Before the
CALIFORNIA PUBLIC UTILITIES COMMISSION

In the Matter of the Joint Application of Frontier Communications Corporation, Frontier Communications of America, Inc. (U5429C), Verizon California, Inc. (U1002C), Verizon Long Distance LLC (U5732C), and Newco West Holdings LLC for Approval of Transfer of Control Over Verizon California, Inc. and Related Approval of Transfer of Assets and Certifications.	Application 15-03-005

Reply Testimony

of

LEE L. SELWYN

on behalf of the

Office of Ratepayer Advocates
of the
California Public Utilities Commission

July 28, 2015

REDACTED – FOR PUBLIC INSPECTION

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EXECUTIVE SUMMARY

The proposed transfer of control of Verizon's ILEC operations in California to Frontier has the potential to be in the public interest, provided that the conditions for approval as outlined in Section VIII of this Reply Testimony are adopted and enforced. Indeed, and as I will discuss in detail in this Reply Testimony, Frontier may well turn out to be a better steward of California's wireline and broadband telecommunications resources than Verizon, which has in recent years been actively seeking to extricate itself from the wireline telephone and broadband business nationally. However, there is no assurance, absent affirmative measures by the CPUC, that the various benefits being claimed by Frontier in support of the transaction will actually flow through to ratepayers. For example, Frontier has estimated that beginning in the third year following the Closing of this transaction, the company will realize some $700-million annually "in total annualized corporate consolidated operating cost savings" a substantial portion of which is attributed to the avoidance of certain "Verizon-allocated centralized corporate costs that will not transfer with this Transaction." However, there is no specific assurance in the Frontier evidence that any portion of this gain will flow to ratepayers rather than shareholders. In fact, the Discounted Cash Flow valuation analysis conducted by Frontier and presented to its Board of Directors appears to assume that the entire savings will flow to EBITDA without any ratepayer sharing.

Verizon has for a number of years been systematically disengaging from the wireline business and has been disinvesting in wireline, choosing instead to direct its management focus and capital resources to mobile wireless and related content services (see Section V). By contrast, Frontier is a pure-play wireline company that is far more likely to support and expand wireline activities – particularly in broadband – than is Verizon, which had some five years ago announced that its infusion of new capital investment in a fiber-to-the-home ("FTTH") broadband architecture branded as *FiOS* had come to an end. Verizon also appears to have been deliberately shifting the costs of certain corporate service activities toward its ILEC operations and away from its other lines of business, burdening the ILECs with costs that are being incurred for the benefit of Verizon's non-ILEC operations. Eliminating these artificial and inflated costs has the potential to make additional resources available for network enhancements and broadband expansion, and could alter the perception of wireline telecom as being an unprofitable business activity. In approving the proposed transaction, however, it is essential that the Commission adopt measures intended to assure that a significant portion of these cost savings and other efficiencies flow to ratepayers and other customers of a post-transaction Frontier by, among other things, requiring that the savings be directed toward broadband expansion and other network improvements rather than being used simply to enhance Frontier's bottom line. Indeed, satisfaction of several Public Utilities Code §854 requirements cannot be assured without the imposition of such affirmative conditions. If the Commission denies or Verizon abandons the Transaction, the Commission should hold Verizon accountable to fix its network and expand the availability of high-speed broadband throughout its operating territory. Whether or not the transaction goes forward, Verizon should be required to pay for its failing to maintain its network and for its failure to use federal CAF support to further build out its broadband network.

The transaction will have no measurable adverse impact upon competition either for traditional voice telephone service or for high-speed broadband Internet access. Frontier currently serves approximately 74,101 residential customers in California; by comparison, Verizon was, as of the end of 2014, serving some 2.39-million California access lines. Following the transaction, Frontier's service area in the state will thus include roughly 2.46-million access lines, not substantially different from Verizon's current operating footprint.

PU Code §854 requires that the Commission make certain findings before it approves a change of control of the type being sought in the instant Application. In this Reply Testimony, I address the requirements of §854(b)(1), (b)(2) and (b)(3), and §854(c)(1), (c)(5) and (c)(6). Other provision of §854 are being addressed by other ORA witnesses.

The transaction will potentially provide short-term and long-term economic benefits to ratepayers as required by §854(b)(1), but without the Commission's imposition of specific conditions for approval, there can be no assurance that such benefits will be equitably allocated between shareholders and ratepayers, or that ratepayers will receive not less than 50 percent of those benefits as required by §854(b)(2). The transaction will not adversely affect competition, as required by §854(b)(3); however, there is no specific assurance that, without the deployment of additional high-speed (i.e., greater than 25 Mbps download speed) broadband by Frontier after it assumes control of the Verizon California network, the transaction will result in increased competition within the expanded Frontier operating territory.

Although the acquisition of the three Verizon operating companies will roughly double the size of Frontier's operations nationwide, Frontier plans to finance the transaction with a combination of debt and equity so as to roughly maintain existing debt ratios and Enterprise Value/EBITDA ratios. On this basis, §854(c)(1) appears to have been satisfied. Moreover, both Verizon and Frontier shareholders stand to realize a substantial net economic gain from the transaction – for Verizon, because the sale price of the three ILECs to Frontier is well in excess of net book value, and for Frontier, because the economic value of the three companies to Frontier is also well in excess of the purchase price, thus satisfying the requirements of §854(c)(5) for the shareholders of both utilities. Finally, substituting a company with a demonstrated commitment to wireline telecommunications for one that has for years been running away from this segment has the potential to be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility, thus satisfying the requirements of §854(c)(6). However, for the various reasons I will discuss in detail herein, without the adoption of several important affirmative conditions for approval, there can be no assurance that the significant economic benefits that Frontier will realize from this transaction will flow to state and local economies, to the communities served by the two utilities involved in the transaction, or to their ratepayers. Accordingly, the Commission should only authorize the transaction to go forward with the conditions that ORA is recommending so as to assure that the various requirements of §854 are satisfied.

(1) Verizon should be held financially accountable for repairs to any of their network assets that are not operational for the functions for which they were designed. This includes, but is not limited to, the Commission holding Verizon accountable to and financially responsible for repairing all company-related facilities that were the subject of complaints reported during the proceeding's Public Participation Hearings (PPHs) and Workshops prior to the closing of the transaction.

(2) Prior to approving the Transaction, the Commission should hold Verizon accountable to warrant that the network assets being transferred to Frontier satisfy all minimum CPUC quality standards.

(3) Frontier's right-to-use license(s) with respect to any Verizon-owned FiOS software, including but not limited to the Interactive Media Guide ("IMG"), should be extended indefinitely.

(4) Subject to certain limitations, Verizon should be required indefinitely to provide Frontier with software support and maintenance comparable to what it will be providing on an ongoing basis to its remaining ILECs, at reasonable cost-based charges.

(5) The Commission should disallow provisions in the Securities Purchase Agreement for purposes of the California transaction whereby Frontier is being required to pay 100% of any costs imposed by regulators as a condition for approval, and/or should require that Verizon accept such disallowance as a condition of approval.

(6) Frontier should expand broadband services at speeds of no less than the FCC's definition of minimum broadband speeds, currently 25 Mbps download and 3 Mbps upload, to 98% of households in its new service territory by no later than December 31, 2020.

(7) Frontier should provide an unredacted copy of its FCC 477 data for Internet Access Services and Local Telephone Services to the CPUC and the ORA every time it files with the FCC.

My testimony assumes that Verizon will apply for and accept federal Connect America Fund ("CAF") Phase II funding by August 27, 2015. If Verizon does not apply for and accept CAF II funding by the August 27, 2015 deadline, then I reserve the right to change the analysis and recommendations in my testimony. Verizon has had an obligation to maintain and support its copper network and to apply for and accept federal CAF funding to further build out broadband in unserved and underserved areas. Verizon should not be allowed to escape these obligations merely by selling off its California ILEC operations to Frontier. The Commission should assure that Frontier is provided with infrastructure that meets the CPUC's service quality standards, and that Frontier is not immediately burdened with having to bear the cost of needed repairs that Verizon should have been making all along. The proposed transaction is in the public interest only if the conditions outlined above are adopted. And if the Commission denies the transaction or if Verizon walks away, the Commission should nevertheless hold Verizon accountable to fix its network and to expand the availability of high-speed broadband throughout its operating territory. Whether or not the transaction goes forward, Verizon should pay for its failure to maintain its network and for its failure to use federal CAF support to further build out its broadband network.

REPLY TESTIMONY OF LEE L. SELWYN

I, Lee L. Selwyn, declare as follows:

I.

INTRODUCTION AND SUMMARY

Qualifications, background and experience

1. My name is Lee L. Selwyn. I am President of Economics and Technology, Inc. ("ETI"), One Washington Mall, 15th Floor, Boston, Massachusetts 02108. ETI is a research and consulting firm specializing in telecommunications economics, regulation and public policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof.

2. I hold a Ph.D. degree in Management from the Alfred P. Sloan School of Management, Massachusetts Institute of Technology. I also hold a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with Honors in Economics from Queens College of the City University of New York. In 1970, I was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time-sharing industry. This work was conducted at Harvard University's Program on Technology and Society, where I was appointed a Research Associate. I was also a member of the faculty at the College of Business Administration at Boston University from 1968 through 1973, where I taught courses in economics, finance and management information

systems. I founded my firm, Economics and Technology, Inc., in January 1972, and have served as its President continuously since that date.

3. I have been actively and continuously involved in the fields of telecommunications economics, policy and regulation since the late 1960s. I have provided expert testimony and analysis on telecommunications economics, technology, rate design, service cost analysis, market structure, form of regulation, and numerous other telecommunications issues before more than forty state public utility commissions, the Federal Communications Commission, the United States Congress, and regulatory bodies in a number of foreign countries, on behalf of commercial organizations, non-profit institutions, and local, state and federal government authorities. Attachment 1 to this Declaration provides a complete record of my publications and prior expert testimony and appearances before regulatory agencies and courts.

4. I have submitted expert reports and testimony in numerous telecommunications regulatory proceedings before the Federal Communications Commission ("FCC") and state public utilities commissions in approximately forty states dating back to the late 1960s, dealing with a broad range of ratesetting and policy matters, including switched and special access charges, price cap regulation, Sec. 251/252 interconnection and unbundling requirements, total service resale and wholesale pricing, universal service, broadband and related Internet access issues, intercarrier compensation, spectrum allocation, handset interoperability, CMRS early termination fees, and many others. I have provided expert testimony in numerous California

PUC proceedings dating back to the mid-1970s. A complete listing of these appearances is included in Attachment 1 hereto.

5. I have had extensive experience with the analysis of consumer and competitive impacts of mergers and spin-offs involving large telecommunications companies, including a number of matters before the California PUC on behalf of the Office of Ratepayer Advocates or Division of Ratepayer Advocates – A. 96-04-038, SBC/Pacific Bell merger (1996-7); A. 98-12-005, Bell Atlantic/GTE merger (1998); A. 05-02-027, SBC/AT&T merger (2005); A. 05-04-020, Verizon/MCI merger (2005), and most recently, the Comcast/TWC merger, A.14-04-013/ A.14-06-012. In 1993, I submitted testimony on behalf of DRA in I.93-02-028, the "spin-off" by Pacific Telesis Group of its cellular and other wireless subsidiaries. I also submitted expert testimony on similar merger-related issues before the FCC and in several other state PUC matters, including Maine PUC Docket No. 96-388, Bell Atlantic/NYNEX merger (1996), on behalf of the Maine Office of Public Advocate; Connecticut DPUC Docket No. 98-02-20, SBC/SNET merger (1998), on behalf of the Connecticut Office of Consumer Counsel; United States District Court for the District of Columbia, Civil Action No. 1:05CV02102 (EGS), SBC/AT&T merger; Verizon/MCI merger, Civil Action No. 1:05CV02103 (EGS) (1996), on behalf of the National Association of State Utility Consumer Advocates (NASUCA); Illinois Commerce Commission Docket No. 09-0268, Verizon sale of its Illinois exchanges to Frontier Communications, Inc. (2009), on behalf of the People of the State of Illinois and the Citizens Utility Board; and FCC WT Docket No. 11-65, AT&T/T-Mobile merger (2011), on behalf of the Ad Hoc Telecommunications Users Committee.

6. I have published several articles dealing specifically with Net Neutrality and related Open Internet issues, including "Revisiting the Regulatory Status of Broadband Internet Access: A Policy Framework for Net Neutrality and an Open Competitive Internet," (with Helen E. Golding), *Federal Communications Law Journal*, Vol. 63 Num. 1, December 2010. I have also contributed chapters to two recent American Bar Association publications, "Network Industry Markets: Telecommunications" (with Helen E. Golding), Chapter X in *Market Definition in Antitrust: Theory and Case Studies*, ABA Section of Antitrust Law (2012), at pp. 411-436, and "Economic Underpinnings: The Economics of Communications Networks, Market Power, and Vertical Foreclosure Theories" (with Helen E. Golding et al), Chapter I in *Telecom Antitrust Handbook, Second Edition*, ABA Section of Antitrust Law (2013), at pp. 1-61.

7. In addition to my various professional activities, I am an elected Town Meeting Member in the Town of Brookline, Massachusetts, and serve on the Town's Advisory and Finance Committee and on the Town's Audit Committee, and have recently served on a special Tax Override Study Committee.

Assignment

8. I have been asked by the Office of Ratepayer Advocates ("ORA") of the California Public Utilities Commission ("CPUC" or "Commission") to review Application 15-03-005 filed herein by Frontier Communications Corporation ("Frontier") and by Verizon California, *et al* ("Verizon") (collectively, "Joint Applicants"), together with their Applications and accompanying expert reports and other related documentation, and based thereon to provide the

Commission with an assessment of the various economic and other public interest benefits being ascribed to the transaction by the Joint Applicants, the potential impact of the proposed transaction upon competition for broadband telecommunications and Internet access services, voice telephone services including both circuit-switched and VoIP, within the Joint Applicants' individual and combined California operating areas, the fairness of the transaction to the two companies' shareholders, and to offer specific recommendations to the Commission regarding the manner in which economic benefits of the transaction are to be shared with ratepayers and other conditions that will protect the public interest, together with recommendations for the disposition of this Application.

Summary and Recommendation

9. The proposed transfer of control of Verizon's ILEC operations in California to Frontier has the potential to be in the public interest, provided that the conditions for approval as outlined in Section VIII of this Reply Testimony are adopted and enforced. Indeed, and as I will discuss in detail in this Reply Testimony, Frontier may well turn out to be a better steward of California's wireline and broadband telecommunications resources than Verizon, which has in recent years been actively seeking to extricate itself from the wireline telephone and broadband business nationally. However, there is no assurance, absent affirmative measures by the CPUC, that the various benefits being claimed by Frontier in support of the transaction will actually flow through to ratepayers. For example, Frontier has estimated that beginning in the third year following the Closing of this transaction, the company will realize some $700-million annually "in total annualized corporate consolidated operating cost savings" a substantial portion of which

is attributed to the avoidance of certain "Verizon-allocated centralized corporate costs that will not transfer with this Transaction." However, there is no specific assurance in the Frontier evidence that any portion of this gain will flow to ratepayers rather than shareholders. In fact, the Discounted Cash Flow valuation analysis conducted by Frontier and presented to its Board of Directors appears to assume that the entire savings will flow to EBITDA without any ratepayer sharing.

10. Verizon has for a number of years been systematically disengaging from the wireline business and has been disinvesting in wireline, choosing instead to direct its management focus and capital resources to mobile wireless and related content services (see Section V). By contrast, Frontier is a pure-play wireline company that is far more likely to support and expand wireline activities – particularly in broadband – than is Verizon, which had some five years ago announced that its infusion of new capital investment in a fiber-to-the-home ("FTTH") broadband architecture branded as *FiOS* had come to an end.[1] As I shall discuss in Section V, Verizon also appears to have been deliberately shifting the costs of certain corporate service activities toward its ILEC operations and away from its other lines of business, burdening the ILECs with costs that are being incurred for the benefit of Verizon's non-ILEC operations. Frontier has estimated that beginning in the third year following the Closing of this transaction, the company will realize some $700-million annually "in total annualized corporate consolidated

1. See Robert Cheng, "Verizon to End Rollout of FiOS," *Wall Street Journal*, March 30, 2010, http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052702303410404575151773432729614.html.

operating cost savings"[2] a substantial portion of which is attributed to the avoidance of certain "Verizon-allocated centralized corporate costs that will not transfer with this Transaction."[3] Eliminating these artificial and inflated costs has the potential to make additional resources available for network enhancements and broadband expansion, and could alter the perception of wireline telecom as being an unprofitable business activity. In approving the proposed transaction, the Commission will want to adopt measures intended to assure that a significant portion of these cost savings and other efficiencies flow to ratepayers and other customers of a post-transaction Frontier by, among other things, requiring that the savings be directed toward broadband expansion and other network improvements rather than being used simply to enhance Frontier's bottom line. Indeed, satisfaction of several of the requirements of Public Utilities ("PU") Code §854 cannot be assured without the imposition of such affirmative conditions.

11. The transaction will have no measurable adverse impact upon competition either for traditional voice telephone service or for high-speed broadband Internet access. Frontier currently serves approximately 74,101 residential customers in California;[4] by comparison, Verizon was, as of the end of 2014, serving some 2.39-million California access lines.[5]

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2. Direct Testimony of John M. Jureller, Executive Vice President and Chief Financial Officer, Frontier Communications Corp. ("Jureller"), at 12.

3. *Id.*, at 11.

4. Direct Testimony of Kathleen Q. Abernathy, Executive Vice President – External Affairs, Frontier Communications Corp. ("Abernathy"), at 14, Table 2, citing Frontier 2014 Form 10-K, at 9.

5. CPUC *Service Quality Standards Reporting, General Order No. 133-C*, Verizon California, as of December 31, 2014. available at (accessed 7/20/15): http://www.cpuc.ca.gov/PUC/Telco/Consumer+Information/Telecommunications+Service+Quality+Reports.htm

Following the transaction, Frontier's service area in the state will thus include roughly 2.46-million access lines, not substantially different from Verizon's current operating footprint.

12. PU Code §854 requires that the Commission make certain findings before it approves a change of control of the type being sought in the instant Application. In this Reply Testimony, I address the following specific §854(b) and (c) requirements:

> §854(b) Before authorizing the merger, acquisition, or control of any electric, gas, or telephone utility organized and doing business in this state, where any of the utilities that are parties to the proposed transaction has gross annual California revenues exceeding five hundred million dollars ($500,000,000), the commission shall find that the proposal does all of the following:
>
> (1) Provides short-term and long-term economic benefits to ratepayers.
>
> (2) Equitably allocates, where the commission has ratemaking authority, the total short-term and long-term forecasted economic benefits, as determined by the commission, of the proposed merger, acquisition, or control, between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits.
>
> (3) Not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result.
>
> §854(c) Before authorizing the merger, acquisition, or control of any electric, gas, or telephone utility organized and doing business in this state, where any of the entities that are parties to the proposed transaction has gross annual California revenues exceeding five hundred million dollars ($500,000,000), the commission shall consider each of the criteria listed in paragraphs (1) to (8), inclusive, and find, on balance, that the merger, acquisition, or control proposal is in the public interest.
>
> (1) Maintain or improve the financial condition of the resulting public utility doing business in the state.

(5) Be fair and reasonable to the majority of all affected public utility shareholders.

(6) Be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility.

Other provision of §854 are being addressed by other ORA experts.

13. The transaction will potentially provide short-term and long-term economic benefits to ratepayers as required by §854(b)(1), but without the Commission's imposition of specific conditions for approval, there can be no assurance that such benefits will be equitably allocated between shareholders and ratepayers, or that ratepayers will receive not less than 50 percent of those benefits as required by §854(b)(2). The transaction will not adversely affect competition, as required by §854(b)(3); however, there is no specific assurance that, without the deployment of additional high-speed (i.e., greater than 25 Mbps download speed) broadband by Frontier after it assumes control of the Verizon California network, the transaction will result in increased competition within the expanded Frontier operating territory.

14. Although the acquisition of the three Verizon operating companies will roughly double the size of Frontier's operations nationwide, Frontier plans to finance the transaction with a combination of debt and equity so as to roughly maintain existing debt ratios and Enterprise Value/EBITDA ratios. On this basis, §854(c)(1) appears to have been satisfied. Moreover, both Verizon and Frontier shareholders stand to realize a substantial net economic gain from the transaction – for Verizon, because the sale price of the three ILECs to Frontier is well in excess of net book value, and for Frontier, because the economic value of the three companies to

Frontier is also well in excess of the purchase price, thus satisfying the requirements of §854(c)(5) for the shareholders of both utilities. Finally, substituting a company with a demonstrated commitment to wireline telecommunications for one that has for years been running away from this segment has the potential to be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility, thus satisfying the requirements of §854(c)(6). However, for the various reasons I will discuss in detail herein, without the adoption of several important affirmative conditions for approval, there can be no assurance that the significant economic benefits that Frontier will realize from this transaction will flow to state and local economies, to the communities served by the two utilities involved in the transaction, or to their ratepayers. Accordingly, the Commission should only authorize the transaction to go forward with the conditions that ORA is recommending so as to assure that the various requirements of §854 are satisfied.

(1) Verizon should be held financially accountable for repairs to any of their network assets that are not operational for the functions for which they were designed. This includes, but is not limited to, the Commission holding Verizon accountable to and financially responsible for repairing all company-related facilities that were the subject of complaints reported during the proceeding's Public Participation Hearings (PPHs) and Workshops prior to the closing of the transaction.

(2) Prior to approving the Transaction, the Commission should hold Verizon accountable to warrant that the network assets being transferred to Frontier satisfy all minimum CPUC quality standards.

(3) Frontier's right-to-use license(s) with respect to any Verizon-owned FiOS software, including but not limited to the Interactive Media Guide ("IMG"), should be extended indefinitely.

(4) Subject to certain limitations, Verizon should be required indefinitely to provide Frontier with software support and maintenance comparable to what it will be providing on an ongoing basis to its remaining ILECs, at reasonable cost-based charges.

(5) The Commission should disallow provisions in the Securities Purchase Agreement for purposes of the California transaction whereby Frontier is being required to pay 100% of any costs imposed by regulators as a condition for approval, and/or should require that Verizon accept such disallowance as a condition of approval.

(6) Frontier should expand broadband services at speeds of no less than the FCC's definition of minimum broadband speeds, currently 25 Mbps download and 3 Mbps upload, to 98% of households in its new service territory by no later than December 31, 2020.

(7) Frontier should provide an unredacted copy of its FCC 477 data for Internet Access Services and Local Telephone Services to the CPUC and the ORA every time it files with the FCC.

My testimony assumes that Verizon will apply for and accept federal Connect America Fund ("CAF") Phase II funding by August 27, 2015. If Verizon does not apply for and accept CAF II funding by the August 27, 2015 deadline, then I reserve the right to change the analysis and recommendations in my testimony. Verizon has had an obligation to maintain and support its copper network and to apply for and accept federal CAF funding to further build out broadband in unserved and underserved areas. Verizon should not be allowed to escape these obligations merely by selling off its California ILEC operations to Frontier. The Commission should assure that Frontier is provided with infrastructure that meets the CPUC's service quality standards, and that Frontier is not immediately burdened with having to bear the cost of needed repairs that Verizon should have been making all along. The proposed transaction is in the public interest only if the conditions outlined above are adopted. And if the Commission denies the transaction or if Verizon walks away, the Commission should nevertheless hold Verizon accountable to fix its network and to expand the availability of high-speed broadband throughout its operating territory. Whether or not the transaction goes forward, Verizon should pay for its failure to maintain its network and for its failure to use federal CAF support to further build out its broadband network.

II.

GENERAL DESCRIPTION OF THE TRANSACTION AND SHAREHOLDER IMPACTS

15. The proposed transaction calls for Verizon to sell to Frontier three of its ILEC operating companies – Verizon California, Verizon Florida, and GTE Southwest in Texas. Both Verizon and Frontier have utilized the codeword “Project Guava” for this transaction; for convenience, I shall throughout this Reply Testimony refer to the three ILECs collectively as the “Guava Companies” or “Guava ILECs.” With certain exceptions, the three ILEC entities are to be transferred to Frontier intact, including most physical assets, customers, business activities, and employees. The proposed mechanics of the transaction involve the creation by Verizon of a new wholly-owned subsidiary referred to as “Newco West Holdings LLC” (“Newco”).[6] Once formed, Verizon will transfer to Newco the three Guava Companies along with certain other assets, rights, licenses, and lines of business not currently within the ILECs’ portfolio.[7] At closing, Frontier will pay Verizon a total of $10.54-billion, consisting of $9.95-billion in cash and the remaining $594-million in assumed Verizon debt, and will acquire ownership of Newco.[8]

16. An overarching concern in any “change of control” type of investigation is whether, on balance, the transfer of ownership and management responsibility for an essential public resource – a major telecommunications common carrier utility in this instance – to a new

6. Jureller, at 9.

7. *Id.*

8. *Id.*, at 20.

operator will be in the public interest. PU Code §854 identifies a number of specific public interest considerations that the Commission is required to evaluate. §854(c)(6) requires that the Commission find that the transaction will "[b]e beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility." In making this evaluation, it is useful to consider the current and likely future business interests and directions of both the existing and the proposed operators, Verizon and Frontier in this case. A brief history of the two companies and their respective interest in the wireline telecommunications business is thus a useful place to begin this examination. As I will discuss in detail below, Verizon's interest in wireline has been on the decline in recent years, as the company has both sold off large blocks of its wireline business and cut back on new investment in the geographic areas it has continued to serve, while Frontier has been aggressively acquiring wireline territories from Verizon, AT&T and others. A change of control from Verizon to Frontier offers the prospect of shifting the stewardship of these wireline assets away from a company that appears to have lost interest in this line of business over to one that has been making large commitments toward expanding its wireline footprint.

A brief history of Verizon

17. Verizon maintains a complex corporate structure consisting of some BEGIN VERIZON CONFIDENTIAL << [redacted] >> END VERIZON CONFIDENTIAL separate domestic and foreign subsidiaries and affiliates.[9] Verizon was formed in 2000 through the merger of Bell Atlantic and GTE Corp.[10] Bell Atlantic was one of the seven original Regional Bell Operating Companies ("RBOCs") created in conjunction with the January 1984 break-up of AT&T Corp. as required by the 1982 Consent Decree entered into by AT&T and the United States Department of Justice in settlement of the 1974 *U.S. v. AT&T et al.* antitrust case.[11] Prior to its 2000 merger with GTE (which was never itself part of AT&T or the "Bell System"), Bell Atlantic in 1998 had first merged with another one of the original RBOCs – NYNEX Corp.[12] At that point, Bell Atlantic was the dominant ILEC in 12 northeast states plus the District of Columbia, and was providing wireless services nationally (via roaming agreements with other carriers) but its wireless network was mainly concentrated in the northeast US. In 2000, Bell Atlantic merged with GTE to form what is now Verizon. In addition to acquiring GTE's ILEC operations, the merger also expanded the size and reach of Verizon's wireless operations with the inclusion of GTE

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9. Verizon Response to ORA Data Request, Set 5, No. 1, Verizon Communications, Inc. April 29, 2015 Hart-Scott-Rodino filing ("Verizon HSR"), at Bates nos. A1503005VZ60078-60114

10. FCC, *GTE Corporation Transferor and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, WC Docket No. 98-184, *Memorandum Opinion and Order*, June 16 2000.

11. *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 139 (D.D.C. 1982).

12. Immediately following the 1984 break-up of AT&T, Bell Atlantic was providing ILEC services in New Jersey, Pennsylvania, Delaware, Maryland, Virginia, West Virginia, and the District of Columbia. NYNEX was serving the states of Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and New York, plus one small area of Connecticut.

Mobilnet, GTE's wireless affiliate. Following the merger, Verizon Wireless ("VZW") had approximately 27.5-million subscribers nationwide, and was at that time the largest US wireless carrier.[13]

18. At the time of the merger, GTE was the largest Independent telephone company in the US, serving some 26-million access lines across 28 states.[14] The designation of "Independent" was used to refer to any ILEC that was not previously owned by AT&T or considered part of the Bell System prior to the AT&T break-up. The only state in which GTE was the sole local telephone service provider was Hawaii; its operating territories in the remaining 27 states varied from small mostly rural areas to portions or all of several large metropolitan areas, including large portions of the Los Angeles and Dallas metropolitan areas and all of the Tampa/St. Petersburg metro. In 2006, Verizon completed its merger with MCI,[15] and shifted most of its medium/large/enterprise business to the MCI entity (renamed "Verizon Business").[16]

19. Beginning just months after its merger with GTE in 2000, Verizon began the process of selling off portions of its wireline ILEC operations. The first of these involved the sale of portions of what had been GTE Southwest's operating areas in New Mexico and Oklahoma to

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13. Verizon Communications Inc., 2000 Form 10-K, March 23, 2001, at 13.

14. GTE Corporation, 1999 Form 10-K, March 30, 2000, at 2.

15. *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-75, *Memorandum Opinion and Order*, November 17, 2005.

16. Verizon Communications Inc. 2006 Annual Report to Shareholders, at 8, 24.

Valor Communications.[17] GTE Southwest's Texas operations were retained, and are now one of the entitles being sold to Frontier. In 2005, Verizon sold its wireline and directory businesses in Hawaii, including Verizon Hawaii Inc., to an affiliate of the private equity firm The Carlyle Group.[18] In 2007, it sold its three Northern New England territories (Maine, New Hampshire and Vermont) to FairPoint Communications, a small North Carolina-based Independent ILEC.[19] In 2010, Verizon's former GTE operations in 13 states along with the former Bell ILEC in West Virginia, were sold to Frontier.[20] Verizon retained the former GTE operations in California, Texas and Florida, along with small former GTE territories in Pennsylvania, Virginia, and North Carolina.[21] Verizon had also acquired several offshore GTE ILEC operations in the Northern Mariana Islands, the Dominican Republic, and Puerto Rico. These were divested in 2005,[22] 2006, and 2007, respectively.[23] Following completion of the proposed transaction, Verizon will have divested its ILEC operations in 25 of the former GTE states plus four former Bell states. The only GTE territories that will remain within Verizon's portfolio are those in Pennsylvania and Virginia, states where Verizon still operates the legacy Bell Atlantic ILEC and in North

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17. Automated Reporting Management System ("ARMIS") Corporate History Verizon GTE Southwest, Inc. d/b/a Verizon Southwest.

18. Verizon Communications Inc. 2006 Annual Report, p. 27.

19. Verizon Communications Inc. 2008 Annual Report, p. 30.

20. *Frontier Communications Corporation and Verizon Communications Inc. for Assignment or Transfer of Control*, FCC WC Docket No. 09-95, *Memorandum Opinion and Order*, Rel. May 21, 2010.

21. ARMIS Corporate History Verizon GTE Corporation (GTTC).

22. ARMIS Corporate History Micronesian (GTMC).

23. Verizon Communications Inc. 2006 Annual Report, at 34.

Carolina. After the sale of the Guava Companies to Frontier, Verizon's remaining wireline ILEC footprint will be limited to eight northeastern states plus the District of Columbia plus two small territories in Connecticut and North Carolina. And recent reports in the financial press have suggested that Verizon may be shopping for a buyer of these properties as well,[24] a move that would transform Verizon into a wireless-only business.

20. Immediately prior to the Bell Atlantic/GTE merger, then-Bell Atlantic's wireless operations, which had been merged with those of NYNEX about three years prior to the full merger of the two RBOCs in 1997, was serving some 5.36-million customers.[25] GTE's wireless business, known as GTE Mobilnet, was at the time serving 4.49-million subscribers.[26] Shortly after the Bell Atlantic/GTE merger was completed, Verizon later that same year entered into a partnership with Vodaphone, the largest UK-based wireless carrier with extensive coverage throughout the US and Europe. At the time of the transaction, Vodaphone was the second largest US wireless carrier, having previously acquired Airtouch – the former Pacific Telesis wireless affiliate that was spun off by Pacific Telesis in 1994[27] and which had subsequently acquired several other wireless providers, including New Vector, the former wireless affiliate of US West, one of the seven original RBOCs, and PrimeCo Personal Communications, L.P. Under the terms of the deal, Vodaphone contributed all of its US wireless holdings and, together

24. "Altice and Verizon Wireline? Really?," Powell, R. (June 4, 2015). in *Telecom Ramblings*, http://www.telecomramblings.com/2015/06/altice-and-verizon-wireline-really/ [accessed on July 15, 2015]/

25. FCC *Third Annual CMRS Competition Report*, Rel. June 11, 1998, at B-11.

26. *Id.*

27. AirTouch Communications 1993 Form 10-K, March 23, 1994, at 4.

with Verizon's US wireless network (which, by then, had included GTE Mobilnet), formed a new entity known as Cellco Partnership. Cellco Partnership, which did business in the US under the Verizon Wireless ("VZW") brand name, was, upon its formation in 2000, the largest wireless carrier in the US.[28] Vodaphone acquired a 45% interest in Cellco, and Verizon Wireless held the other 55%.[29] One of the original objectives of the VZW/Vodaphone deal was to create a multinational wireless service footprint; that goal was never realized for a variety of reasons, not the least of which was that Verizon and Vodaphone were each using incompatible wireless technologies, thereby preventing handset interoperability across the two companies' networks.[30] In February 2014, Verizon bought out Vodaphone's 45% share of Cellco Partnership for $130-billion,[31] and now owns all of the Cellco wireless assets outright. In the years following the GTE merger, Verizon Wireless made several additional acquisitions, including Rural Cellular Corp in 2008 and Alltel in 2009.[32]

21. Included within the family of Verizon subsidiaries and affiliates are several centralized corporate services entities that provide a broad range of services to the wireline, wireless and

28. Verizon Communications Inc. 2000 Form 10-K, March 23, 2001, at 13.

29. Verizon Communications Inc. 2001 Annual Report, at 14.

30. Vodaphone, like all other European wireless carriers, had adopted the Global System for Mobile Communications ("GSM") standard, whereas Verizon had committed to CDMA. GSM handsets could not operate on CDMA networks, and vice versa.

31. "Verizon Reaches Agreement to Acquire Vodafone's 45 Percent Interest in Verizon Wireless for $130 Billion," Verizon press release, September 2, 2013, available at: http://www.verizon.com/about/news/verizon-reaches-agreement-acquire-vodafones-45-percent-interest-verizon-wireless-130-billion; [accessed on July 14, 2015]

32. Verizon Corporate History http://www.verizon.com/about/sites/default/files/Verizon_Corporate_History.pdf [accessed on July 14, 2015], at 4.

other operating units, including IT, billing, accounting, legal, engineering, purchasing, corporate governance, among others. Verizon charges the operating entities for these services via "allocated costs" that are spread across the various companies according to some internal formula that may or may not bear any direct relationship to the actual costs of the services furnished to each. As I shall discuss in more detail below (Section V.), it appears as if the "allocation" formula is weighted toward Verizon's ILEC units and away from its other operations, such that the ILECs bear a disproportionate share of the total costs of these centralized services. Based in part upon its experience following the 2010 acquisition from Verizon, Frontier has concluded that it can perform these same functions for the three Guava Companies at a cost that is significantly less than the current Verizon "allocations" and, indeed, its expectations in this regard are a major economic driver of the transaction.[33]

A brief history of Frontier

22. Frontier had its genesis as Rochester Telephone Corporation[34] ("RTC"), an ILEC whose service area consisted of the Rochester, New York metropolitan area. RTC was at the time the largest Independent telephone company not affiliated with any other ILEC system or holding company. As far back as 1993, RTC had proposed an innovative restructuring arrangement to accommodate the then-emerging competition in the local exchange market. It proposed to split itself into separate "retail" and a "wholesale" entities, with the latter providing underlying

33. Jureller, at 11.

34. Frontier Corporation New York, Press Release in 8-K filing, April 2, 1996, at 1.

network services to RTC's retail operation as well as to competing local carriers. The retail entity would compete with other potential providers, buying service in bulk and as a reseller would not be subjected to full regulatory oversight as would the wholesale entity.[35] Although the specific RTC plan was never implemented as envisioned, it is noteworthy that the wholesale/retail structure ultimately adopted by the UK Office of Communications ("Ofcom") for British Telecom bears a striking resemblance to the original RTC plan.[36]

23. While it is clear that Verizon is shedding its wireline operations generally, and its GTE territories in particular, nearly all of Frontier's investments over the past 20 years have been in wireline operations, which have included the acquisition of a number of GTE territories. In 1993 RTC acquired half a million access lines from GTE. Just six years later, the company made a series of acquisitions from GTE in Arizona, California, Minnesota, Nebraska, and Illinois that amounted to 361,000 additional access lines.[37] To date, Frontier continues to invest heavily in wireline operations both within and outside GTE territories. In 2007, the company acquired nearly half a million access lines in Pennsylvania from Commonwealth Telephone Enterprises, Inc. In that same year, Frontier acquired small ILEC properties in California from Global Valley Networks, Inc. Frontier's largest acquisition was in 2010 when it acquired roughly half of the former GTE ILEC properties from Verizon. That acquisition more than doubled Frontier's size.

35. Rochester Telephone Corporation, Form 8-K, November 18, 1994, at 2.

36. "[British] Telecom splits retail and wholesale," http://www.nbr.co.nz/article/telecom-splits-retail-and-wholesale [accessed on July 15, 2015]

37. Application, at 33, fn. 55.

In approving the 2010 transaction, the CPUC found that "Frontier and its operating companies have a long history in serving rural areas in California and elsewhere;" and that the transaction "will accelerate Frontier's growth, creating a much larger company with increased financial strength and flexibility."[38] Frontier's most recent acquisition was from AT&T, adding nearly one million access lines in Connecticut, now its largest market. Frontier is today the nation's fourth largest ILEC with roughly 3.5-million residential and business customers across 28 states. The proposed acquisition of Verizon's three remaining former GTE areas would roughly double the size of Frontier.[39]

24. Table 1 below compares the total company switched access lines in service of Verizon and Frontier between 2000 and the end of 2014. Figure 1 provides this same data graphically. As Verizon's presence in this segment has declined, Frontier's has mushroomed:

38. *Joint Application of Frontier Communications Corporation et al. and Verizon West Coast Inc. et al for Approval of the Sale of Assets, Transfer of Certificates and Customer Bases, and Issuance of Additional Certificates*, A.09-06-005, D.09-10-056, Nov. 4, 2009, *slip op.*, at 15. Provided as Frontier Response to ORA Data Request Set 1, No. 17, CA Approval.pdf. Bates no. FTR ORA 003577.

39. "Frontier Communications to Acquire Verizon's Wireline Operations in California, Florida and Texas, Doubling Frontier's Size and Driving Shareholder Value," Press Release, February 5, 2015 http://investor.frontier.com/releasedetail.cfm?ReleaseID=895055 [accessed on July 15, 2015].

Table 1

**FRONTIER AND VERIZON
TOTAL SWITCHED ACCESS LINES IN SERVICE
(Nationwide – 2000-2014)**

Year	Frontier	Verizon
2000	996,800	59,127,334
2001	2,481,400	57,836,507
2002	2,444,400	55,703,435
2003	2,386,700	54,369,588
2004	2,321,000	51,889,712
2005	2,219,000	47,650,115
2006	2,126,574	43,920,668
2007	2,429,142	40,285,195
2008	2,254,333	36,161,000
2009	2,117,512	32,561,000
2010	5,745,718	26,001,000
2011	5,266,916	24,137,000
2012	4,880,017	22,503,000
2013	4,727,935	21,085,000
2014	5,412,750	19,795,000

Source: Frontier Form 10-K reports. Beginning in 2012, Frontier changed its reporting from Access Lines to Customers. Figures for 2012-2014 are estimates based upon a conversion factor for access lines-to-customers of 1.5379 calculated by dividing the number of access lines (5,373,859) by the number of customers (3,494,294) provided in Frontier 2012 3rd quarter 10-Q filing, the last filing in which both quantities are provided. Verizon ARMIS reports 2000-2007; 10-K 2008-2014.

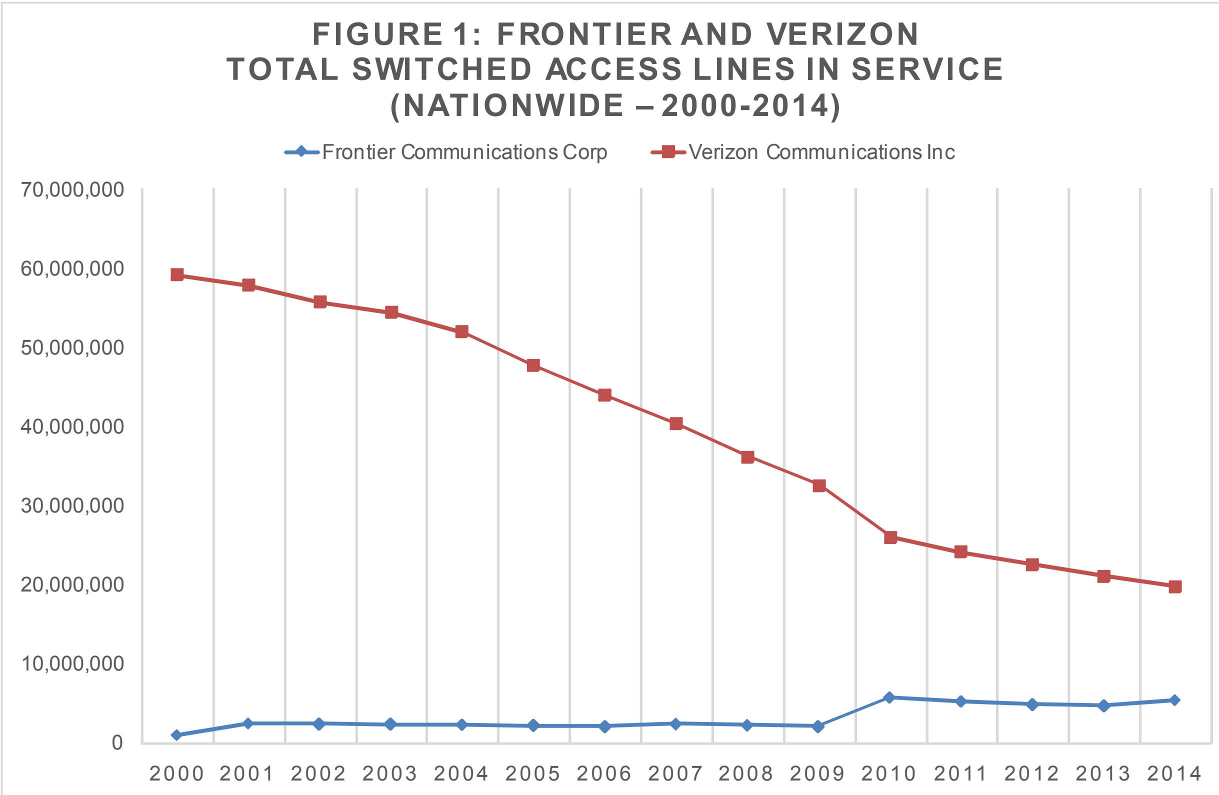

Figure 1: Frontier and Verizon Total Switched Access Lines in Service between 2000 and 2014.

Frontier currently has a minimal presence (approximately 1.07%) in California serving census blocks containing only 135,551 of the total 12.65-million access lines statewide. Following this transaction, however, Frontier will become the second largest ILEC in the state, serving some 20.78% of the total California wireline market.[40]

40. Pre-transaction Verizon California serves census blocks containing 2,628,438 households, which is 20.78% of the total 12.65-million California households as estimated by the US Census Bureau for 2013. (accessed 7/22/15) http://www.dof.ca.gov/research/demographic/state_census_data_center/american_community_survey/

The transaction

25. The terms and details of the proposed transaction are set out in a "Securities Purchase Agreement" ("SPA") entered into by and between Verizon and Frontier on February 5, 2015. Under the terms of the SPA, Frontier will pay Verizon $10.54-billion for "Newco," consisting of $9.94-billion in cash and the balance in an assumption of Verizon debt.[41] Frontier has received a commitment for bridge financing from J.P. Morgan, Bank of America Merrill Lynch and Citibank for 100% of the purchase price. The transaction is not subject to a financing condition.[42]

26. Most of the assets, operations and business of the three Guava ILECs will be taken over by Frontier, with some exceptions. Generally, Verizon affiliates that provide local and long distance services to larger business and enterprise customers will retain that business. However, certain services currently being furnished by Verizon affiliates to retail customers of the three Guava Companies will be transferred to Frontier. These include DSL and *FiOS*, as well as Verizon's *FiOS*-based multichannel video distribution ("MVPD") service, and long distance services. *FiOS* and DSL are furnished to Verizon retail customers under a complex arrangement. The underlying fiber-to-the-home ("FTTH") infrastructure is owned by the individual Verizon ILECs, Verizon California in this case. The retail provider of DSL and the various *FiOS* services is a Verizon affiliate known as Verizon Online LLC ("VON"), which leases the

41. Frontier Communications February 5, 2015 Form 8-K, at 2. Bates No. FTR ORA 001006.

42. Frontier Communications 2014 Form 10-K, at F-47.

underlying DSL and FTTH facilities from the Verizon ILECs and is thus the nominal "provider" of *FiOS* broadband and video services to the Verizon ILEC retail customers. Billing for the service is provided by the Verizon ILECs on behalf of VON. There is a similar arrangement insofar as the retail provision of long distance services to Verizon ILEC customers. The "provider" is Verizon Long Distance LLC ("VLD"), which purchases switched and special access services from the Verizon ILECs (and from other ILECs) and routes traffic originated by the Verizon ILEC retail customers over VLD's network. As with *FiOS*, billing is furnished by the Verizon ILECs on behalf of VLD. Under the terms of the transaction, VLD and VON are being retained by Verizon, but all of their *customers* whose local service is furnished by any of the three Guava Companies will be transferred to Frontier as well. Note that it is the *business* of VLD and VON with respect to the Guava ILECs' retail customers that is being transferred to Frontier, not any actual VLD or VON assets. It is possible that one or both of these Verizon affiliates own physical assets that are located in the Verizon ILEC central offices. If this is the case, it would appear that those assets are excluded from the transaction, and will be retained by the Verizon affiliate.[43] Frontier will then be the owner of the DSL and FTTH network assets, and will route Guava ILEC-originated long distance traffic via its own long distance affiliate rather than VLD.[44]

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43. Verizon may not require that its affiliates' assets that are collocated in Verizon ILEC central office buildings be confined to a "collocation cage" as would be required for any non-affiliated company. Presumably, after the transaction is closed, Frontier will impose such separation requirements on any VON, VLD and other Verizon affiliate collocations.

44. Only customers who are presubscribed to Verizon Long Distance will be switched to Frontier's long distance affiliate. Customers whose PIC is other than VLD will not be affected. Responses of Verizon California Inc. and Frontier to Questions Submitted by ORA by Letters Dated May 29, 2015, at 4.

III.

THE FINANCIAL ASPECTS OF "PROJECT GUAVA" THE CA/TX/FL ACQUISITION

The transaction's effect upon utility shareholders

27. §854(c)(5) requires that the Commission determine that the transaction will "[b]e fair and reasonable to the majority of all affected public utility shareholders." The $10.54-billion sale price is BEGIN VERIZON CONFIDENTIAL <<[redacted]>>END VERIZON CONFIDENTIAL book equity value of the assets being transferred;[45] hence Verizon shareholders will realize a net capital gain of some BEGIN VERIZON CONFIDENTIAL <<[redacted]>> END VERIZON CONFIDENTIAL. Verizon has developed an "Enterprise Value" of the assets being transferred at BEGIN VERIZON CONFIDENTIAL <<[redacted]>> END VERIZON CONFIDENTIAL,[46] resulting in BEGIN VERIZON CONFIDENTIAL <<[redacted]>> END VERIZON CONFIDENTIAL in the total economic value of the company to its shareholders. Verizon management and directors apparently believe that the Company has investment opportunities that will produce a greater return than continued operations of these three ILECs. The transaction will provide a large infusion of cash to support such investments, and potentially create new competitive opportunities for Verizon going forward. BEGIN VERIZON CONFIDENTIAL<<[redacted]

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45. Verizon Highly Confidential Response to ORA Data Request, Set 5, No. 1., Verizon Hart-Scott-Rodino submission ("Verizon HSR"), at Bates no. A1503005VZ60165. In its Confidential Response to ORA Data Request Set 8, No. 2, Verizon provided an alternate – and lower – figure for the Net Book Value of the Guava Companies at BEGIN CONFIDENTIAL<<[redacted]>>END CONFIDENTIAL.

46. *Id.*, at Bates no. A1503005VZ60412.

[redacted][47] [redacted][48] [redacted]>>END VERIZON CONFIDENTIAL.

28. Notably, one thing that Frontier is *not* getting from Verizon is any sort of a non-compete agreement. Verizon will thus have the right to compete for the business of its former (now Frontier) customers immediately following the transaction.[49] While it is extremely unlikely that Verizon will attempt to recapture any of its former *retail* wireline residential and small business customers to Verizon-provided wireline services, after having divested these three ILECs, Verizon certainly could seek to migrate the (then) Frontier ILEC (including *FiOS*) customers to wireless voice, data and broadband services furnished by VZW. Verizon will also be retaining existing large business and enterprise customers currently being served by any of several

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47. Verizon HSR, at Bates no. A1503005VZ60340.

48. VZ closed at 46.35 on 7/23/15, and currently pays $2.20 per share annually in dividends, resulting in a dividend yield of 4.60%. Source: Yahoo Finance, at http://finance.yahoo.com/q;_ylc=X1MDMjE0MjQ3ODk0OARfcgMyBGZyA3VoM19maW5hbmNlX3dlYgRmcjIDc2EtZ3AEZ3ByaWQDBG5fZ3BzAzEwBG9yaWdpbgNmaW5hbmNlLnlhaG9vLmNvbQRwb3MDMQRwcXN0cgMEcXVlcnkDVlosBHNhYwMxBHNhbwMx?p=http%3A%2F%2Ffinance.yahoo.com%2Fq%3Fs%3DVZ%26ql%3D0&fr=uh3_finance_web&uhb=uh3_finance_vert&s=VZ

49. Under the SPA, Verizon may not solicit any of the customers that are to be transferred to Frontier prior to the closing. SPA, §6.2; see also, VZ/FTR Response to ORA May 29, 2015 letter, item 12.

Verizon affiliates other than the local Verizon ILEC. At least some of these "enterprise business" oriented affiliates are the successor to MCI, which Verizon acquired in 2006. Many of the physical assets involved in such businesses are owned by the affiliate, not by the ILEC, and are being retained by Verizon. The affiliate may, however, lease special access and other services from the transferring ILEC entities, and those wholesale service relationships will apparently persist post-Closing, although there is no specific requirement that this be the case.

29. Frontier estimates the economic value of the assets being acquired at between BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL,[50] which is above the $10.54-billion purchase price. The difference appears to be due primarily to the significant savings in annual operating expenses that will arise when the "allocated costs" being paid to various Verizon service affiliates are replaced by actual cost-based expenses. Frontier thus believes that the transaction will increase shareholder value. Frontier does not appear to have quantified or ascribed any specific monetary amount to the lack of a non-compete agreement from Verizon.

30. Frontier has spent or will spend some BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL on fees paid to financial advisors and investment bankers in connection with this transaction,[51] and has estimated integration costs at $450-

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50. Frontier HSR, at Bates nos. FTR ORA 016809, 016815, based upon industry trading multiples and discounted cash flow methodologies, respectively

51. Frontier Confidential Response to ORA Data Request Set 8, No. 1.

million.[52] Together, these payments are BEGIN FRONTIER CONFIDENTIAL<<[redacted]>>END FRONTIER CONFIDENTIAL Frontier's estimated first year savings, and roughly BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL the $283.4-million that Frontier was recently awarded in CAF support with respect to its *existing* operating areas.[53] Frontier states that "[t]he advisor and financing fees are negotiated rates and are customary for transactions of this size and complexity. Advisor fees are not contingent on outcome of transaction but are dependent [sic] the complexity, scope of the work, amount and duration of financing, and the level of financial risk."[54] It is not at all clear what "advice" Frontier received from JPMorgan that would justify a BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL fee, BEGIN FRONTIER CONFIDENTIAL<<[redacted]>>END FRONTIER CONFIDENTIAL is payable at the transaction closing[55] – particularly since JPMorgan does not appear to have played any role in bringing the parties together nor in the negotiations relating to price and terms.

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52. Jureller, at 14.

53. FCC, *Frontier Communications Accepts Over $283 Million Connect America Fund Offer to Expand and Support Broadband for 1.3 Million Rural Americans*, June 16, 2015. Because this offer was based upon the *existing* Frontier operating areas, California's share of the $283-million is only about $6-million.

54. Frontier Confidential Response to ORA Data Request Set 8, No. 1.

55. *Id.*

The issuance of additional Frontier stock to finance the transaction.

31. Mr. John M. Jureller, Frontier's Executive Vice President and Chief Financial Officer, explains that Frontier has secured an 18-month "bridge loan" from several investment banking firms as a backup, but actually intends to finance the purchase through a combination of newly-issued debt and equity: "Frontier expects to issue approximately $3 billion in equity and/or equity-linked securities, with the remainder of the purchase price financed in the debt markets; all financing activity is expected to occur in the second half of 2015."[56] According to Mr. Jureller, Frontier's agreement with Verizon does not contain any financing contingency.[57]

32. Mr. Jureller notes that the proposed transaction does not materially affect Frontier's Leverage Ratio (the measure of debt to Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA")).[58] The Leverage Ratio is an indicator of a company's ability to cover its fixed debt-service (interest plus principal) obligations as well as the variability of its earnings net of interest payments; a material increase in Frontier's leverage ratio would suggest that the proposed transaction will increase Frontier's risk, which could result in an increase in the Company's overall cost of capital. Here, Frontier is planning on financing more than 10% of the deal by raising equity through the issuance of additional Frontier common stock so as to maintain the pre-transaction ratio of debt-to-equity overall.

56. Jureller, at 21.

57. *Id.*, at 20.

58. See, e.g., *Id.*, at Table 2.

33. While issuing additional stock to raise equity to finance a transaction is a frequent occurrence, under certain circumstances it can be deleterious to current shareholders if the stock issuance has a dilutive effect. When a company issues additional shares of stock, all else equal, the current shareholders will own less of the company on a percentage basis. If the stock issuance is conducted at the then-current market price of the stock, the value held by the current shareholders should remain constant, because the value of the company will grow proportionately as the cash proceeds from the new issue are received, leaving per-share value unchanged. If the stock issuance is conducted for a below-market price (as often happens to attract new buyers of the stock), current shareholders will lose value, as the incoming cash does not fully offset the dilution in value from the increase in shares outstanding.

34. The same principle applies when a company uses the proceeds of an equity issue to finance an acquisition, as Frontier proposes to do here. Existing shareholders will gain value if the acquisition is worth more to the company than the price being paid, and will lose value if the opposite is the case. It is possible for such gains to more than offset any losses that result from below-market-price stock issuance. Frontier's financial assessment appears to consider the possibility of having to issue the new shares at a discount relative to market value. The company concluded, however, that even if the newly issued stock were to be sold at a BEGIN FRONTIER CONFIDENTIAL <<[redacted] >> END FRONTIER CONFIDENTIAL discount relative to the

then-current market value, and even if the "worst case" outcome examined by Frontier were to materialize, the net effect would still be accretive.[59]

35. It is a basic principle of economics that transactions between buyer and seller will occur when the incremental value *to the buyer* of the good or service being purchased, sometimes referred to as the "marginal utility" derived from the purchase, exceeds the value of whatever it is that the buyer must give up in order for the purchase to take place, typically expressed in terms of the monetary price to be paid for the item in question. The same economic principle applies in the case of transactions involving businesses or business assets. The buyer of a business may, for example, ascribe greater value to it than the seller where the buyer is able to take advantage of skills, synergies, or other opportunities not available to the seller. For example, a company that owns a chain of 100 retail shoe stores will typically pay lower wholesale prices for its merchandise than will be available to an independent shop. Hence, all else equal, one would expect that, were the chain to purchase the independent shoe store, its same-store costs would be lower and hence its same-store profits would be higher. The economic value of the store to the chain (calculated in terms of the net present value of future profits) would thus be greater than the economic value of the store were it to remain independent. If the purchase price that is agreed to falls somewhere in between, then both the buyer and the seller realize a gain, and a transaction can take place.

59. Frontier HSR filing, at Bates no. FTR ORA 016816.

36. In the case of the Verizon/Frontier transaction at issue here, Verizon has estimated the Enterprise Value *to it* of the Guava assets at BEGIN VERIZON CONFIDENTIAL <<[redacted][60]>> END VERIZON CONFIDENTIAL. As noted above, Frontier's estimate of the "equity value" *to it* of the assets it is acquiring is between BEGIN FRONTIER CONFIDENTIAL <<[redacted][61]>>END FRONTIER CONFIDENTIAL. Both the Verizon estimate, and the Frontier top-end estimate are derived from discounted cash flow (DCF) analysis conducted to terminal value (i.e., an "in perpetuity" time frame). In that regard, the difference between what Frontier is paying and the value it ascribes to the assets it is acquiring, some (BEGIN FRONTIER CONFIDENTIAL <<[redacted]>>END FRONTIER CONFIDENTIAL), provides a quantitative measure of Frontier's assessment of the long-run economic benefit that it will derive from the transaction.

37. During the time period in which Frontier was evaluating the deal, Frontier stock traded at between roughly $5.50 and $7.50 per share, and the Frontier Board of Directors evaluated elements of the deal assuming that Frontier stock traded at BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL. Since the filing of Frontier's HSR disclosure in April of this year, Frontier stock has fallen from roughly $7.00 to $4.95. This price implies that Frontier will have to issue additional shares equivalent to more than 27% of the number of shares outstanding to finance the equity.

60. Verizon HSR, at Bates no. A1503005VZ60412.

61. Fn. 50, *supra.*

38. Despite the theoretical risk of shareholder dilution, Frontier management has run a series of sensitivity analyses all of which indicate that the transaction will be accretive, rather than dilutive, for current shareholders. In its HSR filing, Frontier presents BEGIN FRONTIER CONFIDENTIAL <<[redacted][62] [redacted][63] [redacted]>> END FRONTIER CONFIDENTIAL[64] Frontier has not provided any revision to the sensitivity analysis included in its HSR filing that would account for the effect, if any, of the lower share price, which could, at a minimum, affect the likelihood of any of the various outcome scenarios actually taking place. Moreover, there is no specific consideration given to the possibility that a greater-than-anticipated level of capital expenditures (CAPEX) will be required for network

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62. Frontier HSR, at Bates Nos. FTR ORA 016815-016816.

63. BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL Bates No. FTR ORA 016803.

64. Bates Nos. FTR ORA 016815-016816.

upgrades if, after Closing, Frontier determines that the physical condition of the Verizon California network falls short of its expectations. It is, however, possible that this was considered in establishing the various cost savings scenarios that were used in the sensitivity analyses, although I have not identified anything in the documentation relating to the sensitivity analyses that would confirm this to be the case.

Even under the worst case scenario that was considered by Frontier where none of the anticipated cost savings materialize, the transaction appears to have been reasonably priced on an Enterprise Value/EBITDA basis.

39. In his testimony, Mr. Jureller compares the proposed transaction with other historic ILEC access line sales using the metric of Enterprise Value[65] divided by Earnings Before Interest Taxes Depreciation and Amortization ("EV/EBITDA multiple"). The EV/EBITDA multiple is a common metric used to evaluate companies, especially in capital intensive industries such as wireline telecommunications. The EV/EBITDA multiple is higher when a transaction commands a premium, and lower when the transaction reflects a good deal. The results of Mr. Jureller's analysis are summarized in Table 3 of the Jureller Declaration. Mr. Jureller concludes that Frontier is receiving an especially good deal, given that many ILEC asset sales have occurred at average EV/EBITDA multiples of 6X (ranging as high as 10X), while Frontier is paying only 3.7X.

65. Enterprise Value refers to a company's market capitalization (i.e., price per share x number of shares) plus debt, minority interests, and preferred shares – total cash and cash-equivalents. This is typically estimated as market capitalization + debt.

40. In his testimony, Mr. Jureller does not make it clear that the 3.7X EV/EBITDA multiple is based upon the assumption that all of Frontier's anticipated cost savings from the transaction actually materialize. As discussed above as it relates to shareholder dilution, Frontier management has also calculated its EV/EBITDA multiple under a number of scenarios.[66] Under a scenario where BEGIN FRONTIER CONFIDENTIAL << [redacted][67] [redacted] >> END FRONTIER CONFIDENTIAL

Frontier's evaluation of the deal appears to conservatively contemplate continued subscriber losses in the legacy wireline business

41. There can be no dispute that the legacy wireline ILEC business (as distinct from more modern fiber optic-based video/data/phone offerings such as *FiOS*) has been in decline for some time. It is reassuring that Frontier management has expressly taken this into account, and has

66. *See, e.g.,* Bates No. FTR ORA 016765.

67. *Id.*

contemplated further erosion of the traditional wireline business (voice and DSL provided over copper) in its analysis of the proposed transaction.

42. In the “base case” assumptions used to evaluate the deal, Frontier assumes that Guava’s residential switched voice subscriber base would erode from 1.3-million in 2014 to BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL in 2019.[68] In the “Downside Case” Frontier assumes even poorer performance in its legacy segments. In this scenario, Frontier assumes that Guava’s residential switched voice subscriber base would erode from 1.3-million in 2014 to BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL in 2019 while DSL subscriptions would fall from BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL in 2014 to BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL in 2019.[69] These assumptions are mirrored in Frontier’s projections for legacy business services, and for revenues across the entire legacy segment.

43. In terms of the persistent decline in market *demand* for legacy ILEC voice and DSL services, Frontier does not appear to have entered into this proposed transaction with blinders on or by viewing the demand situation through rose-colored glasses. The erosion of the legacy wireline business is contemplated in Frontier’s projections, and the success of the deal does not depend on Frontier unrealistically turning the tide in legacy segments. Of course, all of these

68. Bates No. FTR ORA 016756.

69. Bates No. FTR ORA 016844.

projections could be heavily impacted by the physical condition of the Verizon network; in addition to confronting higher-than-expected capital costs, Frontier could also experience a higher-than-expected loss of customers if the physical state of the network is more deteriorated than Frontier believes to be the case.

Even under what Frontier considers to be its "worst case" conditions, the transaction appears to be at least fair, if not beneficial, to Frontier shareholders.

44. §854(c)(5) calls upon the CPUC to find that the transaction is "fair" to the shareholders of both firms, which generally appears to be the case. Unlike many merger transactions where only a single firm survives and the senior management of the non-surviving firm is often compensated with massive, sometimes 7- or 8-figure "golden parachutes," that does not appear to be the case here. From their disclosures and HSR materials, it would appear that both firms believe they are acting in their shareholders' best interests, and I see nothing (other than perhaps the possibly excessive "advisory" fees) that would suggest otherwise. Accordingly, the Commission can find that §854(c)(5) is satisfied.

IV.

THE TRANSACTION'S POTENTIAL IMPACT UPON COMPETITION FOR BROADBAND AND LOCAL VOICE SERVICES

The combined Verizon and Frontier operating footprint

45. §854(b)(3) requires the Commission to find that the transaction will "[n]ot adversely affect competition." The *Amended Scoping Ruling* is a bit more specific, focusing in particular upon competition for broadband services: "What is the impact of the transaction on competition for Voice Over Internet Protocol (VoIP) and broadband services?"[70] Table 2 below summarizes the relative sizes of the two companies both with respect to each other and with respect to the total potential California broadband market, expressed in terms of the total number of households in the state:

70. *Amended Scoping Ruling*, July 2, 2015, question 10, at 6.

BEGIN CONFIDENTIAL<<

Table 2

PERCENTAGE OF CALIFORNIA HOUSEHOLDS PASSED BY JOINT APPLICANTS

Company	Households passed	Percentage of total state	Subscriptions (CONFIDENTIAL)
Frontier	135,551	1.07%	
Verizon	2,628,438	20.78%	
Total	2,763,989	21.85%	
Statewide	12,650,592	100.00%	

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs; US Census Bureau, American Community Survey, 2013, at http://www.dof.ca.gov/research/demographic/state_census_data_center/american_community_survey/. Subscription information (CONFIDENTIAL): Frontier's response to ORA Data Request Set 2, no. 16 (CONFIDENTIAL); Verizon's response to ORA's Data Request No.003. June 9, 2015. See "ORA_VZ3.3_Attachment 2_CA FCC Form 477_A1503005VZ110004_CONFIDENTIAL.xlsx").

>>END CONFIDENTIAL

46. The Commission's Communications Division maintains a database of broadband service availability (the "California Broadband Availability Database") that can be used to assess the extent to which residential customers confront competitive sources of broadband access services at various bandwidths, based upon each provider's maximum advertised bandwidth. The most recently available "Round 10" data is based upon submissions by service providers as of June 30, 2014.[71] When combined, the post-transaction Frontier will serve census blocks containing

71. The California Broadband Availability ("CBA") Database contains household counts by census block based upon the 2010 US Census. More recent census data indicate a somewhat larger number of California households; however, the 12.65-million statewide household count is the aggregate of all census blocks in the CBA Database, assuring consistency between the per-provider and total state figures.

2,763,989 California households, representing about 21.85% of the total 12.65-million households in the state.

47. Figure 2 below is a map of the areas in California currently being served by Frontier (in blue) and by Verizon (in orange). Frontier's existing California operating areas cover 8,622 census blocks ("CBs") and 135,551 households ("HHs") primarily in rural areas. Verizon California currently passes some 87,932 census blocks and 2,628,438 households located within those census blocks. Verizon's operating area includes about 20.78% of all California households, whereas Frontier currently passes about 1.07%. When combined, the post-transaction Frontier California ILEC will pass 96,554 CBs containing 2,763,989 households, or about 21.85% of all households in the state. The transaction will produce a minimal Herfindahl-Hirschman Index ("HHI") effect when measured statewide, well below the *Horizontal Merger Guidelines ("HMG")* threshold.[72]

72. The US Department of Justice/Federal Trade Commission's 2010 *Horizontal Merger Guidelines* ("*HMG*") defines a market with an HHI in excess of 2500 as "highly concentrated," and suggests that "[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power." United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines 2010 edition* ("*HMG*"), at §5.3, Market Concentration.

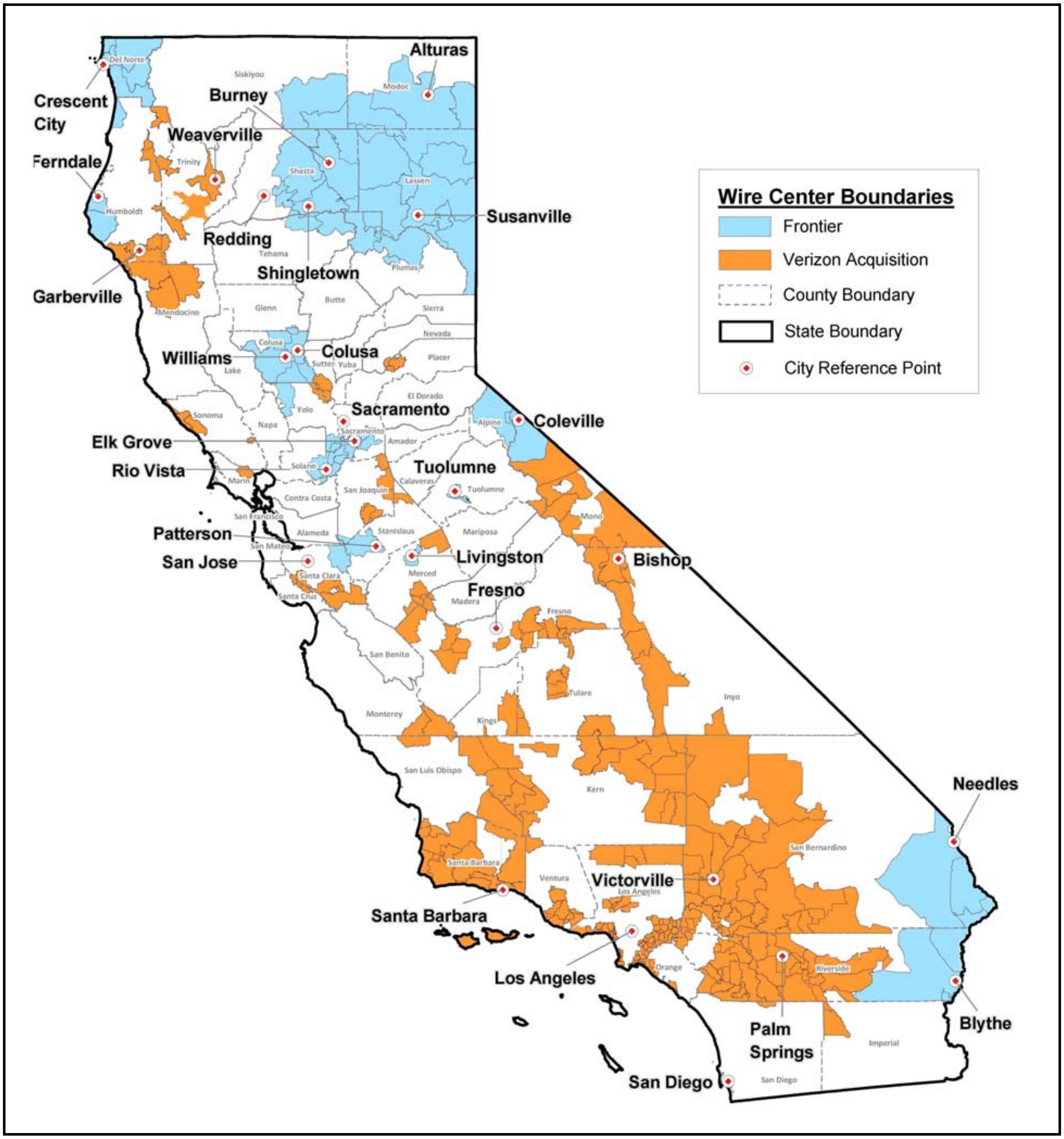

Figure 2. Frontier/Verizon California combined service area.

Competition for broadband services exists in only a portion of the combined Verizon/Frontier California operating areas.

48. Table 3 below shows the current availability of broadband (download) speeds separately for pre-transaction Verizon and for pre-transaction Frontier. Table 4 provides a comparison of the broadband availability by download speed tier for pre-transaction stand-alone Verizon with a post-transaction Verizon+Frontier. A comparison of the pre- and post-transaction broadband market conditions in the areas served by these companies reveals only minor differences in the total number of census blocks and households served by the pre- and post-transaction ILECs.

Table 3

CENSUS BLOCKS PASSED BY PRE-TRANSACTION VERIZON AND BY PRE-TRANSACTION FRONTIER AT EACH DOWNLOAD SPEED

Download Speed	Census Blocks passed by pre-transaction Verizon California	Census Blocks passed by pre-transaction Frontier	Households passed by pre-transaction Verizon California	Households passed by pre-transaction Frontier
≤200 kbps	87,932	8,622	2,628,438	135,551
>200 & <768 kbps	87,932	8,622	2,628,438	135,551
≥768 kbps & <1.5 Mbps	87,932	8,622	2,628,438	135,551
≥1.5 & <3 Mbps	87,932	8,592	2,628,438	135,416
≥3 & <6 Mbps	80,560	8,592	2,468,992	135,416
≥6 & <10 Mbps	64,068	8,475	2,132,673	134,335
≥10 & <25 Mbps	43,838	5,487	1,516,107	110,225
≥25 & <50 Mbps	43,838	-	1,516,107	-
≥50 & <100 Mbps	43,838	-	1,516,107	-
≥100 Mbps & <1 gbps	43,421	-	1,502,075	-
≥1 gbps	-	-	-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

Table 4

CENSUS BLOCKS PASSED BY PRE-TRANSACTION VERIZON AND BY POST-TRANSACTION FRONTIER AT EACH DOWNLOAD SPEED

Download Speed	Census Blocks passed by pre-transaction Verizon California	Census Blocks passed by post-transaction Frontier	Households passed by pre-transaction Verizon California	Households passed by post-transaction Frontier
≤200 kbps	87,932	96,554	2,628,438	2,763,989
>200 & <768 kbps	87,932	96,554	2,628,438	2,763,989
≥768 kbps & <1.5 Mbps	87,932	96,554	2,628,438	2,763,989
≥1.5 & <3 Mbps	87,932	96,524	2,628,438	2,763,854
≥3 & <6 Mbps	80,560	89,152	2,468,992	2,604,409
≥6 & <10 Mbps	64,068	72,543	2,132,673	2,267,008
≥10 & <25 Mbps	43,838	49,325	1,516,107	1,626,331
≥25 & <50 Mbps	43,838	43,838	1,516,107	1,516,107
≥50 & <100 Mbps	43,838	43,838	1,516,107	1,516,107
≥100 Mbps & <1 gbps	43,421	43,421	1,502,075	1,502,075
≥1 gbps	-	-	-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

49. Frontier does not currently offer high-speed broadband Internet access at download speeds in excess of 25 Mbps in any of the California communities it serves.[73] Verizon's fiber-to-the-home ("FTTH") broadband service, *FiOS*, offers download speeds in excess of 25 Mbps (speeds as high as 100 Mbps are available in most places where *FiOS* is being offered) and Verizon's FTTH facilities currently pass census blocks containing 1.516-million California households, or roughly 58% of the total 2,628,438 households in census blocks served by the Company. Overall, Verizon's network passes some 21.9% of the roughly 12.6-million

73. California Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs; Frontier Bundles Help You Save in CA http://frontierbundles.com/frontier-communications/california [accessed July 1, 2015]

households in the state. Hence the number of households passed by a post-transaction Frontier where service at 25 Mbps or greater is available will be, at least initially, exactly the same as the number of households currently being passed by Verizon.

50. Notably, of the 1.516-million households currently passed by Verizon where *FiOS* is being offered, 1.490-million of those households have an available competing provider that is also offering download speeds of at least 25 Mbps. The transfer of these operating territories to Frontier will have no immediate adverse impact upon the *availability* of these high-speed services both from the local exchange carrier (Frontier in this case) as well as from a competing provider, which is in most instances the cable TV operator serving that same area. The transfer does have the potential to affect the unregulated *price* of the service, because certain of Frontier's costs – those relating to video content and operations support systems and other *FiOS*-related software development and maintenance – are likely to be greater than those presently being incurred by Verizon.

51. Table 5a below summarizes the availability of competing services at each of these same speed tiers in the areas currently being served by Verizon. Table 5b provides the corresponding data in terms of households passed within those census blocks:

Table 5a

CENSUS BLOCKS PASSED BY PRE-TRANSACTION VERIZON AND BY AT LEAST ONE COMPETING PROVIDER AT EACH DOWNLOAD SPEED

Download Speed	CBs Passed by VZ	Pct of CBs Passed by VZ	CBs Passed by VZ &1 Competitor	Pct of CBs Passed by VZ &1 Competitor	CBs Passed by VZ & Two or More Competitors	Pct of Cbs Passed by VZ & Two or More Competitors
≤200 kbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
>200 & <768 kbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
≥768 kbps <1.5 Mbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
≥1.5 & <3 Mbps	87,932	100.00%	77,837	88.52%	2,016	2.29%
≥3 & <6 Mbps	80,560	91.62%	77,788	88.46%	2,013	2.29%
≥6 & <10 Mbps	64,068	72.86%	77,665	88.32%	2,012	2.29%
≥10 & <25 Mbps	43,838	49.85%	77,660	88.32%	2,012	2.29%
≥25 & <50 Mbps	43,838	49.85%	76,944	87.50%	2,012	2.29%
≥50 & <100 Mbps	43,838	49.85%	76,458	86.95%	2,012	2.29%
≥100 Mbps & <1 gbps	43,421	49.38%	25,783	29.32%	1,698	1.93%
≥1 gbps	-	-	1	0.00%	326	0.37%

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

Table 5b

HOUSEHOLDS PASSED BY PRE-TRANSACTION VERIZON AND THOSE PASSED BY AT LEAST ONE COMPETING PROVIDER AT EACH DOWNLOAD SPEED

Download Speed	HHs Passed by VZ	Pct of HHs Passed by VZ	HHs Passed by VZ &1 Competitor	Pct of HHs Passed by VZ &1 Competitor	HHs Passed by VZ & Two or More Competitors	Pct of HHs Passed by VZ & Two or More Competitors
≤200 kbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
>200 & <768 kbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
≥768 kbps and <1.5 Mbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
≥1.5 & <3 Mbps	2,628,438	100.00%	2,485,118	94.55%	85,148	3.24%
≥3 & <6 Mbps	2,468,992	93.93%	2,484,515	94.52%	85,118	3.24%
≥6 & <10 Mbps	2,132,673	81.14%	2,483,084	94.47%	85,099	3.24%
≥10 & <25 Mbps	1,516,107	57.68%	2,483,072	94.47%	85,099	3.24%
≥25 & <50 Mbps	1,516,107	57.68%	2,469,749	93.96%	85,099	3.24%
≥50 & <100 Mbps	1,516,107	57.68%	2,462,705	93.69%	85,099	3.24%
≥100 Mbps <1 gbps	1,502,075	57.15%	741,464	28.21%	63,579	2.42%
≥1 gbps	-	-	-	-	12,000	0.46%

Source: California Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

52. In Tables 6a and 6b, I provide corresponding information on the availability of competing services at each of the speed tiers in the areas currently being served by Frontier:

Table 6a

CENSUS BLOCKS PASSED BY PRE-TRANSACTION FRONTIER AND THOSE PASSED BY AT LEAST ONE COMPETING PROVIDER AT EACH DOWNLOAD SPEED

Download Speed	CBs Passed by FTR	Pct of CBs Passed by FTR	CBs Passed by FTR &1 Competitor	Pct of CBs Passed by FTR &1 Competitor	CBs Passed by FTR & 2 or More Competitors	Pct of CBs Passed by FTR & 2 or More Competitors
≤200 kbps	8,622	100.00%	3,357	38.94%	956	11.09%
>200 & <768 kbps	8,622	100.00%	3,357	38.94%	956	11.09%
≥768 kbps and <1.5 Mbps	8,622	100.00%	3,357	38.94%	956	11.09%
≥1.5 & <3 Mbps	8,592	99.65%	3,352	38.88%	956	11.09%
≥3 & <6 Mbps	8,592	99.65%	3,343	38.77%	956	11.09%
≥6 & <10 Mbps	8,475	98.30%	3,243	37.61%	956	11.09%
≥10 & <25 Mbps	5,487	63.64%	3,242	37.60%	956	11.09%
≥25 & <50 Mbps	-	-	3,104	36.00%	955	11.08%
≥50 & <100 Mbps	-	-	2,944	34.15%	955	11.08%
≥100 Mbps & <1 gbps	-	-	2,934	34.03%	954	11.06%
≥1 gbps	-	-	-	-	-	-

Source: California Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs. Services at speeds > 25 Mbps are available only from competitors; Frontier does not currently offer services at speeds in excess of 25 Mbps.

Table 6b

HOUSEHOLDS PASSED BY PRE-TRANSACTION FRONTIER AND THOSE PASSED BY AT LEAST ONE COMPETING PROVIDER AT EACH DOWNLOAD SPEED

Download Speed	HHs Passed by FTR	Pct of HHs Passed by FTR	HHs Passed by FTR &1 Competitor	Pct of HHs Passed by FTR &1 Competitor	HHs Passed by FTR & 2 or More Competitors	Pct of HHs Passed by FTR & 2 or More Competitors
≤200 kbps	135,551	100.00%	66,782	49.27%	36,920	27.24%
>200 & <768 kbps	135,551	100.00%	66,782	49.27%	36,920	27.24%
≥768 kbps <1.5 Mbps	135,551	100.00%	66,782	49.27%	36,920	27.24%
≥1.5 & <3 Mbps	135,416	99.90%	66,728	49.23%	36,920	27.24%
≥3 & <6 Mbps	135,416	99.90%	66,578	49.12%	36,920	27.24%
≥6 & <10 Mbps	134,335	99.10%	65,403	48.25%	36,920	27.24%
≥10 & <25 Mbps	110,225	81.32%	65,399	48.25%	36,920	27.24%
≥25 & <50 Mbps	-	-	63,709	47.00%	36,920	27.24%
≥50 & <100 Mbps	-	-	60,218	44.42%	36,920	27.24%
≥100 Mbps & <1 gbps	-	-	60,156	44.38%	36,920	27.24%
≥1 gbps	-	-	-	-	-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

53. Tables 5a and 5b provided the total number of census blocks and households, respectively, being served by one or more competitors at any given speed tier. In all of the speed tiers from 6 Mbps (download) on up, many Verizon customers who cannot get broadband (download) speed services at 25 Mbps or greater from Verizon can get these speeds from at least one competitor. For example, in the 25-50 Mbps speed tier, Verizon service is available at 43,838 census blocks and to the 1,516,107 households in those census blocks, whereas within Verizon California operating areas, *at least one competitor* is offering the same 25-50 Mbps service to 78,956 census blocks and 2,554,848 households – i.e., in 35,118 census blocks and to 1,038,741

households where comparable Verizon broadband speeds are not currently offered. Tables 7a and 7b below correspond to Tables 5a and 5b, but here provide competitive availability at a given speed tier only with respect to the specific census blocks in which Verizon is itself offering service at that same speed. Thus, at the 25-50 Mbps level, Verizon is offering service to 43,838 census blocks and to 1,516,107 households, and *within those same 43,838 census blocks*, at least one competitor is offering service to 42,515 of those same census blocks and 1,490,002 households. In other words, only about 26,000 out of the 1,516,107 households in Verizon territory where 25-50 Mbps service is available *do not presently have at least one alternate provider of the same or faster service*:

Table 7a

CENSUS BLOCKS WHERE THERE IS AT LEAST ONE COMPETING PROVIDER OFFERING THE SAME DOWNLOAD SPEED AS VERIZON

Download Speed	CBs Passed by VZ	Pct of CBs Passed by VZ	CBs Passed by VZ &1 Competitor	Pct of CBs Passed by VZ &1 Competitor	CBs Passed by VZ & Two or More Competitors	Pct of Cbs Passed by VZ & Two or More Competitors
≤200 kbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
>200 & <768 kbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
≥768 kbps <1.5 Mbps	87,932	100.00%	77,846	88.53%	2,020	2.30%
≥1.5 & <3 Mbps	87,932	100.00%	77,904	88.60%	1,949	2.22%
≥3 & <6 Mbps	80,560	91.62%	71,904	81.77%	1,755	2.00%
≥6 & <10 Mbps	64,068	72.86%	60,669	69.00%	878	1.00%
≥10 & <25 Mbps	43,838	49.85%	42,438	48.26%	418	0.48%
≥25 & <50 Mbps	43,838	49.85%	42,515	48.35%	341	0.39%
≥50 & <100 Mbps	43,838	49.85%	42,526	48.36%	330	0.38%
≥100 Mbps & <1 gbps	43,421	49.38%	11,409	12.97%	-	-
≥1 gbps	-	-	-	-	-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

Table 7b

HOUSEHOLDS WHERE THERE IS AT LEAST ONE COMPETING PROVIDER OFFERING THE SAME DOWNLOAD SPEED AS VERIZON

Download Speed	HHs Passed by VZ	Pct of HHs Passed by VZ	HHs Passed by VZ &1 Competitor	Pct of HHs Passed by VZ &1 Competitor	HHs Passed by VZ & Two or More Competitors	HHs Passed by VZ
≤200 kbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
>200 & <768 kbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
≥768 kbps & <1.5 Mbps	2,628,438	100.00%	2,485,308	94.55%	85,223	3.24%
≥1.5 & <3 Mbps	2,628,438	100.00%	2,488,516	94.68%	81,751	3.11%
≥3 & <6 Mbps	2,468,992	93.93%	2,345,272	89.23%	70,730	2.69%
≥6 & <10 Mbps	2,132,673	81.14%	2,065,406	78.58%	48,253	1.84%
≥10 & <25 Mbps	1,516,107	57.68%	1,484,183	56.47%	24,691	0.94%
≥25 & <50 Mbps	1,516,107	57.68%	1,490,002	56.69%	18,871	0.72%
≥50 & <100 Mbps	1,516,107	57.68%	1,490,437	56.70%	18,437	0.70%
≥100 Mbps & <1 gbps	1,502,075	57.15%	384,138	14.61%	-	-
≥1 gbps	-	-	-	-	-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs.

54. Within its existing California operating areas, Frontier does not currently offer service at download speeds greater than the 10-25 Mbps tier (in fact, the fastest currently advertised download speed being offered by Frontier appears to be 24 Mbps[74]). However, and as shown on Tables 4a and 4b above, within the existing Frontier California service area, roughly 34% of the census blocks and 47% of the households served by Frontier currently can get service at download speeds of at least 25 Mbps from at least one competing (non-Frontier) source.

74. http://frontierbundles.com/frontier-communications/california [accessed July 15, 2015]

55. Verizon has deployed *FiOS* in about 43,838 CBs that include 1,516,107 households, or about 57.7% of all households served by Verizon California. About 1.03-million of the households within the Verizon operating areas that do not have access to *FiOS* can obtain 25+ Mbps broadband from at least one competitor, mostly from one of the major cable MSOs. Notably, all but about 25,000 of the 1.5-million households where *FiOS* is available can also obtain comparable 25+ Mbps speeds from at least one competitor. That situation will not materially change following the sale to Frontier.

56. The Commission's Broadband Availability Database also contains the Median Household Income separately for each census block. Using this data, I undertook to determine whether any income-related pattern was evident both with respect to broadband deployment by the two ILECs *and* with respect to broadband deployment by competing providers. The results of this analysis are summarized on Tables 8 and 9 below for Verizon and Frontier, respectively.

Table 8

VERIZON CALIFORNIA
MEDIAN HOUSEHOLD INCOME AND MAXIMUM AVAILABLE DOWNLOAD SPEED

	Households passed by VZ		Households passed only by VZ		Households passed by VZ AND by one or more competitors		Households passed by VZ OR by one or more competitors	
Maximum Download Speed	Number	Median Income	Number	Median Income	Number	Median Income	Number	Median Income
<3 Mbps	159,446	$77,196	5,148	$55,412	154,298	$77,923	5,815	$55,913
≥3 & <6 Mbps	336,319	$71,261	34,608	$56,976	301,711	$72,899	35,427	$57,230
≥6 & <10 Mbps	616,566	$68,538	10,957	$60,864	605,610	$68,676	11,792	$58,468
≥10 & <25 Mbps	0	$0	0	$0	0	$0	13,323	$49,871
≥25 & <50 Mbps	0	$0	0	$0	0	$0	7,044	$52,113
≥50 & <100 Mbps	14,032	$63,780	44	$59,958	13,988	$63,792	632,059	$68,332
≥100 Mbps & <1 gbps	1,502,07	$68,878	7,149	$69,726	1,494,92	$68,874	1,910,97	$70,394
≥1 gbps	-	-	-	-	-	-	12,000	$91,877

Source: California Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs. Median average household income is weighted by the number of households in each census block.

Table 9

FRONTIER CALIFORNIA
MEDIAN HOUSEHOLD INCOME AND MAXIMUM AVAILABLE DOWNLOAD SPEED

	Households passed by FTR		Households passed only by FTR		Households passed by FTR AND by one or more competitors		Households passed by FTR OR by one or more competitors	
Download Speed	Number	Median Income	Number	Median Income	Number	Median Income	Number	Median Income
<1.5 Mbps	134	$38,068	134	$38,068	0	$0	134	$38,068
≥1.5 & <3 Mbps	0	$0	0	$0	0	$0	0	$0
≥3 & <6 Mbps	1,081	$32,929	632	$29,679	449	$37,500	650	$29,899
≥6 & <10 Mbps	24,111	$48,112	9,316	$50,525	14,795	$46,592	9,892	$49,625
≥10 & <25 Mbps	110,225	$66,240	21,767	$50,733	88,458	$70,056	24,246	$50,484
≥25 & <50 Mbps	-	-	-	-	-	-	3,491	$51,937
≥50 & <100 Mbps	-	-	-	-	-	-	62	$51,584
≥100 Mbps &<1 gbps	-	-	-	-	-	-	97,076	$67,762
≥1 gbps			-	-			-	-

Source: California PUC Broadband Availability Database, Round 10 data (as of June 30, 2014) as submitted by ISPs. Median average household income is weighted by the number of households in each census block.

57. From this analysis, we can draw several conclusions:

(1) Verizon does not appear to have been targeting higher income areas with respect to *FiOS* deployment and, indeed, *FiOS* has not yet come to some of the highest-income areas within the Verizon footprint. Frontier, however, does appear to favor higher income areas for its highest-speed broadband services.

(2) Competitors appear generally to be targeting higher income areas for entry within each of the ILEC's operating areas.

From this, one might conclude that this pattern of deployment and entry is suggestive of deliberate redlining, targeting investment in higher-bandwidth facilities to higher income communities. While that is certainly a possibility, another explanation may well be that many of the communities with the lowest median household incomes also tend to be relatively low-density rural areas where the per-customer cost of facilities deployment is relatively high, such that unsubsidized investment in such areas is simply not sustainable as an economic matter. The Connect America Fund and other programs targeting high-cost communities should be addressing this problem. Verizon has not thus far applied for nor has it received such support, whereas Frontier is aggressively pursuing it, and has indicated its intention to seek such support specifically with respect to the territories it is acquiring from Verizon. Frontier will receive more than $6-million in CAF Phase II support that will serve nearly 13,000 businesses and homes in its *existing* rural California service areas.[75] Carriers who receive the CAF support must build out broadband by 2020 and deliver download speeds of at least 10 Mbps. Frontier has indicated that it will utilize CAF funding in the high cost areas within the Verizon territories, and forecasts approximately $32-million annually in funding for broadband expansion in these areas for at least six years.[76] There is, of course, no guarantee that the FCC will grant Verizon's CAF Phase II application, or allow Frontier to step in following its completion of the acquisition. However, when viewed in the context of the overall transaction, the projected increases in EBITDA, and the various other financial parameters of the deal as described by Mr. Jureller, even if Frontier were to fund these broadband expansions internally, the impact upon the overall financial outcome of the transaction would be minimal, reducing Frontier's projected annual financial gain by, at the very most, somewhere in the range of 4.5% in each of the first six years only. The Commission should consider, as a condition for approval, requiring that the proposed CAF-funded broadband expansion be pursued by Frontier *whether or not Frontier actually receives the full CAF Phase II funding as anticipated*.[77]

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75. Abernathy, at 22; FCC, "Frontier Communications Accepts Over $283 Million Connect America Fund Offer to Expand and Support Broadband for 1.3 Million Rural Americans," June 16, 2015. https://www.fcc.gov/document/connect-america-fund-expanding-broadband-13-m-frontier-customers [accessed on July 16, 2015].

76. Abernathy, at 23; see also, July 1, 2015 *ex parte* letter from William F. Maher, WT Docket No. 15-44.

77. The total amount of CAF Phase II funding for the three Guava ILECs combined has been given by the FCC as about $32-million per year for six years (i.e., $192-million total), a small fraction of the $10.54-billion purchase price or even of the costs that Frontier has committed to incur for the BEGIN FRONTIER CONFIDENTIAL << [redacted] >> END FRONTIER CONFIDENTIAL that are contemplated in connection with the transaction. Not in any way to minimize the importance of CAF funding for broadband expansion, the short-term and long-term economic benefit to Frontier from this transaction will be so far in excess of the amount of the sought-after CAF support that, were that support not forthcoming, the use of Frontier funds for this purpose would fall well within the "not less than 50 percent" ratepayer benefit sharing requirement of §854(b)(2).

58. As noted above, Verizon has expressly discontinued further deployment of FTTH facilities and the expansion of *FiOS*. In 2010, Verizon announced that it was cancelling any further deployment of FiOS nationwide,[78] and that policy has not changed. Consequently, were Verizon to continue to operate its California ILEC, the census blocks and households where *FiOS* would be offered would be locked down, and no further expansion of high-speed Internet access would be anticipated. However, as noted, Frontier has announced its intention to expand high speed broadband availability, although no specific plans have been announced for California beyond those proposed for CAF support. As a wireline-only service provider, Frontier would likely have a stronger incentive than Verizon to expand broadband availability in California, particularly where the cable companies within large portions of what will become its operating areas are currently offering high-speed services. Frontier wireline (voice) customers who are forced to go to their cable company for broadband access because Frontier does not offer it in their area are likely also to switch their voice service to their cable provider as well, thus removing that customer altogether from contention by Frontier. Hence, if anything, the transaction is far more likely to enhance competitive broadband availability in California than diminish it. It is important, however, that the Commission pin down Frontier's specific deployment plans and establish deployment targets as conditions for approval. These could be coupled with CPUC support for Frontier's efforts to obtain CAF and other funding.

78. "Verizon to End Rollout of FiOS," *Wall Street Journal*, March 30, 2010. http://www.wsj.com/articles/SB10001424052702303410404575151773432729614 [accessed on July 16, 2015].

Competition for voice and VoIP services

59. The ILECs are the principal, if not the only, provider of traditional circuit-switched local voice telephone service, and the number of customers taking this service has been experiencing a rapid decline in recent years, both nationally and within the California operating areas being served by Verizon and Frontier. Table 10 below summarizes the number of residential circuit-switched voice service customers being served by Verizon and Frontier in California between 2010 and 2014, inclusive. In just one year from the end of 2013 to the end of 2014, Verizon California's total voice access lines (including circuit-switched and VoIP, copper and fiber) decreased from BEGIN CONFIDENTIAL <<[redacted]>> END CONFIDENTIAL to BEGIN CONFIDENTIAL <<[redacted]>> END CONFIDENTIAL, a BEGIN CONFIDENTIAL <<[redacted]>>END CONFIDENTIAL drop. Although much smaller, the Frontier operating areas in California experienced comparable declines in demand for this service.

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Table 10

VERIZON CALIFORNIA AND FRONTIER CALIFORNIA TOTAL VOICE SUBSCRIBERS

	Verizon Residential Lines by Category					Total Voice Lines	
Year	**Res FiOS Voice (VoIP) Lines**	**Non-Res FiOS Voice (VoIP) Lines**	**Residential FiOS Voice (non-VoIP) Lines**	**Non-Res FiOS Voice (non-VoIP) Lines**	**Residential Copper Lines**	**Verizon**	**Frontier**
2010	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2011	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2012	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2013	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2014	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: Verizon: ORA VZ4 13 Attachment 1 A1503005VZ120001; Frontier: ORA Set 1 No 16- Revised Bates No. FTR ORA 016584

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60. Traditional circuit-switched voice telephone services of the type being offered by ILECs offers several unique features that are not provided by the newer competing services. Circuit-switched POTS service is powered by the central office via the copper loop, and will frequently remain fully operative during a power outage. In addition, circuit-switched services may provide more reliable connections for certain types of data applications, such as alarm systems, fax machines, and medical monitoring devices, among other things. These features are important to many customers, but many others do not consider them all that important. For this group, competing services are available from Broadband ISPs, including the ILEC itself, cable MSOs, and wireless carriers. Cable companies such as Comcast and TWC offer a "digital voice" telephone service that is available on a bundled basis with their video and/or broadband Internet

access services. For many customers, wireless mobile phone service is also a direct substitute for wireline access.

61. So-called "fixed" VoIP is typically provided by a broadband access provider (the ILEC or a cable MSO) utilizing a dedicated Internet Protocol ("IP") channel that is carved out from the overall capacity of the IP facilities serving the customer, so that the VoIP telephone service can be furnished in a "walled off" segment of the IP data stream and thus not be required to compete for bandwidth with the customer's Internet access or other broadband data applications. VoIP telephone services are also offered on a "nomadic" or "over-the-top" ("OTT") basis from companies such as Vonage, MagicJack, Skype and 8x8 that do not themselves offer broadband access. These services do not utilize a dedicated, walled-off IP channel, and thus do compete for bandwidth with the customer's other broadband uses. This is sometimes a problem with relatively low download speed DSL-type services when, for example, the customer is streaming video content or downloading a large file at the same time that another user in the household is attempting to make a telephone call. For most residential customers of services offering download speeds in excess of 25 Mbps, the lack of a walled-off dedicated VoIP channel is rarely a problem. FCC rules do not currently require that the broadband access provider offer the same type of dedicated IP channels, which the FCC now refers to as "Non-BIAS Data Services," to customers for use with over-the-top VoIP and other over-the-top services.[79]

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79. *Protecting and Promoting the Open Internet*, FCC GN Docket No. 14-28, *Report and Order on Remand, Declaratory Ruling, and Order*, Adopted: Feb. 26, 2015; Rel: March 12, 2015, FCC 15-24 ("*Open Internet Order*"), at paras. 207-213. "Non-BIAS Data Services" "... generally share the following characteristics ... First, these services are not used to reach large parts of the Internet. Second, these services are not a generic platform – but rather a specific "application level" service. And third, these services use some form of network management to isolate the capacity used by these services from that used by broadband Internet access services." Para. 209.

(continued...)

62. Competition for wireline voice telephone services depends heavily upon the availability of relatively high-speed broadband access. Where broadband is available, customers have considerable choices both for bundled "fixed" VoIP services and for over-the-top "nomadic" VoIP offerings. Where broadband services with sufficiently fast download speeds are not available, most residential customers will be forced to retain their ILEC-provided circuit-switched local phone service or utilize their mobile phone instead.

63. Most non-lifeline residential and all business local telephone services are no longer subject to rate regulation by the CPUC. For customers in urban and suburban areas, this is not a particularly serious problem because VoIP and/or mobile alternatives are typically available. However, in many rural areas where competitive alternatives to ILEC-provided local voice services are either not readily available or not sufficiently reliable as replacements for traditional wireline local telephone service, the non-rate-regulated ILEC may now engage in a harvesting strategy aimed at extracting maximum revenue from its most captive customers. The fact that ILECs typically do not include popular service features such as Call Waiting, Caller ID, 3-way Calling, Call Forwarding, and Voice Mail in their basic local telephone service offerings *where most VoIP and mobile voice services do include these features* underscores how captive many ILEC voice customers actually are.

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79. (...continued)
Examples of such services include "facilities-based VoIP and Internet Protocol-video offerings [as well as] connectivity bundled with e-readers, heart monitors, or energy consumption sensors ... to the extent these services are provided by broadband providers over last-mile capacity shared with broadband Internet access service." Para. 208.

Impact of the transaction on wireline competitors

64. Various providers currently offer residential and business circuit-switched and VoIP-based voice telephone service in competition with Verizon. Critical to such competition is the ability of service providers to interconnect with each other and with the dominant ILECs serving the communities in which these rival providers operate. Sections 251/252 and 271 of the *Telecommunications Act of 1996* address such interconnections as well as requirements for competitor access to essential ILEC network elements and facilities. While at the same time challenging in the federal courts, with some success, their obligations to furnish such access, Verizon and the other ILECs have largely met their obligations in this area, although many CLECs continue to report difficulties in obtaining wholesale services from ILECs.[80] The federal *Telecommunications Act of 1996* ("TA96") does not specifically address VoIP and interconnections between ILECs and VoIP providers and, perhaps not surprisingly, IP-to-IP interconnection is still far from fully resolved. There is no technical reason why IP-IP interconnections cannot be accomplished and, indeed, accomplished more efficiently than via TDM.

65. Notwithstanding the inescapable fact that for large areas of California there is only one broadband provider offering service at speeds that satisfy the FCC's 25/3 Mbps download/upload

80. *See*, e.g., A.15-03-005, *Response of the California Association of Competitive Telecommunications Companies on the Joint Application of Frontier Communications and Verizon California for Approval Of Transfer of Control and Related Approval of Transfer of Assets and Certifications*, April 27, 2015 ("*CALTEL Protest*"), at 3.

threshold,[81] the proposed transaction will not make that condition any worse, and thus will have no measurable adverse impact upon competition either for basic telephone services or for broadband within the territories being served by the two ILECs in California. On this basis, the Commission can thus find that §854(b)(3) is satisfied. However, there is also no assurance that the transaction will, in and of itself, result in any net improvement in broadband availability and broadband competition within the post-transaction Frontier operating areas.

The level of competition for broadband service within the combined Verizon/Frontier service area is still inadequate, and is unlikely to materially improve as a result of the transaction.

66. Deployment of broadband distribution facilities – particularly under a *FiOS*-type FTTH architecture, involves substantial capital investment most of which is driven by the number of homes passed rather than by the number of homes connected. As such, the investment per home *connected* will vary inversely with the overall share of the market that the provider is able to attract. There are today roughly a million homes within the Verizon/Frontier operating areas that cannot get high-speed broadband from the ILEC *but can get it from their cable company and/or other provider*. Even if a post-transaction Frontier were to proceed to extend *FiOS* (or equivalent) to these areas, it would likely encounter difficulty overcoming the cable companies' first-to-market advantage and, without sufficient market share in these areas, a Frontier investment might not prove economically sound. Verizon had apparently reached this conclusion some five years ago, and is now, as here, engaged in an effort to divest much, if not eventually

81. For example, for some 76.6% of households within census blocks passed by the then-proposed combined Comcast/TWC/Charter/Bright House cable entity, there is no competing provider at the 25/3 download/upload speed level. Calif. PUC A.14-04-013, A.14-06-012, Decl. of Lee L. Selwyn, Dec. 10, 2014, at 72, Table 10.

all, of the FTTH facilities that it had constructed. These issues are unlikely to be resolved in the present proceeding, but the Commission should be under no illusion that merely by authorizing the sale to Frontier the broadband availability situation in California will be materially improved.

67. The traditional notion of economic regulation of "natural monopolies" was premised upon the determination that certain services "affected with the public interest" could most efficiently be produced by a single provider, and the expectation that, with only a single provider, market failure would arise absent affirmative regulation to constrain the pricing and other practices of the monopoly provider acting in its own self-interest. By the mid-1960s, the FCC began to recognize that the "natural monopoly" theory was not necessarily applicable across all elements of the telephone network, that certain segments could be opened to competition without necessarily diminishing the efficiency offered by a single provider. The epiphany here was the recognition that while the "natural monopoly" may have achieved *static efficiencies* that would necessarily be sacrificed if multiple providers were to split up the market, the exclusion of any type of competition across the entire spectrum of telecommunications services sacrificed the creation of *dynamic efficiencies* that would be possible only through rivalrous competitive activity and the innovation that such competition would stimulate.

68. As competition increased *or was perceived to have increased*, incumbent providers argued that they needed the flexibility to adjust prices in response to competitor initiatives, and that their prices and conduct would be effectively constrained by competitive marketplace forces, thus obviating the need for ongoing regulation of their prices and earnings. In 1989, the CPUC began the process of replacing traditional cost-plus regulation with a model that, by partially de-

linking prices from costs, relied at least in part upon competitive marketplace forces.[82] That initial step was followed by a series of rulings that expanded the reliance upon marketplace forces, ultimately culminating in the 2006 *Unified Regulatory Frameworks* decision that eliminated rate regulation entirely for most large ILEC retail telecommunications services.[83]

69. Underlying all of these deregulatory initiatives is the *assumption* that the level of competition for the legacy incumbent provider's services has matured to the point where marketplace forces can be reliably counted upon to replace regulation in constraining the incumbent's pricing and conduct. Much of the debate that has arisen over the past several decades – and in particular since the 1996 federal legislation – has been directed at determining when competition is sufficient to supplant regulation in protecting consumers and in achieving a "competitive outcome." While some consider the matter fully settled, the increasing complexity and concentration across broad telecom industry sectors presents new challenges that need to be carefully examined and resolved.

82. *Alternative Regulatory Frameworks for Local Exchange Carriers*, I.87-11-033, D.89-10-031, 1989 Cal. PUC LEXIS 576; 33 CPUC2d 43; 107 P.U.R.4th 1 ("*New Regulatory Frameworks*" decision).

83. D.06-08-030.

V.

VERIZON HAS LARGELY ABANDONED ITS INTEREST IN AND COMMITMENT TO WIRELINE SERVICES

Verizon has for many years been systematically disinvesting in its wireline operations and has been directing its management and capital resources toward wireless and other ventures.

70. §854(b)(1) requires the Commission to find that the transaction "[p]rovides short-term and long-term economic benefits to ratepayers." For at least the past decade, perhaps longer, Verizon has been systematically shifting its corporate attention and resources away from wireline services, and recent press reports suggest that Verizon has already begun shopping for a buyer of its remaining former Bell System territories in the northeast.

71. Up until 2007, the FCC required all Tier 1 ILECs, a group that included Verizon and all of its ILEC subsidiaries – to submit extensive financial and operations data to the FCC in electronic form. This was maintained in a publicly-accessible database known as the Automated Reporting Management Information System ("ARMIS"). The FCC discontinued requiring a number of components of the ARMIS Financial Reports after 2007,[84] so we do not have access to the same level of detail about Verizon's wireline investments and operating statistics after that year. In 2006, the CPUC similarly discontinued requiring the major California ILECs to submit

84. *In the Matter of Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's ARMIS Reporting Requirements*, FCC WC Docket No. 08-190, WC Docket No. 07-139, WC Docket No. 0-204, WC Docket No. 07-273, WC Docket No. 07-21, *Memorandum Opinion and Order And Notice of Proposed Rulemaking*, September 6, 2008.

state-level data similar to that required by the FCC in ARMIS.[85] However, even confining the analysis to the period of time during which ARMIS data is still available, we find a persistent pattern of *disinvestment* in wireline on the part of Verizon.

72. In 2007, ARMIS data put the net book value of the three Guava Companies at $7.675-billion.[86] According to Verizon's Hart-Scott-Rodino filing with the United States Department of Justice ("Verizon HSR"), the "book equity value" of the three ILECs being sold to Frontier is BEGIN VERIZON CONFIDENTIAL << >> END VERIZON CONFIDENTIAL,[87] a drop of some BEGIN VERIZON CONFIDENTIAL << >> END VERIZON CONFIDENTIAL, or BEGIN VERIZON CONFIDENTIAL << >> END VERIZON CONFIDENTIAL.[88] Data provided by Verizon in response to ORA Data Requests suggests that the net book value of the Guava Companies may be even lower than as shown in the Verizon

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85. *Uniform Regulatory Framework*, R.05-04-005, Phase I, D.06-08-030, August 24, 2006, *slip. op.,* at 217. "... we eliminate all NRF-specific monitoring reports and choose to rely on the FCC ARMIS data." Notably, even though no longer required by the FCC, the New York Public Service Commission ("NYPSC") has continued to require that Verizon annually submit ARMIS-type financial data on its operations in New York, covering the Verizon ILEC formerly known as the New York Telephone Company, now Verizon New York.

86. FCC, ARMIS Report 43-02, USOA Report: Table B-1.B, Year ending 2007; Available at http://www.fcc.gov/wcb/eafs [accessed July 7, 2015].

87. Verizon HSR, at Bates no. A1503005VZ60165.

88. Source: FCC, ARMIS Report 43-02, USOA Report: Table B-1.B, Year ending 2007; ARMIS Report 43-02, USOA Report: Table B-5, Year ending 2007. Available at http://www.fcc.gov/wcb/eafs (accessed July 7, 2015). Gross Telephone Plant in Service for the three Verizon ILECs in 2007 was $24.621-billion, with net investment at 7.733-billion. The Gross TPIS for the individual states was $12.513-billion (California), $5.741-billion (Texas), and $6.368-billion (Florida). The Net TPIS for the individual states was $3.505-billion (California), $2.091-billion (Texas), and $2.138-billion (Florida).

HSR submittal.[89] Because Verizon ceased reporting data to ARMIS after 2007, we do not know if the apparent disinvestment had persisted in each of the six intervening years, or only in some of them.

73. While the corresponding data specific to California is not published, it is certainly available within Verizon's books of accounts and could potentially be obtained by the Commission. In fact, ORA requested this information from Verizon for each year over the 2005-2014 period.[90] Verizon provided much of the requested data, but only for 2012 through 2014.

74. While ARMIS-level detail for the individual Verizon ILECs covering periods later than 2007 is not available, aggregate corporate-wide financial data for Verizon Communications, Inc. is reported quarterly and annually in 10-Q and 10-K Reports filed with the US Securities and Exchange Commission ("SEC"). Verizon reports certain financial results on a sector basis, separately for wireline and wireless. To a certain extent, year-over-year comparisons of 10-K data is somewhat problematic due to the lack of detail regarding operations at below the sector level. However, for certain purposes, these comparisons may nevertheless be instructive.

75. Table 11 below compares Verizon's wireline sector net investment with total Verizon corporate net assets over the period 2000 through and including 2014. This data is presented

89. Verizon Confidential Response to ORA Data Request Set 8, No. 2, ORA_VZ8.2_Attachment1_Confidential_A1503005VZ170002.xlsx, Data provided by Verizon in this response differs from corresponding figures contained in its Annual Reports as filed with the CPUC. ORA will attempt to obtain a reconciliation of the differences through additional Data Requests to Verizon, and I reserve the right to address this further in my Supplemental Report.

90. *Id.*

graphically on Figure 3. Over this period, wireline became a successively smaller component of the total Verizon capital asset base. Prior to 2006, Verizon reported sector level results separately for its local (ILEC) wireline business and for Verizon Business, which consisted of services furnished mainly to enterprise and government customers. In 2006, the Verizon local wireline sector represented 98.01% of the total (local + Business) wireline sector. Beginning in 2007, these two segments were combined for 10-K reporting purposes; hence, the assets shown on Table 11 and Figure 3 for "wireline" include more than just "local wireline" and thus overstate the percentage of Verizon's total asset base that is associated with its ILEC operations. Also in 2006, Verizon merged with MCI, and from that point forward the former MCI operations were included within the "wireline" sector for 10-K reporting purposes. However, there is no precise way to separate the MCI portion of the post-2006 "wireline" sector from the ILEC portion. However, it is possible to approximate the separation between these two components. To do this, I have used the Verizon Business asset figure for 2006 (which includes the former MCI and was still being separately reported) as a surrogate for Verizon Business assets for all subsequent years. If one assumes that Verizon is continuing to invest in this (former MCI) segment, then excluding the 2006 asset figure from all subsequent years likely still results in an overstatement of the proportion of Verizon total assets that is devoted to its ILEC operations.

Table 11

VERIZON COMMUNICATIONS INC
SECTOR LEVEL NET ASSETS
2000-2014
($billion)

Year End	Total Verizon Assets	Wireless Assets	Estimated ILEC Wireline Assets Excluding MCI	Total Wireline Assets Including MCI
2000	$134.1	$56.0	$78.1	$78.1
2001	$142.9	$60.3	$82.6	$82.6
2002	$144.5	$63.5	$81.0	$81.0
2003	$147.3	$65.2	$82.1	$82.1
2004	$146.9	$68.0	$78.8	$78.8
2005	$151.9	$76.7	$75.2	$75.2
2006	$174.3	$82.0	$71.4	$92.3
2007	$176.0	$83.8	$71.4	$92.3
2008	$202.4	$112.0	$69.5	$90.4
2009	$226.9	$135.2	$70.9	$91.8
2010	$222.7	$138.9	$63.0	$83.8
2011	$233.6	$147.4	$65.3	$86.2
2012	$227.3	$142.5	$63.9	$84.8
2013	$231.0	$146.4	$63.7	$84.6
2014	$237.1	$160.4	$55.8	$76.7

Source: Verizon Communications Inc. Form 10-K Reports for 2000-2014, Segment-level Assets

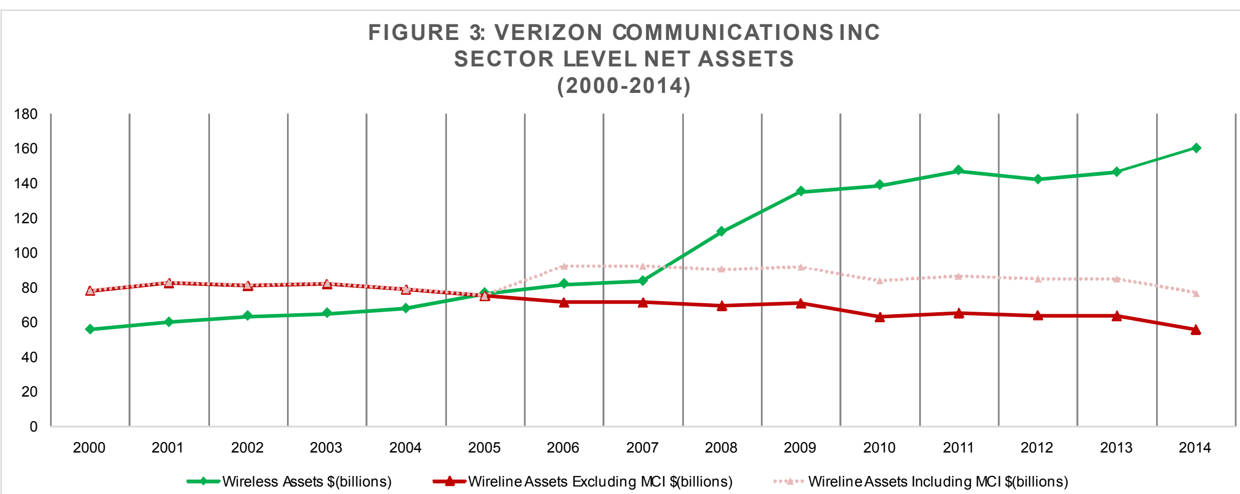

Figure 3: Verizon Communications, Inc. wireline and wireless net assets between 2000-2014.

76. A review of all of the available Verizon financial data over the past 15 years confirms the persistent shift in investment away from wireline and over to wireless and other non-local wireline operations. Immediately following the Bell Atlantic/GTE merger in 2000, some 73.39% of total Verizon revenues came from its ILECs; after the completion of the current transaction, that share will be reduced to 26.79%.

77. As noted above, Verizon commenced off-loading some of the ILEC operations it acquired via the Bell Atlantic/GTE merger within months of the closing of that transaction. Still, and as discussed above, in 2006, Verizon announced plans for an ambitious investment program to deploy fiber-to-the-home (FTTH) broadband to 18-million of its (then) 25.1-million residential wireline subscribers.[91] But after building out to a point where *FiOS* was available to about 15.6-million homes,[92] Verizon in 2010 shut down further *FiOS* investment other than that required to complete projects already underway.[93] At the time of the announcement, the company had 3.4-million *FiOS* Internet and 2.9-million *FiOS* TV subscribers[94] – the majority of these had signed up for both services. By the end of 2010, Verizon had spent some $23-billion.[95] In a 2009 *ex parte* presentation to the FCC, Verizon provided its costs per home *passed* and per home

91. FCC, ARMIS Report 43-08, USOA Report: Table III: Residential Switched Access Lines–Lifeline plus Residential Switched Access Lines–Non-Lifeline–Primary, Year ending 2006; Available at http://www.fcc.gov/wcb/eafs [accessed July 24, 2015].

92. Verizon Communications Inc. 2010 Annual Report, at 2.

93. "Verizon to End Rollout of FiOS," *Wall Street Journal*, March 30, 2010. http://www.wsj.com/articles/SB10001424052702303410404575151773432729614 [accessed on July 16, 2015].

94. *Id.*

95. *Id.*

connected.[96] There, Verizon put its actual 2006 cost per home passed at $799 and per home connected at $842. At a talk I presented to the CPUC Division of Ratepayer Advocates in June of 2010, shortly after Verizon had announced its plan to cease further *FiOS* investment, I estimated that even assuming a 30% take rate and a $600 per-customer acquisition cost, Verizon's up-front (capital + acquisition cost) outlay was about $4,100 per actual *FiOS* customer being served.[97] I had concluded that *FiOS* was not proving to be profitable in large part because of the relatively small fraction of the 15.6-million homes passed that had by then actually signed up for the service. Apparently Verizon had reached a similar conclusion, as demonstrated by its decision to stop investing in *FiOS*, and/or that it had better uses for the investment capital that was available.

Despite its status as a "pure play"wireline service provider, Frontier has also been writing off more in annual depreciation accruals than it has been investing in new wireline plant and equipment, a pattern that should also concern the CPUC going forward.

78. Frontier also appears to be writing off more in annual depreciation accruals than the amount of new investment it is making in its network each year. Mr. Jureller addresses this directly. In response to the question "Do ILECs typically spend as much in capital investments as they expense in depreciation each year?," Mr. Jureller explains:

> No. Over the last 15 years, the ILEC industry has undergone significant changes that affect capital investment levels. To the best of my knowledge, wireline depreciation expenses are higher than capital expenditures for all ILECs. It is important to address this question to assure the Commission that Frontier is

96. Verizon *ex parte* letter to the FCC, GN Docket No. 09-51, *A National Broadband Plan for our Future*, August 27, 2009.

97. Lee L. Selwyn, "The Transition to IP Telecom: Evolution, not Revolution," presentation sponsored by the CPUC Division of Ratepayer Advocates, June 16, 2010, at 23-34.

> continuing to invest at appropriate levels. Two major reasons explain the phenomenon. ILECs continue to report depreciation of long-lived network assets, which supported traditional switched access services, while the number of customer access lines have been on a steady decline over the last decade. With fewer access lines in service, network investment to maintain and support switched access services understandably has declined. The second reason is that emerging technologies and increased competition have increased companies' emphasis on capital investments in new technologies. ILECs, like Frontier, have committed to more efficient fiber-based networks and advanced electronics that in some cases are more economical to deploy in terms of per-unit costs than those for legacy networks and related equipment.

That this consistent *disinvestment* applies to most, perhaps all, ILECs is not a valid justification for the policy, particularly when, as both here in California and nationally, the level of ILEC-provided high-speed (i.e., >25 Mbps download) broadband Internet access is as limited as it currently is. Mr. Jureller is certainly correct that the demand for legacy wireline POTS-type voice services has been experiencing a rapid decline, and he is also correct that in many cases newer solid state electronic technology and fiber optic transport systems are often less costly for a given functionality than legacy electromechanical and analog electronic switches and copper-based transport and distribution facilities. That said, the demand for *wireline* services is actually growing *when all high-speed broadband Internet access, including services furnished by cable MSOs, is considered*.

79. Significantly, it appears that Frontier's planned level of capital expenditures for the three Guava Companies being acquired is BEGIN FRONTIER CONFIDENTIAL<<[redacted]>>END FRONTIER CONFIDENTIAL than corresponding CAPEX projections for the

existing Frontier ILECs overall.[98] There are several possible explanations for this. In the worst case scenario, Frontier is projecting larger-than-average CAPEX needs for these companies because the condition of their respective networks is relatively poor when compared with the rest of Frontier's ILEC operations. Second, and not unrelated, is the possibility that Frontier, having owned most of its other ILECs for some years now, has already made investments there that are going to be replicated for Guava upon completion of the acquisition. But since Frontier has generally disclaimed any "hands-on" knowledge of the state of the Guava networks, it's somewhat less clear as to how Frontier would know that the Guava acquisition will require a higher rate of CAPEX investment than its existing operating areas. At the very least, the Commission might want to consider, as a condition for approval, requiring that Frontier commit to the level of capital investment for California that it has forecast. Finally, it is also possible that the seemingly greater-than-average rate of new investment in the Guava companies is attributable to Frontier's assessment of the growth and revenue opportunities that these acquisitions will bring. After all, these are the last GTE operations that Verizon has put on the block, suggesting that, inasmuch as Verizon had held onto them the longest, on balance they were relatively more profitable than the other former GTE properties that Verizon had given higher priority for divestment. If this is the case, the proposed levels of CAPEX are a positive indicia of Frontier's commitment to the California acquisition, and of the prospects for Frontier shareholders.

80. For more than fifteen years, ILECs across the country have been aggressively pursuing a strategy of persuading regulators and legislators at both the state and federal levels that continued

98. *See, e.g.,* Frontier FTR, at Bates No. FTR ORA 016760.

regulation inhibits their ability to invest in and deploy broadband infrastructure on a massive scale. This mantra was repeated by Verizon and others as recently as this past spring in reaction to the FCC's *Open Internet* decision to reclassify broadband Internet access as a Title II common carrier service.[99] ILECs and other providers have literally *promised* that, if only regulation were reduced or, better still, eliminated altogether, they would invest in broadband and ultimately make broadband universally available. Conversely, these same providers have *threatened*, as we saw them do in response to the FCC's *Open Internet* ruling, that unless they are freed from continued regulation, no such investments will be made.[100] In California, the CPUC's *Uniform Regulatory Frameworks* decisions were made, in large part, in response to such arguments,[101] as was the California legislature's adoption of Senate Bill 1161, which enacted PU Code §710 deregulating,

99. FCC *Open Internet Order*, fn 79, *supra.*

100. Verizon Policy Blog, January22, 2015, "Verizon CFO Fran Shammo reiterates the dangers of Title II for jobs and investment." " I guess I would emphasize also that the approach, in whole or in part, on Title II is an extreme and risky path that will jeopardize our investment and the development of innovation in broadband Internet and related services. It will also tie up the industry in a very uncertain time and cause all types of litigation. ... If we curtail the investment of this industry, it will definitely trickle down to what we would consider middle-class jobs. And it's because of most of – at least for Verizon Wireless – a lot of our build are done by thousands of contractors across the United States. That will impact those small businesses and impact their employees." http://publicpolicy.verizon.com/blog/entry/verizon-cfo-fran-shammo-reiterates-the-dangers-of-title-ii-for-jobs-and-inv

101. In its July 21, 2008 Comments on the PD in R.05-04-005, URF Phase II, Verizon, for example, advised: "Recognizing that competition from intermodal providers in particular has fundamentally transformed the communications market, *the Commission eliminated obsolete economic regulations and monitoring requirements that were unnecessarily tying the hands of competitors, dampening investment and innovation*, and denying consumers the full benefits that the market has to offer." At 1, emphasis supplied.

with several notable exceptions, IP-based services altogether.[102] Having achieved these deregulatory objectives, the ILECs – large and small – have done little to fulfill their promises.

81. Having gotten out from under most or all price and earnings constraints, the ILECs have raised prices on services where they still maintain either an absolute or effective monopoly, and have diverted the cash flow derived therefrom to finance a variety of horizontal and vertical acquisitions, invest in non-wireline services such as wireless, content (e.g., Verizon's recent acquisition of AOL), and various overseas investments. Wireline broadband has been, up to now, rather low on the larger ILECs' list of priorities. Verizon initiated an FTTH build-out in 2005 that was, initially, supposed to reach 60% of its 25.1-million residential wireline customers. But even before Verizon shut down further *FiOS* investment after 2010, it had already begun the process of disposing of wireline operations that would never have likely been *FiOS* candidates in the first place. AT&T did not follow Verizon's FTTH lead, offering instead a slightly souped-up DSL under the *U-Verse* brand supported by a far less costly fiber-to-the-node ("FTTN") architecture. Only within the past 12 months has AT&T begun a serious FTTH play, but thus far has announced commitments that would cover only 21 cities out of its total 22-state residential

102. California Senate Energy, Utilities and Communications Committee April 17, 2012 Hearing on S.B. 1161, Author's (Sen. Alex Padilla) Purpose: "The author states that this bill will reaffirm California's current policy of not regulating VoIP and IP-enabled services accessible through a broadband connection unless authorized by federal law and specified by the Legislature, *thereby fostering continued investment, job creation, and innovation* in California's technology sector and the Internet economy, and continued availability of affordable communications technologies and services that meet consumer demand and provide consumer and public benefits." (At 6, emphasis supplied.)

service area.[103] Thus far, this enhanced FTTH offering is available in only twelve AT&T markets.[104]

82. The US was one of the first developed countries to achieve universal telephone service. By 1984, some 91.8% of all US households had a telephone; by 1998, that number had increased to 94.1%.[105] This deployment was accomplished under what might best be described as a public-private partnership supported by a regulatory model that relied upon private capital with public underwriting of risk, providing investors with a guaranteed return on and recovery of their investment while protecting consumers from excessive prices where competitive market constraints were either impractical or nonexistent. This form of economic regulation, known as Rate-of-Return Regulation ("RORR"), went out of favor more than two decades ago, but the consequences of its demise have never been seriously examined. On the plus side, there can be no question but that competitive entry has produced major technological innovations that would probably not have arisen, at least not to the same degree, under continued RORR. On the other hand, two decades of near or, more recently, total price deregulation has still failed to bring about universal broadband availability or even serious and geographically extensive competition in the broadband market. Moreover, and while the nature and quality of broadband services has

103. "AT&T Eyes 100 U.S. Cities and Municipalities for its Ultra-Fast Fiber Network" http://about.att.com/story/att_eyes_100_u_s_cities_and_municipalities_for_its_ultra_fast_fiber_network.html (last accessed July 24, 2015).

104. https://www.att.com/shop/u-verse/gigapower.html (last accessed July 24, 2015).

105. Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, *Telephone Penetration by Income by State* (Data Through 1999), March 2000, at 4.

improved substantially in recent years, the (unregulated) price levels being charged by the incumbent broadband monopolies continues its steady and persistent escalation.

83. Mr. Jureller's rationale for persistent depreciation accruals in excess of annual new investment might have some theoretical appeal if the sole impact of technology was to reduce the costs of replacing worn-out or technologically obsolete plant and equipment. But that is clearly not the case here. Advances in information and telecommunications technologies have done far more than affect the *supply* side of these markets, they have created whole new markets and market segments and have stimulated a great deal of investment aimed at exploiting these new demands. Mr. Jureller's statement that "wireline depreciation expenses are higher than capital expenditures for all ILECs" is not correct when examined at the corporate level rather than being confined, as he has done, to legacy wireline operations. Verizon, for example, has been investing heavily in wireless. While the investment required for wireless plant and equipment may be lower (on a per-customer basis) than for wireline services that require extensive physical wireline distribution infrastructure (i.e., poles, conduits, remote distribution terminals, repeaters, large central office switches, and the like), when electromagnetic spectrum and acquisition costs of existing wireless entities are included in the calculus, there is considerable net investment on Verizon's corporate books – i.e., new investments easily outstrip annual depreciation accruals. And it is entirely appropriate, when comparing wireline and wireless capital investment requirements, that the costs of electromagnetic spectrum licenses be included. Electromagnetic spectrum is, for wireless, the counterpart of wires, poles, conduits and the other elements of a wireline distribution network.

84. As of the end of 2014, Verizon carried some $75-billion worth of spectrum on its balance sheet. In February 2014, Verizon paid $130-billion to buy out Vodaphone's 45% share of Verizon's domestic wireless operations. Some of these investments (e.g., spectrum) do not depreciate. In 2014, total Verizon corporate depreciation reserve was $140.56-billion; Verizon's ILEC operations represented $86.37-billion of this, or about 61%. Verizon has been systematically extracting capital from its ILEC operations for investment in wireless – *and not for reinvestment in wireline broadband*.

85. Mr. Jureller's attempt to rationalize Frontier's own pattern of "wireline depreciation expenses ... higher than capital expenditures" on the basis of practices of other ILECs is of particular concern, in that, unlike Verizon and AT&T, Frontier is a "pure play" wireline telecommunications provider. Frontier does not have any wireless operations to speak of, and has not been diverting capital to wireless. But Frontier has been engaged in rapid horizontal and, primarily, inorganic growth via a succession of acquisitions. Thus, whereas other ILEC holding companies have extracted capital from their ILEC operations and diverted it toward wireless, Frontier appears to also have extracted capital from its ILEC operations and diverted it toward additional ILEC acquisitions.

86. Seen in this light, Mr. Jureller's focus upon EBITDA is particularly telling. While a widely used metric of financial performance, EBITDA – Earnings Before Interest, Taxes, Depreciation and Amortization – is basically a measure of *cash flow from current operations* that effectively ignores all capital-driven costs (interest, depreciation and amortization) as well as ongoing capital investment programs. In response to the question, "Does the fact that EBITDA

does not subtract capital expenditures signal that Frontier will not invest in the Verizon California network?," Mr. Jureller explains that "investors understand well that EBITDA does not include capital expenditures, and they are advised that EBITDA calculations do not provide a complete view of a company's financial position or its planned investment." He goes on to state that "The use of the metric does not suggest anything about Frontier's intentions related to capital investments," but assures us that "Frontier understands the importance of investment in network and services and is committed to invest at levels that support a strong and competitive business, likely at levels that are consistent with or superior to those of other ILECs."[106] Yet Frontier offers no specific commitment as to the extent and nature of any further broadband deployment within the Verizon California operating areas that it is acquiring.

87. Frontier does intend to seek subsidy support for broadband expansion in rural and high-cost areas from the Connect America Fund and perhaps other state and federal funding mechanisms. But these efforts need to be considered in a broader context. If Verizon applies for and accepts CAF II funding, Frontier might obtain $32-million annually in CAF Phase II funding for six years, totaling approximately $192-million, to support broadband expansion in California.[107] That is a small amount when compared with the typical level of new investment that Verizon has been making in California. Between 2013 and 2014, Verizon California's Gross

106. Jureller, at 16.

107. Abernathy, at 24.

Property, Plant and Equipment increased by BEGIN CONFIDENTIAL<<[redacted]>> END CONFIDENTIAL.[108]

88. The change-of-control of these California ILEC operations from Verizon – which has all but disavowed any further interest in wireline in any form – to a company with a strong commitment and track record of investing and supporting a robust wireline operation is a good thing and should be viewed positively by the CPUC. That said, without some firm commitment to a major expansion of broadband to the 1,112,331 households within Verizon-served census blocks in California where *FiOS* is not presently being offered,[109] there can be no real assurance of a net benefit to California ratepayers in the form a service improvement from this transaction. The Commission should approve the transaction, but impose a condition for approval that will produce a true improvement in broadband availability within the ILEC footprint that Frontier will be managing.

Verizon has also been extracting cash from its ILEC operations by other means

89. Fifteen years ago, when Bell Atlantic asked this Commission to approve its merger with GTE, the Company represented, as an §854(b)(1) economic benefit, the increase in overall operating efficiency that would result from the increased scale and scope of operations that

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108. Verizon Confidential Response to ORA Data Request Set 8, No. 2, Table 2a.

109. See Table 5b, *supra*. Verizon serves census blocks containing 2,628,438 households,. *FiOS* is currently available to 1,516,107 of these.

combining Bell Atlantic with GTE would achieve. Specifically, the two companies advised the Commission that:

> The merger is expected to allow Bell Atlantic and GTE to achieve increased efficiencies resulting from the increase in scale and scope. Applicants estimate that gross annual expense savings from synergies across both corporations resulting from the merger will reach $2 billion by the third year after the completion of the merger, and that gross annual synergies in capital purchasing would reach $500 million by that time. These savings include, among other things, savings from the elimination of duplicative functions, savings from combining the companies' capital purchasing programs, savings from adopting the best and most efficient operational and managerial practices (hereinafter "best practices") of GTE and Bell Atlantic, and savings in development costs for new systems and services. These savings will make the combined company more efficient and better able to offer services to its customers at competitive prices.[110]

90. Bell Atlantic/GTE witness John H. Landon undertook to quantify the potential merger-driven expense savings, which he attributed to economies of scale and scope, adoption of best practices, and access to lower equipment and financing costs:

> The results of my benchmarking indicate that the expected percentage expense savings from the GTE/Bell Atlantic merger are very close to those of the SBC/Pacific Telesis and SBC/Ameritech mergers. For these three mergers, expense savings attributed to telephone operations, as a percent of actual expenses, range between five and six percent. Savings to GTE-California and Pacific Bell telephone operations are both five percent of actual expenses. Expense savings attributed to G&A, as a percent of actual expenses, range between 14 and 16 percent. For GTE-California G&A related

110. *Joint Application of GTE Corporation ("GTE") and Bell Atlantic Corporation ("Bell Atlantic") to Transfer Control of GTE's California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE's Merger With Bell Atlantic*, A. 98-12-005, *Joint Application of GTE Corporation and Bell Atlantic Corporation*, December 2, 1998, at 16-17.

expense savings are estimated at 16 percent of actual expenses. The other two mergers resulted in predicted savings of 14 percent.[111]

We do not know specifically if or to what extent any such merger-driven savings attributable to increased economies of scale had actually materialized as a result of the Bell Atlantic/GTE merger as would have been required by §854(b)(1); we do not know, assuming that such economies of scale had actually materialized, if any of those savings had actually been flowed through to the Verizon ILEC entities rather than being "allocated" to other Verizon activities such as, for example, wireless; and we do not know, even if the ILEC entities had received some portion of the merger economic benefits, that any of those had actually been flowed through to ratepayers as would have been required by §854(b)(2).

91. All of that notwithstanding, it is noteworthy that (a) none of the Applicants in the present case have addressed the *reverse* effect of splitting off Verizon California from the former Bell Atlantic portion of Verizon – the potential for *dis*economies resulting from the reduction in scale that, by the same logic, should produce *higher costs* and less efficiency overall. Morever, and as I shall discuss below, it would appear that, contrary to the "economies of scale" theory advanced by the predecessors to Verizon back in 1998, Frontier here actually anticipates substantial cost savings in the California ILEC operations that it is acquiring from Verizon following the separation of that ILEC from the rest of Verizon.

111. *Id.*, Chapter VI, Report of John H. Landon, Principal and Director, Energy and Telecommunications Practice, Analysis Group/Economics, at 16-17.

92. Verizon's ILECs are organized into a number of mostly state-level operating subsidiaries, although in some instances there may be more than one corporate entity operating in a state either where both a legacy Bell and a legacy GTE ILEC had existed prior to the creation of Verizon, or where more than one GTE ILEC had operated in the jurisdiction (e.g., GTE California, now Verizon California, and GTE Northwest, now Verizon Northwest). A few Verizon ILEC entities provide service in several states. Other Verizon "service company" entities provide a range of centralized services to the ILECs as well as to other non-ILEC Verizon operations. The use of centralized services has a long history in the telecommunications industry, dating back to AT&T Bell System days, when the AT&T General Department provided a broad range of back-office services and Bell Laboratories provided centralized research and development for the entire AT&T corporate family. Frontier also employs centralized service provisioning for its ILEC entities. In theory, the use of centralized services should produce scale and scope efficiencies that would then benefit all of the using entities. In practice, this is not always the case. Verizon and its predecessors, in particular, have a long history of employing the use of centralized services organizations to extract profits from their operating telephone companies.

93. One particularly well-known example of this conduct is the case of the NYNEX Materiel Enterprises Company ("MECO") that was created by NYNEX following the Bell System break-up to provide centralized procurement services to the two NYNEX ILEC affiliates – New York Telephone Company ("NYT") and New England Telephone Company ("NET"). MECO would purchase equipment and supplies from vendors, and then resell it at a markup to the two ILECs. In 1990, the NYPSC initiated an investigation of NYT's purchasing practices and, in particular,

its purchases from and through MECO.[112] The NYPSC determined that an independent auditor would be hired to perform a thorough investigation of NYT's transactions with affiliates and determine their financial effects on NYT's ratepayers. In a subsequent session, NYT was ordered to perform a cost/benefit analysis for directory services it provided to ratepayers in order to establish whether the transactions and arrangements between NYT and its affiliate NYNEX Information Resources Company ("NIRC") were best serving the public.[113] After seven years of discovery and other efforts, a settlement agreement was approved in 1997 that resolved both cases. In exchange for an end to the investigation of NYT's transactions with affiliates, the settlement provided refunds of $30-million for transactions with NIRC and another $53-million for transactions with affiliates other than NIRC (including MECO).[114] To the best of my knowledge, none of the more recent affiliate transactions involving Verizon California or other Verizon ILECs and the various Verizon centralized services affiliates has been the subject of anything close to this level of scrutiny.

112. *Proceeding on Motion of Commission to Investigate Transactions Among New York Telephone Company and its Affiliates*, New York Public Service Commission, Case Nos. 90-C-0191 and 90-C-0912, *Order Granting Interlocutory Appeal In Part*, November 26, 1990.

113. *Proceeding on Motion of the Commission to Investigate the Directory Publishing Operations of New York Telephone Company and NYNEX Affiliates* State of New York Public Service Commission Case No. 92-C-0272, Order Instituting Proceeding, April 1, 1992, at 5-6.

114. *Id.*, *Opinion and Order Approving Settlement with Modifications*, June 5, 1997.

94. The services that the various Verizon service companies provide to the Guava ILECs and to most or all other Verizon operating affiliates (including both wireline and wireless) consist of the following specific expense categories:[115]

Engineering and Network
Network and Technology
Contact Centers/HD
IT Systems/Billing
Real Estate
HR Ops
CFO Ops
Supply Chain Ops
Procurement Fees
Legal / Public Affairs
Executive
Aviation

According to the data provided by Verizon in response to ORA Data Request Set 8, approximately BEGIN CONFIDENTIAL <<[redacted]>>END CONFIDENTIAL of the total expenses incurred by the various Verizon service affiliates (including the parent company) are "allocated"

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115. Verizon Confidential Response to ORA Set 8, Item 1(a); see also, Frontier HSR, at Bates no. FTR ORA 016832.

to the three Guava ILECs.[116] However, although ORA had requested it, no explanation was provided by Verizon as to the basis of or mathematical formula upon which the total costs in each of the various expense categories were being "allocated" to the three Guava ILECs vis-a-vis the other user entities within Verizon that receive services from these centralized service organizations. We do not know, for example, whether the "allocations" were based upon the total number of customers, total number of switched access lines, total number of "connections" including *FiOS* lines, total revenue, gross investment, net investment, head count, some combination of these factors, or something else entirely. We also do not know anything about how Verizon allocated the roughly BEGIN CONFIDENTIAL <<[redacted]>>[117] END CONFIDENTIAL in expenses for all of these categories combined between its ILEC and non-ILEC entities.

95. We can, however, explore this "allocation" arrangement up to a point even in the absence of the specific data that Verizon has thus far withheld. As noted above, we can determine from the Verizon responses that the three Guava ILECs account for approximately BEGIN CONFIDENTIAL <<[redacted]>>END CONFIDENTIAL of the total expenses incurred by the various Verizon service affiliates. Based upon access line counts, the three Guava companies account for roughly 17.5% of total Verizon ILEC voice switched access lines. Extrapolating from the Guava-specific "allocation" to all Verizon ILECs on this basis, we can estimate the total portion of the service company affiliate expenses that Verizon "allocates" to its ILEC entities at

116. Verizon Confidential Responses to ORA Set 8, No. 1, Confidential Attachments 1(c) and 1(f).

117. *Id.*

approximately BEGIN CONFIDENTIAL <<[redacted]>>END CONFIDENTIAL of the total expenses incurred by the various Verizon service affiliates.

96. Verizon states that "All [expense] categories [incurred by its service affiliates] are allocated to all Verizon entities,"[118] and that for 2014 the total of all such expense categories was BEGIN CONFIDENTIAL <<[redacted]>> END CONFIDENTIAL.[119] And, while "All categories [of the affiliate expenses] are allocated to all Verizon entities," it would appear that the ILECs may be bearing a disproportionately high share of these costs relative to other Verizon lines of business. For example, when Verizon's investment in spectrum is included together with wireless PPE, it would appear that wireline represents somewhere in the range of about 30% of Verizon's net asset base, yet appears to account for approximately BEGIN CONFIDENTIAL <<[redacted]>>END CONFIDENTIAL of Verizon's "allocated" centralized services expenses.

97. The possibility that Verizon is grossly overallocating its corporate and service affiliate expenses to its ILECs, and to the three Guava ILECs in particular, is further confirmed by Frontier's own financial analysis of these expenses. According to data contained in Frontier's HSR filing, Frontier expects to avoid some $525-million in expenses in Year 1 by replacing the Verizon affiliate services with its own.[120]

118. Verizon Confidential Response to ORA Data Request Set 8, No. 1(f).

119. *Id.*, confidential attachment ORA_VZ8.1c_Confidential.xlsx.

120. Jureller, at 11-12 (calculated by subtracting "$175 million in annualized cost savings from shared service efficiencies by the end of the third year of operation" from "total annualized corporate consolidated operating cost savings of $700 million").

98. There is an obvious inconsistency here, and possibly an outright misrepresentation. When Verizon's predecessor sought the CPUC's approval to merge with GTE, in order to satisfy the requirements of §854(b)(1) and, presumably, of §854(b)(2), it made explicit representations as to the economic gains to be achieved through increased economies of scale and scope following the combination of the Bell Atlantic and GTE operations. But now, we are being assured that *by splitting up Verizon* and making it smaller, §854(b)(1) will also be satisfied because the smaller Frontier will realize substantial efficiency gains by getting out from under the Verizon "cost allocations" and by replacing Verizon operating practices with its own more efficient ones. True, some 17 years have elapsed between the 1998 "bigger is better" claim and the 2015 "smaller is better" contention. Notably, however, and despite the enormous size of both Comcast and TWC in last year's proposed merger, the Joint Applicants there had also invoked the "bigger is better" canard and advanced claims that their combination would lead to increased efficiencies and lower costs overall.[121]

99. Adding some degree of substance to Frontier's "smaller is better" perspective are some facts that have emerged about Verizon's operations with respect to the three Guava ILECs since the Bell Atlantic/GTE combination took effect in 2000. Frontier's witness Mr. Michael P. Golob, Senior Vice President of Network & Engineering Integration, testifies here that "Frontier's 2010 transaction with Verizon required that the Company transition more than four million lines across fourteen states, with thirteen of those states using legacy GTE back-office systems similar to

121. See, e.g., Comcast/TWC Application, A.14-05-013, at 14.

those used by Verizon California."[122] Recall that Bell Atlantic had assured the Commission that its merger with GTE would create substantial efficiencies and cost savings:

> The merger is expected to allow Bell Atlantic and GTE to achieve increased efficiencies resulting from the increase in scale and scope. Applicants estimate that through "gross annual expense savings from synergies across both corporations resulting from the merger will reach $2 billion by the third year after the completion of the merger, and that gross annual synergies in capital purchasing would reach $500 million by that time. These savings include, among other things, savings from the elimination of duplicative functions, savings from combining the companies' capital purchasing programs, savings from adopting the best and most efficient operational and managerial practices (hereinafter "best practices") of GTE and Bell Atlantic, and savings in development costs for new systems and services.[123]

Yet now we discover that Verizon's promised integration and adoption of "best practices" never occurred at least with respect to the GTE ILECs' "back office" IT and operations support systems ("OSS"). Ten years after the Bell Atlantic/GTE merger became effective, all of the former GTE ILECs that were acquired by Frontier in 2010 were still using the pre-2000 legacy GTE back office systems. And, as further confirmed by Frontier's Mr. Golob, fifteen years after the integration of Bell Atlantic and GTE was supposed to have happened, Verizon's (former-GTE) California ILEC is still utilizing the same pre-2000 legacy GTE systems.

100. A conversion of the GTE back office and operations support systems is a complex undertaking, but once complete would (presumably) have produced the types and magnitudes of

122. Direct Testimony of Michael P. Golob, Senior Vice President of Network & Engineering Integration, Frontier Communications Corp. ("Golob"), at 14.

123. Bell Atlantic/GTE Merger Application, A.98-12-005, at 16.

costs savings that Bell Atlantic and GTE had assured the CPUC (and the FCC) would result from their merger if only it were allowed to go forward. Notably, Mr. Golob testifies that Frontier did not encounter any serious problems when it undertook to transition the former GTE ILECs that it had acquired in 2010 over to Frontier's OSS:

> After the close of the 2010 transaction, the conversion of operational support systems ("OSS") was completed approximately one year ahead of schedule, and included the successful transition of both former GTE OSS in thirteen states, as well as former Bell Atlantic OSS in West Virginia. West Virginia is notable because it was a statewide transition that required a complete system cutover at closing, at the same time as it became Frontier's largest system in any state. Frontier was able to accomplish the cutover effectively because of the technical expertise of its workforce, as well as its proven, scalable back-office operations and OSS. In Connecticut in 2014, Frontier was able to cutover from the former SNET/AT&T OSS on the day the transaction closed, transitioning more than 900,000 customers (ILEC and other services) to Frontier's operating systems.[124]

Mr. Golob states that, based upon its past experience, Frontier anticipates no difficulties in transitioning the Verizon California systems to Frontier's various platforms: "Frontier will transition the Verizon California operations to the Company's existing billing system and OSS at closing, negating the need to build new systems and avoiding a disruptive transition period for customers."[125]

101. That Frontier anticipates achieving a significant cost saving when it replaces Verizon's use of legacy GTE IT and OSS is hardly surprising. These systems were in place back in 2000 when Verizon took over the GTE companies, but they are likely more ancient than that, possibly

124. Golob, at 14.

125. *Id.*, at 14-15.

dating back as much as a quarter century or longer. Since there have been major changes in the industry since 2000, these legacy GTE systems will have had to have been upgraded and updated over the years. However, by continuing to maintain parallel Bell Atlantic and GTE IT platforms, Verizon has likely sacrificed precisely the gains it had promised from integration and best practices. Moreover, its apparent ability to consistently overallocate costs to its ILEC operations is indicative of either a true lack of any real competitive discipline confronting these ILECs, and/or a deliberate strategy to "harvest" the remaining customers for the ILECs' services for as long as possible.

102. Under a "harvesting" strategy, the provider accepts the fact that demand for its products or services is dwindling, but also recognizes that for a large (albeit shrinking) body of customers the combination of insufficient competitive alternatives coupled with simple customer inertia can support higher price levels than might be applied if the goal was to attract and grow the firm's customer base. AT&T readily admitted to adopting such a "harvesting strategy" with respect to its 4.677-million CLEC residential customers that existed as of July 2004, when it announced that it was exiting the CLEC business and, shortly thereafter, commenced discussions that led to its ultimate merger with SBC.[126] AT&T implemented its 2004 harvesting strategy by effecting a

126. *BellSouth Corporation and AT&T Inc. Application Pursuant to Section 214 of the Communications Act of 1934 and Section 63.04 of the Commission's Rules for Consent to the Transfer of Control of BellSouth Corporation to AT&T Inc.* FCC WC Docket No. 06-74, March 31, 2006, Declaration of James S. Kahan, Senior Executive Vice President – Corporate Development, AT&T Inc. paras. 46-47, at 22-23. "As the Commission is aware, legacy AT&T made a unilateral decision in June 2004 to cease actively marketing its traditional wireline services to mass market customers and to carry out a "harvesting" strategy to maximize the profitability of its eroding mass market customer base. The Commission correctly concluded in SBC/AT&T that because of these steps, the merger would not harm competition in the mass market. Since the SBC/AT&T merger, the new AT&T has continued the harvesting strategy of legacy AT&T with respect to mass market wireline customers outside our ILEC territory. Since June 2004, AT&T has not actively marketed to those mass market wireline customers and we have no plans to
(continued...)

succession of rate increases that those of its CLEC customers who remained with the company continued to pay until such time as they eventually found a lower-priced alternative. Verizon's ILECs have been hemorrhaging customers for several years,[127] yet persist in charging rates for basic local telephone service that are generally higher than those of most competitors.

103. As it turns out, substantial cost savings –coming both from the savings that Frontier expects to confer upon Verizon California and the other two Guava ILECs by extricating them from the burdensome "cost allocations" imposed by Verizon, and from the additional cost savings resulting from the adoption of Frontier best practices and other synergies – represent the principal economic driver of the entire transaction as seen from Frontier's perspective. As can be seen in Frontier management's review of the transaction, the two principal metrics being used to evaluate the benefits of the transaction are EBITDA and free cash flow ("FCF").[128] There are generally two ways to increase EBITDA and FCF in the normal course of operating a business: increase revenue or decrease costs. While Frontier does hope to increase revenue in its newly acquired territories, this potential is small when compared to Frontier's expected cost reductions.

104. Frontier management has identified three semi-distinct potential sources of cost savings:

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126. (...continued)
do so in the future."

127. See Table 1, *supra*.

128. *See, e.g.,* Bates Nos. FTR ORA 016720, 016730, 016747. Frontier's HSR filing references FCF and EBITDA a combined total of nearly 250 times.

(1) *Replacement of functions currently being supported by Verizon service affiliates*. The first is replacing services currently being furnished by Verizon affiliates at exorbitant "allocated" intracompany transfer costs with less expensive services provided in-house by the ILEC itself or by a Frontier service affiliate. (Notably, while Frontier expects to perform these functions at a lower cost overall than the amounted currently being "allocated" by Verizon to its three Guava ILECs, Frontier nowhere specifies how its own service affiliate costs will be "allocated" to these companies following Frontier's takeover.) These cost savings are said to be "Day 1 Savings" because they will occur simply by removing the Guava affiliates from Verizon control.

(2) *Improvements in the efficiency with which these affiliate services are provided.* The second category of savings is related to the first, and stems from making improvements to the provisioning of these in house services to achieve additional savings. Together, Frontier management predicts that these savings will represent the majority of the cost savings, and thus EBITDA and FCF improvement.

(3) *Synergies to be achieved through integration of the Guava companies' back office systems with existing Frontier companywide operations.* The third cost improvement comes from possible synergies that would result from the deal. Even though Verizon touted integration synergies in its own pitch to acquire these very same assets from GTE in 1999, Verizon had apparently never actually moved the Guava ILECs to a common Verizon back office infrastructure based upon the preexisting Bell Atlantic IT and OSS platforms. The legacy GTE infrastructure – now 15 years old at the very least – still exists and is in use by the

Verizon-operated Guava ILECs. Frontier has pledged to integrate the Guava back office systems with its own, potentially saving tens of millions in operating expenses. Frontier states that it has experience with such efforts, having already completed the integration of the former GTE systems (and AT&T systems) from earlier acquisitions.

105. In combination, Frontier management estimates that total cost savings may be in the neighborhood of $700-million annually from year 4 onward, flowing straight to EBITDA, and indirectly improving FCF.[129] As Mr. Jureller discusses, the anticipated improvements in FCF, if achieved, would result in Frontier having one of the most attractive dividend payout ratios of all of the ILECs.[130]

106. Frontier advises that its projected cost savings from extricating the Guava ILECs from the Verizon "cost allocations" is borne out by its prior experience with the 2010 acquisition:

> Frontier has a sound track record in estimating and achieving such transaction-related synergy savings. In a similar transaction with Verizon in 2010 (which, in part because it occurred across 14 states, was more complex than the current transaction) the Company estimated $500 million in annual synergies by the end of the third year following closing based on Frontier's cost structure being lower than Verizon's cost allocations. In comparison with the current transaction, the estimated cost savings in the 2010 Verizon transaction represented approximately 23% of the total operating expenses of the operations the Company was acquiring. Frontier not only successfully achieved the $500 million in estimated cost savings, but realized approximately $650 million in annualized synergies as of the end of 2012 (see Frontier SEC 2012 Form 10-K, p. 2). Thus, Frontier realized a 30% reduction in the total operating expenses of the properties it acquired from Verizon

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129. Jureller, at 11.

130. *Id.*, at Table 6.

> in 2010 (versus the 17% reduction it has estimated in the current proposed transaction). ...[131]

Frontier's apparently consistent experience with replacing Verizon operations with its own serves to further underscore the longstanding nature of Verizon's practice of overcharging and thus overburdening its wireline ILECs. If substantive deficiencies in the technical state of Verizon's California operations are determined to exist, the Commission should not ignore the fact that Verizon has been extracting capital from its California ILEC rather than reinvesting it in California. The Commission should make sure that this *laissez-faire* approach is not repeated once Frontier takes over.

107. As I have discussed in previous sections of this Reply Testimony, Verizon has been systematically *disinvesting* in its ILEC networks – and certainly in its California ILEC – for a number of years. Verizon has been systematically overallocating certain costs to its ILECs, and has maintained legacy GTE IT and OSS platforms despite assurance that, following its 2000 merger with GTE, the Company would implement a variety of synergies including best practices and the avoidance of duplication. Frontier has advised ORA that it had not undertaken any extensive examination of the physical state of the California ILEC network facilities that it is acquiring from Verizon as part of its due diligence, and that such an evaluation would not commence before the closing of the transaction.[132]

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131. Frontier Response to ORA Data Request, Set 6 No. 9(b).

132. April 15, 2015 meeting between ORA and Frontier; see also, Golob, at 13.

108. The condition of the physical network assets that Verizon will be conveying to Frontier is obviously of considerable importance to the ILEC's *customers* irrespective of who happens to own them and is providing the services derived from those assets. The lack of due diligence on the part of Frontier in this area together with the history of Verizon's stewardship of its ILEC assets both in California and elsewhere needs to be addressed in order for the Commission to make the various findings that are required under §854 prior to approval of the transaction. The very first question identified in the July 2, 2015 Assigned Commissioner's Amended Scoping Ruling ("Amended Scoping Ruling") is, "What is the current physical condition of the Verizon landline network?" The Amended Scoping Ruling goes on to address the question of "How would the condition of Verizon's network affect the proposed transaction in terms of service to customers, interconnection of Competitive Local Exchange Carriers (CLECs), and investments needed to fulfill the obligations of a Carrier of Last Resort (COLR)."[133] The June 5, 2015 ALJ Ruling established a schedule for a series of eleven workshops and Public Participation Hearings be held at locations across California within the Verizon operating footprint for the specific purpose of ascertaining the physical state of the local exchange carrier network assets that Frontier will be acquiring:[134]

> The workshops will review the technical condition of the network in the areas adjacent to the PPH locations in order to inform the parties and Commission about the operational status of the facilities to be migrated from Verizon to Frontier, and what steps may be necessary to satisfy the consumer benefit and public interest tests for approval of such transfers under the Public Utilities Code.

133. July 2, 2015 Amended Scoping Ruling, at 4.

134. *Administrative Law Judge's Ruling Setting Workshops and Public Participation Hearings and Requiring Customer Notice*, June 5, 2015, at 1.

This process will have been only partially completed as of the July 28, 2015 filing date that has been set for this Reply Testimony and for other ORA and intervenor testimony. Accordingly, I would reserve the right to address the matter of the condition of the network assets to be transferred to Frontier in my Supplemental Testimony.

109. The extent of §854(b)(1) economic benefits may, however, be affected by the physical condition of the network assets (switches, local distribution facilities, interoffice facilities) that are being sold by VZ to FTR. Under the terms of the "Securities Purchase Agreement" between Verizon and Frontier, the various network assets being transferred are sole "as is, where is" without any warranty as to their condition or any recourse on the part of Frontier.

110. The condition of the physical network assets that are to be transferred must be a central focus of concern for the Commission. Prior sales of Verizon ILEC assets have been beset by serious network deficiencies. Perhaps the most serious of these involved the 2008 sale of Verizon's northern New England (Maine, New Hampshire and Vermont) ILEC operations to FairPoint Communications. In January 2007, Verizon entered into an agreement with FairPoint Communications to sell its local exchange access lines and operations in Northern New England for approximately $2.715-billion, based on the number of shares (as adjusted) and closing price of FairPoint common stock on the date immediately prior to the announcement of the merger.[135] Although the sale expanded FairPoint's geographic footprint and market share fivefold,[136] the

135. Verizon Annual Communication 2007 Annual Report, at 19.

136. FairPoint Communications, Inc November 20, 2009 10-Q, at 12.

newly acquired assets proved to be far more degraded than FairPoint had anticipated, and presented far too onerous a challenge for FairPoint to overcome.[137] Following the acquisition, FairPoint faced significant challenges integrating Verizon's telecommunications network into the company, which required significant repair and upgrading, and transitioning certain back-office operations from Verizon's integrated systems to FairPoint's systems.[138] These problems caused costs to rise and its customer base to drop. Just 18 months after becoming the 7th largest local telephone company in the United States,[139] FairPoint Communications filed for Chapter 11 bankruptcy protection. In 2011, FairPoint sued Verizon,[140] claiming that it had paid a high price for Verizon's outdated telephone infrastructure and that Verizon had failed to transfer essential IT networks and back office operations.[141] While the case was settled in FairPoint's favor, to this day FairPoint struggles to recover from the acquisition. For example, in October 2014, FairPoint froze the pensions of approximately 1,800 employees in Northern New England, having just two months earlier eliminated post-retirement healthcare benefit plans.[142] A company spokesperson argued that these changes are essential if FairPoint wants to remain a competitive contender in

137. "Verizon deal sends FairPoint spiraling into Ch. 11" (October 26, 2009). http://www.crainsnewyork.com/article/20091026/FREE/910269988/verizon-deal-sends-fairpoint-spiraling-into-ch-11 [accessed on July 21, 2015].

138. FairPoint Communications, Inc November 20, 2009 10-Q, at 12.

139. *Id.*

140. *United States District Court for the Western District of North Carolina Charlotte Division,* FairPoint Communications, Inc et al. Litigation Trust v Verizon Communications Inc., NYNEX Corporation, Verizon New England, Inc., and Verizon Information Technologies LLC, Civil Action Case No. 3:11-cv-00597, filed November 23, 2011.

141. "Verizon To Pay $95M To Settle FairPoint Acquisition Row." (August 13, 2014). Law 360. http://www.law360.com/articles/566923/verizon-to-pay-95m-to-settle-fairpoint-acquisition-row [accessed on July 21, 2015].

142. FairPoint Communications, Inc November 20, 2014 10-Q, at 18.

Northern New England's telecommunications market.[143] However, they came at the cost of jeopardizing relations with labor unions and employees. FairPoint is still trying to find solid footing, seven years after closing its deal with Verizon.

111. Not only does the SPA make no provision for any warranty on the part of Verizon as to the physical condition of the network assets being sold to Frontier, it expressly provides that any costs that a regulatory body might see fit to impose upon Verizon as a condition for approval – such as, for example, a requirement that Verizon compensate Frontier for network repairs needed to bring the facilities to some minimum service standard – would apparently have to be paid by Frontier *even if imposed upon Verizon*.[144]

143. "FairPoint freezes pensions for workers" (October 14, 2014). The Washington Times. http://www.washingtontimes.com/news/2014/oct/14/fairpoint-freezes-pensions-for-workers [accessed on July 21, 2015]

144. SPA, at §2.3.

VI.

THE "SECURITIES PURCHASE AGREEMENT" AND ASSOCIATED ANNEXES INCLUDING THE SOFTWARE LICENSE AGREEMENT

112. The terms and conditions governing Frontier's purchase of the three Guava Companies from Verizon is set out in a lengthy "Securities Purchase Agreement" ("SPA") with multiple annexes and attachments, entered into between the parties and dated as of February 5, 2015. I have reviewed the SPA along with the various annexes and attachments for the purpose of gaining an understanding of the *business relationships* between the parties that is contemplated by the agreement and the *business and operational conditions* that will confront Frontier once it assumes ownership and operation of the Guava Companies and related Transferred Assets following the closing. I understand that these are legal documents and am in no sense offering a legal opinion with respect to any of the provisions therein.

113. With the exception of certain limited commitments on the part of Verizon to assist Frontier with the transition of the California, Texas and Florida ILEC operations to Frontier and various seemingly standard legal warranties and representations as to Verizon's ownership of the assets to be transferred, any liabilities linked thereto, and the authority of those Verizon officers and others who are entering into the agreement with Frontier to do so, Verizon makes no actual warranties as to the physical condition of any of the tangible, intellectual property, and other assets being transferred, nor is there any provision for recourse to Verizon by Frontier following the closing of the transaction. As a general matter, the Verizon ILECs and assets are being sold

to Frontier "as is," with virtually all of the risk as to the physical condition of these assets falling upon Frontier:

> THE TRANSFERRED ASSETS AND TRANSFERRED COMPANIES ARE ASSIGNED "AS IS" WITHOUT ANY WARRANTY OF ANY KIND, WHETHER EXPRESS OR IMPLIED, AT LAW OR IN EQUITY, INCLUDING ANY WARRANTIES OF OR RELATED TO TITLE, MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.[145]

114. The assets being transferred to Frontier constitute a going telecommunications business, and include, in addition to certain physical network assets (central office buildings and central office equipment, copper and fiber optic distribution and feeder cables, drop wires, remote terminals and cross-connect points, poles and conduits, interoffice and interexchange transport facilities, among others), other physical assets (land and buildings, motor vehicles, computer and related equipment, office equipment and furnishings, etc.), employees, customers, customer relationships and customer contracts, databases, computer software and related intellectual property, and vendor relationships, among other things.

115. Certain software and other intellectual property will continue to be used by Verizon to support the ILEC and other operations that are not involved in the current transaction. Some of this software is owned by Verizon; others are licensed by Verizon from third parties. The SPA, the "Software License Agreement" ("SLA"), and certain other elements of the SPA set out the terms under which Frontier will be afforded access to such software. In generally, Frontier's rights are limited in several important respects.

145. Securities Purchase Agreement, §10.10, capitalization in original.

- For Software that is owned by Verizon (e.g., software that Verizon has developed in-house or that was developed for its exclusive use), Frontier's access is restricted to the version of the software as it exists on the day of closing. Frontier is not entitled to receive any maintenance updates or feature upgrades.[146]

- In most cases, Frontier's access to Verizon-owned software is time-limited, typically to five years following the closing date. The Agreement does not give Frontier any option or ability to extend the term of the license, to obtain updates and upgrades, or maintenance support. However, it does not preclude such arrangements, but is silent as to manner in which these might be negotiated.

- For software that is not owned by Verizon – i.e., that Verizon is utilizing subject to a license from the third-party owner, Frontier is generally being required to negotiate the terms of its own licenses directly with those third-party owners.[147]

116. As discussed earlier, Frontier intends to migrate the three Guava Companies over to Frontier's own back-office and operations support systems immediately upon closing, and thus does not require access to either Verizon- or third-party-owned software supporting these functions. However, in other areas, continued use by Frontier of Verizon-owned software will be critical to its operations. One such area is the Interactive Media Guide ("IMG") that is used in

146. SLA, §7.1.

147. SPA, §6.17(a), (b)

connection with *FiOS* video services. Several of the former GTE and West Virginia ILECs that Frontier acquired from Verizon in 2010 were providing *FiOS* at various localities within their respective service areas, and following the acquisition Frontier continued to offer both *FiOS* Internet and *FiOS* video services under the *FiOS* brand. Under the terms of its 2010 agreement with Verizon, Frontier obtained a five-year right-to-use license for the *FiOS* IMG and other *FiOS* software. That license was set to expire earlier this year. When Frontier negotiated the current procurement agreement with Verizon, it obtained, for the three Guava Companies, a similar five-year right-to-use license for the IMG and other *FiOS* software. As part of the current deal, Verizon also agreed to *extend* the 2010 licenses for an additional five years, such that both the 2010 and 2015 licenses will mature on the same date in 2021, i.e., five years after the 2016 closing date for the current transaction.[148]

117. At a Meet & Confer conference call held on June 18, 2015 with Frontier, Frontier advised ORA that it intends indefinitely to continue to offer *FiOS* Internet and video services under the *FiOS* brand, and that Verizon supports that decision. It is thus somewhat unclear why Frontier is prepared to accept a 5-year sunset date on its access to the IMG or other *FiOS*-related software. Frontier has advised ORA that it "believes five years is a sufficient period during which Frontier will analyze, determine and put in place a plan to replace the software if needed or enter into an extension with Verizon, ... that it continues to review the software that Frontier will be acquiring and/or licensing from Verizon as part of this transaction and will implement plans to

148. SLA, §2.1(b), ©.

address any risk of losing access to Verizon software after five (5) years."[149] Yet a similar five-year arrangement was agreed to by Frontier in 2010, and there is no indication that the company had made any progress toward "address[ing] any risk of losing access to Verizon software after five (5) years" from the 2010 closing date.

118. One apparent difference between the 2010 and 2015 Software License Agreements is that under the current agreement Frontier is to receive the actual source code for the licensed software and will be allowed to "derive derivative works" by modifying or extending the software to meet its needs. At a meeting with ORA on April 15, 2015, Frontier expressed the notion that even though their overall software license would expire after five years, because the would have the source code, they could develop and utilize indefinitely their own functionally equivalent version. Unfortunately, that is not how I read the SLA and, indeed, it is not at all apparent that having access to the source code overcomes the risks associated with a potential termination of the software license after five years have elapsed.

119. Specifically, with respect to using the source code to create derivative works, the SLA provides as follows:

> §5.2. Ownership and License of Derivative Works. Licensor, for itself and its Affiliates, acknowledges and agrees that to the extent that Licensees are granted the right to create derivative works of the Licensed Software pursuant to Section 2.1, as among the Parties and their Affiliates, ownership of the new original elements of any such derivative work (the "Original Elements") shall reside with

149. Responses of Verizon California Inc. and Frontier to Questions Submitted by ORA by Letters Dated May 29, 2015, at 11.

> such Licensee that has created such derivative work. As of the time of creation of any such derivative work, Buyer, on behalf of itself and its Affiliates, hereby grants to Licensor and its Affiliates a perpetual, irrevocable, worldwide, royalty-free, fully paid-up, non-exclusive, sublicensable, nontransferable (except as set forth herein) right and license to use, modify, reproduce, display, perform, distribute and create derivative works of Original Elements and to make, have made, use, import, sell and offer for sale products and services incorporating the Original Elements.

It would appear from this language that, in the event that Frontier makes any changes or additions to the source code, it is *required* to make those changes available to Verizon *without charge* on an indefinite, perpetual basis – a condition that would seemingly persist even after Frontier's own rights to the Original Elements being licensed from Verizon terminates at the end of five years. Of even greater concern is what happens when the five year term is up:

> §8.6. <u>Effect of Termination.</u> Upon any termination of this SLA, Buyer agrees (a) not to use or have used for the benefit of Licensees, the Licensed Software, or any portion thereof, for any purpose whatsoever, (b) to uninstall promptly all Licensed Software from any Qualified Equipment or any of Licensees' IT Systems, © and either to (I) destroy the Licensed Software and any copies thereof, in whole or in part, then in Licensees' possession (including any Licensed Software that underlies any derivative works created pursuant to Section 5.2), or (ii) return to Licensor any copies of the Licensed Software then in Licensees' possession or control, and to certify that it has either destroyed or returned all such Licensed Software, as the case may be.

At the end of the fifth year, Frontier will apparently be required to discontinue using the licensed software and to destroy or return to Verizon all source and object code. Even though Frontier would retain ownership of any "Derivative Works" that it had created, if the use of those "Derivative Works" requires any of the Original Elements of the software that had been licensed to Frontier by Verizon, Frontier would also be forced to forego further use of its own Derivative Works.

120. Relative to that point, ORA propounded the following question to the Joint Applicants:

> Sec. 8.6 Effect of Termination. Sec. 8.1 defines the "Term" as extending for five (5) years from the Closing Date. Is the expiration of those five years a "Termination" to which Sec. 8.6 will apply? If so, does that mean that Frontier will have no ability to utilize any Licensed Software beyond the five-year time frame, or is there a provision whereby that can be extended if necessary? Why is Verizon limiting Frontier's access to such software to five years? Why is Frontier willing to accept a five-year limitation for software? Has Frontier undertaken a cost and/or a risk assessment with respect to the consequences of losing all access to Verizon software after five years?

To which the Joint Applicants responded as follows:

> Any expiration or termination of the Agreement would require Frontier to cease using the Licensed Software and remove it from its systems. Should Frontier seek to extend the license grant beyond the initial 5-year term, it may seek to negotiate such an extension with Verizon.
>
> Given the rapid changes in technology and software, Frontier states that it believes five years is a sufficient period during which Frontier will analyze, determine and put in place a plan to replace the software if needed or enter into an extension with Verizon. Frontier states that it continues to review the software that Frontier will be acquiring and/or licensing from Verizon as part of this transaction and will implement plans to address any risk of losing access to Verizon software after five (5) years.

Verizon did not respond to the question as to why "is Verizon limiting Frontier's access to such software to five years?" and, inasmuch as the SLA neither requires nor expects that Verizon will provide any ongoing software maintenance or updates from and after the closing date, this particular provision seems unduly burdensome, onerous and risky from Frontier's perspective. And while Verizon responds that Frontier "may seek to negotiate ... an extension with Verizon," the SLA itself does not actually contain any provision actually *requiring* Verizon to negotiate any such extension at all, or on reasonable terms. With the parameters of any such "negotiation" left entirely unspecified, Frontier could find itself forced to accept onerous conditions in order to prevent a potentially major disruption in its business operations.

121. The arrangements involving *FiOS*-related software are both surprising and somewhat troubling. At a superficial level, it would seem that the *FiOS* services to be offered by Verizon and by Frontier will not compete with one another because each company's offering will be confined to its respective non-overlapping operating footprint. Both versions will share the *FiOS* brand name, and under those circumstances it would seem that it should be in Verizon's interests for the brand to be protected by ensuring that the co-branded services are substantially similar in nature, functionality, and quality. Yet the SPA would require that, upon Closing, the underlying operating systems and Interactive Media Guide software diverge, that they be separately maintained and supported, all at a combined cost that will be considerably higher than if the effort is accomplished collaboratively. By casting Frontier adrift with respect to *FiOS* software, Verizon is diminishing Frontier's ability to compete in the broadband space, which (as I will discuss at para. 126 below), may well be precisely what Verizon has in mind.

122. Generally, the SPA together with its various annexes and attachments does not appear even to contemplate, let alone provide any specific guidelines, for the type of subsequent post-closing negotiations that are alluded to in the Joint Applicants' Response to ORA's May 29, 2015

Meet & Confer Letter. The SPA does include, not surprisingly, a customary "Entire Agreement" provision at §10.4. As I indicated, I have not identified any language in the SPA or in its various annexes or attachments that contemplate the types of "negotiations" that are described in the Joint Applicants' Response to ORA's May 29, 2015 Letter. If the representations contained in that Response are thus to be afforded any merit as legitimate interpretations of the SPA, the language in the Response should be incorporated by reference into the SPA. For convenience, the Response is annexed hereto as Attachment 2.

Other provisions of the SPA

123. As noted, the transaction in general involves the intact transfer of three Verizon ILEC operating companies to Frontier, but there are certain exceptions. Certain additional items are included in the deal – e.g., the DSL and *FiOS* Internet services furnished by Verizon Online to the Guava Companies' retail customers, and the long distance business of Guava retail customers that are presubscribed to Verizon Long Distance LLC. And certain assets are also being excluded. Included within the SPA's definition of "Excluded Assets" are "all assets and operations owned or used by Verizon Long Distance LLC," "all assets and operations owned or used by Verizon Online LLC," "all assets and operations owned or used by Verizon Network Integration Corp. and Verizon Select Services Inc.," and "any third party communications facilities that are used to support the Excluded Assets." The phrase "owned or used" is both broad in scope and vague as to what is actually included. For example, FLC "uses" sets of the Guava ILECs and other Verizon ILECs for call origination and call completion. It pays for the use of these assets in the form of access charges to the ILECs. But it does unambiguously "use" those assets. Similarly,

Verizon Online "uses" ILEC loops, central office equipment, poles and conduits, and (for *FiOS*) fiber optic cables, optical splitters, and optronic equipment on customers' premises. ORA asked for clarification, but the responses were largely confined to what Verizon Long Distance ("VLD") and Verizon Online ("VOL") *own* rather than on what they *use*. For example, with respect to VOL, the response was:

> **Verizon Online (VOL)** – VOL is an Internet Service Provider (ISP) that packages access services (including dial-up, DSL, and FiOS) provided by the ILEC with other ISP services such as email, portal and customer support. VOL offers ISP services to end user customers. VOL owns certain network equipment and leases transport to provide these services. End user customers of Verizon California who subscribe to VOL services will be transferred to Frontier; specifically, the accounts receivable, Customer Contracts and portions of Master Agreements associated with those customers will be transferred to Frontier. In addition, certain customer premise equipment (CPE) (e.g., modems and set-top boxes), owned or leased by VOL and leased to end user customers, will be transferred to Frontier. VOL's network equipment and leased transport will not be transferred to Frontier. Post-Closing, Frontier will provide ISP services over its own facilities or through arrangements with third parties similar to the way it currently provides ISP services in its existing service territory.

Nowhere does the response actually address the status of Guava ILEC assets that VOL "uses," such as the "access services (including dial-up, DSL, and FiOS) provided by the ILEC." One might infer from the response that these "access services" will be retained by the Guava ILECs and hence transfer to Frontier, but the inclusion of the word "uses" is less than definitive. Also less than clear is precisely what "network equipment" is described as "owned or leased by VOL" that will be retained by VOL after the closing. Where is this located – i.e., is any of it on customers' premises, on ILEC poles (which Verizon has expressly indicated are included in the assets to be transferred to Frontier[150]) or other outside plant elements within the ILECs' local distribution networks, in ILEC central offices, etc., and what specific components are included in this "retained" category? At the very least, the Commission will need to have these issues clarified before it can have sufficient information upon which to adequately make the required §854 findings.

124. As also noted earlier, the SPA does not include any sort of non-compete provisions that would limit Verizon's ability to aggressively seek to recapture Guava Company customers after Frontier takes over. However, under the terms set out in the SPA, Verizon is permitted to actively engage in efforts to migrate customers that are currently receiving service from any of the three ILECs to a competing Verizon entity that will be retained by Verizon post-closing. ORA asked: "During the period prior to the Closing, does the SPA prohibit Verizon from migrating existing customers of Verizon California to another Verizon affiliate or subsidiary or from engaging in practices whose intent and/or effect would be to encourage such migration – e.g., from wireline to wireless, from the Verizon California entity to Verizon Business (f/k/a MCI), to VES, to VSSI?"[151] ORA received the following response:

> Such migrations would be prohibited under the SPA if they were to occur outside the Ordinary Course. The conduct-of-business covenant (SPA section 6.2) generally requires Verizon to operate in the Ordinary Course and to preserve the business being transferred. There are many products and services offered by Verizon and its Subsidiaries in the Ordinary Course. Some of these products and

150. E-mail from Henry Weissmann to ALJ Bemesderfer, July 03, 2015. "On behalf of Verizon California, I confirm that all poles and wires owned by Verizon California ... are included in the assets to be transferred to Frontier."

151. ORA May 29, 2015 Meet & Confer Letter to Frontier, item 11.

> services may compete with one another such that a customer selecting one of these services may be migrated from one service to another or from one Verizon Subsidiary to another. *As part of its Ordinary Course, Verizon markets its products to existing Verizon customers, in some cases encouraging customer migration. This activity is not prohibited.*[152]

125. On a related point, there is nothing in the SPA that would prohibit Verizon from sharing ILEC Customer Proprietary Network Information ("CPNI") with any other Verizon affiliate prior to Closing under this same "Ordinary Course of Business" theory: "Verizon California may share CPNI with affiliates only to the extent permitted by law and in the Ordinary Course."[153] Verizon California publishes its "Privacy Policy" on the Verizon website,[154] from which one can obtain a better indication as to exactly how Verizon interprets this "Ordinary Course" provision:

> Information Shared Within the Verizon Family of Companies:
>
> Verizon shares customer information within our family of companies for a variety of purposes, including, for example, providing you with the latest information about our products and services and offering you our latest promotions. ...
>
> Customer Proprietary Network Information (CPNI) is information that relates to the type, quantity, destination, technical configuration, location, amount of use, and related billing information of your telecommunications or interconnected Voice over Internet Protocol (VoIP) services. Federal law governs our use and sharing of CPNI.

Customers have the right to "opt out" of allowing Verizon to share their CPNI with Verizon affiliates, but as a practical matter very few actually take the trouble to do so. So if, as appears to

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152. Response, to ORA May 29, 2015 letter, item 11, emphasis supplied.

153. *Id.*, item 12.

154. http://www.verizon.com/about/privacy/policy/#info (accessed 07/16/15)

be the case, Verizon ILECs, in the Ordinary Course, routinely and regularly share their CPNI with other Verizon affiliates, they may continue to do so up until moments prior to the Closing.

126. Verizon can thus, for example, use its current access to ILEC customer CPNI to market wireless services as a substitute for wireline. And in the context of its recent acquisition of AOL, Verizon can be expected to initiate efforts to migrate *FiOS* customers to wireless broadband:

> Speaking to investors at the Jefferies TMT 2015 conference, John Stratton, Verizon's newly appointed EVP and operations president for its wireless and wireline division, emphasized that the main impetus behind Verizon's purchase of AOL is the company's ad platform that Verizon believes will help it generate revenue "above the network layer." In addition, he said that the company is laser-focused on delivering a mobile-first video experience targeted at millennials because it believes they consume video very differently. He said AOL's ad platform, as well as other Verizon acquisitions including its January 2014 purchase of Intel's OnCue platform, will help Verizon fulfill this vision.[155]

I have long believed that the provision of wireline and wireless telecommunications services by the same company undermines the potential for competition between these two technologies, so in that sense the potential for Verizon and Frontier to compete not just for voice but also for broadband and video is clearly in the public interest. However, here Verizon appears to have reserved for itself the opportunity to initiate a wireline-to-wireless migration strategy *while it controls both.* Through its *pre-Closing* access to Verizon California CPNI, Verizon Wireless can target specific *FiOS* customers based upon their use of the service and other customer-specific

155. "Verizon's Stratton: Our primary focus with AOL purchase is mobile-first video," Fierce Wireless Report, May 12, 2015, http://www.fiercewireless.com/story/verizons-stratton-our-primary-focus-aol-purchase-mobile-first-video/2015-05-12

information, and once that CPNI has been "shared" with the wireless affiliate, that process can be expected to persist well beyond the Closing date.

127. The foregoing discussion notwithstanding, the Securities Purchase Agreement has been adopted and agreed to by both parties, and will govern the change of control both up to and beyond the Closing date. However, to the extent that the specific terms of the SPA dealing with software, assets and business that are to be retained by Verizon, and Verizon's ability to utilize ILEC CPNI to advantage its competing activities post-Closing should be considered by the Commission in making its §854(b) and © findings, and in considering appropriate conditions for approval.

VII.

ALLOCATION OF ECONOMIC BENEFITS

128. §854(b)(2) requires that, "where the commission has ratemaking authority," an equitable allocation be made of "the total short-term and long-term forecasted economic benefits ... of the proposed merger, acquisition, or control, between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits."[156]

129. In its decision in the Bell Atlantic/GTE Merger proceeding, the CPUC determined "the short-term to be up to five years, and the long-term to be five years, beginning with consummation of the merger."[157] Both Verizon and Frontier will realize substantial short-term and long-term economic benefits from this transaction to which the requirements of §854(b)(2) may apply.

156. Note that the statute requires allocation "where the commission has ratemaking authority" and not where the commission actually exercises or imposes such ratemaking authority. Thus, any service with respect to which the Commission has forborne from regulation but where it still "has ratemaking authority" should fall within the scope of §854(b)(2). Counsel advises that the CPUC has jurisdiction and the obligation to encourage the timely and reasonable deployment of broadband and VoIP services in California, and may take regulatory measures to promote the deployment of these services pursuant to Section 706(a) of the 1996 federal *Telecommunications Act*.

157. *Joint Application of GTE Corporation and Bell Atlantic Corporation to Transfer Control of GTE's California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE's Merger with Bell Atlantic*, A.98-12-005, D.00-03-021, *slip. op.*, at 42.

Frontier

130. Frontier has identified several categories of economic benefits that will result from this transaction and upon which Frontier's Board of Directors has relied in deciding to pursue the Guava ILECs purchase from Verizon:

(1) Cost savings resulting from the transfer to Frontier of various expense categories supported by Verizon affiliates under an "allocated cost" arrangement ($525-million annually, beginning on "Day 1" following the closing);[158]

(2) Efficiency gains to be realized by Frontier from transferring the back-office IT and OSS, and various other administrative and management functions, from Verizon legacy GTE platforms to those established by Frontier and that are being utilized by Frontier on a companywide basis (ramping up to $175-million in annualized savings to be realized by the end of year 3);[159]

(3) Additional CAF Phase II funds that will be available to Frontier post-transaction that Verizon had neither pursued nor received (approximately $32-million annually for five years[160]);

158. Jureller, at 11-12 (calculated by subtracting "$175 million in annualized cost savings from shared service efficiencies by the end of the third year of operation" from "total annualized corporate consolidated operating cost savings of $700 million").

159. *Id.*

160. FCC, "Final Adopted Model for Offer of Model-Based Support to Price Cap Carriers – CAM 4.3 Offer by State Showing Location Obligations," Report 3, "Number of Funded Locations Lacking 4/1, and Number and Percentage of Locations Above Extremely High Cost Threshold," April 23, 2015. Verizon California has 77,401
(continued...)

Offsetting these gains will be "$450 million in one-time integration-related operating expenses and capital expenditures from the period between the signing of the SPA to the first year after the close of the Transaction."[161]

131. Ms. Abernathy gives the number of Verizon California access lines at approximately 2-million, or about 54% of the total 3.7-million access lines that, by her count, Frontier will be acquiring in the three Guava ILECs combined.[162] Using this 54% as an allocation factor for California, we can estimate California's share of Frontier's five-year net cost savings and other economic benefits as shown in Table 12:

160. (...continued)
Locations in Census Blocks Subject to Offer of Model-Based Phase II Funding, and is eligible to receive CAFII funding of $31,978,057 annually for five years. www.fcc.gov/wcb/CAM_4.3_Results_Final_042915.xlsx (accessed 7/23/15)

161. *Id.*, at 13. Frontier also anticipates increases in video content fees payable to content providers for MVPD services furnished by Frontier over the FiOS service platform it is acquiring from Verizon. Content fees are typically linked to the overall volume of business that an MVPD provider does with individual content providers; on a per-subscriber basis and because of its relatively small size, Frontier expects that its content costs will be higher than Verizon's for the Guava companies. On the other hand, the increase in the overall number of *FiOS* subscribers that will occur should enable Frontier to pay less for content in connection with MVPD services it providers to its existing *FiOS* and *u-verse* subscribers. In any event, MVPD services are not regulated by the CPUC and content costs fall far outside of the CPUC's ratemaking authority; hence, any increases in content costs cannot be applied against cost savings and other efficiency gains to be realized for services that are subject to the Commission's ratemaking authority.

162. Abernathy, at 14. The CPUC Service Quality Standards Reporting, General Order No. 133-C gives Verizon California, as of December 31, 2014 at 2.39-million. See fn. 5, *supra*.

Table 12

FRONTIER CALIFORNIA
§854(b)(2) RATEPAYER ALLOCATION OF
SHORT-TERM AND LONG-TERM ECONOMIC BENEFITS

Source	Total Guava	California share (54%)
Year 1 cost savings	$525,000,000	$283,500,000
Year 2 cost savings (estimate, see Note)	$600,000,000	$324,000,000
Year 3 cost savings (estimate, see Note)	$650,000,000	$351,000,000
Year 4 cost savings	$700,000,000	$378,000,000
Year 5 cost savings	$700,000,000	$378,000,000
TOTAL Year 1-5 savings	$3,175,000,000	$1,714,500,000
Less: Integration costs	($450,000,000)	($243,000,000)
TOTAL NET Year 1-5 benefits	$2,725,000,000	$1,471,500,000
50% §854(b)(2) Ratepayer Allocation		$735,750,000
Anticipated CAF funding		$192,000,000
TOTAL §854(b)(2) Ratepayer Benefits		$927,750,000

Note: Mr. Jureller does not provide estimates for additional synergy benefits for Years 2 and 3. I have conservatively estimated these at $75-million (Year 2) and $125-million (Year 3). CAF Phase II funding is estimated at $32-million per year for five years.

132. Notably, Frontier's estimate of the "equity value" *to it* of the assets it is acquiring, as presented to its Board of Directors and as included in its HSR filing,[163] does not appear to contemplate *any* specific offset for a "ratepayer allocation" of the economic benefits arising from the transaction. Frontier should be required to commit not less than the full $927.75-million, representing "not less than 50 percent of [the short-term and long-term economic] benefits" that Frontier will realize as a result of the transaction over the next five years, to upgrade its California network to conform to the minimum definition of "broadband" as established by the FCC – i.e., at

163. Fn. 50, *supra.*

least 25 Mbps download/3 Mbps upload speeds[164] – throughout its operating footprint. In sharing these economic benefits with ratepayers, Frontier will substantially increase both its operating revenues (from increased sales of broadband and MVPD services) as well as enhancing its competitiveness *vis-à-vis* rival broadband (mainly cable TV) providers. The net cost to Frontier, if any, will thus be considerably less than the full $927.75-million, resulting in both a substantial ratepayer benefit as well as a recurring economic benefit to Frontier that will extend well beyond the five-year time frame contemplated by the CPUC – clearly a "win-win" outcome.

Verizon

133. Verizon will also realize immediate economic benefit in the form of a BEGIN VERIZON CONFIDENTIAL <<[redacted]>> END VERIZON CONFIDENTIAL capital gain in that the sale price of the Guava assets exceeds their net book value by that amount. Unlike the case with Frontier, where the source of the economic benefit is attributable to efficiency gains and the replacement of services for which Verizon has been allocating excessive costs to its ILECs, Verizon's capital gain is largely if not entirely attributable to its policy of disinvestment in its ILECs and ILEC networks, its self-created operating inefficiencies resulting from the excessive centralized services cost allocations, deferred maintenance leading to a serious deterioration of its ILEC network, and a general lack of management attention to these ILECs. While more details regarding the current state of Verizon California's network are in the process

164. FCC, *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 14-126, Rel. Feb 4, 2015, at 3.

of being compiled in the various workshops being held throughout this summer in communities across Verizon's operating territories, preliminary indications are that the condition of Verizon's copper distribution infrastructure is seriously impaired and in need of restoration.[165]

134. From the six Public Participation Hearings that have taken place up through July 24, it appears that significant shortcomings in Verizon's California network have been identified:

> When I moved over to housing, you could pick up the phone and hear other people talking on the line. You can actually hear the conversations going on between two people. I went as far as telling them, hey, when you get done with the phone, call me back so I can make my phone call, please. It is a common thing to be happening locally here. It is kind of ridiculous when you can't make a phone call out of your own house.
>
> The other problems we have are things – it is really super hard to hear, because staticy, or when you are talking all of a sudden the person can't hear you. You can hear them, and then back and forth you can't hear each other.[166]
>
> * * *
>
> MR. SALBERG: Hello. My name is Tom Salberg. And I would like to elaborate a little bit on what she talked about, which is the fire that hit the lines. And PG&E was out here the very next day getting our electric service back up, but we went without telephone for over a week. And when the phone was hooked back up, it was because a couple of people who worked for Verizon came and decided – they were bummed that these employees or these residents didn't have telephone. And so they just hooked up a bunch of wires on the ground, and they got us some phone service back. That was a week. But then that thing stayed on the ground for over six months. And Verizon never came out here to replace the lines. And they expect me to pay my bill every month, but my service wasn't important enough to them to hook it up.

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165. See Direct Testimony of ORA expert Ms. Ayat Osman.

166. Reporter's Transcript (RT), Orleans PPH, July 8, 2015, Vol. 4, at 169

So I'm a disabled person. I no longer have a driver's license. I live too far out of town to walk into town. So my phone service is very important to me, and to be able to call somebody. My parents live down in Southern California. They were totally freaked out when they tried to call, and they couldn't get anybody, and they didn't know who to call.

So you know, the phone service is very important to me. I have it. I'm expected to pay my bill every month, but Verizon is not expected to fix their lines. And that is really what I wanted to say.[167]

* * *

The other thing I want to speak to is emergency services. It is a real problem out here. I'm speaking to the – for the volunteer fire department. Our 911 service is abysmal. It is often nonexistence. We've had some really critical situations where 911 was not available. There is to dial tone, or we get sent to Redding. How did that happen? That just shouldn't happen.[168]

* * *

And another thing, I have an elderly mother. And a lot of times we pick up the phone, and the phone line will be dead. Two weeks ago I picked it up and it was dead. And so those are real concerns of mine. And – because she is 83, she – her health is failing, and it is scary when you are not able to call out.[169]

* * *

I also would like to talk about the echos on the phone. I have heard other people's conversations on my phone. Dropped calls.

My biggest thing is emergency, situations with family in the past have put me on, you know, couple of miles from my mom's house. And not being able to call her to make sure she is okay because the landlines are down is not okay to me. When we couldn't get across the way to go over Red Cap from where I was, that was scary. We have had snow that stopped me from going over and checking on her. I am thankful for

167. RT, Orleans PPH, July 8, 2015, pp. 155-233, at 173-174.

168. RT, Orleans PPH, July 8, 2015, pp. 155-233, at 184.

169. RT, Orleans PPH, July 8, 2015, pp. 155-233, at 195-196.

neighbors that would walk over and check on her, because I had no phone line to call.[170]

* * *

I did want to – I guess I raised it. I didn't mean it to be sort of snarky, but I raised the question to Verizon about the – about something I said. You know, you guys want out and clearly you want out at the lowest possible cost, or the greatest profit. I'm not sure what the deal is. I assume it is proprietary. But you are cashing out of an underserved asset. I feel like we are in the home inspection process saying that part of the house down in Southern California is nice, but this outbuilding up here in the north is pretty run down. It is going to need a new roof, new foundation, a whole bunch of stuff. I don't know how you guys work it out corporately between is the price going to get lower when you actually realize how bad the network is that you are buying, or is Verizon going to commit – when I bought my house, we got the sellers to fix the roof. They could have lowered the price, but they fixed the roof before they sold it. I don't know if the idea here is Verizon is going to fix all this stuff before they sell it. I doubt it. But I hope they lower the price enough so Frontier has the cash to invest.[171]

* * *

For another thing, there is very poor service. For example, I often have to redial repeatedly, maybe even five or six times, to get a line that is free enough of static to be able to connect to the Internet. Some of their lines are quite clear, and why others are full of static is never really clear. Clearly, they are not maintaining them correctly. And you can even tell them these things, there is no mechanism to easily report these.[172]

* * *

We've had inferior service always. Like when something – the phone calls were coming to me, I could not get the telephone number, whatever you call that, caller ID. I had to go to the sheriffs department and make a report in order to for them to tell me. Verizon wouldn't tell me what the number was before I had a sheriffs report. That was

170. RT, Orleans PPH, July 8, 2015, pp. 155-233, at 198

171. RT, Weitchpec PPH, July 8, 2015, at 140-141

172. RT, Garberville PPH, July 6, 2015, at 25.

making – it turned out to be some mechanical failure of PG&E. But this is very bad service.[173]

* * *

First, there are no upgraded lines. The copper plant has not been properly maintained. Verizon has not provided technicians for the resources and needs to do that.

The problem is there is bad cable which was not authorized to be replaced, rather the tech I spoke to today said they bypass the bad cable, which is much quicker. They have become quite creative in creating solutions because we want the customers serviced.

One technician told me another story. He was at that office in the '60s, in Beaumont, and the cell tower had problems as well because Verizon did not approve cable replacement. The tech went for over half a mile to do this work. So the people called, the customers. The tech replaced the wire with stranded wire and he told me if this wire gets wet it will degrade. And we finally get rain, the moisture in the line will cause problems. I went there today. How is it now? It rained yesterday.

Another problem is there were about 65 positions in the copper network. Today there are about 22. The consequence of that we hope this transaction will protect against, add high speed and promote jobs and communities.

We look to you for financial and operational capabilities to address a number of problems caused by Verizon. This means not only proper maintenance of the copper plant but also investment of the network. These options should not be foreclosed. Finally, the Commission must determine that the proposed transaction is fair for the utility. We want to make sure that Verizon maintained it and in fact it is proper so we can provide the quality services for our customers.[174]

* * *

The Verizon plant in this area and many other areas is old and has not been properly maintained for many years. Our areas in the mountains can't provide many basic services, and that has caused the loss of customers and consequently the loss of many

173. RT, Garberville PPH, July 6, 2015, at 33.

174. RT, Rancho Mirage July 20, 2015, Vol V, at 132-133.

> of our employees in the mountain area. I want to the describe four problems which can be found in the network of this area. These problems cause customers to lose service, get noise on their line, get cross lines with other customers and have problems with public safety when the lines go down. The first instance I'd like to speak of is the use of plastic tarps, which are used to make temporary splices throughout the copper lines.
>
> The second is failed batteries, which gives service to rural areas around our network.
>
> The third one is lack of proper maintenance on aerial cable and underground cable as well. And the fourth one is areas that have very slow DSL opportunities for customers and other problems that are related to that.[175]

The apparently deteriorated state of Verizon's infrastructure should be addressed prior to approval of the proposed transaction. To the extent that remedial measures are required, these should be the responsibility of Verizon.

135. Verizon has inserted a provision in the SPA requiring that, if any costs are imposed by regulatory agencies as conditions for approval of the transaction, the entirety of such costs will be borne by Frontier.[176] The presence of this provision creates something of a "Catch-22" for the Commission: Even through the responsibility for the deterioration of the Verizon California network can be placed squarely upon Verizon, any attempt by the Commission to address this problem in the present proceeding will work to weaken Frontier while leaving Verizon and its shareholders unscathed because, under the SPA, Frontier would be required to pay for any upgrades and repairs to the Verizon network that the Commission might order in a final decision in this proceeding, while leaving Verizon and its shareholders unscathed. Put slightly differently,

175. RT, Rancho Mirage July 20, 2015, Vol V, at 135.

176. SPA, at §2.3.

the inclusion of this "Frontier pays" provision in the SPA directly undermines the explicit requirements of §854(b)(2) that the proposed change-of-control transaction "equitably allocates ... the total short-term and long-term forecasted economic benefits ... of the proposed merger, acquisition, or control, between shareholders and ratepayers" and that "[r]atepayers shall receive not less than 50 percent of those benefits." The SPA, as drafted, would seem to expressly preclude any sharing of economic benefits between *Verizon* shareholders and *Verizon* ratepayers. It is important that the Commission look beyond this transparent attempt to subvert its statutorily-mandated jurisdiction.

136. It is my understanding that the Commission clearly has the authority to require that any ILEC under its jurisdiction provide "safe and reliable service" and, where the Commission determines that an ILEC is not fulfilling this obligation, to impose remedial measures upon the ILEC including, for example, ordering the ILEC to fix and/or upgrade its network so that it provides safe and reliable service to California consumers.[177] If the Commission were conducting an investigation into the current condition of Verizon California's network, it could require Verizon to incur the capital costs and take other actions to correct any identified shortcomings and deficiencies. If, for example, the Commission were to set, as a condition for approval of the transaction, that some portion, or all, of the required §854(b)(2) economic benefits to be allocated to ratepayers be used to upgrade the condition of the Verizon California network *and further require, the SPA notwithstanding, that none of these costs could be shifted to Frontier*, and if Verizon refuses to accept the condition and the transaction fails to occur, the Commission could

177. See, e.g., Pub. Util. Code §451.

then initiate a proceeding to consider requiring that Verizon make the needed remedial investments to bring its network up to the Commission's quality of service standards and to ensure that the Verizon California network is providing safe and reliable service.[178] Verizon should not be allowed to escape responsibility for maintaining its network at an appropriate level of service.

137. Notably, back in the late 1980s when the CPUC and other regulatory bodies were examining alternatives to traditional cost-plus rate-of-return type regulation, concerns were expressed that if ILECs were allowed to retain excess profits realized through cost-cutting measures, they would have an incentive to defer or forgo altogether needed maintenance. When the CPUC adopted its first incentive regulation regime in 1989 – the *New Regulatory Framework*[179] – it implemented specific measures aimed at negating such incentives:

> A comprehensive monitoring program which builds on extensive reporting requirements already in place is developed and adopted in Section XI. If our monitoring efforts indicate in any way that ratepayers are being harmed, either through deteriorating service quality or adverse financial consequences, we would take immediate steps to rescind or alter the new regulatory program adopted today. However, it is our expectation that ongoing experience with this new approach will verify that our confidence in it is well-placed.[180]

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178. See, e.g., G.O. 133-C, Pub. Util. Code § 451.

179. *New Regulatory Frameworks*, D.89-10-031

180. *Id.*, 33 CPUC2d 43, 153.

And in the referenced Section XI, the Commission adopted a number of monitoring and reporting requirements expressly aimed at preventing cross-subsidization and assuring maintenance of service quality:

> f. Avoidance of Cross Subsidies and Anticompetitive Behavior
>
> Improper cross-subsidies increase the costs to be borne by basic ratepayers, undermining affordability and universal service goals. Unfair competition can drive otherwise [*24] efficient competitors out of the market, thereby increasing prices, decreasing customer choices, and discouraging innovation. The monitoring program should be tailored to consider, at the minimum, the following measurement tools:
>
> 1. Service-specific financial reports for monopoly and competitive services.
> 2. Cost allocation instructions, documentation, and changes.
> 3. FCC reports on peak forecasted usage for joint investments.
> 4. Embedded direct and fully distributed cost tracking reports and systems.
> 5. Time reporting and coding procedures and controls.
> 6. Affiliate company transactions, financials, and policy/procedural guidelines.
> 7. Intercompany personnel movements and organizational changes.
> 8. Utility diversification activities.
> 9. Numbers and types of complaints filed by competitors against local telephone utilities.

> The service-specific reporting requirements are new. Most of the other measurements are now received by the Commission, although not uniformly from both Pacific and GTEC. Workshops should clarify appropriate uniform reporting.[181]

138. Over the next two decades, the CPUC and most other state PUCs relaxed or eliminated most of these safeguards, allowing the utilities to retain profits without limit which, in turn, provided the incentive to disinvest, to defer maintenance, to engage in cross-subsidization, and to shift costs to their least competitive services and most captive customers. The outcome of this *laissez-faire* approach is readily visible in the current condition of Verizon California's infrastructure – a seriously deteriorated network, degraded service quality, underinvestment by Verizon, and overallocation of costs to the ILECs to the benefit of Verizon shareholders and other affiliates. Had competition actually developed as the architects of such broad deregulatory measures had hoped, the competitive market might have prevented such tactics. Indeed, in the case of wireless, where competition has developed, not only don't we see the same kinds of underinvestment and deferred maintenance, we actually see Verizon deliberately shifting costs away from its wireless units and over to its ILECs *precisely because competition in wireless is compelling such responses and the lack of competition in wireline is enabling Verizon to treat Verizon ILECs in this manner.*

139. The BEGIN VERIZON CONFIDENTIAL<<[redacted]>> END VERIZON CONFIDENTIAL capital gain that Verizon will immediately realize from the sale of the three Guava companies to Frontier would certainly qualify as a short-term economic benefit that is to

181. *Id.*, 33 CPUC2d 43, 199.

be “equitably allocated ... between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits.” But the gain also represents the capitalization of long-term Verizon California excess profits that are directly attributable to the persistent underinvestment and excessive cost allocations to which Verizon California has been subjected.

140. Table 13 below provides a calculation of the §854(b)(2) ratepayer benefits based upon the immediate capital gain that Verizon will realize from the transaction. As above, I have allocated 54% of the capital gain to the California company, and then have allocated 50% of the California share to ratepayers.

BEGIN VERIZON CONFIDENTIAL <<

Table 13

VERIZON CALIFORNIA
§854(b)(2) RATEPAYER ALLOCATION OF
SHORT-TERM AND LONG-TERM ECONOMIC BENEFITS

Source	Total Guava	California share (54%)
Projected capital gain from the sale		
50% §854(b)(2) Ratepayer Allocation		
Source: Verizon HSR, at Bates no. A1503005VZ60165		

>> END VERIZON CONFIDENTIAL

Verizon should be made to utilize this ratepayer share to pay for the maintenance upgrades to its existing California network resources that have been allowed to deteriorate to the point where their continued survival is uncertain.

141. Requiring that Verizon pay for remedial maintenance upgrades to its network as a condition for a sale to Frontier is certainly not without precedent. In 2010, the West Virginia PSC required that Verizon place $72.4-million in an escrow account specifically to fund network repairs:

> Normally, because of our continuing jurisdiction over Verizon and a continuing obligation for Verizon to comply with Commission Orders, it would be sufficient for the Commission to determine a level of service-quality improvement expenditures and a period of time to make those expenditures and issue an Order for Verizon to budget and spend the required dollars over the time frame directed by the Commission. For reasons discussed herein, the Commission will become more active in reviewing expenditures by Verizon directed to improving service quality. We will require Verizon to establish an irrevocable Escrow Account of $72.4 million with such funds to be an equity infusion into Verizon. The reduction of the balance in that fund will be allowed only for Verizon expenditures that are consistent with the intent of this Order. Those expenditures must be directed to improving service quality for basic telephone service. Capital expenditures and operating expenses, including payroll related expenses, will qualify to be paid out of the Escrow Account, but only with Commission approval.[182]

While the Verizon service quality and Verizon/Frontier transaction were being examined in separate WVPSC dockets, the two cases were being heard concurrently and their outcomes were linked. Three days after it imposed the escrow requirement, the West Virginia PSC issued an order approving Verizon's sale of its West Virginia ILEC to Frontier. In that order, it expressly conditioned its approval upon Verizon's compliance with the escrow account requirement:

> 6. Verizon WV will comply with all requirements of the currently effective RQSP [Retail Quality of Service Plan] or other conditions imposed by the Commission in Case No. 08-0761-T-G1, including any modifications or

182. West Virginia Public Service Commission, Case No. 08-0761-T-GI, Verizon West Virginia Inc. Investigation into Quality of Service, *Commission Order*, issued May 10, 2010, *slip op.*, at 10.

> commitments to the RQSP approved or required by the Commission, and continuing through at least July 1, 2011, or for such period the RQSP remains in effect.
>
> 7. Verizon shall comply with the escrow account requirement contained in the May 10, 2010 Commission Order in Case No. 08-076 1 -T-GI, before closing of the Transaction. These funds shall complete the obligations of Verizon under the retail service quality case.[183]

142. It is instructive to extrapolate the WVPSC's $72.4-million escrow requirement into a California equivalent. Frontier West Virginia has approximately 350,000 access lines; Verizon California has approximately 2.39-million access lines,[184] i.e., approximately seven times that of the West Virginia company. On that basis, a $72.4-million Verizon escrow requirement for West Virginia would translate, roughly, into about $500-million. The precise amount that was determined by the West Virginia PSC was presumably linked to its assessment as to the amount of money that would be required to remedy the deteriorated condition of Verizon's West Virginia infrastructure. Without specific knowledge as to the relative conditions of Verizon's West Virginia network in 2010 and its California network in 2015, a precise extrapolation of the West Virginia number to California would require additional information regarding both the West Virginia network as it existed in 2010 and the California network as it exists today. However, based upon the scaling estimate I have just provided, it is apparent that the total cost of repairing

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183. West Virginia PSC, *Frontier Communications Corporation et al., Verizon West Virginia Inc., et al. Joint Petition for Consent and Approval of the Transfer of Verizon's Local Exchange and Long Distance Business in West Virginia to Companies to be Owned and Controlled by Frontier Communications*, Case No. 09-0871-T-PC, Appendix A, Conditions and Commitments Imposed on Consummation of the Transaction, Conditions 6 and 7, *slip op.* at Appendix A, page 1. Provided as Frontier Response to ORA Data Request Set 1, No. 17, Bates no. FTR ORA 004182, ORA Set 1 No 17 WV Approval.pdf.

184. Fn 5, *supra.*

the Verizon network in California is likely of the same order-of-magnitude as my calculation of the §854(b)(2) ratepayer share of Verizon's economic benefits attributable to the transaction. Thus, the CPUC should impose a similar requirement upon Verizon in this case. The funds set aside by Verizon for this purpose should be earmarked for the needed repairs, and Frontier should be directed to bring what will then be its California ILEC network up to a minimum standard to be established by the CPUC. The CPUC should monitor Frontier's performance for a minimum of five (5) years to ensure that the upgrades have been made as expected. As noted above, the Commission should require Verizon and Frontier to modify §2.3 of the SPA to ensure that Verizon, and not Frontier, bears these costs.

Tax consequences of the transaction for Frontier and Verizon

143. Ordinarily, when the shares of a corporation are sold, the net book value of the firm's assets – the "basis" that is used for tax purposes – is unchanged, and the buyer simply maintains the pre-purchase asset valuations on the corporation's balance sheet. In this case, however, the transaction is being structured for tax purposes under Internal Revenue Code ("IRC") §338(h)(10). Under this election, the buyer (Frontier) is permitted to take a step-up in basis for the assets being acquired in its acquisition of Newco to the full purchase price that is being paid ($10.54-billion), rather than retaining the considerably lower basis price for the physical assets involved in the transaction as currently carried on Verizon's books. This step-up provides a significant tax benefit to Frontier in that it allows Frontier to base its depreciation and amortization accruals upon the full $10.54-billion rather than on the much lower basis amount that had been carried on the books of the acquired companies. Frontier estimates the base case

net present value of this tax benefit at BEGIN FRONTIER CONFIDENTIAL <<[redacted]>> END FRONTIER CONFIDENTIAL,[185] which would be *in addition to* the cost-savings-based benefits discussed here and quantified in Table 12 above.

144. This is a significant source of additional short-term and long-term economic benefits that should be considered by the Commission in establishing the appropriate ratepayer share as required by §854(b)(2). However, the Frontier HSR does not provide a year-by-year breakdown of the §338(h)(10) tax benefit, so I am not able to estimate the five-year amount that would be subject to §854(b)(2) at this time. Additionally, by structuring the transaction in this manner, Verizon may be subject to a capital gains tax that is greater than would apply in the absence of the §338(h)(10) election. Accordingly, and to be consistent, if the benefits inuring to Frontier are to be adjusted upward to reflect the §338(h)(10) tax benefit, then it may be necessary to make a corresponding downward adjustment to the economic benefits inuring to Verizon relative to the calculation presented in Table 13 above. I do not at this time have sufficient information upon which to make either of these calculations; if ORA is able to obtain the required additional information, I would reserve the right to address this issue again in my Supplemental Testimony.

185. Frontier HSR, at Bates no. FTR ORA 016814.

VIII.

THE TRANSACTION SHOULD BE APPROVED, BUT WITH CERTAIN CONDITIONS.

145. Based upon my analysis and the foregoing discussion, it is my recommendation that the proposed transfer of control of Verizon California to Frontier be allowed to go forward. However, while the transaction offers the prospect of significant benefits, their achievement cannot be assured without the imposition of certain specific conditions that both Verizon and Frontier should be required to accept in order for the requirement of §854 to be satisfied. Based upon my testimony and that of the other ORA witnesses, ORA recommends that the Commission consider and adopt, as conditions for approval of the proposed transaction, each of the following:

(1) Verizon should be held financially accountable for repairs to any of their network assets that are not operational for the functions for which they were designed. This includes, but is not limited to, the Commission holding Verizon accountable to and financially responsible for repairing all company-related facilities that were the subject of complaints reported during the proceeding's Public Participation Hearings (PPHs) and Workshops prior to the closing of the transaction.

(2) Prior to approving the Transaction, the Commission should hold Verizon accountable to warrant that the network assets being transferred to Frontier satisfy all minimum CPUC quality standards.

(3) Frontier's right-to-use license(s) with respect to any Verizon-owned FiOS software, including but not limited to the Interactive Media Guide ("IMG"), should be extended indefinitely.

(4) Verizon should be required indefinitely to provide Frontier with software support and maintenance comparable to what it will be providing on an ongoing basis to its remaining ILECs, at reasonable cost-based charges, provided that Verizon shall not be required to provide ongoing support and maintenance with respect to any software that has been significantly modified and/or expanded by Frontier. Verizon should also be required to offer to provide any upgrades or major releases to such Verizon-owned software, except to the extent that such upgrades or major releases pertain to Verizon proprietary products or services to which Frontier access would compromise Verizon's competitive interests.

(5) The Commission should disallow provisions in the Securities Purchase Agreement for purposes of the California transaction whereby Frontier is being required to pay 100% of any costs imposed by regulators as a condition for approval, and/or should require that Verizon accept such disallowance as a condition of approval.

(6) Frontier should expand broadband services at speeds of no less than the FCC's definition of minimum broadband speeds, currently 25 Mbps download and 3 Mbps upload, to 98% of households in its new service territory by no later than December 31, 2020 . In efforts to avoid a focus of deployment only in affluent and/or highly dense areas, 98% of households in tribal lands and low income areas should have access to the FCC's

minimum definition of broadband speeds, currently 25 Mbps download and 3 Mbps upload, by no later than December 31, 2020. The following deployment milestones should be met:

Table 14

FRONTIER REQUIRED BROADBAND AVAILABILITY TARGETS

by December 31,	Percentage of Households with Broadband Availability of at least 25/3 Mbps download/upload speed
2016	
2017	
2018	78%
2019	88%
2020	98%

Reporting Requirements: On July 1, 2016, and every year thereafter until July 1, 2020, Frontier shall submit a progress report to the Commission and the Office of Ratepayer Advocates (ORA) identifying the progress made for deployment of broadband and the work completed to meet the interim deployment milestones set forth above. The report shall identify the number of households with access to the FCC's minimum broadband speeds, currently of 25 Mbps and 3 Mbps upload, including a list of census blocks where the households are located.

On December 31, 2018, and every year thereafter until Dec. 31, 2020, Frontier shall submit a progress report certifying that the percentage of households identified in the deployment milestones set forth above are met.

(7) Frontier should provide an unredacted copy of its FCC 477 data for Internet Access Services and Local Telephone Services to the CPUC and the ORA every time it files with the FCC.

146. My testimony assumes that Verizon will apply for and accept federal Connect America Fund ("CAF") Phase II funding by August 27, 2015. If Verizon does not apply for and accept CAF II funding by the August 27, 2015 deadline, then I reserve the right to change the analysis and recommendations in my testimony. Verizon has had an obligation to maintain and support its copper network and to apply for and accept federal CAF funding to further build out broadband in unserved and underserved areas. Verizon should not be allowed to escape these obligations merely by selling off its California ILEC operations to Frontier. The Commission should assure that Frontier is provided with infrastructure that meets the CPUC's service quality standards, and that Frontier is not immediately burdened with having to bear the cost of needed repairs that Verizon should have been making all along. The proposed transaction is in the public interest only if the conditions outlined above are adopted. And if the Commission denies the transaction or if Verizon walks away, the Commission should nevertheless hold Verizon accountable to fix its network and to expand the availability of high-speed broadband throughout its operating territory. Whether or not the transaction goes forward, Verizon should pay for its failure to

maintain its network and for its failure to use federal CAF support to further build out its broadband network.

147. This concludes my direct testimony at this time.

VERIFICATION

I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information and belief, and if called to testify thereon I am prepared to do so.

LEE L. SELWYN

Executed at Boston, Massachusetts

this 28th day of July, 2015.