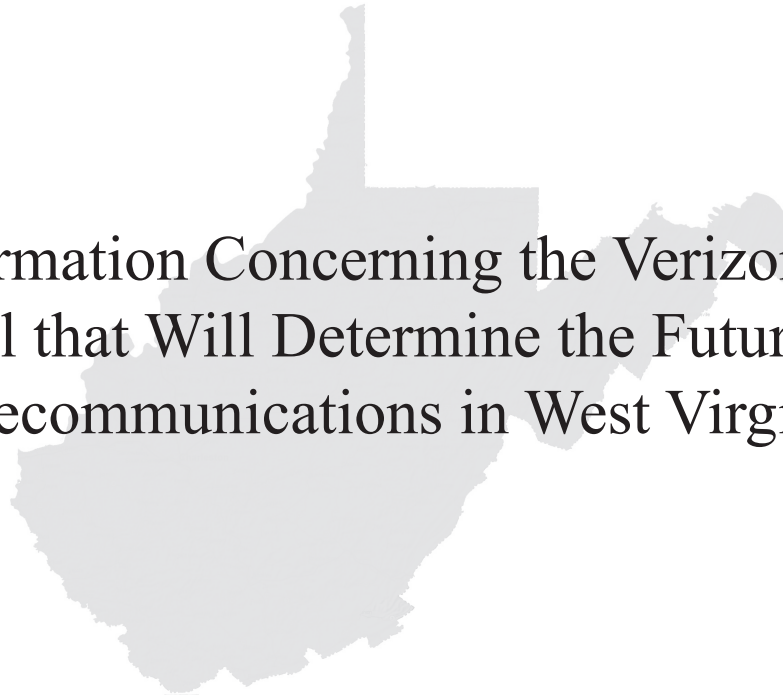


PREVENTING A TELECOMMUNICATIONS DISASTER



New Information Concerning the Verizon-Frontier
Deal that Will Determine the Future of
Telecommunications in West Virginia

Communications Workers of America
May 3, 2010

Introduction

The West Virginia Public Service Commission (PSC) will soon make a decision that will affect the future of telecommunications – and thus economic development – in West Virginia. The PSC will decide whether to approve, approve with conditions or deny the largest telecommunications transaction in the state’s history.

Verizon and its Bell system predecessors have provided telephone service to the vast majority of West Virginians for more a century. Now, Verizon has proposed to sell its operations in West Virginia – along with those in 13 other states – to Frontier Communications (Frontier).

Frontier will transfer \$3.3 billion to Verizon Communications and issue stock worth \$5.3 billion to Verizon shareholders. Verizon chose Frontier, a much smaller company, in order to qualify for a special tax loophole. Frontier will be saddled with \$3.3 billion in added debt while Verizon will obtain the \$3.3 billion tax free.

No other telecommunications company in the U.S. has attempted a deal of this complexity and size. The deal includes 4.8 million access lines spread over parts of 14 states stretching from coast to coast. The next largest similar deal ever attempted (just one-third the size) resulted in bankruptcy. This deal is also four times larger than any other Frontier acquisition. If the transaction is approved, Frontier will have to contend with a tripling of its access lines, a tripling of its workforce and – most significantly – a 75% increase in its debt.

The stakes are especially high for West Virginia. If the deal is approved Frontier would become the largest telecommunications firm in the state and one of the state’s largest private sector employers.

The following report utilizes recently revealed information that further illustrates the significant risks associated with the deal for West Virginia.

- West Virginia is more at risk than any other state affected by the deal.
 - Frontier will control 85% of the state’s access lines – the average for the other 13 states is just 8%.
 - The integration of Verizon’s operational, computer and support systems is entirely different and more complicated than the integration of the systems in the other states.
- Frontier’s finances - which were shaky to begin with – have deteriorated since the deal was first announced.
 - Revenue, net income, and shareholder equity have declined since the deal was announced.
 - Frontier recently revealed an additional \$141 million in expenses associated with the deal.

- Frontier's eroded finances have further undermined the reliability of the company's financial model which is used to inform regulators about the company's financial condition over the next few years.
 - Frontier has responded by making misleading claims to regulators.
 - Frontier will continue its "cash cow" policy of paying out more to stockholders than it earns in net income – a policy which has transferred \$3.3 billion from operations to shareholders since 2004.
 - Frontier paid out a higher percentage of its net income in dividends than any other major telecommunications firm in 2009.
- The limited commitments required by other states fall far short of what West Virginia needs in terms of expanding broadband and improving Frontier's finances.
 - Nine of the thirteen states did not require any broadband commitments by Frontier. The commitments in the four other states were inadequate since they require very slow speeds (1 to 3 megabits) to be reached over a long period of time (up to 4 years) while still leaving out 1.1 million households. The national broadband goals of the Federal Communications Commission require speeds of 50 mbps by 2015 to 80% of U.S. households. If the deal is approved, Frontier's customers will be left far behind the rest of the country.
 - Only one state attempted to address Frontier's shaky finances in a very limited and inadequate fashion by limiting cash transfers from Frontier's state subsidiary to the parent company if certain service quality measures were not met. This provides no real protection to consumers if Frontier runs into major financial or operational problems.

The PSC should deny the sale. The bottom line is that the risks of this deal far outweigh any supposed benefits. Frontier is a financially challenged company that will not have the resources to meet West Virginia's needs for high speed broadband, improved service quality and high quality jobs. Two similar Verizon deals in Northern New England and Hawaii resulted in bankruptcy, eroded customer service, disrupted E-911 service, and limited broadband build out. The proposed sale to Frontier is another disaster waiting to happen.

West Virginians will face much less risk with Verizon than with Frontier. There is no question that Verizon is much less susceptible to financial and operational problems than Frontier. Regulators should not allow Verizon to walk away from its responsibilities and pocket \$3.3 billion tax free while leaving West Virginians to pick up the pieces when Frontier falters.

Rejecting the deal does not mean that Verizon will let West Virginia wither. Verizon has a fiduciary responsibility to maximize the profitability of its assets,

the PSC has the power to improve customer service, and the state and federal governments can enact policies to expand broadband build-out. If Verizon still wants to sell its landline operations, then it should open the bidding to companies with sufficient financial, technical and operational resources to meet West Virginia's needs – rather than limiting the bidding to much smaller, highly indebted companies like Frontier because they allow Verizon to qualify for a tax loophole.

PART ONE: WEST VIRGINIA IS AT GREATER RISK THAN ANY OTHER STATE

1. The risks of failure are greater in West Virginia because Frontier will control 85% of all the access lines in the state

If the deal is approved, the post-merger Frontier will be the largest phone company in West Virginia. Currently, Verizon controls 69% of the state's access lines and Frontier controls 16%. The post-merger Frontier will control 85% of all access lines in the state. The average for the other 13 states is just 8%.¹ No other state involved in the deal is so affected or has so much to lose. If things don't go well for Frontier – the vast majority of West Virginians will be affected adversely.

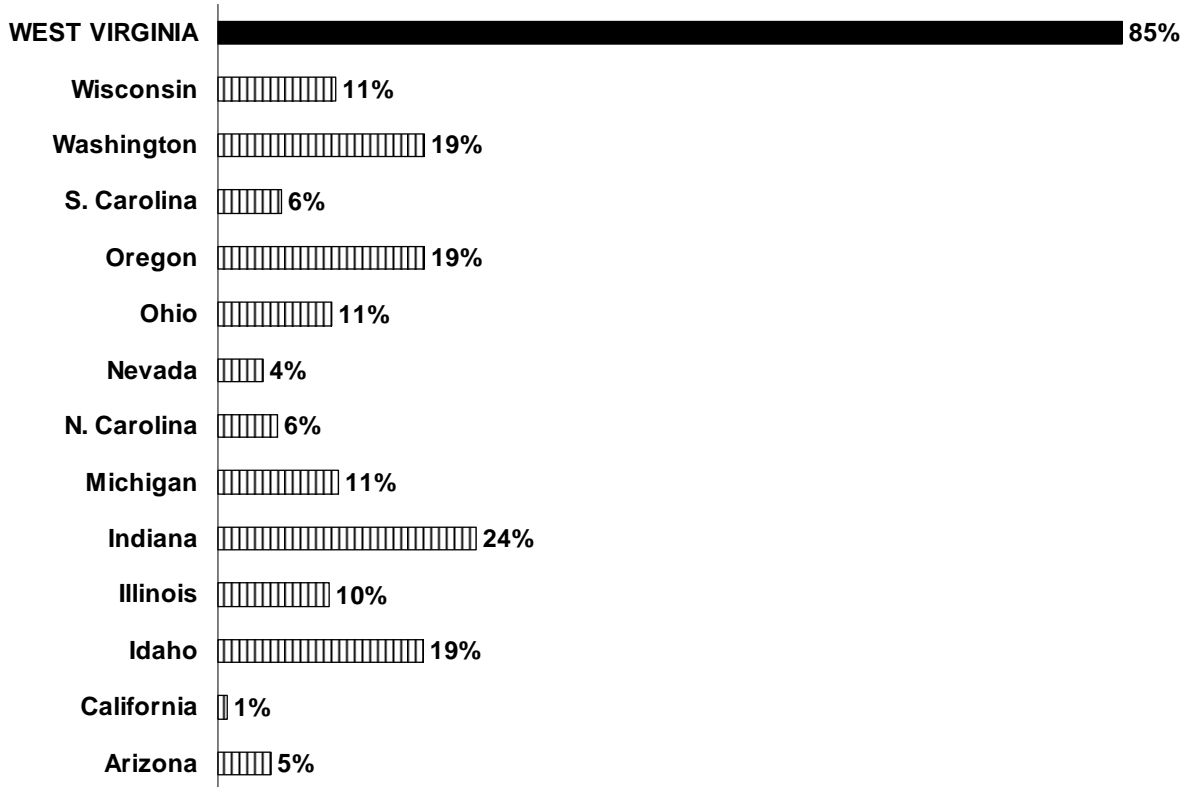
In West Virginia, Frontier would experience an increase of 617,000 or 430% in access lines and 1,700 workers or 870% in its employment level.² Frontier would become one of the major private sector employers in the state.

The following chart shows the post-merger company's share of total access lines for each of the fourteen states directly affected by the proposed deal.

¹ Frontier Communications, *Welcome to the New Frontier*, May 13, 2009; Federal Communications Commission, *Local Telephone Competition: Status as of June 30, 2008*, table 7.

² Frontier Communications, *Welcome to the New Frontier*, May 13, 2009

Post-Merger Frontier Access Lines as Percentage of Total State Access Lines



Source: Frontier Communications, "Welcome to the New Frontier," May 13, 2009; Federal Communications Commission, "Local Telephone Competition: Status as of June 30, 2008" table 7

2. Frontier's integration of Verizon's West Virginia systems is entirely different, more complicated and riskier than the integration of systems in other states

Unlike the thirteen other states involved in the transaction, Frontier must integrate West Virginia's systems on Day One – something that has never been done with former Bell Atlantic systems.

Frontier's track record in relation to systems integration is not very good. Frontier had integration problems after it acquired Rochester Telephone.³ It took seven years for Frontier to integrate these systems and even then there were significant service quality problems.

³ West Virginia PSC, Case No. 09-0871-T-PC, Testimony of John Pusloskie on the behalf of the Communications Workers of America.

PART TWO: FRONTIER'S FINANCES HAVE DETERIORATED, ITS PROJECTIONS HAVE BEEN UNDERMINED AND ITS CLAIMS ARE MISLEADING

Frontier recently released new data on the transaction showing that the company's financial condition has deteriorated and it has incurred significant new operating expenses. These new revelations prove that the company's financial model is demonstrably unreliable. In response, Frontier has made misleading claims that mask the company's real financial condition.

1. Frontier's finances have deteriorated since the deal was first announced

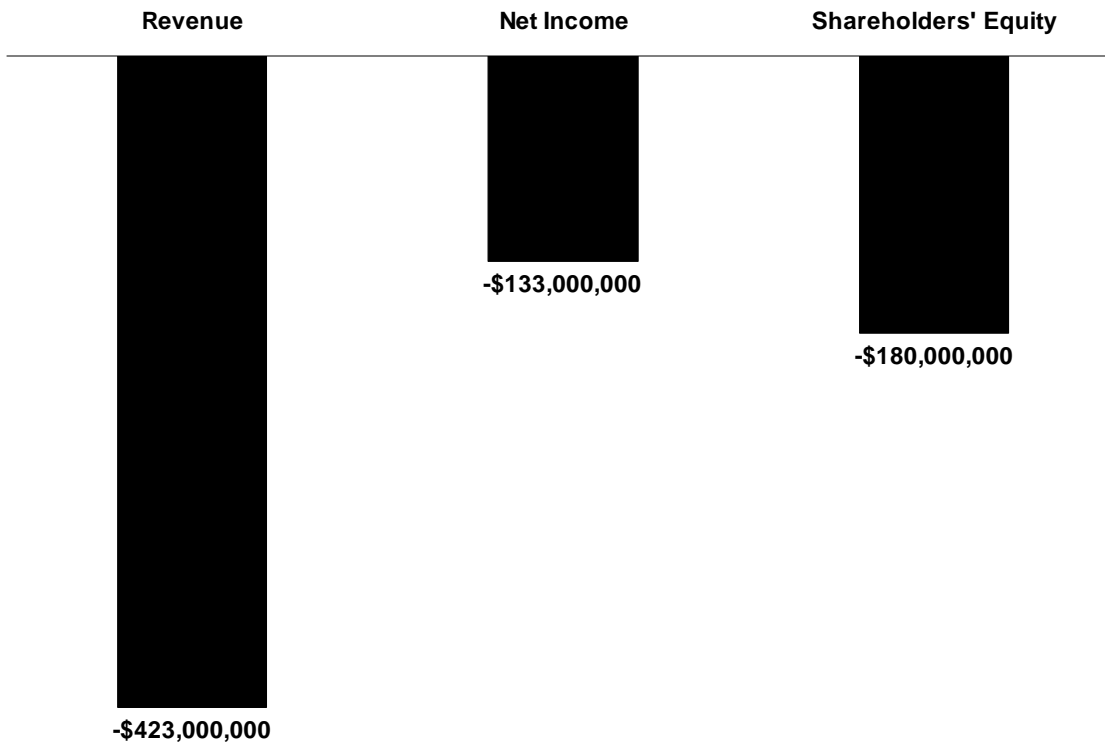
Frontier recently released pro forma financial statements for 2009 that reveal a seriously deteriorating situation for Frontier and its to-be-acquired Verizon operations in 14 states (called Verizon Separate Telephone Operations or VSTO).⁴ Specifically, the 2009 pro forma figures for the combined Frontier/VSTO operations compared to the 2008 figures show a 6.5% decline in revenue (from \$6.49 billion to \$6.07 billion), a 23% decline in net income (from \$565 million to \$439 million) and a whopping 35% decline in Frontier's shareholders equity (from \$519 million to \$339 million).

Ironically, Frontier consistently used the 2008 pro forma results to support its argument that the combined companies' operations were financially sound. The 2009 results undermine Frontier's contention and reveal a company with significant problems.

The following chart illustrates the decline in Frontier's revenue, net income and shareholder equity from 2008 to 2009.

⁴ Frontier Communications Commission, SEC Form S4, July 24, 2008, pp. 170-176; SEC Form 8K, March 24, 2010, pp. 5-11.

Combined Frontier/VSTO Pro Forma Results
2009 vs. 2008



Sources: Frontier March 24, 2010 8-K filing with the SEC showing 2009 results; Frontier September 16, 2009 Definitive Proxy Statement showing 2008 results

2. \$141 million in newly identified integration costs include a new \$105 million payment to Verizon and puts further strain on Frontier's finances

Frontier recently revealed that the company's integration costs increased by \$141 million or 74% (from \$192 million to \$333 million).⁵ This increase includes a requirement that Frontier pay an additional \$105 million to Verizon for computer software. The payment to Verizon is to be made at the closing of the deal. These additional costs further strain Frontier's finances.

3. Frontier's financial model is demonstrably unreliable

Actual results for 2009 are worse than those projected by Frontier's financial model. For example, 2009 revenue, net income and free cash flow are much lower than figures Frontier projected just 11 months ago. It should be noted that specific data cannot be disclosed because it is highly confidential.

⁵ Frontier Communications, SEC Form 8K, March 24, 2010

Furthermore, in its rush to do this deal, Frontier did not evaluate how the combined companies would perform under even modestly stressed conditions.

4. Frontier is making misleading claims

Frontier continues to make misleading claims that could influence the decisions of regulators examining the deal. One problem is that Frontier uses its historic 2008 pro forma results as the basis for statements about what its condition will be in future years. This is not only misleading but using 2008 as a basis for projections into the future is not supported by Frontier's own financial model.

- Frontier states that "Free cash flow after dividend payments will be \$681 million without any synergies and \$991 million if synergy targets are achieved."⁶ However, Frontier's own financial model reveals that post-dividend free cash flows will be much less. Even with the \$500 million in claimed synergies, Frontier's financial model never even gets within \$300 million of the \$991 million figure.
- Frontier states "Thus, analyzed properly, Frontier's leverage is actually quite comparable to Verizon, particularly the 2.2 ratio Frontier expects to achieve with synergies."⁷ However, Frontier's own financial model projects higher leverage ratios that refute this claim.

5. Frontier's business strategy of paying out more in dividends than earning in net income is fundamentally flawed and not sustainable

Frontier pays out significantly more in dividends than it earns in net income. Since reinstating dividends in 2004, Frontier has paid out almost \$2.5 billion in dividends while earning less than half that (\$1.1 billion), even before counting the \$835 million Frontier has returned to stockholders via stock repurchases during the same period.⁸ Frontier has transferred a total of \$3.3 billion in cash from company operations to stockholders in the form of dividends and stock repurchases. Frontier uses its operations as a cash cow for stockholders rather than reinvesting and significantly improving operations.

Frontier does not plan to alter this "cash cow" strategy if the merger is closed. Frontier has promised to cut its dividend from \$1 to \$0.75 after the merger. Even after this 25% cut in its dividend Frontier would still have paid out 172% of its net income in dividends if the deal had gone through in 2009.

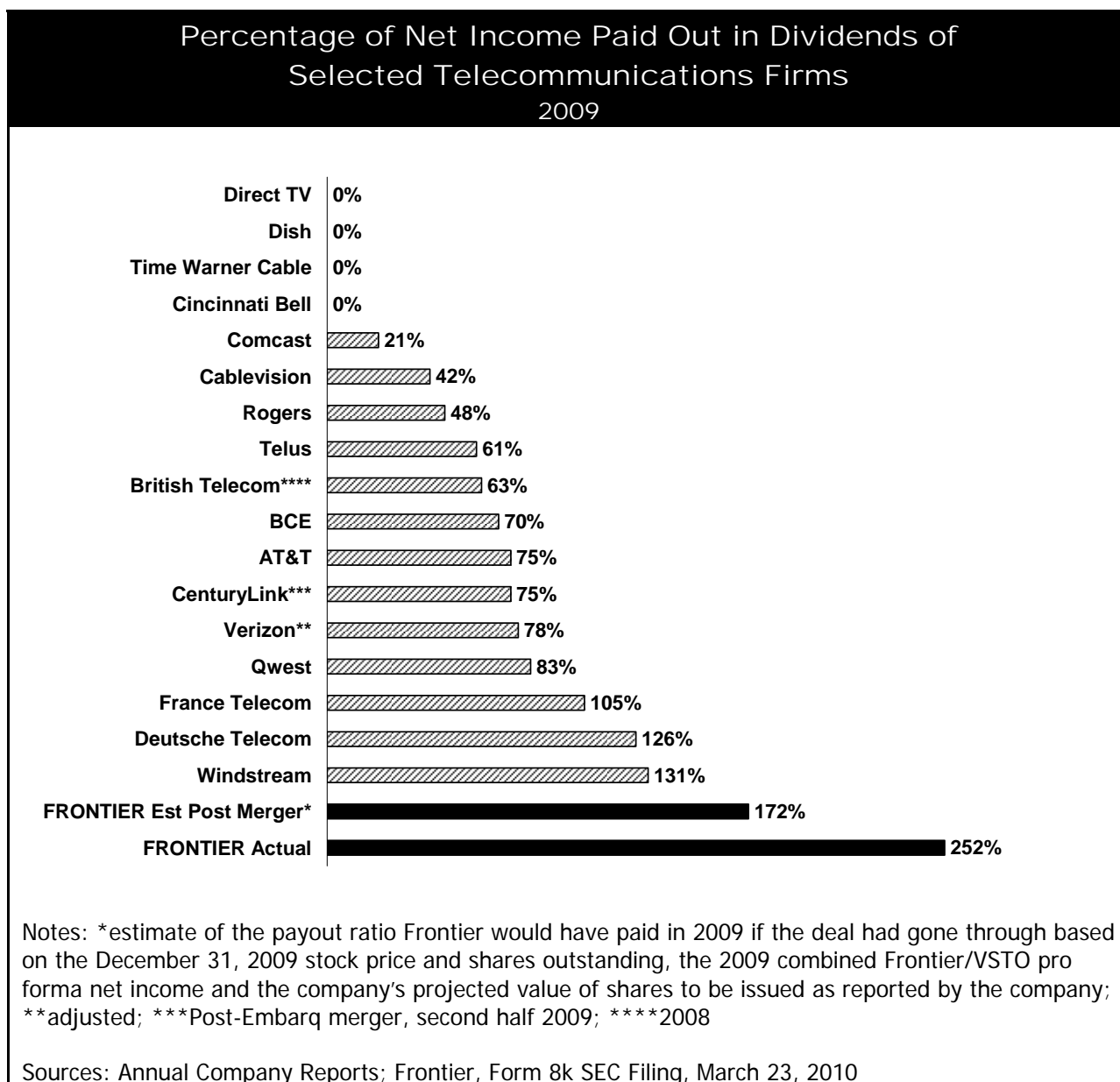
⁶ Verizon/Frontier Ex Parte letter to the FCC dated December 17, 2009.

⁷ Verizon/Frontier Ex Parte Letter to FCC dated December 17, 2009. Frontier/Verizon make the same misleading assertions on pages 20 and 22 of Verizon/Frontier's Opposition to Petition to Deny and responses #16 and #17 to the FCC's data requests

⁸ Frontier Communications, Annual 10K filings with the SEC.

Frontier’s “cash cow” strategy acts as a major drain on Frontier’s retained earnings which have declined from almost \$2 billion in 2001 to \$339 million in 2009. The demise in retained earnings represents a significant hole if Frontier runs into any problems in the future.

As the following chart makes clear, Frontier is the industry leader in transferring resources to its shareholders. In 2009, Frontier paid out more of its net income in dividends than any of the leading telecommunications firms. Frontier would still have been the industry leader even if the deal had gone through in 2009 and it had instituted its promised 25% cut in dividends. Frontier’s massive transfer of cash to its stockholders stands in stark contrast to those companies that continue to plow resources back into operations.



6. Frontier's plan to cut \$500 million in annual operating expenses is unprecedented and will result in the erosion of jobs and service quality

Frontier's projected annual cost savings of \$500 million or 21% is unprecedented. By comparison, FairPoint projected cost savings of 8% to 10% when it purchased Verizon's access lines in Maine, New Hampshire, and Vermont. FairPoint was not even able to meet these projections. The most recent major merger involving rural landline operations, CenturyTel's acquisition of Embarq, entailed projected synergy savings of 9% of Embarq's expenses.

The consequences of such a massive reduction in annual operating expenses will be significant. Frontier's CEO, Maggie Wilderotter, admitted that "Frontier plans to cut jobs" as part of its effort to achieve cost savings of \$500 million a year.⁹

The combination of financial pressures and drastic cuts in employment are likely to adversely affect the timeliness and quality of Frontier's installation, maintenance, and repair activities.

PART THREE: COMMITMENTS REQUIRED BY OTHER STATES FALL FAR SHORT OF WHAT WEST VIRGINIA NEEDS AND THE FCC'S GOALS

1. Frontier's broadband commitments are inadequate

West Virginia currently ranks near the bottom of the states in terms of broadband access and broadband speeds. West Virginia ranks 44th in DSL availability and 40th in cable modem availability¹⁰ and 50th in terms of broadband upload speeds and 33rd in terms of broadband download speeds.¹¹ Specifically, West Virginia averages 4.6 megabits per second (mbps) download and 0.5 mbps upload speeds. The U.S. average is 5.1 mbps download and 1.1 upload speeds.

Frontier's broadband commitments are inadequate to meet consumers' needs in the 13 other states involved in the transaction (see Appendix for a breakdown of Frontier's broadband commitments in each state). Frontier has made no broadband commitments in 9 states. In the other four states, Frontier's commitments were for slow broadband (speeds ranging from just 1 to 3 mbps) within a relatively long period of time (from three to four years) while

⁹ Charleston Gazette, *Verizon landline purchase good for W.Va., Frontier CEO says*, by Eric Eyre, October 29, 2009

¹⁰ Federal Communications Commission, *High Speed Services for Internet Access: Status as of June 30, 2009*, July 2009.

¹¹ Communications Workers of America, *3rd Annual Speed Test Report*, August 2009.

providing access to just 85%-89% of households. Overall, Frontier's commitments would leave 1.1 million households without access to even these slow speeds in the thirteen states.

Frontier's promises to West Virginia (not enforceable commitments at this point) are inadequate to meet consumers' needs. Frontier has stated that, if the deal were to be approved, it would offer broadband of 3 mbps to 85% of the former Verizon customers where "technically feasible."¹² Yet, this would still leave more than 92,000 West Virginian households without access to Frontier's broadband at even these slow speeds.

Frontier's commitments are inadequate for the nation. The Federal Communications Commission has set a national broadband goal for actual speeds of at least 4 mbps to 100% of the population. By 2015, the goal is for 100 million households (approximately 80% of the entire US population) to obtain speeds of 50 mbps. And by 2020, the national goal is for 100 million households to have broadband with speeds of 100 mbps.¹³ In the best case scenario, Frontier's customers will be stuck at speeds of 3 mbps within 4 years when 80% of the rest of the nation will be reaching speeds of 50 mbps.

Adding insult to injury, Frontier's current broadband offerings are expensive and slow. Frontier offers DSL with maximum speeds of 3 mbps in most areas and 6 mbps in just a few areas. The price is \$49.99 for 3 mbps which is the same price that Verizon charges for its 15 mbps FiOS service where available.

CWA estimates that it will cost Frontier at least \$600 million to reach 85% of the current Verizon households with DSL throughout the 14 states – a commitment Frontier has not made. Frontier would be very hard pressed financially to reach this 85% even with slow speeds. Reaching 100% deployment would cost even more – requiring resources that Frontier will not possess.

2. No financial commitments from Frontier or Verizon

Of the nine states that have approved the transaction, only one has required even a minimal requirement dealing directly with Frontier's finances. The Illinois Commerce Commission required a condition preventing Frontier's Illinois subsidiary from transferring funds from its Illinois operations to its corporate parent if service quality falls below certain levels.

However, this condition will fail to protect Illinois consumers if Frontier goes bankrupt (as happened in previous Verizon sales to Hawaiian Telcom and

¹² West Virginia Public Service Commission, Case No. 09-0871-T-PC, Transcript Day 1, p. 141

¹³ Federal Communications Commission, *Connecting America: The National Broadband Plan*, March 16, 2010.

FairPoint) or even if Frontier is unable to maintain adequately, much less improve, broadband and the basic telecommunications infrastructure.

3. State commissions have failed to recognize the lessons of FairPoint and have left Verizon totally off the hook

In 2008, the regulatory commissions in Maine, New Hampshire and Vermont approved the sale of Verizon's properties to FairPoint. The commissions required Verizon to reduce its sale price by \$360 million and required FairPoint to limit its dividend payment and meet specific service quality and broadband build-out requirements or face stiff penalties.

In October 2009, FairPoint declared bankruptcy. It was unable to service the new debt it acquired to fund its purchase or successfully manage the transfer from Verizon's operational systems. The \$360 million price reduction that the commissions thought would help stabilize FairPoint's finances were not large enough. The reporting requirements for the integration of Verizon's operational and computer systems were inadequate. With bankruptcy, the fines for inadequate broadband build-out and service quality were dropped. The commissions could not fix what they should not have approved in the first place. Consumers have suffered from reduced service quality, inadequate broadband expansion, billing nightmares and E-911 disruptions.

There are many similarities between FairPoint and Frontier. Both took on enormous increases in debt and made similar promises such as a smooth transition from Verizon's operational and computer systems, expanded broadband build-out, and improved service quality while instituting significant cuts in annual operating expenses. Both had a similar "cash cow" business plan based upon dividend payouts that were significantly larger than net income.

There is no question that Frontier will be stretched financially and it will be very difficult to meet its promises. Frontier may or may not go bankrupt. However, there will be significant problems even if Frontier merely limps along.

There is no excuse for the commissions dealing with the sale to Frontier to have refused to address Frontier's financial condition or require Verizon to provide more money given the lessons of FairPoint and Hawaiian Telcom. At least the Northern New England commissions required Verizon to reduce the price by \$360 million (to provide some financial help to FairPoint) as well as make tens of millions of dollars available for infrastructure investments. These actions did not prevent FairPoint's bankruptcy – but at least the commissions recognized the risk and took some action. The lack of recognition of Frontier's financial weakness and the lack of any action to even try to rectify the problems by the regulatory commissions in the states approving the Frontier deal is truly astounding given recent history.

PART FOUR: THE DEAL SHOULD BE DENIED

Consumers and workers face far greater risks with Frontier than they would with Verizon. Verizon clearly chose Frontier to avoid paying taxes on \$3.3 billion, not because the deal is better for West Virginians.

1. West Virginians will clearly face less risk with Verizon than with Frontier. There is no question that Verizon is much less susceptible to financial and operational problems than Frontier. Verizon is more profitable and has significantly more resources.
2. The FCC and state commissions made the wrong decision when confronted with similar deals with FairPoint and Hawaiian Telcom. The significant regulatory conditions imposed by commissions in Hawaii, Vermont, New Hampshire and Maine were not enough to prevent bankruptcy, the erosion of service quality and a much slower than promised broadband build-out.
3. The proposed sale should be denied. Verizon should not be allowed to abandon its responsibilities to West Virginia, pocket \$3.3 billion tax free, and leave its customers and workers in harms way – facing significant risks with Frontier, a company that is financially and operationally challenged.
4. Instead, regulators the legislature and the governor should ensure that Verizon meet its responsibilities to West Virginia. There is no question that Verizon, unlike Frontier, has the resources needed to improve its existing infrastructure, maintain adequate workforce levels and extend high speed broadband. Rejecting the deal doesn't mean Verizon will let its West Virginia operations wither. Verizon retains a fiduciary responsibility to its shareholders to maximize earnings from these properties. In upstate New York, Verizon tried to sell its rural lines but couldn't find a buyer. Since then, Verizon has invested almost \$900 million in upstate New York.
5. If Verizon still wants to sell after meeting its West Virginia responsibilities then it should open up the bidding to companies with sufficient capital and technical resources to meet West Virginia's needs – rather than limit the bidding to much smaller companies like Frontier in order to qualify for a tax loophole.

APPENDIX

Frontier's Broadband Commitments in States to be Acquired from Verizon		
State	State Broadband Conditions	Access Lines Without Any Commitment
Ohio	85% of households to have DSL access of at least 1 mbps by 2013	95,100
Illinois	85% of households to have DSL access of at least 3 mbps by year end 2013	86,000
Washington	89% of households to have DSL access of at least 1.5 mbps and 80% of households to have access to 3 mbps by year end 2013	63,700
Oregon*	Broadband deployment of 1.5 to 3.0 mbps to not less than 95% of wire centers within two years; 60% of households in 15 new wire centers; 60% in 22 non-served centers.	47,000
West Virginia	PSC has not issued order but Frontier has committed to deployment of 3 mbps to 85% of households "where technically feasible."	92,600
Arizona**	Regulated - No Commitment	2,500
California**	Regulated - No Commitment	10,000
Nevada**	Regulated - No Commitment	14,400
S. Carolina**	Regulated - No Commitment	51,000
Michigan**	No Jurisdiction/No Commitment	203,000
N. Carolina**	No Jurisdiction/No Commitment	105,400
Wisconsin**	No Jurisdiction/No Commitment	112,600
Indiana**	No Jurisdiction/No Commitment	287,300
Idaho**	No Jurisdiction/No Commitment	45,200
TOTAL		1,215,000
<p>*Oregon's conditions were difficult to quantify; therefore, it was assumed to total 85% of households though most likely this is an overestimate.</p> <p>**Verizon's average broadband penetration rate in all these states is 60%. Frontier has made no commitments in these states to expand broadband beyond this percentage or to increase available speeds.</p> <p>Sources: Orders of regulatory commissions in Arizona, California, Illinois, Michigan, Nevada, Ohio, Oregon, South Carolina and Washington. Access lines to be acquired are from Frontier Communications.</p>		

For more information visit: www.bad4wv.com.