line 1) (referencing FairPoint Response to Staff 2-9 (Staff Exh. 44)).

¹¹⁸ Direct Testimony of Falcone/King at 27 (lines 1-7).

¹¹⁹ Direct Testimony of Falcone/King at 27 (lines 2-4) (referencing Direct Testimony of Harrington at 6 (line 3)).

¹²⁰ Direct Testimony of Falcone/King at 29 (lines 1-14).

¹²¹ Rebuttal Testimony of Brown/Harrington/ Smee at 6 (lines 16-18).

¹²² Direct Testimony of Falcone/King at 30 (lines 1-5) (referencing FairPoint Response to Staff 2-12 (Staff Exh. 49C)).

FairPoint conducted its due diligence review at a very general level, without depth or breadth in its inspections.

FairPoint did not review any of Verizon's reported measurements of service quality related to ordering and provisioning performance.¹²³ Furthermore, based on its review of Verizon's documentation FairPoint determined that "data provided by Verizon reflected declining troubles [as of April 2006]."¹²⁴ Yet, in fact, between 2004 and 2006, Verizon's outside plant trouble rate [BEGIN CONFIDENTIAL] [REDACTED]
[REDACTED] [END

CONFIDENTIAL]¹²⁵ A loss of access lines would typically result in a proportionate reduction in trouble reports, not an increase.

Early in the discovery process, FairPoint committed to meeting the Commission's existing service quality standards beginning six months after close.¹²⁶ FairPoint has subsequently modified its commitment substantially. It now asks not to be measured against the Commission's service quality standards until two years after cutover.¹²⁷ In addition, FairPoint has not agreed to be subject at any time to automatic financial penalties for failure to meet service quality benchmarks.¹²⁸

¹²³ Direct Testimony of Falcone/King at 30 (lines 9-10) (referencing FairPoint Response to Staff 2-12 (Staff Exh. 49C)).

¹²⁴ Direct Testimony of Falcone/King at 30 (lines 6-7) (referencing FairPoint Response to Staff 2-12 (Staff Exh. 49C)).

¹²⁵ Direct Testimony of Falcone/King at 91 (lines 3-11) (referencing Verizon confidential attachment to its Response to OCA 1-34 (Staff Exh. 54C); see also 10/29/07 Tr. at 113-116).

¹²⁶ Direct Testimony of Falcone/King at 89 (lines 4-8) (referencing FairPoint Responses to OCA FDR II-6 and FDR II-17a (Staff Exh. 45)).

¹²⁷ Rebuttal Testimony of Brown/Harrington/ Smeed at 26 (lines 1-21); see also 10/29/07 Tr. at 56 (lines 15-22), at 59 (lines 13-18) and at 81-83.

¹²⁸ Direct Testimony of Falcone/King at 89 (line 19) through 90 (line 1) (referencing FairPoint Response to OCA FDR II-17d (Staff Exh. 45)).

b. The extent of investment required to bring Verizon's network up to standard is substantial.

FairPoint claims it can address service quality issues through the addition of approximately ten technicians, based on information it has received verbally from Verizon.¹²⁹ The addition of a few technicians, however, will not be sufficient to reduce the troubles experienced by New Hampshire customers and documented in Verizon's quality of service reports. As FairPoint has admitted, faulty plant facilities currently exist and will require replacement before many service quality problems can be improved.¹³⁰

FairPoint has also not developed a disaster recovery plan,¹³¹ and it needs such a plan in order to be able to cope with major outages due to snow or ice storms or major flooding, such as occurred in the central office in Raymond this year, let alone more substantial disasters that might occur. Given FairPoint's tenuous financial condition, it is questionable whether it will be able to make the expenditures necessary to resolve all of these problems, particularly given the requirements of funding important on-going capital projects such as completion of the Pinkham Notch ring and of the Raymond central office remediation.¹³²

Furthermore, the staffing issues discussed above with regard to cutover readiness apply equally to quality of service concerns, particularly with respect to FairPoint's ability to retain the existing Verizon staff it expects to receive at close. If FairPoint does

¹²⁹ Direct Testimony of Falcone/King at 89 (lines 16-18) (*referencing* FairPoint Response to OCA FDR II-4 (Staff Exh. 45)).

¹³⁰ Direct Testimony of Falcone/King at 91 (lines 3-19) (*referencing* Verizon confidential attachment to its Response to OCA 1-34 (Staff Exh. 54C) and Verizon Response to Staff FDR 2-7 (Staff Exh. 52); *see also* 10/29/07 Tr. at 119 (lines 7-20)).

¹³¹ FairPoint Exh. 58 (FairPoint response to oral data request).

¹³² Direct Testimony of Falcone/King at 31 (line 6) through 32 (line2) and at 95 (lines 1-16).

not receive adequate staff resources at the time of close, it will have no recourse to remedy that deficiency.¹³³

4. FairPoint's promises to expand broadband availability in New Hampshire underestimate the capital expenditures required.

FairPoint has consistently expressed its intent to provide expanded broadband services to the customers of northern New England. Indeed, increased access to broadband service is a key selling point for New Hampshire customers. High-speed access to information has become increasingly important to businesses and consumers. According to the latest FCC report on broadband availability, however, New Hampshire currently has the lowest reported level of ILEC DSL availability in the United States.¹³⁴ New Hampshire's low ranking is a reflection of Verizon's lack of commitment to investing in broadband deployment in northern New England. New Hampshire residents and businesses should not be forced to continue being disadvantaged in this way.

a. FairPoint's very welcome plan to expand broadband has several critical flaws.

i. Technical issues.

From a technical point of view, FairPoint's broadband strategy, which is to use DSL as its prime technology, is cheaper to deploy than Verizon's use of fiber-to-the-premises (FTTP) technology and thus would be more likely to increase broadband availability in the more rural parts of the state that are underserved through Verizon's broadband approach.¹³⁵ However, DSL has inherently less bandwidth capability than a full fiber-based technology. Thus, if FairPoint were to cut back on FTTP deployment in

¹³³ 10/29/07 Tr. at 11 (lines 2-9).

¹³⁴ Direct Testimony of Falcone/King at 8 (lines 11-14) (*referencing* FCC table on "Percentage of Residential End-User Premises with Access to High-Speed Services as of June 30, 2006" (Staff Exh. 63).

¹³⁵ Rebuttal Testimony of Sicker at 2-3.

the more densely populated parts of New Hampshire, customers in this portion of the state would not be well served. FairPoint has committed to maintain the Verizon FTTP facilities, but it is not at all clear that it will expand the capabilities or reach of this technology.¹³⁶

ii. Unsupported assumptions.

Furthermore, FairPoint's broadband planning has been based on too many unsupported assumptions,¹³⁷ which FairPoint has acknowledged.¹³⁸ At the same time, FairPoint's due diligence did not include a review of the fiber-fed remote terminals where it plans to install DSL equipment¹³⁹ or of the central offices where FairPoint will be installing DSL equipment to introduce DSL service to customers who previously have not had access to it.¹⁴⁰

Record evidence suggests that either Verizon has not been forthcoming with the detailed network information that FairPoint needs to produce a reliable and accurate expansion plan or FairPoint has not even requested what it needs.¹⁴¹ The evidence

¹³⁶ 10/29/07 Tr. at 18 (line 17) through 20 (line 14).

¹³⁷ Direct Testimony of Falcone/King at 12-18 (*referencing* FairPoint's broadband plan (Staff Exh. 51P/C/HC)).

¹³⁸ Direct Testimony of Falcone/King at 13 (line 10) through 14 (line 8) (*referencing* FairPoint Response to Staff 2-35 (Staff Exh. 44)).

¹³⁹ Direct Testimony of Falcone/King at 14 (lines 11-18) (*referencing* FairPoint Response to Staff 2-9 (Staff Exh. 44); *see also* 10/29/07 Tr. at 76 (lines 9-14)).

¹⁴⁰ Central Office inspections were limited to Concord, Dover, New Market and Hanover; *see* 10/29/07 Tr. at 100 (lines 11-13).

¹⁴¹ *See, for example*, Direct Testimony of Falcone/King at 17 (lines 16-17) ("FairPoint is still working to obtain the necessary data from Verizon") and 18 (lines 4-5) ("Verizon believes that it has provided all of the data that FairPoint has requested and that FairPoint *has the right to review* under the Merger Agreement" [emphasis added]). *See also* Supplemental Testimony of Antonuk at 11 (lines 19-21); 10/29/07 Tr. at 127 (lines 18-20) ("so . . . the changes [to the plan] were the result of better information from Verizon"?), Brown's response: "Absolutely."); and 10/29/07 Tr. at 44 (lines 7-9) ("I would say that within 12-18 months of running the company we will have access to all the records necessary to develop that plan" (*referencing* FairPoint's complete broadband plan)).

further suggests that Verizon provided FairPoint with faulty data which affected FairPoint's planning.¹⁴²

Based on the revisions that FairPoint has made to its broadband plans in New Hampshire it is apparent that Staff's concerns about the lack of confidence it had with FairPoint's assumptions were warranted. From June 2007, when FairPoint shared its original plan,¹⁴³ to September 2007, when FairPoint shared its revised plan in the joint rebuttal testimony of Michael S. Brown, Michael L. Harrington and John Smee, the cost of the expansion plan increased from [BEGIN CONFIDENTIAL] ██████████ [END CONFIDENTIAL] to [BEGIN CONFIDENTIAL] ██████████ [END CONFIDENTIAL]¹⁴⁴ while the coverage of the plan with respect to additional customer lines to be made available for DSL service has drastically decreased.¹⁴⁵ The number of central offices in which FairPoint will install Multi-Service Access Node (MSAN) equipment has decreased from [BEGIN CONFIDENTIAL] ██████████ [END CONFIDENTIAL] in the original plan to 69 in the revised plan.¹⁴⁶ Similarly, the number of lines served by central offices receiving DSL capability for the first time through this plan has decreased from [BEGIN CONFIDENTIAL] ██████████ [END CONFIDENTIAL] to 12,289,¹⁴⁷ and the number of remote terminals receiving MSAN equipment is reduced from [BEGIN CONFIDENTIAL] ██████████ [END CONFIDENTIAL] to 130.¹⁴⁸

FairPoint has scaled back its commitment considerably. In the original broadband plan, FairPoint indicated that "completion of this initial investment will provide

¹⁴² 10/29/07 Tr. at 124 (line 6) through 125 (line 9) and 125 (line 21) through 126 (line 13).

¹⁴³ See Confidential Attachment CFPNH 2158-CFPNH 2170 (Staff Exh. 51P).

¹⁴⁴ See Confidential Exhibit BHS-1 (FairPoint Exh. 14C).

¹⁴⁵ Joint Rebuttal Testimony of Brown/Harrington/Smee at 31 (lines 15-17).

¹⁴⁶ Rebuttal Testimony of Brown at 30 (lines 4-7).

¹⁴⁷ *Id.* at 30 (line 5); *see also* 10/29/07 Tr. at 79 (lines 5-9).

¹⁴⁸ Rebuttal Testimony of Brown at 31 (line 13)..

broadband service to an additional 113,591 access lines in the State of New Hampshire, the majority of which currently have no access to Verizon broadband,” but in the revised plan, FairPoint noted that it “will achieve a total of approximately 57,800 additional access lines that will be broadband addressable at the end of this phase.”¹⁴⁹

b. The evolution of FairPoint’s broadband plan indicates that FairPoint has underestimated the cost of implementation.

Muddying the water even further is the fact that FairPoint has been extremely unclear about exactly what it is committing to in its plan. In the original June 2007 plan FairPoint noted that “within 12 to 18 months this will bring the broadband addressability rate from its present 63% to approximately 75% and within 24 months from closing to approximately 82%.”¹⁵⁰ By July, FairPoint had reduced the 24-month commitment to “approximately 80%.”¹⁵¹ Finally, in September FairPoint began to refer to its commitment as a “book-end approach;”¹⁵² that is, FairPoint’s latest commitment is “somewhere in the book-end from 71 percent to 83 percent.”¹⁵³ In addition, FairPoint has used inconsistent and confusing terminology to describe its broadband expansion commitment, including such expressions as broadband “qualified,” broadband “addressable,” or broadband “available,” without a clear definition of the differences. Thus, it is unclear exactly what FairPoint’s commitment actually entails.

These uncertainties also have implications for FairPoint’s financial condition. It is not possible to reliably predict the amount of capital needed for FairPoint’s expansion plan without data on the current network architecture and a detailed analysis of this data

¹⁴⁹ *Id.* at 31 (line 16); *see also* 10/29/07 Tr. at 79 (lines 14-16 and 21-24).

¹⁵⁰ *See* Staff Exh. 51.

¹⁵¹ An interim revised plan was provided on July 27, 2007, in confidential attachment CFPNH 3018-3030 (Staff Exh. 60 P/C/HC).

¹⁵² 10/31/07 Tr. at 15 (line 22).

¹⁵³ 10/31/07 Tr. at 16 (line 13).

to identify the network modifications that will need to be made.¹⁵⁴ The implications to FairPoint's plan if its assumptions turn out to be invalid are that it will either have to allocate more capital toward implementation of the plan or it will have to scale back its broadband expansion objectives.¹⁵⁵

Decisions to expand broadband service are largely based on two factors: incremental revenues to be gained by further expansion and the cost of that expansion. In light of the fact that Verizon has not yet chosen to expand broadband into the areas of the state that FairPoint includes in its plans, one can assume that Verizon determined that costs were too high and/or revenue was not sufficient to support such expansion. It is therefore reasonable to assume that expansion to those areas will be costly. Without the detailed network analysis that is needed to accurately determine the equipment needed to be installed or modified, there is substantial cost uncertainty in FairPoint's expansion plan.¹⁵⁶ The potential for unexpected expenditures to achieve broadband objectives adds to the concern that Staff has with FairPoint's ability to maintain its financial viability.

5. The proposed transaction raises customer and corporate governance issues, as well.

Another important consideration for the Commission is to ensure that retail and wholesale customers are not disadvantaged by the proposed transfer of Verizon's operations to FairPoint. In particular, it is important that retail customers are protected from rate increases that FairPoint might wish to implement to shore up its shaky financial condition and to bring service quality up to New Hampshire standards. In addition, retail

¹⁵⁴ Direct Testimony of Falcone/King at 20 (line 11) through 21 (line 2) (*referencing* Direct Testimony of Harrington at 10 (line 8)).

¹⁵⁵ Direct Testimony of Falcone/King at 21 (lines 3-16).

¹⁵⁶ Supplemental Testimony of Antonuk at 11 (lines 7-17).

customers should experience a seamless service transition and continue to have access to the same sales and service options they currently enjoy.¹⁵⁷

In the interest of maintaining a healthy wholesale market, FairPoint must assume the same obligations that Verizon currently has, whether or not it technically meets the federal regulatory requirements that Verizon currently meets.¹⁵⁸ At hearing, FairPoint committed to providing section 271 checklist obligations that “the New Hampshire Commission would have the authority to ensure that [it does].”¹⁵⁹ Since, according to FairPoint, it is not a Bell Operating Company (BOC) under the Telecommunications Act,¹⁶⁰ section 271 would not legally bind FairPoint. As a result, FairPoint must fulfill its commitment under state law. Accordingly, “as a condition of approval of the merger,”¹⁶¹ consistent with Mr. Skrivan’s testimony, FairPoint should file rates and terms for these services in a tariff pursuant to RSA 378:1.

This transaction also raises a number of concerns regarding corporate governance. In order for FairPoint to serve the interests of the residents and businesses of New Hampshire and the rest of northern New England, the FairPoint Board of Directors must include members that understand and can represent those interests. Furthermore, the structure of the current FairPoint Board is problematic in that it lacks a Finance Committee and has the dangerous provision for an Executive Committee that may take key actions without full board approval.¹⁶² Finally, given the major reorganization of FairPoint’s corporate structure that this transaction would represent, it is very important

¹⁵⁷ Direct Testimony of Falcone/King at 97–104.

¹⁵⁸ Direct Testimony of Falcone/King at 104–116.

¹⁵⁹ 10/25/07 Tr. at 183 (lines 11-19).

¹⁶⁰ *Id.* (lines 7-10).

¹⁶¹ *Id.* (lines 17-19).

¹⁶² Direct Testimony of Antonuk at 19-23.

that service agreements among the different corporate entities and affiliate transaction policies and procedures be established prior to close.¹⁶³

III. STANDARD OF REVIEW

The Commission as arbiter under RSA 363:17-a is tasked with weighing the interests of both the customers affected by the proposed transaction and the regulated companies undertaking the transaction. In its review, the Commission must assess the implications of Verizon's proposed discontinuance of service as well as the proposed transfer of assets to FairPoint.

Commission approval is subject to a "public good" standard. Under RSA 374:28, the Commission may authorize Verizon to discontinue service where the public good does not require further continuance of that service. At the same time, the Commission must find that the proposed transfer of Verizon's franchise, works or systems to FairPoint will be for the public good under RSA 374:30, and that the proposed stock transfers are lawful, proper and in the public interest under RSA 374:33.

The New Hampshire Supreme Court has found that to be in the public good, a proposed transaction "must be a thing reasonably to be permitted under all the circumstances of the case." *Grafton County Elec. Light & Power Co. v. State*, 77 N.H. 539, 540 (1915). As such, "[t]he question of public good is not to be answered by looking only to the immediate interests of the public served by these companies, nor by a mere consideration of advantage to those who furnish the service. ...it is a question of what is reasonable taking all interests into consideration." *Id.* at 542. Similarly, the Court has found that the "public good" as assessed under RSA 374:28 includes not only the needs of particular persons directly affected by curtailment of utility services, but also

¹⁶³ Direct Testimony of Antonuk at 37-38.

the needs of the public at large and the general welfare of the utility involved. *Boston & Maine Railroad v. State* (1959) 102 NH 9, 148 A2d 652.

While the New Hampshire Supreme Court has cautioned that “it is not for the public good that public utilities be unreasonably restrained of liberty of action, or unreasonably denied the rights as corporations which are given to corporations not engaged in the public service” (*Grafton County Elec.* at 540), the Court also recognized that the public good may require certain restrictions “for sound reason.” *Id.*

The Commission traditionally has applied a “no net harm” test to “ensure that the interests of ratepayers are balanced against the right of shareholders to be free of regulation which unreasonably restrains legitimate corporate activities.” *Re Hampton Water Works, Co.* 80 NH PUC 468, 473 (1995); see also *Aquarion Water Company of New Hampshire*, Order No. 24,691 (October 31, 2006), citing *Hampton Water Works, Inc.*, 87 NH PUC 104 (2002), *Consumers New Hampshire Water Co.*, 82 NH PUC 814 (1997), and *Eastern Utilities Associates*, 76 NH PUC 236 (1991). Toward that end, the Commission, in its review of transactions such as the one before it in this proceeding, “has a longstanding practice of evaluating the managerial, financial, and technical ability of the proposed transferee to operate a public utility.” *Hampstead Area Water Company, Inc.*, Order No. 24,803 (November 2, 2007) at 3.

Here, the Commission must review the proposed transfer of landline assets and operations and Verizon’s subsequent departure from the New Hampshire telephony market with a view toward the implications for New Hampshire customers and the New Hampshire telecommunications market as a whole. FairPoint’s managerial, technical, and economic capabilities should be foremost in the Commission’s thoughts as it reviews

the complex and wide-ranging issues raised by the proposed transaction. The Commission must assess FairPoint's capabilities not just as another telecommunications public utility entering the New Hampshire market – but as a telephone carrier assuming the statewide footprint and extensive regulatory obligations of the only ILEC in New Hampshire operating throughout the state. In light of all interests and all circumstances implicated by the petition, the Commission should consider whether the public good standard can be met through approval with certain conditions imposed on one or both of the companies that ensure minimal disturbance to the market and the continuing economic viability of Verizon's successor.

IV. CONCLUSIONS

A. The proposed transaction raises a number of issues the Commission should consider regarding FairPoint's managerial, technical and financial ability to assume Verizon's operations in New Hampshire.

The Commission is faced with a difficult choice. Verizon has asked the Commission to determine whether it is in the public interest to allow it to discontinue service. The company is no longer interested in providing public utility service in the state.¹⁶⁴ The record demonstrates, however, that Verizon has not adequately maintained the assets it seeks to transfer. Verizon has enjoyed the benefits of utility service through the boom times and now seeks to abandon ship and keep the gold. Verizon should not be allowed to discontinue service if the Commission is not convinced its successor has the managerial, technical and financial ability to provide safe, adequate and reliable service.

FairPoint, on the other hand, has asked the Commission to determine whether it is in the public interest to turn over stewardship of the public utility to it. The record demonstrates FairPoint is eager to improve things and ensure safe, adequate and reliable

¹⁶⁴ See, generally, 10/31/07 Tr. at 101-245 (Cross-Examination of Nestor).

service.¹⁶⁵ FairPoint's managerial team has sound experience, the right intentions, and appears to be technically competent. FairPoint has a plan to improve quality of service. Verizon does not. FairPoint has a plan to extend broadband to the most rural areas of the state. Verizon does not. These promises would make the transfer of utility assets in the public interest if the Commission could be sure the promises would be realized.

The primary concern is whether FairPoint is financially able to meet its commitments. The evidence establishes that FairPoint is highly leveraged as a result of the price it has agreed to pay Verizon. The financial risk is exacerbated by the price of the TSA and the uncertainty of the cost needed to repair the network and to complete the broadband plans.

The public interest requires Verizon to ensure the network is in adequate condition before it is allowed to discontinue service and leave behind unfulfilled obligations. The public interest also requires a finding that FairPoint is financially capable of providing safe, adequate and reliable service. Unless Verizon reduces the amount of FairPoint's debt, reduces the financial risk associated with an extended TSA, and ensures the network will be adequately restored to meet quality of service standards, the Commission cannot find this transaction to be in the public interest.

B. There are a number of conditions the Commission should impose to ensure the transaction is in the public good.

The Commission should not approve this transaction unless FairPoint and Verizon meet certain conditions that will ensure that New Hampshire customers are properly protected from the financial, managerial and technical concerns that the transaction raises.

¹⁶⁵ See PSNH Exh. 3P, NGrid Exh. 2P and Unitil Exh. 2P.

The Commission should impose a specific set of conditions to provide adequate assurances that Verizon is not leaving the New Hampshire wireline business under circumstances that impose too great a financial risk, given the difficult transition issues that FairPoint faces, its lack of financial reserve capability, and the shrinking market.

First, Verizon should be required to cause a \$200 million debt reduction as of closing and without cost to FairPoint. Second, FairPoint should be required to cut its dividends by 20% from their current per share level, in order to provide a source of cash flow to meet a \$30 million per year debt pay-down requirement. Such a dividend cut will ensure additional debt pay down of \$227 million over eight years of FairPoint's Northern New England operations (*i.e.*, the period covered by its financial model as presented in its testimony).

To address the financial risk of an extended TSA period, the Commission should also fix the price of the TSA, regardless of its length. The price of the TSA far exceeds the costs of the services it addresses, thereby offering an excessively large, additional source of profit to Verizon.¹⁶⁶ FairPoint's financial model assumes TSA services will cost \$115 million¹⁶⁷ which, at the current price, will allow only about 5 months of TSA service.¹⁶⁸ Both Verizon¹⁶⁹ and FairPoint¹⁷⁰ have testified that the assumption of four months on TSA services from close to cutover on May 30, 2008, is reasonable.

Cutover from the TSA may only occur every other month.¹⁷¹ Therefore, if the TSA extends beyond four months, FairPoint will have to pay for 6 months of service.

¹⁶⁶ See Labor Exh. 11 HC.

¹⁶⁷ 10/23/07 Tr. at 238 (lines 15-16 and line 23).

¹⁶⁸ 10/23/07 Tr. at 239 (lines 17-19).

¹⁶⁹ 10/24/07 Tr. at 220 (lines 2-9); see also Verizon Exh. 2P at 17 (lines 11-14).

¹⁷⁰ 10/23/07 Tr. at 237 (lines 4-5) and 239 (line 20) through 240 (line 1)

¹⁷¹ 10/30/07 Tr. at 27 (lines 13-17).

The monthly price for TSA service in the first 8 months is \$16.5¹⁷² million. Adding \$115 million for 5 months of service assumed in FairPoint's financial model and \$16.5 million for an additional month would cost FairPoint approximately \$131.5 million for 6 months of TSA service. FairPoint can withstand this level of TSA payment without undue financial risk, but it cannot withstand the additional TSA costs that will accrue if the TSA length extends beyond 6 months. Therefore, the price of the TSA should be capped at \$131.5 million, to mitigate the financial risk of an extended TSA.

To further assure that FairPoint's cutover occurs when it is fully ready, FairPoint must engage a third-party monitor, chosen by Staff, to review and assess its cutover readiness criteria in all dimensions, including systems, business processes, staffing, and training, and to monitor whether these readiness criteria have been met.

To assure service quality needs are addressed, FairPoint must provide the Commission a network improvement plan two months after close. FairPoint must also meet the New Hampshire service quality standards at the statewide level within nine months of close and at the central office level within twelve months. FairPoint has stated it would not pursue additional acquisitions until it is 100 percent confident its operations are providing high quality of service.¹⁷³ FairPoint should not be allowed to complete any future acquisitions until it has met service quality standards in New Hampshire for six consecutive months. Given the significant systems changes it plans to implement, FairPoint must agree to an audit of its service quality measurements, both those that apply to retail and those that apply to wholesale customers. In addition, FairPoint must be prevented from reducing its capital expenditure budgets from its current forecasted

¹⁷² 10/23/07 Tr. at 244 (line 13).

¹⁷³ 10/23/07 Tr. at 124-125.

levels, if it experiences financial reversals. Staff notes that FairPoint has reached memoranda of understanding with the electric utilities that have participated in this proceeding and believes that these address our concerns about pole maintenance.

Verizon must be required to provide funds that can be used to bring the network up to quality standards. The Commission opened docket number DT 04-019 on Verizon's service quality in 2004. At the time, Verizon argued service quality in 2003 was uncharacteristic.¹⁷⁴ According to Balhoff rebuttal testimony Verizon's highest non-FIOS capital investment in recent years occurred in 2004 during which Verizon invested \$172 million in northern New England (NNE).¹⁷⁵ Verizon's quality of service improved in 2004 and then declined.¹⁷⁶ Before discontinuing its utility obligations in New Hampshire, Verizon should be required to contribute \$35 million to FairPoint's capital fund at close, approximately half of New Hampshire's proportionate share of the 2004 NNE annual capital investment, to ensure Verizon pays for network problems it is leaving behind.¹⁷⁷

The existence of competition in the more populous areas of the state should provide the correct incentives for FairPoint to address the needs of the customers in these areas. However, one of the key potential advantages of this transaction would be the extension of broadband availability to the rest of the state. To make sure that this occurs, FairPoint should be required to meet specific broadband availability objectives, with a clear commitment that "broadband availability" means that FairPoint can provision DSL

¹⁷⁴ See NHPUC Order No. 24,551 (December 1, 2005).

¹⁷⁵ FairPoint Exh. 12P at 11 (line 4).

¹⁷⁶ OCA Exh. 2C at 282.

¹⁷⁷ See, for example 10/31/07 Tr, at 125 (lines 5-14) and 10/29/07 Tr. at 119 (lines 7-16).

or any other technology it chooses to implement at speeds of no less than 1.5 Mbps in the downstream direction within standard provisioning intervals. The objectives should be:

- 75% of access lines have broadband availability within 18 months of close.
- 85% of access lines have broadband availability within 24 months of close.
- 95% of access lines have broadband availability within 60 months of close.

As we have noted, there is considerable uncertainty about how much it will cost FairPoint to meet these targets, as evidenced by the continually changing and increasingly costly numbers in FairPoint's plans. We have also noted that this uncertainty results from the limited information Verizon has provided FairPoint and FairPoint's incomplete due diligence. Therefore, as Staff witness John Antonuk recommended in his supplemental testimony, Verizon must provide funds beyond \$21.6 million (150 percent of FairPoint's original estimate) to ensure that FairPoint can meet the 85% availability goal.¹⁷⁸ However, in order to provide a reasonable ceiling to the amount of Verizon's obligations, we propose that Verizon place \$20 million in escrow, with any unused amount to be returned to Verizon when FairPoint achieves 85% availability.

This transaction must not leave either retail or wholesale customers worse off than they are currently under Verizon's management. Therefore, the Commission should impose the conditions in item 14 that Mr. Antonuk recommended in Attachment A of his supplemental testimony.¹⁷⁹ Staff recognizes that many of the wholesale conditions Mr. Antonuk has proposed are included in the stipulation that FairPoint has reached with some CLECs,¹⁸⁰ but not all the requirements in the stipulation apply to all wholesale customers. In addition to what is included in the CLEC stipulation, FairPoint must

¹⁷⁸ See Staff Exh. 4 at Appendix A, item 3.

¹⁷⁹ See Staff Exh. 4 at Appendix A, item 14.

¹⁸⁰ See FairPoint Exh. 15.

provide all wholesale products and services that Verizon currently offers pursuant to RSA 378:1.

Besides the list of conditions for maintaining retail service quality that are contained in item 14 in Mr. Antonuk's recommended conditions, the Commission should require that FairPoint make no retail rate increases for three years after close.

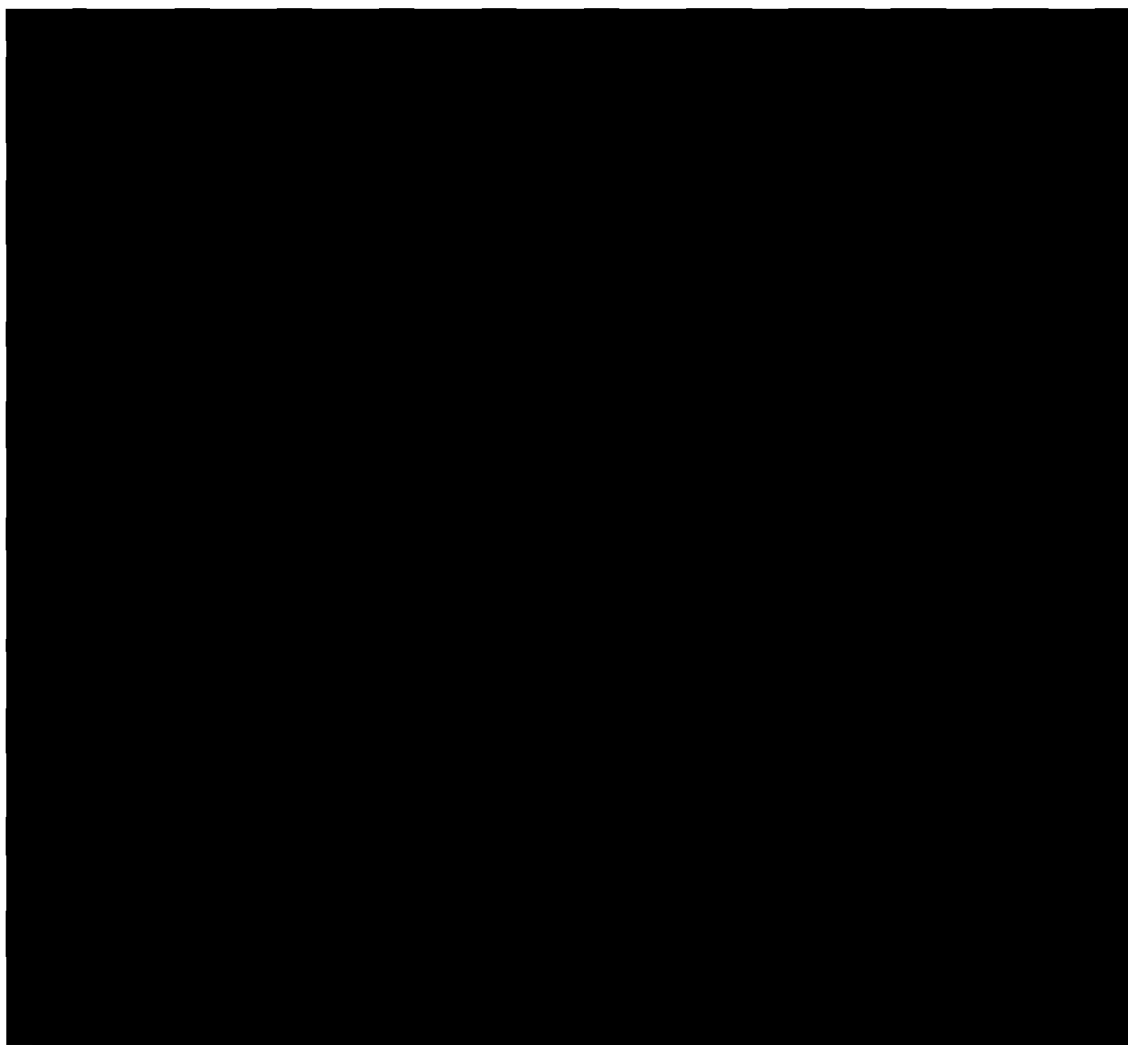
Finally, the Commission should adopt the conditions recommended by Mr. Antonuk to address governance issues in items 15 and 16 of his supplemental testimony.¹⁸¹

¹⁸¹ See Staff Exh. 4 at Appendix A, items 15 and 16.

ATTACHMENT A

The following chart summarizes the effects of the three measures proposed in section II.A.11 to ensure FairPoint's future financial viability.

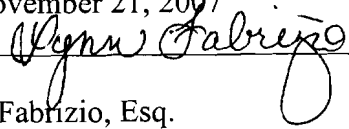
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Respectfully submitted
On behalf of the Commission Staff

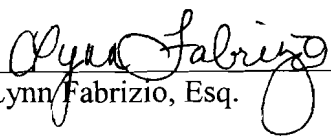
On November 21, 2007

By 

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Certificate of Service

I hereby certify that a copy of the foregoing brief has been sent on this 21st day of November 2007 either by first-class mail or by e-mail to the parties on the service list in the above-captioned matter.


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