BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holdings, Inc., and Verizon Communications Inc. for Consent and Approval of a Change in Control.	)))))	Case No. 09-454-TP-ACO

OPINION AND ORDER

The Commission, after reviewing the testimony, public comments, briefs, and stipulations, hereby issues its opinion and order in this case.

APPEARANCES:

Mr. Thomas E. Lodge and Ms. Carolyn S. Flahive, 41 South High Street, Suite 1700, Columbus, Ohio 43215-3435, on behalf of Frontier Communications Corporation and Verizon Communications, Inc.

Mr. A. Randall Vogelzang, 600 Hidden Ridge, P.O. Box 152092, Irving, Texas 75015-2092, and Mr. Joseph M. Ruggiero, 1320 North Court House Road, Floor 9, Arlington, Virginia 22201-2525, on behalf of Verizon Communications, Inc.

Mr. Kevin Saville, 2378 Wilshire Boulevard, Mound, Minnesota 55364, on behalf of Frontier Communications Corporation.

Mr. Scott J. Rubin, 333 Oak Lane, Bloomsburg, Pennsylvania 17815, on behalf of the International Brotherhood of Electrical Workers Local 986 and the Communications Workers of America.

Ms. Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Mr. Terry E. Etter, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215-3485, on behalf of Ohio residential consumers.

Carpenter, Lipps & Leland LLP, by Mr. Mark A. Whitt and Mr. Joel E. Sechler, 280 Plaza, Suite 1300, 280 North High Street, Columbus, Ohio 43215 and Davis, Wright, Tremaine LLP, by Mr. K.C. Halm and Mr. Michael Sloan, 1919 Pennsylvania Avenue NW, Suite 200, Washington, D.C. 20006-3402, on behalf of Comcast Phone of Ohio.

Richard Cordray, Attorney General, by Mr. Thomas W. McNamee and Mr. John Jones, Assistant Attorneys General, 180 East Broad Street, Floor 6, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission of Ohio.

BACKGROUND

On May 29, 2009, Frontier Communications Corporation (Frontier), New Communications Holdings, Inc., (NCH) and Verizon Communications Inc. (Verizon) (the applicants) filed a joint application, pursuant to Section 4905.402, Revised Code, seeking approval of a change in ownership whereby Frontier will acquire control of Verizon North Inc. (Verizon North), a domestic telephone company. The applicants also seek approval of the transfer of certain long distance customers from Verizon North, Verizon Long Distance LLC (Verizon Long Distance), and Verizon Enterprise Solutions LLC (Verizon Enterprise) to Frontier.

In the application, the applicants state that Frontier is a Delaware corporation. Frontier describes itself as one of the largest providers of service to rural communities and smaller cities. Serving customers in 24 states, it offers, among other services, telephone, television, and Internet services. With approximately 5,600 employees, Frontier states that it serves a total of 2.8 million voice and broadband connections, including 2.3 million access lines. Financially, Frontier reports that in 2008 it earned revenue of $2.2 billion, with a net income of $182.7 million (Joint Application 4).

Frontier states that, although it is not a regulated telephone company in Ohio or elsewhere, it has local telephone subsidiaries that are regulated by the Federal Communications Commission (FCC) and by the states in which they are located. Frontier points out, for example, that Frontier Communications of Michigan, Inc. is an operating subsidiary of Frontier that provides service to approximately 500 access lines in the Cooney Exchange in Williams County, Ohio. Frontier Communications of America, Inc. is a subsidiary of Frontier that provides long distance service throughout Ohio (*Id.*).

Verizon is a Delaware corporation whose subsidiaries provide regulated and unregulated telecommunications services in various locations in the United States and foreign countries. Verizon subsidiary incumbent local exchange carriers (ILECs) provide service in 26 states, including Ohio (*Id.*).

According to the joint application, Verizon is not a regulated telephone company in Ohio or elsewhere. Like Frontier, Verizon has ILEC subsidiaries or operating companies that are regulated by the FCC and by the states in which they are located. Verizon North is one of Verizon's subsidiaries. Verizon North provides local telephone service, access service, and intraLATA (local access and transport area) toll service in Ohio between its own exchanges and the exchanges of other local exchange carriers (LECs). The applicants describe Verizon North as a "domestic telephone company" within the meaning of Section 4905.402, Revised Code (Joint Application 4-5).

Verizon Long Distance is a Verizon subsidiary that provides long distance telecommunication services pursuant to Certificate No. 90-5680. According to the application, Verizon Long Distance will not become an affiliate of Frontier. However, Verizon Long Distance customers who are located in Verizon North territory will be transferred to New Communications Online and Long Distance, Inc. (NewLD) (Joint Application 5).[1]

Verizon Enterprise is a Verizon subsidiary that provides long distance telecommunication services in Ohio pursuant to Certificate No. 90-5721. Similarly, Verizon Enterprise will not become an affiliate of Frontier. As with Verizon Long Distance, Verizon Enterprise customers who are located in Verizon North territory will be transferred to NewLD (Joint Application 5-6).

Some Verizon affiliates will not be involved in the transaction. They include Verizon Select Services Inc., Verizon Wireless, MCImetro Access Transmission Services LLC dba Verizon Access Transmission Services, and MCI Communications Services, Inc. dba Verizon Business Services. None of these companies will be transferred to Frontier (*Id.*).

<u>THE TRANSACTION</u>

In describing the transaction, the applicants state that on May 13, 2009, Frontier, Verizon, and NCH entered into a merger agreement whereby Frontier intends to acquire approximately 4.8 million access lines and certain related assets currently owned by Verizon subsidiaries in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, Wisconsin, West Virginia, and California. In addition to entering into a merger agreement, Frontier and NCH entered into a Distribution Agreement. The agreements are designed to facilitate the transaction by establishing NCH as a holding company for Verizon's local and long distance companies, spinning off the stock of the new entity to Verizon shareholders, and merging NCH into Frontier.

NCH is currently a subsidiary of Verizon. Through two subsidiaries,[2] NCH will, on the one hand, own the stock of Verizon ILECs and, on the other hand, will hold the accounts receivables, liabilities, and customer relationships related to long distance operations. After NCH acquires the stock of Verizon subsidiaries, it will distribute the stock to Verizon shareholders, effectively a "spin off" from Verizon to Verizon's stockholders. Immediately afterward, NCH will merge with Frontier and will cease to

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1 By application filed on May 29, 2009, under Case No. 09-455-TP-ACE, NewLD seeks authority to provide long distance telecommunication services in Ohio.

2 The subsidiary NCIH will own the stock of Verizon North and other operating ILECs. NewLD will hold long distance and other operations. (Joint Application 9).

exist after the merger is complete. Frontier will be the surviving holding company, holding the stock of NCIH and NewLD. It will continue with its existing name and corporate structure. Frontier will manage Verizon's assets through its board of directors and management personnel.

As a result of the merger, Verizon North will become an indirect, wholly owned subsidiary of Frontier. Because Frontier will not operate under the Verizon name in any state, Verizon North will be renamed.

According to the application, Frontier and Verizon will operate independently, subject to review and approval by regulatory and government authorities. After the transaction, the applicants point out that Verizon North will remain intact. Verizon North's authorizations and licenses will remain in place. There will be no change in rates, terms, or conditions for any services provided in Ohio. No lines, plant, franchises, permits, or operations will be merged between Frontier and Verizon North. The applicants claim that the transaction does not involve the merger of any telephone companies. The applicants further claim that there will be no interruption in the provision of long distance services.

The applicants assure the Commission that the transaction will promote public convenience. As a result of the transaction, Frontier proclaims that it will become the fifth largest ILEC in the United States. It will serve predominately rural communities and will have 8.6 million voice and broadband connections, including more than seven million access lines generating $6.5 billion in revenues. Frontier expects to become the largest provider of voice, broadband, and video services focused on rural to smaller city markets in the United States.

Frontier proclaims that it has a successful track record of acquiring, operating, and investing in telecommunications properties nationally. It claims to have also successfully integrated and consolidated other telecommunications operations.

The applicants pledge that the transaction will be transparent to customers of Verizon North and customers of the affected Verizon long distance service providers. Frontier will use the same operational systems, including ordering and billing. There will also be an effort to ensure continuity in billing, customer account systems, and plan record systems. With respect to wholesale operations, Frontier assures the Commission that there will be no adverse impact upon wholesale customers. Frontier will retain all obligations under Verizon's current interconnection agreements and other arrangements.

In its application, Frontier promised that its operations will be managed by employees who are not only knowledgeable of local telephone businesses, but also have a commitment to the needs of the local community. In addition, Frontier intends to back its operations with experienced executives and local managers. Frontier also plans to provide a smooth transition for employees by retaining experienced and dedicated employees. Moreover, Frontier intends to honor the union labor agreements in affected states.

Frontier emphasizes that the proposed transaction will promote the deployment of broadband in Ohio. Frontier anticipates that the transaction will generate greater cash flow, reduce its debt, and lead to an increase in its financial strength, thus improving access to and lowering the cost of capital. As a strategy to counter the ten percent access line loss per year experienced by Verizon North, Frontier intends to increase the deployment of broadband in the rural areas that it intends to serve. Frontier states that it has made broadband available to over 90 percent of its customers in its existing service areas. By comparison, Verizon's operating companies offer broadband to about 60 percent of the homes and businesses in the areas that Frontier seeks to acquire.

PROCEDURE

By entry issued June 17, 2009, the Commission suspended this case. Several parties moved to intervene. The Office of the Ohio Consumers' Counsel (OCC) filed a motion to intervene on June 1, 2009. In addition, the OCC filed a motion on August 18, 2009, urging the Commission to deny the application or, in the alternative, impose conditions on the merger. Cincinnati Bell Extended Territories LLC (CBET) filed a motion to intervene on June 5, 2009. The International Brotherhood of Electrical Workers Local 986 (IBEW) moved to intervene on June 18, 2009. The Communications Workers of America (CWA) filed a motion to intervene on June 19, 2009. Comcast Phone of Ohio, LLC (Comcast) filed a motion to intervene on July 17, 2009. Notwithstanding the applicants' memoranda contra, the Commission granted the motions to intervene by entry issued August 24, 2009. On August 20, 2009, Level 3 Communications, LLC (Level 3) filed a motion to intervene. The Commission granted the motion on September 21, 2009.[3]

On July 9, 2009, the applicants filed direct testimony in support of the application. In its August 24, 2009, entry, the Commission directed the applicants to file supplemental testimony addressing certain issues by September 8, 2009. Other parties could respond to the applicants' direct and supplemental testimony by October 8, 2009. The Commission allowed the applicants to file rebuttal testimony by October 29, 2009. By entry issued September 23, 2009, the Commission granted the OCC's September 18, 2009, motion to extend the dates for filing responses and rebuttal testimony to October 14, 2009, and November 4, 2009, respectively.

The Commission scheduled six local public hearings. Pursuant to an entry issued August 24, 2009, the attorney examiner held local public hearings in New Philadelphia,

3 Level 3 filed a notice of withdrawal from this proceeding as an intervenor on December 4, 2009.

Marion, and Portsmouth on September 8, 9, and 10, 2009, respectively. By entry issued September 17, 2009, the attorney examiner held local public hearings in Troy, Athens, and Norwalk on October 6, 7, and 8, 2009, respectively.

After considering the testimony filed by the parties and the information gathered from the local public hearings, the Commission directed that an evidentiary hearing be conducted to decide the issues. Accordingly, the Commission issued an entry on October 28, 2009, directing the attorney examiner to schedule an evidentiary hearing. On November 10, 2009, the attorney examiner issued an entry scheduling a hearing for December 8, 2009. Upon joint motion of the parties, the attorney examiner continued the hearing date to December 9, 2009. The attorney examiner conducted a hearing on December 9, 2009. The parties filed briefs on January 8, 2010.

ISSUES

Section 4905.402(B), Revised Code, states in pertinent part as follows:

> No person shall acquire control, directly or indirectly, of a domestic telephone company or a holding company controlling a domestic telephone company unless that person obtains the prior approval of the public utilities commission under this section. To obtain approval the person shall file an application with the commission demonstrating that the acquisition will promote public convenience and result in the provision of adequate service for a reasonable rate, rental, toll, or charge. The application shall contain such information as the commission may require. If the commission considers a hearing necessary, it may fix a time and place for hearing. If, after review of the application and after any necessary hearing, the commission is satisfied that approval of the application will promote public convenience and result in the provision of adequate service for a reasonable rate, rental, toll, or charge, the commission shall approve the application and make such order as it considers proper.

Under the authority of Section 4905.402(B), Revised Code, the Commission, in its August 19, 2009, entry set forth the following issues upon which it would adjudicate the merits of the application: transactional synergies and financial considerations, in-state presence, quality of service, and competition and wholesale operations. Though lacking jurisdiction over the matter, the Commission also expressed an interest in the applicants' commitment to the expansion of broadband services. With regard to the issues over which it has jurisdiction, the Commission stated the following:

TRANSACTIONAL SYNERGIES AND FINANCIAL CONSIDERATIONS: The applicants should demonstrate that the synergies resulting from the proposed transaction will benefit Ohio subscribers and that Frontier will be a financially sound entity once the transaction is completed.

IN-STATE PRESENCE: The applicants must explain their plans for preserving the existing in-state corporate presence and, in particular, the level of autonomy and local decision-making abilities, which are important relative to serving local customers. The applicants must explain how the proposed transaction will affect the companies' employment levels in the State of Ohio, and where specifically growth or cuts in these levels will occur.

QUALITY OF SERVICE: The Commission seeks to ensure that the proposed transaction does not create the potential for the deterioration of customer service and service quality for end users. Rather, there is the expectation that the proposed transaction will result in customer service and service quality that meets or exceeds current service standards, ensures the provisioning of adequate service for a reasonable rate, and that the applicants continue to make improvements in customer service and service quality as necessary. The applicants should demonstrate how the transaction will satisfy these customer service and service quality objectives relative to Ohio customers, with special attention focused on residential subscribers. The applicants should further demonstrate that quality of service will not be harmed up to and throughout the transition period.

COMPETITION AND WHOLESALE OPERATIONS: The Commission seeks to ensure that the change in control does not create the potential for the deterioration of customer service and service quality for its competitors. There is the expectation that the proposed transaction will result in improvements such that the new entity will be able to provide adequate service to its competitors that meets its obligations under the current interconnection agreements. Specifically, the Commission seeks to ensure the provisioning of adequate service by staffing adequate field personnel in Ohio to keep up with the installation and repair activity as necessary.

STIPULATIONS

On December 8, 2009, after negotiations, the applicants, the Commission's staff, the OCC, CBET, and Comcast filed stipulations recommending approval of the application with certain commitments. The applicants, the Commission's staff, and the OCC filed a Stipulation that embodies a comprehensive settlement between the parties. CBET joined the Stipulation by filing a separate concurrence. Comcast entered into a separate agreement with the applicants and filed a separate Stipulation (Comcast Stipulation). The IBEW and the CWA (the Unions) did not enter into a stipulation and remain opposed to the application.

The applicants' Stipulation with the Commission's Staff and the OCC provides that Frontier North[4] will develop and implement a Broadband Program for the deployment of broadband services throughout the Verizon North service area (VNSA). By December 31, 2013, Frontier North intends to implement broadband service of at least one megabit per second (mbps) download to 85 percent of the households within the VNSA. Frontier North will target unserved areas and will work with the Commission's Staff and the OCC to define the geographic scope of broadband service.

For each of the three years following the closing of the merger, Frontier North agrees to make capital investments within the VNSA at an average rate of at least $110 per access line or $50 million overall, whichever results in a greater total capital investment. If broadband facilities are not available to 80 percent of the households within the VNSA by December 31, 2012, this agreement shall be extended for one additional year from the merger closing date.

Frontier North will not pursue any right or opportunity to increase Tier 1, residential, basic local exchange rates in the VNSA for the duration of the Broadband Program. The commitment does not, however, apply to bundled service offerings that include basic local exchange service. To maintain quality of service, Frontier North will track and report periodically to Staff and the OCC on its performance in four key areas: troubles/100 access lines, repeat troubles, out-of-service restoral, and service affecting conditions restoral. As an incentive to comply with the four identified metrics, the Stipulation provides for quarterly reports and financial forfeitures for noncompliance. Frontier North's commitments to quality of service shall remain in effect for three years after the merger close.

The Stipulation also addresses wholesale services, operations support systems, and facilities. With respect to interconnection agreements and wholesale tariffs, Frontier North commits to maintain the terms of current interconnection agreements and intrastate special access tariffs in the VNSA for a period of 24 months following the merger close, unless permitted to do otherwise by a change in federal or state law. Requesting carriers may extend their existing interconnection agreements at the merger close even if the initial term of the agreement has expired. Carriers may opt for such an extension until at least 30 months from the merger close. This commitment does not apply where a carrier requests reopening or renegotiation of an existing agreement. Frontier North will continue to provide information to wholesale carriers concerning wholesale operations support systems and wholesale business practices via the competitive local exchange carrier (CLEC) Manual, industry letters, and the change management process. Frontier North will also continue to use the CLEC User Forum process. For wholesale carriers, Frontier

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4 Frontier North refers to Verizon North as owned and operated by Frontier after the merger closure date.

North will provide training and education on any wholesale operations support systems implemented by Frontier North after the merger is closed. A change management process (CMP) will remain in place along with monthly CMP meetings.

Verizon North will replicate its existing systems and transfer existing data to the replicated systems. Testing will take place prior to the systems being put into use. Upon successful testing, Verizon North will separate and transfer the CLEC customer operations support systems to Frontier North. After the separation and transfer, Verizon North will use the CLEC operations support systems for at least 60 days prior to the closing to confirm that the systems are fully operational. The closing will not occur until the systems are fully operational. Frontier will not replace these systems during the first three years after the close of the merger unless it provides 180 days prior notice to the Commission and to the CLECs.

In the retail arena, Verizon North will share with the Commission's Staff and the OCC the "Program Test Strategy" Plan that will be used to review the replicated systems. Verizon North will also share the results of pre-production functionality tests on systems that serve retail telecommunications customers. Prior to the merger closing, Verizon North will share with the Commission's Staff and the OCC production results of the customer-affecting systems that serve retail telecommunications customers. The results must meet certain benchmark requirements and will be validated by an independent third-party reviewer. For three years following the merger closing, Frontier North commits to provide the Commission's Staff and the OCC quarterly reports concerning material business and repair office operations and billing systems issues.

The Comcast Stipulation provides terms for testing operations support systems. Comcast seeks to ensure that replicated operations support systems are fully operational. To do so, the Comcast Stipulation provides for the testing of retail and wholesale service provisioning. The Comcast Stipulation specifies additional terms that seek to maintain for a definite period seamless continuity of current services, interconnection agreements, and other arrangements without significant changes in costs, rates, or terms of service.

TESTIMONY AND BRIEFS

A. Applicants' Direct Testimony

1. Mr. Timothy McCallion

At the hearing, Verizon presented the testimony of Timothy McCallion to support its application. Mr. McCallion is Verizon's West Region president (Joint Ex. 2, p. 1). In his direct testimony, Mr. McCallion asserted that the proposed transaction will promote public convenience and result in the provision of adequate service at reasonable rates. As reasons, Mr. McCallion pointed out that the Commission will retain its regulatory authority (Joint Ex. 2, p. 7-8). Because Frontier North will have the same tariffs and services offered under the same rates, terms, and conditions, retail customers will not be affected by the transaction (*Id.* at 8-9). Similarly, wholesale customers will not be affected because existing interconnection agreements and commercial wholesale agreements will remain in place (*Id.* at 11). To effect a smooth transition, Verizon and Frontier will coordinate billing, customer account systems, and plant record systems (*Id.* at 15). To ensure further the smooth transition of services, Verizon North's more than 1,000 employees will be transferred to Frontier North (*Id.* 16). As an additional means of providing a smooth transition, Verizon North will replicate its existing support systems that it uses to provide retail and wholesale services in Ohio and transfer the replicated systems to Frontier North as physically separate and functional systems. Mr. McCallion distinguished this approach from the ones used by FairPoint Communications, Inc. and Hawaiian Telcom. He believes that those operations failed in part because the companies created and deployed new untested systems that resulted in service disruptions and financial problems (*Id.* 16-24).

2. Mr. Daniel McCarthy

Mr. Daniel McCarthy is the Executive Vice President and Chief Operating Officer for Frontier (Tr. 107-108). In his direct testimony, he explained how the transaction satisfies Section 4905.402, Revised Code. After describing Frontier, Mr. McCarthy testified concerning the financial soundness of the transaction. For revenue and income, Mr. McCarthy states that Frontier posted revenue of $2.2 billion with a net income of $182.7 million in 2008. For the first quarter of 2009, Frontier posted revenue of $538 million with a net income of $36.3 million. In 2008, Mr. McCarthy reported that Frontier generated cash flow of $493.2 million. Through March 31, 2009, the company generated $146.1 million. Mr. McCarthy also highlighted Frontier's stockholder value, noting that in 2008 the company repurchased $200 million of its own common stock and paid shareholders an annual dividend of $1.00 per common share. This represents a 65 percent payout (Joint Ex. 5 p. 13).

Pointing to the company's growth, Mr. McCarthy stated that the company added approximately 20,100 new high-speed Internet customers. As of March 31, 2009, the company had approximately 600,000 high-speed data customers and approximately 771,000 customers subscribed to a bundle or package of services. Beginning in 2005, Frontier offered television services. By March 31, 2009, Mr. McCarthy reveals that the company had approximately 146,000 customers buying a package of telephone and video services (Joint Ex. 5, p. 13).

Further analyzing the financial metrics, Mr. McCarthy concluded that Frontier would be stronger after the transaction. Turning attention to the leverage ratio (net debt divided by earnings before interest, taxes, depreciation and amortization, or EBITDA), Mr.

McCarthy projected a decrease from 3.8 times to 2.6 times. This, he testified, approaches investment grade. As a result, Mr. McCarthy expects Frontier to improve its access to capital markets, improve the management of its balance sheet, and enable it to invest in new products for its customers (Joint Ex. 5, p. 24, 57).

Praising Frontier's commitment to broadband, Mr. McCarthy declares that, nationally, Frontier has a proven record of achieving significantly higher rates of broadband availability in its service areas. Frontier claims that it has made broadband available to over 90 percent of the households in the areas that it serves. In Ohio, Frontier claims a rate of 85 percent availability (Joint Ex. 5, p. 29).

Citing other benefits of the transaction, Mr. McCarthy notes one of Frontier's customer service program options where the company provides and installs computers as a promotion for broadband service subscribers. By increasing its size and scale, Frontier expects to increase its efficiency and improve its service to customers. Frontier intends to design service bundles to address a broad spectrum of telecommunication needs. Furthermore, Frontier claims that it has a proven track record in successfully serving rural communities and smaller to moderately sized cities (Joint Ex. 5, p. 57-58).

B. Applicants' Supplemental Testimony

On August 19, 2009, the Commission issued an entry in which it identified certain issues to be addressed in this proceeding. In response to the Commission's direction, on September 8, 2009, the applicants filed the testimony of Mr. McCallion and Mr. McCarthy.

1. Mr. Daniel McCarthy

Mr. McCarthy discussed the financial position of Frontier before and after the transaction. Mr. McCarthy asserts that a major benefit of the transaction comes from deleveraging. Deleveraging will propel the company toward an investment grade rating. Moreover, Frontier will be able to generate relatively higher and more predictable cash flows from a combined business. After the transaction, Frontier also expects to improve its access to capital markets, obtaining more cost-effective pricing for financial resources. Owing to an improved financial position, Frontier hopes to secure the financing that is necessary to complete the transaction (Joint Ex. 6, p. 7).

Responding to objections over Frontier's acquiring additional debt in the amount of $3.3 billion, Mr. McCarthy emphasizes that the company will experience an offset of increased revenues from $2.37 billion to over $6.5 billion. Without including any anticipated synergies, Frontier expects an increase in EBITDA from $1.2 billion to over $3.1 billion. With synergies, the combined EBITDA increases to $3.6 billion, using 2008 results (*Id.* at 8-9). By comparison, Mr. McCarthy refers to the acquisition involving CenturyTel and Embarq where CenturyLink (the new combined entity after the merger) retained an investment grade credit rating after increasing its net debt load by $5.8 billion to a total of $8.8 billion. According to Mr. McCarthy, it is insufficient to analyze debt alone. For further comparison, Mr. McCarthy refers to AT&T and Verizon at the end of the second quarter of 2009 where AT&T had a net debt of approximately $69.4 billion and Verizon's debt was over $64 billion in net debt; nevertheless, both companies retained investment grade ratings (*Id.* at 9). In comparing Frontier's leverage ratio with other ILECs, Mr. McCarthy concludes that Frontier compares favorably (*Id.*).

Relying on credit rating agency reports, Mr. McCarthy proclaims that Frontier has received favorable ratings from Moody's Investor Service and Fitch Ratings (Joint Ex. 6, p. 7-8). Moreover, Mr. McCarthy's analysis of the post-transaction financial data shows that Frontier compares favorably to CenturyLink and other industry peers (*Id.* at 18). Frontier distinguishes itself from Fairpoint and Hawaiian Telecom because their back-office systems proved to be expensive and insufficient, leading to a loss of customers and revenue (*Id.* at 31, 34).

Considering synergies, Frontier expects to realize on a consolidated basis in 2013 approximately $500 million in pre-tax synergies from this transaction (*Id.* at 22). Based on past transactions, Frontier believes the anticipated cost savings are reasonable and achievable (*Id.* at 23-25). Frontier reports that independent analysts, such as Stifel Nicolaus and UBS Investment Research, have supported Frontier's cost savings expectations (*Id.* at 25-26). Frontier contends that the expected synergies are not necessary for the success of the transaction. Even without realizing the predicted synergies, Frontier claims that it will generate significantly greater cash flow and achieve a significantly lower leverage ratio (*Id.* at 26-27).

In regards to in-state presence, Frontier highlights that Verizon expects that approximately 1,100 Verizon North service and support employees in Ohio will continue as employees with Frontier North (*Id.* at 38-39). Moreover, Frontier North, for 18 months after the close of the transaction, will not terminate any installers or technicians. Frontier North will also maintain a senior-level general manager in Ohio with significant decision-making authority and local presence (*Id.* at 39). In addition, Frontier North plans to have at least two substantial centralized operational and administrative locations in Marion and Norwalk, Ohio (*Id.* at 38).

2. Mr. Timothy McCallion

Addressing quality of service, Mr. McCallion alluded to Verizon North's compliance with the Minimum Telephone Service Standards (MTSS). He explained that in 2006-07 the Commission's staff conducted an investigation into Verizon North's compliance with the MTSS. A result of the investigation was Verizon North entering into a stipulation regarding the company's MTSS compliance. The Commission approved the stipulation (Joint Ex. 3, p. 4). He provides further that in 2008 the Commission's staff filed a report that determined that Verizon North had complied with its obligations under the stipulation. Referring to *In the Matter of the Settlement Agreement Between the Staff of the Public Utilities Commission of Ohio and Verizon North Inc.*, Case No. 07-511-TP-UNC (Case No. 07-511-TP-UNC), Mr. McCallion adds that the Commission issued an entry accepting the report and closed the case (Joint Ex. 3, p. 4). Since the closing of the case, Mr. McCallion proclaims that Verizon North has continued to meet the standards set forth in the stipulation. Mr. McCallion testified that he does not expect service quality to suffer as a result of the transaction because Frontier intends to retain existing Verizon North employees who know the network and the customers that they serve (*Id.* at 4-5).

Reporting on competition and wholesale operations, Mr. McCallion noted that Verizon North currently has approximately 120 interconnection agreements with CLECs and wireless carriers in Ohio. Since 2000, there has never been a finding that Verizon North breached any agreement (Joint Ex. 3, p. 6). He pointed out further that Verizon North measures its wholesale services performance with its Performance Incentive Plan. The Performance Incentive Plan measures 136 metrics for pre-ordering, ordering, provisioning, maintenance, network performance, billing, and collection. Mr. McCallion reports that Verizon North met over 96 percent of the plans metrics (*Id.* at 7). Frontier North does not expect any deterioration in wholesale service quality. Moreover, Frontier North intends to assume the responsibility for providing wholesale service under Verizon North's applicable tariffs and interconnection agreements that are in effect at the time of the closing (Joint Ex. 6, p. 43). Furthermore, Frontier North commits to adhering to the same rates, terms, and conditions, along with the service quality benchmarks contained in the agreements (*Id.*).

C. Unions' Arguments

On January 8, 2010, the Unions filed a joint brief opposing the proposed transaction. The Unions state that they represent approximately 1,000 employees of Verizon North (Union Ex. 1, p. 1). The primary concern of the Unions is that Frontier will not be financially fit to own and operate Verizon's landline operations. According to the Unions, a relevant inquiry is whether a new entity is financially fit by objective criteria and how a proposed new owner's financial condition compares to the present owner (Union Br. 5). The Unions conclude that the proposed transaction fails both tests. First, the Unions point out that Frontier does not have an investment-grade bond rating. Second, the Unions highlight that Frontier's revenue and income have been in a steady decline. The Unions accuse Frontier of fashioning a business model where it uses its operating utilities as cash machines to generate extraordinarily high dividend payments for shareholders rather than investing in the communications network. The Unions also believe that Frontier's financial condition, before and after the transaction, is significantly weaker than Verizon's financial condition (Union Br. 5-6). In support of their contention, the Unions claim that from 2004 through 2008 Frontier paid nearly $3 billion to its stockholders, while earning about $1 billion (Union Ex. 1, Sch. 4). The Unions further claim that the trend worsened in the first half of 2009, where the company paid $156 million to stockholders while earning $65 million in net income (Union Ex. 1, p. 19). Similarly, with regard to infrastructure, the Unions emphasize that Frontier pays more to stockholders than it reinvests in infrastructure. As an example, the Unions cite that from 2005 through 2008, Frontier made capital improvements of $1.1 billion while paying stockholders more than $2.1 billion (Tr. 133-134). The Unions believe that Frontier's high-dividend, low-investment practice is unsustainable and will expose the company to high financial risk (Labor Ex. 1, p. 20-21; Union Br. 9-10). Moreover, the Unions believe that Frontier is "eating itself alive" by paying out more in dividends than it earns (Union Br. 27). As an example, the Unions state that in 2001 Frontier had net property, plant, and equipment of $4.5 billion. Currently, its property is valued at $3.1 billion. The Unions expect yearly declines to continue (Union Br. 27; Union Ex. 1, Schs. 3 and 7).

By contrast, the Unions praise Verizon for having a more appropriate business practice. Instead of transferring most of its earnings to investors, the Unions commend Verizon for reinvesting in its landline business and updating its network with new technology. Verizon has been reinvesting between 77 percent and 96 percent of the cash it receives from depreciation compared to Frontier's 51 to 58 percent (Union Ex. 1, Sch. 13). More conservatively than Frontier, Verizon's dividends range between 76 percent and 86 percent of its net income (Union Ex. 1, Sch. 12). During 2008, Frontier paid dividends equal to 174 percent of its net income. In the first half of 2009, Frontier paid 240 percent of it profits (Union Ex. 1, p. 19). Moreover, Verizon maintains an investment-grade bond rating, whereas Frontier does not (Tr. 113).

The Unions criticize Frontier for failing to obtain the more than $3 billion to complete the transaction. The Unions point out that Frontier must issue approximately $3.1 to $3.3 billion in new debt in order to make a cash payment to Verizon. At this time, Frontier neither has the cash nor a commitment from a lender for the necessary financing (Tr. 135-136). Mr. McCarthy explained that obtaining a commitment prior to the transaction would require fees of 70 to 80 million dollars that could otherwise be invested in infrastructure (Tr. 135). Nevertheless, the Unions regard it as incredible and unprecedented that a transaction would be undertaken without knowing financing terms such as interest rate, debt service requirements, security requirements, business restrictions, or other lender terms and conditions (Union Br. 12).

Added to their concern regarding the $3.1 to $3.3 billion payment to Verizon, the Unions point out that Frontier expects to triple its line of credit (from $250 million to at least $750 million) to be able to operate Verizon's properties (Tr. 132-133). Similarly, the Unions are concerned that Frontier has no lender that has committed to extend a line of credit. In addition, the terms and conditions for the line of credit are not known at this time (Union Br. 12-13).

The Unions do not trust Frontier's financial projections. Contesting Frontier's claim that the transaction will improve its financial condition, the Unions point out that the company will not achieve even a minimal investment-grade bond rating. Moreover, the Unions reject Frontier's financial projections for relying on overly optimistic assumptions. Taking into account Frontier's recent revenue declines, the Unions doubt Frontier's expectation that revenue losses will decrease (Union Br. 13). Similarly, the Unions question Frontier's expense projections which show synergy savings of $500 million annually (Union Br. 14; Joint Ex. 6, Sch. DM-4, p. 18). Contrary to Frontier's assertion that it can achieve such savings without affecting the field work force, the Unions estimate that Frontier would have to make labor cuts of 20 percent to achieve such a goal (Tr. 122; Union Br. 14). Furthermore, the Unions reject the applicants' reliance upon 2008 data as support for savings forecasts in the year 2013. The Unions find no basis for assuming that 2008's actual results will be representative of conditions in 2013 (Union Br. 15). Casting further doubt, the Unions contend that Frontier has not successfully projected financial aspects of mergers. As an example, the Unions allude to Frontier's acquisition of Commonwealth Telephone Company where its predicted leverage ratio has not fallen in line with actual figures. The Unions recommend that the Commission give no weight to Frontier's financial projections (Union Br. 15). Ultimately, the Unions believe that Frontier is not financially fit to own and operate Verizon North (*Id.* at 16).

The Unions point out that Frontier initially estimated that 1,100 Verizon North employees would transfer to Frontier North (Tr. 125; Joint Ex. 6, p. 38). Upon cross-examination, Frontier revised the figure to between 1,000 and 1,050 to reflect "realignment" (Tr. 125; Union Br. 17). The Unions note that, to achieve projected synergy savings, Frontier will need to reduce substantially its workforce by 2013 (Union Br. 17-18). The Unions emphasize that Frontier has not disclosed how many job losses there will be in Ohio (Union Br. 18). Frontier regards the information as confidential (Union Br. 28; Union Ex. 1, p. 36). Because Frontier has not committed to retain a certain number of employees in Ohio and has not fully disclosed the number of labor reductions, the Unions urge the Commission to deny the application (Union Br. 19).

The Unions highlight what they perceive to be service quality risks arising in part from a change in practices, priorities, and financial pressures (Union Br. 20). The Unions claim that an additional risk is posed by the cutover of 600,000 lines in West Virginia. The Unions warn that any problems encountered in the cutover could have repercussions in Ohio. Unexpected expenses and the need for additional technicians may draw resources away from Ohio. Furthermore, because West Virginia will be Frontier's largest state, the Unions warn that problems there could jeopardize the entire transaction (Union Ex. 2, p. 35).

Added to these risks is what the Union's characterize as a lack of due diligence on the part of Frontier. The Unions claim that Frontier has not conducted a thorough review and inspection of Verizon North's operations (Union Br. 21). The Unions point out that only three months passed between the initial exploration and the announcement of the transaction (Union Ex. 2, p. 30). Moreover, the Unions contend that Frontier did not conduct a field visit in Ohio and has not conducted an audit of Verizon's physical plant. To the Unions, this is tantamount to purchasing Verizon's operations "sight unseen" (Union Ex. 2, p. 75).

Another cause for concern for the Unions is the comparative sizes of Verizon and Frontier in Ohio. Currently Frontier has only one exchange in Ohio that serves 550 access lines (Union Br. 22; Joint Ex. 5, p. 7). In contrast, Verizon serves approximately 634,000 lines in 244 exchanges (Union Br. 22; Joint Ex. 2, p. 8). Another contrast is that in 2008 Frontier received 48 service orders in Ohio (Union Br. 22; Union Ex. 2, p. 31). Verizon received 345,000 (*Id.*). Overall, the Unions conclude that Frontier is much smaller and has a fundamentally different business, consisting of fewer wholesale customers, fewer wholesale orders, and fewer service orders per line (Union Br. 22).

Reviewing other mergers, the Unions have additional concerns about Frontier's ability to provide good service quality. As an example, the Unions point to Frontier's acquisition of Global Valley Networks in California (Global Valley) in February 2007. Global Networks had approximately 13,000 access lines (Union Ex. 2, pp. 36, 42). Through ARMIS (Automated Reporting Management Information System) data reports, the Unions discovered that Global Valley reported an average installation time of 6.3 days, initial out of service intervals of 30.7 hours, and repeat out-of-service intervals of 32.1 hours (Union Ex. 2, p. 36). The Minimum Telephone Service Standards (MTSS), by comparison, require new service installation within five days and all other outages must be restored within 24 hours (Union Br. 24; Rule 4901:1-5-08, Ohio Administrative Code (O.A.C.)). From the Global Valley example, the Unions conclude that Frontier's service standards would not rise to the level of the MTSS.

As another example, the Unions refer to Frontier's 2001 acquisition of Rochester Telephone. Starting in 2007, ARMIS data show that service problems began to rise (Union Ex. 2, p. 37). Trouble reports per 100 lines increased from 24.9 in 2006, to 29.8 in 2007, and to 33.8 in 2008 (*Id.*). Outages increased from fewer than 18 per 100 lines in 2006 to more than 24 per 100 lines in 2008, an increase of 30 percent (Union Ex. 2, pp. 37-38). Outage repair time increased from 18.8 hours in the years 2005 through 2007 to 26.8 hours in 2008, an increase of more than 40 percent (Union Ex. 2, p. 38).

Pointing to failures with Hawaiian Telcom, Idearc,[5] and FairPoint, the Unions reject the notion that conditions placed on the approval of a change in ownership can protect the public and ensure financial viability. As a solution, the Unions recommend that Verizon remain committed to the success of the change in ownership, either through a joint venture or by means of a guarantee from Verizon (Union Ex. 1, p. 54-56). Given that Frontier intends to take on debt in excess of $3 billion and cut $500 million from its operating costs in three years, the Unions doubt that Frontier will be sufficiently viable to protect the public interest (Union Br. 27-28). The Unions liken this case to the one put before the Vermont Public Service Board (VPSB) where it considered the acquisition of FairPoint by Verizon. The Unions state that the VPSB initially rejected the proposal because it could not develop conditions to ensure that the company would have sufficient operating and capital funds to maintain operations, deploy broadband, and sustain service quality standards. The VPSB also doubted FairPoint's ability to meet what it considered to be large debt obligations (Union Br. 28). Ultimately, the VPSB approved a modified transaction involving a cash infusion from Verizon (*Id.* at 29).

LOCAL PUBLIC HEARINGS

To allow the general public to comment on issues related to the proposed transaction, the Commission ordered the attorney examiner to conduct local public hearings throughout the State of Ohio. Pursuant to entries issued August 24, 2009, and September 17, 2009, the attorney examiner conducted local public hearings on September 8, 2009, in New Philadelphia, September 9, 2009, in Marion, September 10, 2009, in Portsmouth, October 6, 2009, in Troy, October 7, 2009, in Athens, and October 8, 2009, in Norwalk.

Local residents touched upon many of the same issues raised by the parties to the case. Some had concerns whether Frontier would have the financial wherewithal to carry out its proposals (Tr. September 17, 2009, at 22; Tr. November 5, 2009, at 16-18; Tr. November 10, 2009, at 9). Several witnesses testified concerning the need for broadband in rural communities (Tr. September 17, 2009, at 22; Tr. September 23, 2009, at 33, 34; Tr. September 24, 2009, at 17; Tr. November 10, 2009, at 18). For example, some customers have an interest in broadband for educational purposes. For homework assignments and for conducting research for school papers, some parents and students regard broadband as essential (Tr. September 23, 2009, at 34; Tr. September 24, 2009, at 23; Tr. November 10, 2009, at 18; Tr. November 5, 2009, at 32). One witness noted that access to broadband would aid her in the home schooling of her child (Tr. September 17, 2009, at 25). Other witnesses emphasized the business applications for broadband in rural communities (Tr. September 17, 2009, at 22; Tr. November 10, 2009, at 22).

5 Fred Sabol, business manager of the IBEW Local 986, testified that in March 2009, Idearc, a Verizon spinoff, filed for bankruptcy to protect its Yellow Pages publication business (Tr. 14 , 11/10/09).

Some witnesses testified in favor of the transaction because they perceive reluctance and hesitation on the part of Verizon to extend broadband to rural communities. Moreover, they believe that Verizon's business strategy involves divesting itself of landlines. In contrast, in Frontier they see a willingness to deploy broadband in rural communities (Tr. September 24, 2009, at 11, 12-13; Tr. November 5, 2009, at 8-9, 20; Tr. November 10, 2009, at 22, 25). Even where Verizon has deployed broadband, one witness regarded Verizon's 768k speed as "unusable" (Tr. November 5, 2009, at 29).

STIPULATIONS

A. Unions

The Unions reject the Stipulation as inadequate to address the problems presented by the transaction. The Unions first criticize the Stipulation for failing to provide financial protections. There are no sanctions if Frontier fails to spend money in Ohio or if it is unable to make investments in Ohio as promised. Section 4905.46(B), Revised Code, provides that the Commission may suspend a telecommunication utility's dividend if the Commission finds a violation of a Commission order or if there is a finding of inadequate service. The Unions are surprised to find that there is nothing in the Stipulation that would restrict the payment of dividends where Frontier fails to make capital investments and broadband expenditures (Union Br. 30).

In addition to financial concerns, the Unions point out that staffing is absent from the Stipulation. The Unions acknowledge that Frontier has stated that it has no plans to reduce employment at the Marion call center or to reduce field workforce after the 18-month transition period. However, given Frontier's plan to cut $500 million from Verizon's annual operating expenses, the Union's anticipate a cut in the workforce and a concomitant reduction in Frontier's ability to provide reliable installation, maintenance, and repairs. Without assurances that Frontier will maintain an adequate workforce, the Unions urge the Commission to reject the Stipulation (Union Br. 31).

The Unions reject the Stipulation's broadband targets as inadequate. The Stipulation provides that by December 31, 2013, Frontier will deploy broadband services to 85 percent of the households in the VNSA. The Stipulation defines broadband as having a download speed of at least one mbps (Union Br. 32). The Unions lodge two criticisms. First, the Unions take issue with allowing Frontier to take 3.5 years to provide a level of deployment that is less than what Frontier provides in other states. Second, the Stipulation defines broadband in a manner that is not only inferior to the current state of technology but will be even more inferior to the technology that will be demanded in three years.

The Unions point out that Frontier makes DSL available to approximately 92 percent of its customers (Union Br. 32; Tr. 154). In Pennsylvania, Frontier provides 100 percent availability (Union Br. 32; Tr. 15-16). In 2006, Frontier provided 90 percent of its customers with broadband access (Union Br. 32). Commonwealth Telephone, which Frontier acquired in 2007, took three or four years to establish 85 percent availability where there had previously been no broadband at all (*Id.*). With these comparisons, the Unions are not impressed with Frontier's commitment to increase broadband availability to 85 percent in 3.5 years from Verizon's current 65 percent availability. Nor are the Unions impressed by Frontier's commitment to provide broadband at only one mbps. In other parts of the country, Frontier has provided more broadband availability in less time (Union Br. 33). Noting that the applicants' witness Mr. McCarthy testified that Frontier could provide 85 percent availability in three years at 3 mbps, the Unions question why the Stipulation provides for less (Union Br. 33; Tr. 34).

The Unions' witness, Ms. Susan Baldwin, recommended a sequence of broadband targets that take into account the state of current technology. Specifically, she recommended the following:

(1) Within one year of the transaction closing date, 75 percent of the lines in the transaction territory should be capable of carrying DSL service at three mbps download speed;

(2) within two years of the transaction closing date, 90 percent of the lines in the transaction territory should be capable of three mbps DSL service, and 75 percent of lines should be capable of five mbps service;

(3) within three years of the transaction closing date, 100 percent of the lines in the transaction territory should be capable of five mbps DSL service, and 85 percent of lines should be capable of seven mbps DSL service.

(Union Br. 34; Union Ex. 2, pp. 114-115). The Unions believe that these targets are attainable and reflect the current state of technology. For comparison, the Unions note that Verizon provides 7 mbps DSL service in some areas (Tr. 80). The broadband speed provided in the Stipulation, the Unions conclude, falls far short of what Frontier provides around the country (Union Br. 34).

Another fault that the Unions find in the Stipulation is an absence of penalties for failing to meet broadband commitments. The Stipulation provides that Frontier will extend its capital expenditure commitment by an additional year if it fails to reach 80 percent availability. To the Unions, Frontier's capital expenditure commitment is so low that it is meaningless (Union Br. 34). The Unions claim that the Stipulation provides that

Frontier shall spend an average of $110 per access line on capital investments for each of the first three years it owns Verizon North. Referring to the testimony of Mr. McCarthy, the Unions highlight that Frontier spends a nationwide average of $123 per access line (Union Br. 35; Tr. 25-26). Upon review of Frontier's prospectus, the Unions discovered that Frontier invested an average of $128 per access line in 2008 and $130 per access line in 2007 (Union Br. 35). In other acquisitions, the Unions find that Frontier has agreed to greater average access line investments. Comparing the Stipulation's capital expenditure target with what Frontier has invested elsewhere, the Unions conclude that the Stipulation's target is inadequate. Moreover, the Unions deride the Stipulation for not providing a penalty for failing to make the targeted capital expenditures (Union Br. 36).

Turning to retail service quality standards, the Unions likewise regard the Stipulation as insufficient. The Stipulation provides retail service standards to which Frontier has agreed to adhere. Having standards in place as a check against service deterioration is desirable, but the Unions do not find the standards adequately enforced. In their interpretation of the Stipulation, the Unions reveal that if Frontier's service were to deteriorate during the first year after the closing, there would be no penalty. A penalty of $100,000 per standard would be imposed only if service were substandard for two years. The Unions calculate that the maximum penalty for the two years would be $400,000, which the Unions equate to a handful of full-time employees. To the Unions, such a penalty is too small to provide any incentive to spend appropriate amounts for maintenance and repair. The Unions suggest that a more appropriate penalty would be to prohibit Frontier from paying a dividend (Union Br. 36-38).

B. OCC

The OCC recommends that the Commission approve the Stipulation without modification. In summary, the OCC believes that the Stipulation promotes the deployment of broadband in rural portions of Ohio, that it helps to ensure improvement in facilities and service quality, that it maintains reasonable basic service rates, and that it provides for a smooth transition through the replication of Verizon North's operation support system. Overall, the OCC concludes that the Stipulation provides for adequate service at a reasonable rate that is consistent with Section 4905.042, Revised Code (OCC Br. 6).

The OCC identifies broadband deployment as the cornerstone of the proposed transaction. The OCC points out that broadband is not widely available in Verizon North's service area. Relying on Mr. McCallion's testimony, the OCC notes that Verizon North has no plans to expand broadband in Ohio (OCC Br. 7; Tr. 80). The OCC claims that Frontier supported its application by emphasizing its intent to deploy broadband in rural areas (OCC Br. 7). In the Stipulation, Frontier has committed to making broadband available to 85 percent of the households in the VNSA by December 31, 2013. The OCC has identified a list of 108 unserved exchanges to serve as the primary focus of Frontier's broadband efforts. Prior to the Stipulation, the OCC points out that the applicants established no commitments or timeframes for the deployment of broadband (*Id.* at 8).

Broadband is defined in the Stipulation as having a download speed of at least one mbps. This speed is higher than the 768 kbps speed that Verizon North currently offers (OCC Br. 9; Tr. 80). Frontier's witness, Mr. McCarthy, clarified that 1mbps is a minimum. Where possible, the company plans to roll out three mbps service (OCC Br. 9; Tr. 32-33).

Another benefit of the Stipulation is that it puts a cap on basic local exchange service rates in the VNSA for the duration of the Broadband Program. Frontier has committed to this notwithstanding that Verizon North already has authority to raise basic service rates in 21 exchanges and legislation is currently under consideration that would facilitate the raising of rates by ILECs (OCC Br. 10).

In the Stipulation, Frontier North has committed to invest at least $110 per access line within Verizon North's present service territory for each of the three years following the close of the merger. There is also a provision for a minimum investment of $50 million for the three years. If Frontier North does not make broadband available to 80 percent of the households within Verizon North's territory by December 31, 2012, the investment commitment will extend for an additional year at the same annual average investment rate, but based on the number of access lines Frontier North has within Verizon North's present Ohio service territory at that time (OCC Br. 10-11). The OCC remarks that this commitment represents a significant increase over the current level of capital investment by Verizon North. Relying on the testimony of Mr. McCallion, the OCC states that in 2007 and 2008 Verizon invested approximately $85 per line in core capital investments in the 16 areas that Frontier will acquire. Contrasting the access line investment figures of $132 in 2007 and $153 in 2008 asserted by the Union's witness, Ms. Baldwin, the OCC points to Mr. McCallion's testimony where he claims that she relied upon misleading investment figures (OCC Br. 11; Joint Ex. 4, p. 25; Union Ex. 2, p. 65-66). Based on Verizon North's current $85 per access line, the OCC calculates that Frontier's commitment is approximately 30 percent higher than Verizon North's capital expenditures. It is the OCC's expectation that Frontier North's increased capital investments will translate to improved quality of service (OCC Br. 11-12).

In addition to increased capital expenditures, the OCC expects that the service quality benchmarks provided in the Stipulation will ensure the provision of adequate service. The Stipulation provides metrics that Frontier must meet during the first three years after the close of the merger. Specifically, Frontier must maintain an average of no more than 1.44 trouble reports per 100 access lines statewide during a 12-month period. This is an improvement upon the Commission's former MTSS standard of no more than three trouble reports per 100 access lines (OCC Br. 12; Stipulation 6).

Another metric concerns repeat trouble reports, which is defined as a trouble report for the same customer within 30 days from the clearance of the initial report. The Stipulation provides that Frontier will commit to maintaining repeat trouble reports to no more than 16.2 percent of initial trouble reports on a 12-month statewide average. In its review of ARMIS data, the OCC finds that such a benchmark is reasonable (OCC Br. 13; Stipulation 6-7).

For repair responses, Frontier has committed to clearing out-of-service conditions within 24 hours 90 percent of the time and service-affecting conditions 85 percent of the time. Both are to be achieved on a statewide average basis. The OCC recalls that these standards are similar to those applied in Case No. 07-511-TP-UNC (OCC Br. 13).

The OCC points out that the Stipulation contains incentives in the form of penalties. Failing to adhere to metric standards in any two years of the three-year period will expose Frontier to penalties. For each metric that it misses, Frontier will forfeit $100,000. In addition, for each metric that it fails to meet in all three years, Frontier will pay to the State of Ohio an additional $100,000 (Stipulation 7). In addition to these penalties, the Stipulation provides for customer credits pursuant to Section 4901:1-5-08, O.A.C., even if the credits are removed by law (OCC Br. 13; Stipulation 10). The OCC believes that these incentives are sufficient to ensure that Frontier will provide adequate service to customers (OCC Br. 13).

The OCC had concerns that the transition from Verizon North's operations support systems to Frontier North's replicated system would not go smoothly. To alleviate these concerns, the Stipulation allows the Commission and the OCC to monitor the replication process and review the results of replication before and after the merger closing. Moreover, Frontier will test the replication systems and will subject the results to review and validation by an independent third party. Prior to producing the replicated systems, Verizon will share with the Commission's staff and the OCC the Program Test Strategy Plan that will be used to review the replicated systems and pre-production functionality tests for customer-affecting retail telecommunication services. Likewise, an independent third party will validate the results of the test.

As a safeguard prior to the closing of the merger, Verizon will use four measures to assess production results of customer-affecting systems that serve retail telecommunications customers: (1) installation orders for basic service completed within five business days; (2) out-of-service conditions restored within 24 hours; (3) service affecting conditions repaired within 48 hours; (4) and billing error complaints. These measures must meet certain benchmarks and will be evaluated by an independent third party. Verizon will share the production results with the Commission's staff and with the OCC (OCC Br. 14).

Ultimately, Frontier will use test results to verify that the replicated system is fully operational prior to closing. After the closing, Frontier will provide to the Commission's staff and to the OCC quarterly reports over a three-year period. The reports shall contain material business and repair office operations, billing systems issues, and any consolidation of network operations changes and staffing levels. The OCC is assured that the opportunity to be involved and to review the transition to the replicated operation support system will protect consumers from adverse affects. After reviewing the terms of the Stipulation, the OCC is convinced that it will promote public convenience, that it will result in the provision of adequate service for a reasonable rate, and that it should be approved without modification (OCC Br. 15).

C. Commission's Staff

Commission Staff recommends that the Stipulation be approved. Staff also recommends that the Commission approve the stipulation between the applicants and Comcast (Staff Br. 7). Staff reveals that the Stipulations are the result of extensive discussion and negotiation. Staff believes that Frontier will be a financially sound entity once the transaction is complete. Moreover, Staff agrees with the applicants that Frontier is financially qualified to complete the Verizon acquisition and to operate the acquired properties. In support of the Stipulation, Staff points to Frontier's successful track record of acquiring, operating, and investing in telecommunications properties nationally. Specifically, Staff refers to the 750,000 access lines that it purchased from Verizon's predecessor, GTE, between 1993 and 2000 (Staff Br. 8). Staff holds up Frontier's acquisitions of Commonwealth Telephone in Pennsylvania and Global Valley in California as examples of successful acquisitions (*Id.*).

Staff notes that if the transaction is approved, Verizon North customers will receive the same regulated intrastate services, service rates, and service terms and conditions from Frontier North (*Id.*).

Focusing on financial matters, Staff believes that Frontier's financial position will improve from the transaction. By deleveraging its balance sheet and by decreasing both its per-share dividend payout by $.25 per share of common stock and dividend payout ratio, Staff expects Frontier to become a stronger, more stable competitor. With an improved financial structure and cash flow, Staff also expects Frontier to provide more efficient service and have the means to make investments in broadband (Staff Br. 9).

Staff believes that Frontier can improve on Verizon North's performance because Frontier will not, like Verizon, be encumbered by capital and management commitments to a diverse array of other delivery platforms like wireless service, global enterprise services, or more urbanized markets. In contrast, it is Frontier's intent to focus on rural areas and smaller to mid-sized communities (Staff Br. 9-10).

The Staff believes that a notable feature of the transaction is the replication of Verizon North's operations support systems. These systems support retail ordering and billing, wholesale ordering and billing, network monitoring and maintenance, and all customer support functions (Staff Br. 10; Joint Ex. 5, p. 32). Verizon will replicate these systems and physically separate them from the systems that it will use for its own operations. Prior to separation and exclusive use by Frontier North, Verizon North will test the systems providing Frontier North opportunities for review and feedback before the systems are put into production and use by Frontier North. Verizon North will provide system support for at least a year after the merger closing. Frontier North may continue to receive support from Verizon North beyond one year if it wishes (Staff Br. 10).

Staff cites Rule 4901-1-30, O.A.C., for the principle that parties may enter into stipulations in Commission proceedings. Acknowledging Commission precedent, Staff is aware that stipulations are not binding on the Commission. Stipulations are, however, given substantial weight. Staff notes that the Commission has applied a three-part test from *Industrial Energy Consumers of Ohio Power Co. v. Pub. Util. Commission*, 68 Ohio St. 3d 559, 561, 629 N.E. 2d 423, 426 (1994) to determine whether a stipulation is reasonable. The test consists of the following:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

Commission Staff asserts that the Stipulation signed by the applicants, Staff, and the OCC settles all issues and is the product of serious bargaining by experienced counsel and capable, knowledgeable parties. All parties began settlement discussions on November 23, 2009, and continued until the Stipulation was filed on December 8, 2009. For the discussions, Staff points out that the parties had before them the application, prefiled testimony, discovery, public comments, and testimony. In meeting the first prong of the test, Staff points out that the parties are experienced in regulatory matters, are well-informed, and are experienced in proceedings before the Commission. It is also important that the parties represent diversified interests: utilities, residential customers, wholesale competitors, and the State of Ohio. To Staff, the Stipulation represents a true compromise where parties traded concessions to reach an overall reasonable and equitable outcome.

Among other benefits, the Staff points to a 20 percent increase in broadband deployment over the next three years (Staff Br. 12-13).

Owing to Frontier North's commitment to broadband deployment, the Commission's Staff regards the Stipulation as being beneficial to ratepayers and in the public interest. Under its Broadband Program, Frontier North commits to providing broadband at speeds of at least one mbps to 85 percent of the households in VNSA by December 31, 2013. Frontier North's initial target will be those areas that are currently unserved by a broadband service provider. Together with the OCC, Frontier North has targeted 108 exchanges. In an effort to augment its intended capital investment, Frontier North will apply for federal stimulus funding for the Broadband Program (Staff Br. 14-15).

As noted by the OCC, Frontier will make capital investments within Verizon North's service area at an annual average of at least $110 per access line, or $50 million overall, whichever results in a greater total capital investment for each of the three years following the merger closing. If by December 31, 2012, Frontier North has not made broadband facilities available to 80 percent of the households within the VNSA, Frontier North will extend its commitment for one additional year from the merger closing. Frontier North will base its commitment on the same annual average rate based on the then-current number of access lines (Staff Br. 15).

Another benefit to consumers is that Frontier North will not pursue an increase in Tier 1, residential, basic local exchange rates in Verizon North territory during the Broadband Program. Staff notes that the commitment does not apply to bundled service offerings that include basic local exchange service (Staff Br. 15). Echoing the OCC, Staff highlights that the Stipulation also incorporates metrics and enforcement provisions to maintain quality of service (Staff Br. 16-17).

In its brief, the Staff reiterates the provisions in the Stipulation that relate to maintaining the continuity of interconnection agreements and wholesale tariffs, the replication of operations support systems, wholesale and retail service commitments, and reporting requirements (Staff Br. 17-21). As for service quality metrics, Staff points out that several of the metrics equal or exceed Verizon North's current service standards (Staff Br. 23-24).

Staff believes that the transaction will be seamless and transparent to customers because the Stipulation provides for the continuity of employees. Frontier North has pledged to retain the employment of Verizon North installers and technicians for 18 months after the close of the merger. In addition, Staff points to Frontier North's commitment to honor all existing collective bargaining agreements (Staff Br. 25).

Staff states that the vast majority of Verizon North employees are network operations and engineering employees. Many of these employees are located in the Marion and Norwalk operations centers. Verizon North has a call center in Marion and a dispatch center in Norwalk (Staff Br. 25-26). Referring to Mr. McCarthy's testimony at the hearing, Staff notes that Frontier North made a commitment to locate its call center in Marion and its dispatch and operations center in Norwalk (Staff Br. 26, Tr. 124). Staff expects the transaction to be seamless and transparent to customers because most of Verizon North's employees will remain in Ohio as Frontier North employees (Staff Br. 26). Because the same employees will remain, Staff also expects that wholesale service quality will remain the same (Staff Br. 26).

As a final matter, Staff asserts that the Stipulation does not violate any important regulatory principle or practice as evidenced by the fact that most of the parties have signed the Stipulation. Moreover, Staff contends that the Stipulation meets the requirements of Chapters 4905 and 4909, Revised Code, and the Commission's regulatory principles and practices. Furthermore, Staff believes that the Stipulation satisfies the Commission's three-part test. In its opinion, Staff concludes that the Stipulation should be adopted in its entirety (Staff Br. 26-27).

CONCLUSION

Upon reviewing the application, the evidence, and the stipulations, the Commission concludes that the proposed transaction, as modified by the stipulations, will promote public convenience and result in the provision of adequate service at reasonable rates, rentals, tolls, or charges, as defined by Section 4905.402, Revised Code. Further, we believe that the transaction will promote the state's telecommunications policy of competition, diversity, and customer choice. In reaching this decision, the Commission thoroughly considered all of the issues identified in its August 19, 2009, entry: (1) transactional synergies and financial considerations, (2) in-state presence, (3) quality of service, and (4) competition and wholesale operations. We also took into account Frontier's commitment to deploying broadband in rural communities.

With respect to transactional synergies and financial considerations, we appreciate the concern that the Unions have for the financial underpinnings of the proposed transaction. We are, however, given assurance by favorable reviews of the transaction given in credit rating agency reports. Moreover, to complete the transaction, the applicants must secure financial backing from a lender. From the necessity of a lender with a stake in the financial outcome of the transaction, we draw additional assurance that this matter will be given prudent review.

Frontier has projected that it will experience, on a consolidated basis in 2013, $500 million in pre-tax synergies (Joint Ex. 6, 22). In response to the Unions' criticism that

Frontier's projected $500 million in savings through synergies is not achievable, Frontier responds that its projection has been independently reviewed by independent research analysts at Stifel Nicolaus and USB Investment Research. Their reports concluded that Frontier's synergy savings are reasonable, achievable, and are within the range of industry experience (*Id.* at 25-26). In further refutation of the Union's criticism, Frontier claims that the success of the transaction is not contingent upon the projected synergies. Even without the projected synergies, Frontier claims that its significantly greater cash flow and a significantly lower leverage ratio will ensure success (*Id.* at 27).

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

To satisfy concerns for in-state presence, Frontier has committed to retaining approximately 1,000 Verizon North employees in Ohio for 18 months after the close of the transaction. Among the employees, there are installers and technicians (Joint Ex. 6, 38-39). Furthermore, Frontier will retain a senior-level general manager in Ohio with significant decision-making authority and local presence in Ohio (Joint Ex. 6, 39). Comprising additional in-state presence, Frontier will locate at least two substantial centralized operational and administrative offices in Marion and Norwalk. Along with a business sales and billing center, Marion will continue to be the location of a consumer sales and service center. Norwalk will be the location of a dispatch resource center, an automated provision center, and a database management center (*Id.* at 38).

The retention of key service employees, a local management head, and the preservation of operational and business offices shows a commitment to maintaining in-state presence. These measures are reasonable and effective steps to ensure transparent, seamless continuity of service. The retention of local employees who are familiar with the network, facilities, and the local area should maintain service quality and avoid the service lapses that would ordinarily attend a learning curve required by new employees.

The Stipulation contains provisions that should maintain and enhance the current quality of service. The Stipulation provides metric criteria by which to measure Frontier North's performance. Specifically, the Stipulation provides performance goals for trouble reports, repeat trouble reports, out-of-service restoral, and service affecting conditions restoral. Frontier North has committed to maintain an average 12-month statewide performance level of not more than 1.44 troubles per 100 access lines (Stipulation 6). For repeat troubles, Frontier will maintain an average 12-month statewide performance level of not more than 16.2 percent repeat troubles within 30 days after the initial trouble is cleared (*Id.*). For out of service restoral, Frontier commits to maintaining an average 12-month statewide performance level of 90 percent for the MTSS requirement for restoring out-of-service conditions within 24 hours (*Id.*). For service affecting conditions restoral, Frontier agrees to maintain an average 12-month statewide performance level of 85 percent for the MTSS requirement for restoring service-affecting conditions within 48 hours. These metric commitments are scheduled to last for three years after the merger closure (Stipulation 7). We find these metric commitments reasonable and reasonably reflective of adequate service quality (*Id.*).

The Stipulation provides penalties upon Frontier North's failure to abide by the Stipulation's performance requirements. If Frontier fails to meet one or more of the four service metrics for any two years of this commitment, Frontier shall forfeit $100,000 to the State of Ohio for each of the four service metrics it failed to meet. In addition, if Frontier fails to meet one or more of the four performance metrics for the three 12-month periods during the term of this commitment, Frontier shall forfeit an additional $100,000 to the State of Ohio for each of the four service metrics it failed to meet (Stipulation 7). We find that the penalties are adequate. They are high enough to provide an incentive, but not so high as to cause undue financial hardship. Undue financial hardship from penalties could ultimately jeopardize consumer service by undermining the financial stability of the company. Regardless, the Stipulation shall not bar the Commission from taking additional action should quality of service fall below adequate levels..

CBET and Comcast have entered into agreements that resolve their wholesale concerns. The Stipulation provides for the replication, testing, and separation of Verizon North's operations support systems for wholesale and retail services. Pursuant to the Stipulation, the Commission's Staff and the OCC have the opportunity to review and participate in the development of the replicated system. The parties have determined that the measures provided by the Stipulation are reasonable and should be approved by the Commission.

Finally, Frontier North has committed to providing broadband of at least one mbps to 85 percent of the households in Verizon North's service area by December 31, 2013 (Stipulation 5). With the assistance of the OCC, Frontier North has targeted 108 exchanges that are currently without broadband service. We are very pleased that Frontier North will undertake the commitment to provide broadband service to rural areas of Ohio. Without the widespread availability of broadband, Ohio cannot realize the business potential that lies dormant in its nonurban areas. Nor can rural students and teachers fairly compete with their urban counterparts. With this commitment to deploy broadband to unserved areas, we are hopeful that, ultimately, any location in Ohio will have the potential for business, learning, and communication.

Based on our review of the application, the stipulations, and the commitments made by the applicants, we have determined that the proposed transaction fairly addresses the issues that we set forth in our August 19, 2009, entry. Furthermore, we find that the stipulations meet the necessary criteria, provide for a reasonable resolution of the issues, and should be approved in their entirety. We are particularly encouraged to approve the Stipulation between the applicants, the OCC, and Staff because of Frontier North's plan to dramatically increase capital expenditures and broadband deployment over Verizon North's current levels. We agree with the Unions that, on a consolidated basis, Verizon is financially stronger than Frontier, as evidenced by Verizon's investment grade bond rating. Nevertheless, it is because of Frontier North's agreement to increase capital expenditures above current levels that we find the Stipulation particularly attractive. It is clear from Verizon North's declining capital expenditures over the past several years that Verizon is not prioritizing its landline business in Ohio (Union Ex. 2, p. 64). Moreover, in the Stipulation, Frontier North has acceded to measurable benchmarks and significant penalties for failing to meet its commitments. Also encouraging our approval is the applicants' explicit commitment under Stipulation Section 5.a. to recognize the Commission's current jurisdiction over ILECs. No less important to us is the applicants' pledge to abide by the agreements and commitments in the Stipulation for three years following the merger, notwithstanding any changes in law.

Even though we approve the stipulations and the applicants' financial plan for accomplishing the change of ownership, we share the Unions' concerns regarding Frontier's debt rating as well as Frontier's practice of paying dividends in excess of earnings. By directing resources to debt management and shareholders rather than towards maintenance and investment in the network, customer service and financial stability could ultimately suffer. To promote the public convenience and to ensure the provision of adequate service, we shall maintain full, ongoing regulatory oversight of the terms and conditions of the Stipulation. To this end, we shall require that the applicants report periodically on their compliance with certain commitments in the Stipulation. In addition to other reporting obligations required by the Stipulation under Section 5.d., the applicants should consult with the Staff to establish the content and time periods to report on other matters that affect quality of service, such as capital investments within the VNSA. In the event of any marked deterioration in service quality or any other event that would give us cause for concern, we reserve authority to implement corrective measures.

If there are any arguments raised by the parties, but not specifically addressed herein, they are rejected. Additionally, all pending motions for protective treatment are deemed reasonable and should be granted. The Docketing Division should maintain for 18 months from the date of this Opinion and Order all documents that are currently under seal in this proceeding.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(1) On May 29, 2009, Frontier, NCH, and Verizon filed a joint application pursuant to Section 4905.402, Revised Code, seeking approval of a change in ownership whereby Frontier will acquire control of Verizon North, a domestic telephone company.

(2) By entry issued June 17, 2009, the Commission suspended this case.

(3) On July 9, 2009, the applicants filed direct testimony.

(4) By entries issued August 24, 2009, and September 21, 2009, the Commission granted motions to intervene filed by CBET, Comcast, CWA, IBEW, OCC, and Level 3.

(5) On August 19, 2009, the Commission directed the applicants to file supplemental testimony addressing certain issues. The applicants filed supplemental testimony on September 8, 2009. The intervenors filed responsive testimony on October 14, 2009. The applicants filed rebuttal testimony on November 4, 2009.

(6) By entries issued August 24, 2009, and September 17, 2009, the attorney examiner scheduled local public hearings in Athens, Marion, New Philadelphia, Newark, Portsmouth, and Troy, Ohio.

(7) Local public hearings were held on September 8, 2009, in New Philadelphia, September 9, 2009, in Marion, September 10, 2009, in Portsmouth, October 6, 2009, in Troy, October 7, 2009, in Athens, and October 8, 2009, in Norwalk, Ohio.

(8) By entry issued November 10, 2009, the attorney examiner scheduled a December 8, 2009, evidentiary hearing. Pursuant to a joint motion filed December 7, 2009, the hearing was continued to December 9, 2009.

(9) On December 4, 2009, Level 3 filed notice of its withdrawal as an intervenor.

(10) On December 8, 2009, the applicants, the Commission's Staff, and the OCC filed a Stipulation resolving their contested issues. CBET filed a concurrence with the Stipulation.

Comcast entered into a separate and independent stipulation with the applicants. The applicants and the Unions proceeded to hearing.

(11) An evidentiary hearing was held on December 9, 2009.

(12) The applicants, the OCC, the Commission's Staff, and the Unions filed briefs on January 8, 2010.

(13) The application should be approved subject to the commitments expressed in the December 8, 2009, stipulations. The Commission finds, subject to the commitments set forth in the stipulations, that the transaction will promote public convenience and will result in the provision of adequate service at reasonable rates, rentals, tolls, or charges as defined in Section 4905.402, Revised Code.

(14) To ensure that this transaction and events subsequent continue to promote the public interest, the Commission shall retain continued oversight authority to implement any measures or modifications that it deems necessary to protect the public interest.

It is, therefore,

ORDERED, That the proposed change of ownership is approved subject to the commitments expressed in the December 8, 2009, stipulations entered into by the parties. It is, further,

ORDERED, That the request of Level 3 to withdraw as an intervenor is granted. It is, further,

ORDERED, That the applicants comply with the agreements and commitments set forth in the stipulations filed on December 8, 2009, and consult with Staff to establish periodic reporting requirements for quality of service matters that are not addressed in the Stipulation. It is, further,

ORDERED, That the Docketing Division shall maintain for 18 months from the date of this Opinion and Order all documents which have been filed under seal in this proceeding. It is, further, ORDERED, That any name change of an Ohio public utility resulting from this transaction must be approved by the Commission prior to its implementation. It is, further,

ORDERED, That approval of this application does not constitute state action for the purposes of antitrust laws. It is not our intent to insulate the companies from the provisions of any state or federal laws that prohibit the restraint of trade. It is, further,

ORDERED, That, except as specifically provided for or clarified in this Opinion and Order, nothing shall be binding upon the Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That the applicants formally notify the Commission when the proposed transaction has occurred within three days of its closure. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all parties and interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

LDJ/vrm

Entered in the Journal

FEB 11 2010

Reneé J. Jenkins

Secretary