



The Real Story behind Frontier's Promises – Job Loss, Less Capital Investment, Less Financial Stability, Worse Service Quality, and No High Speed Internet

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Promises, Promises. Frontier is promising that its proposed purchase of Verizon's landline operations in 14 states will benefit consumers, workers, stockholders and communities. Sounds great but a closer look at Frontier's promises should generate significant skepticism. Frontier is promising too much to too many including the following:

- service \$8 billion in debt obligations – a \$3.3 billion increase over current debt
- invest enough capital to maintain the acquired physical plant, improve service quality, and expand broadband
- ensure adequate staffing and increase jobs
- cut \$500 million in annual operating expenses in the states acquired from Verizon
- set up a new operational-administrative-billing system in West Virginia
- lease existing computer systems from Verizon in the 13 other states until it integrates those systems in 2012
- continue to pay out a lot more in dividends than it makes in profits

Both FairPoint and Hawaiian Telcom made similar promises and went bankrupt after they purchased Verizon's landline operations. Instead of the promised benefits, the consumers and communities in Maine, New Hampshire, Vermont and Hawaii have suffered from major service quality problems. Frontier loudly promises that, unlike FairPoint and Hawaiian Telcom, it can meet the challenges it will face. However, a reality check shows that even if Frontier does not go bankrupt, it will still lack the resources needed to meet all of its promises. The Frontier deal places consumers, workers and communities at significant risk – a level of risk that they would not face with Verizon.

THE REAL STORY – FRONTIER WILL CUT JOBS

Frontier Promises More Jobs. Frontier CEO Wilderotter stated that "We're here to grow and growth is about job creation and sustaining jobs."¹ As part of the merger agreement, Frontier made the commitment that it would not layoff any installers or technicians for eighteen months and that it would honor existing union contracts. Frontier also promised that it would create a southeast regional headquarters in Charleston along with 30 to 40 new positions in engineering, technical, operational and public affairs.²

¹ Charleston Gazette, *Verizon landline purchase good for W.Va., Frontier CEO says*, by Eric Eyre, October 29, 2009.

² Frontier Communications, *The Truth about the Frontier/Verizon Transaction in West Virginia*, November 3, 2009.

Reality Check – Loss of Jobs.

- ✓ On November 4, in an interview with Bloomberg News, Frontier CEO Wilderotter finally admitted that Frontier “plans to cut jobs” – as part of its effort to achieve cost savings of \$500 million a year.³ Frontier should publicly release its projected employment levels so the public can understand the size of the job losses that will be imposed.
- ✓ Frontier’s no-layoff promise only applies to technicians and installers for 18 months and does not cover any other workers.
- ✓ A significant number of Verizon workers in the areas to be acquired will retire rather than risk their future with Frontier. Thus, Frontier will be faced with the issue of backfilling and training new workers --- not laying-off workers.
- ✓ Frontier has a history of significantly reducing its workforce - especially after its mergers.
- ✓ Frontier has promised to honor, not extend, existing union contracts. The latest negotiations with workers in Pennsylvania provide a good indication of how Frontier will act when the current contracts expire. Specifically, Frontier is demanding concessions that would reduce jobs, wages, benefits, job security and pensions.

THE REAL STORY - FRONTIER WILL REDUCE INVESTMENT IN INFRASTRUCTURE

Frontier Promises More Investment. Frontier promises to invest in the network to deliver a customer experience that exceeds expectations” and to extend broadband availability to the households it will be acquiring. Obviously, better service quality and extended broadband require significant amounts of investment.

Reality Check – Less Investment.

- ✓ Frontier actually plans to cut capital expenditures below Verizon’s historic levels in the properties to be acquired. From 2005 through 2008, Verizon invested between \$703 million to \$733 million in the infrastructure to be acquired by Frontier. But Frontier does not plan to maintain this level of capital spending.
- ✓ Frontier’s significant cuts in capital expenditures will occur during the same period that Frontier claims it will be increasing investment to expand broadband and improve service.
- ✓ After 2012, Frontier proposes to make even more drastic cuts in the levels of capital expenditures.

THE REAL STORY - THE FINANCIAL HEALTH OF THE OPERATIONS TO BE ACQUIRED BY FRONTIER WILL BE WEAKER

Frontier Promises Stronger Financial Health. Frontier states that the transaction will “strengthen Frontier’s balance sheet, improving its Net Debt/Ebitda ratio from 3.8x to 2.6x” and that it will “reduce its dividend by 25 percent at the close of the transaction.”⁴ Frontier CEO

³ Bloomberg News, *Frontier Says Verizon Assets to be integrated by 2012*, November 4, 2009. <http://quote.bloomberg.com/apps/news?pid=20601087&sid=aDX3mPzTHHZ4&pos=7>

⁴ Frontier Communications, November 3, 2009.

Wilderrotter stated that “We are a very financially healthy company, and this makes us even more financially healthy... This reduces our debt.”⁵

Reality Check – Financial Erosion for the Acquired Operations.

- ✓ While Frontier argues that somehow this deal will make it stronger, the issue for the states being sold is *how much weaker it will make the operations in those states*. Right now, the Verizon operations have only about 34 cents in debt for every dollar of operating cash flow. After the Frontier deal closes, these same Verizon properties will be responsible for at least \$2.60 in debt for every dollar of operating cash flow, an increase of over 600%!
- ✓ The Verizon properties will be tied to Frontier - a company with much lower profits and, thus, a much lower margin for error.
- ✓ Frontier’s financial condition is eroding.
 - Frontier will take on an additional \$3.3 billion in debt -- for which it has not yet been able to obtain financing.
 - So far this year Frontier has experienced significant reductions in revenue, access lines, and net income.
- ✓ Frontier continually pays out more in dividends than it earns in income -- 174% more in 2008 and 199% more during the first nine months of this year. This is just not sustainable. Even after Frontier cuts its dividend by 25 cents -- its dividend payout will still represent 125% to 142% of its net income.
- ✓ Frontier’s financial forecasts are not accurate. For example, Frontier overstates its revenue. Frontier’s projections rely on Verizon’s year-end 2008 results. But since June 30, 2008, the Verizon areas that Frontier wants to buy have lost more than 11% of its access lines, resulting in a significant decline in revenues, cash flow, and net income. And Frontier admitted that “The combined company will likely face further reductions in access lines, switched access minutes of use, long distance revenues and federal and state subsidy revenues, which could adversely affect it.” However, Frontier has not revised its financial projections to reflect this reality.
- ✓ FairPoint projected that its leverage ratio would be strengthened by its purchase of Verizon's Northern New England operations --- this did not protect it from bankruptcy.

THE REAL STORY - FRONTIER’S \$500 MILLION CUT IN ANNUAL EXPENDITURES WILL ADVERSELY AFFECT CONSUMERS, WORKERS AND COMMUNITIES

Frontier Promises a Painless Cut of \$500 million in Annual Expenses. Frontier states that “transaction synergies will not come from reductions in front-line jobs” and that “the increased scale and scope of the combined company will allow Frontier to leverage its common support functions and systems...to achieve both operating expense and capital expenditure synergies.”⁶

⁵ Bloomberg News, November 4, 2009.

⁶ Frontier Communications, November 3, 2009.

Reality Check – Frontier’s \$500 Million in Annual Cuts will be Very Painful

- ✓ It is just not believable that Frontier will do a \$500 million a year better job at cutting costs than Verizon -- a company that is much more profitable and has much greater economies of scope and scale than Frontier.
- ✓ Frontier has not publicly released its plan to realize the \$500 million in annual operational expense cuts NOR has it publicly released its projections for labor force levels and labor costs going forward.
- ✓ Frontier’s projected cost savings are unprecedented. By comparison, when FairPoint purchased Verizon’s access lines in Maine, New Hampshire, and Vermont, FairPoint projected reducing costs by 8% to 10% (and FairPoint has not been able to achieve even those savings). The most recent major merger involving rural landline operations, CenturyTel’s acquisition of Embarq, entailed projected synergy savings of 9% of Embarq’s expenses. It is unprecedented to have expense savings of the magnitude projected by Frontier for a transaction of this size.
- ✓ Frontier’s projected cuts in annual expenses are either wishful thinking or will require such draconian reductions in service, workforce, and maintenance that Frontier will not be able to deliver on its promises to improve service and extend broadband.

THE REAL STORY – FRONTIER WILL NOT PROVIDE HIGH SPEED BROADBAND

Frontier Promises Broadband Everywhere. Frontier’s CEO stated that “We believe Frontier is the best-positioned company to extend the reach of broadband.” Frontier also states that its broadband service reaches 92% of the households in its current territory compared to Verizon’s 60%.

Reality Check – Frontier Will Not have the Resources Needed to Expand Truly High Speed Internet

- ✓ Frontier has not made any specific commitments to deploy the fiber needed to expand truly high-speed Internet access or even to expand DSL.
- ✓ Frontier has not demonstrated that it will have the resources needed to invest in high speed fiber.
- ✓ Frontier has not demonstrated that it would improve upon Verizon’s broadband deployment and pricing. In contrast to Verizon’s experience with FiOS, “ultra 7 mbps” and other DSL services, Frontier’s broadband experience is largely limited to speeds up to 3 mbps download and 384 kbps upload.
- ✓ Frontier has not demonstrated how it would be able to justify broadband deployment to areas that Verizon has not yet served.⁷

⁷ Mbps stands for megabits per second; Kbps stands for kilobits per second. These are measures for the speed of connections to the Internet. The greater the speed and capacity, the faster the Internet experience and the greater the amount of information that can be downloaded or uploaded.

THE REAL STORY – FRONTIER FACES A SIGNIFICANT CHALLENGE BECAUSE OF THE SIZE, SCOPE AND COMPLEXITY OF THE DEAL

Frontier Promises Everything Will Go Smoothly. CEO Wilderotter states “We know how to do this... We’re good at this, and we’re customer focused.”⁸ The company also referred to its past acquisitions when it stated “Frontier has successfully transferred customers to its existing systems – including more than 1.7 million access lines from Rochester Telephone, Commonwealth Telephone and Global Valley Networks.”⁹

Reality Check – There is a Significant Risk that Things Will NOT Go Smoothly

- ✓ **No other telecom in the U.S. has attempted a deal of this complexity and size** which includes integrating approximately 4.8 million access lines spread over parts of 14 states stretching from coast to coast.
- ✓ **The next largest deal ever attempted (just one-third the size) has run into major problems.** The biggest deal ever attempted from a Verizon divestiture was the FairPoint transaction in Northern New England—about 1.5 million lines in three states. That transition has not gone well, resulting in service outages, poor customer service, a significant loss of access lines and the revenues and earnings needed to run the company.
- ✓ **This deal is at least 4 times larger than any other Frontier acquisition.** Frontier’s biggest deal was the acquisition of Global Crossing’s telephone landline assets, including Rochester Telephone. This acquisition totaled approximately 1 million lines but nearly all of these were located in one state.
- ✓ **The integration of West Virginia’s system is unprecedented.** No one has ever attempted a large divestiture of access lines from the former Bell Atlantic network. This deal includes 600,000 access lines in West Virginia that will have to be “cut-over” from those Bell Atlantic systems to Frontier’s systems at closing. It’s never been done before.
- ✓ **Frontier has had problems integrating its Rochester Telephone operations.** Frontier acquired Rochester Telephone in 2001. Yet, it took Frontier seven years to merge Rochester Tel’s operational and computer systems into Frontier’s systems. The transition has not gone smoothly and there have been many problems with the billing and dispatch systems. For example, technicians have repeatedly been sent to wrong addresses or to correct addresses but with incorrect orders and equipment.
- ✓ **Frontier’s system integration will impact customer service, infrastructure and Internet build out.** While Frontier is confident in its ability to manage all of the integration challenges, there is a significant risk that management will be distracted and have to focus its attention on the integration and transition process, rather than on improving customer service, increasing broadband penetration, enhancing preventive maintenance activities, and all of the other things that are needed to provide high-quality service to the public.

⁸ Charleston Gazette, October 29, 2009.

⁹ Frontier Communications, November 3, 2009.

THE REAL STORY – VERIZON IS BETTER THAN FRONTIER FOR THESE STATES

Frontier Promises that it would be Better than Verizon. Frontier has been careful not to directly criticize Verizon. However, Frontier also states that it has a more rural focus, pays more attention to customers and provides a higher percentage of broadband access than Verizon.

Reality Check – Consumers Would Be Better Off with Verizon

- ✓ There is no question that Verizon is much less susceptible to financial and operational problems than Frontier. Verizon has more resources to respond to changes in the economy and emergencies and more resources to devote to operations. The risk is very high that Frontier will not have such resources.
- ✓ Just ask consumers in Maine, New Hampshire, Vermont and Hawaii if they were better off with Verizon than they are now with FairPoint and Hawaiian Telecom.
- ✓ Verizon clearly agreed to this transaction because it could avoid paying taxes on \$3.3 billion, not because this deal is better for customers. Verizon avoided paying any taxes on the \$3.3 billion it will get from the sale by selecting a much smaller company like Frontier. This allowed the sale to qualify as a tax-free Reverse Morris Trust (RMT)—a “loophole” in the tax code that allows businesses to reorganize their assets without having to pay taxes. Verizon chose to avoid taxes by selling to Frontier rather than open the transaction to larger companies.

THE BOTTOM LINE – THIS DEAL IS NOT GOOD FOR CONSUMERS, COMMUNITIES, AND EMPLOYEES

- ✓ The risks of the deal for consumers, workers and communities far outweigh any supposed benefits and the PSC has an obligation to protect the public interest.
- ✓ **Verizon should not be allowed to abandon its responsibilities**, pocket \$3.3 billion tax free, and leave its consumers and workers – and the state’s telecommunications future – in the hands of a company that will be financially and operationally challenged.
- ✓ **Instead, regulators, the legislature and the governor should ensure that Verizon meet its responsibilities.** There is no question that Verizon, unlike Frontier, has the capital needed to improve its existing infrastructure, maintain adequate workforce levels and extend high speed broadband. If the proposed transaction is denied, it is up to state officials to ensure that Verizon meet its responsibilities through stronger regulations and policies to stimulate broadband build-out.
- ✓ **There is a precedent for increased investment by Verizon following a failed attempt to sell.** After Verizon failed to sell its upstate New York lines, it changed course and invested in fiber to the home in a number of upstate communities.