Communications
Workers of America
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October 26, 2007

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

RE: Ex Parte Notice. WC Docket No. 07-22. In the Matter of Application Filed for the Transfer of Certain Spectrum Licenses and Section 214 Authorizations in the States of Maine, New Hampshire and Vermont from Verizon Communications Inc. and its Subsidiaries to FairPoint Communications, Inc.

Dear Ms. Dortch:

What FairPoint lacks in financial resources, operational capacity or experience to conduct the Maine, New Hampshire and Vermont operations it wants to acquire from Verizon, it makes up in chutzpah.

FairPoint and Verizon glibly tell the Federal Communications Commission (Commission) that "no further information [than that presented by FairPoint] is necessary to allow the Commission to find that the transfer of Verizon assets to FairPoint is in the public interest."[1] Of course, FairPoint does not want the Commission to examine additional information because it would reveal a set of shaky finances that would make it impossible for them to deliver quality service and invest in high-speed networks in Northern New England (NNE). In sum, FairPoint is asking the Commission to "trust us" rather than submit to an in-depth analysis commensurate with the size and impact of the deal. Thus,

[1] Letter from Shirley Linn and Robin Tuttle of FairPoint and Michael Glover, Karen Zacharia and Leslie Owsley of Verizon to Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No. 07-22 (filed October 10, 2007).

FairPoint attempts to evade close scrutiny and avoid providing the Commission with the critical information that demonstrates the serious harms that the transaction poses to consumers.

In this letter, the Communications Workers of America (CWA) and the International Brotherhood of Electrical Workers (IBEW) address several issues raised in recent *ex parte* submissions by FairPoint and Verizon.[2] First, we discuss the critical importance of an extensive examination of FairPoint's financial condition and operational capacity for the Commission's determination of the public interest benefits and harms of the proposed transaction. Given the critical importance of such a review for the development of a comprehensive record, we recommend that the Commission examine the evidence compiled in the state proceedings and wait until after the states have completed these proceedings before reaching a decision. There are precedents in which the Commission has issued orders after state proceedings have ended.

Second, we highlight the serious concerns raised by the Maine Public Advocate, the New Hampshire Consumer Advocate and the staff of the New Hampshire Public Utility Commission (PUC) that have conducted extensive reviews of the proposed transaction. Based on their analysis, they recommend that the transaction as proposed be denied. However, they would support the sale if the transaction and the Transition Services Agreement were restructured significantly, back office systems be fully functional before cutover, dividend restrictions imposed, broadband build-out commitments extended, service quality improved, Verizon's commitment to pay a significant share of capital expenditures required, retail and wholesale prices restricted, and FairPoint's corporate policies adjusted. These conditions would cost Verizon at least $600 million. The conditions also would require FairPoint to change its business model from

[2] Letters from Shirley Linn and Robin Tuttle of FairPoint and Michael Glover, Karen Zacharia and Leslie Owsley of Verizon to Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No. 07-22 filed October 10, 2007 and October 11, 2007 (FairPoint October 10, 2007 *Ex Parte* and FairPoint October 11, 2007 *Ex Parte*).

an acquisition firm focused on generating high dividends and debt in order to fund a series of telephone mergers to an operating telecommunications company focused on providing high quality advanced services to its customers.

Finally, we examine FairPoint's ostrich-like reaction to an impending exodus of experienced workers.

I. The Commission Should Conduct an Extensive Analysis of the Proposed Transaction and Wait for the Conclusion of the State Proceedings

The proposed transaction is somewhat different than many of the telecommunications mergers recently considered by the Commission. It does not directly involve major competitive concerns. However, it does involve significant financial and operational issues. Indeed, the financial and the operational capacity of FairPoint are highly suspect.

The analysis of the financial expert witnesses of the New Hampshire PUC, the New Hampshire Consumer Advocate, the Maine Public Advocate, the Vermont Department of Public Service and CWA/IBEW all depended upon a large amount of information only made available by FairPoint after extensive interrogatory requests and submissions. Such information has not been publicly available in the proceeding before this Commission. The Maine Public Advocate underscored the importance of this information when he stated that their analysis and recommendations

> …were developed based on the examination by Public Advocate Attorneys and its four expert witnesses of thousands of pages of documents and testimony in the case. During the just-concluded hearings, Public Advocate attorneys cross-examined Verizon and FairPoint witnesses, including FairPoint's top management, and introduced substantial evidence that paints a clear picture of the implications of the proposal from the viewpoint of telephone customers.[3]

[3] Maine Public Advocate, Public Advocate Announces Recommendations to PUC in FairPoint's Proposed Acquisition of Verizon-Maine, October 11, 2007.

FairPoint and Verizon want to limit the Commission to the information contained in their meager filings. The Applicants are actually making the claim that the less information provided to the Commission the better. Obviously, the Commission should reach its decisions based on the most comprehensive base of information available. Unlike FairPoint and Verizon, the CWA and IBEW believe that informed decisions are best.

The CWA and IBEW are not asking the Commission to rely solely on the analyses in the state proceedings. By all means, the Commission should conduct its own extensive analysis. However, as active parties in the state proceedings it has become obvious to us that the Commission could benefit greatly from the documents, responses to interrogatories, cross examination and briefs filed in the state proceedings. The completed record in those proceedings would provide the information needed to assess the public interest benefits and harms of the transaction based on an informed analysis of FairPoint's ability to adequately fund its operations, maintain and improve service quality, successfully complete the replacement of Verizon's 600 back systems, improve service quality and expand broadband build-out.

There is nothing unusual in the Commission reaching a decision after state proceedings have concluded. The Commission reached decisions on the ATT-BellSouth, Bell Atlantic-GTE, SBC-Ameritech and Bell Atlantic-NYNEX mergers AFTER the various state commissions issued their orders.

FairPoint actually threatens the Commission that if it issues a decision after the state proceedings "it could prevent FairPoint from moving forward with its broadband plans within the timeframes to which it has publicly committed…In this respect, CWA's request would postpone not just this proceeding but the advancement of an important policy goal."[4]

[4] FairPoint October 10, 2007 *Ex Parte*, p. 3.

The Commission should not give in to such baseless threats. The Vermont Department of Public Service already stated that FairPoint's broadband deployment plan does not represent any material improvement over Verizon's plan that is already in place (see Section II below). Indeed, the real risk is that FairPoint will not have the finances or operational capacity to actually implement its broadband deployment plan.

II. FairPoint's Shaky Finances and Assumptions

While FairPoint attempts to paint a rosy picture about its financial condition, its own projections show a company that will be financially stressed and at serious risk of being unable to pay its common stock dividend, refinance its multi-billion dollar debt, meet its obligations to employees, and make the necessary investments in network maintenance and improvements. In testimony presented to the New Hampshire Public Utility Commission, the PUC's own consultant stated the following:

> Put simply, FairPoint's financial condition is not strong enough to allow it to thrive except under assumptions far too optimistic for the Commission to rely upon in judging the transfer…A more realistic view of key operating and financial factors shows that FairPoint will not be able to maintain the financial strength needed to satisfy its lenders or to give confidence that it will continue to have reasonable access to capital markets…It clearly does not serve the public interest for the state's major telecommunications provider to begin from a thin financial position that will face severe threat under conditions less optimistic that those that form the basis of FairPoint's financial modeling in this case.[5]

The New Hampshire PUC consultants identified a number of "suspect assumptions" including the following:

[5] Docket No. DT 07-011, Supplemental Testimony of John Antonuk on behalf of the Public Utilities Commission of New Hampshire, September 10, 2007, pp. 3-5 (NH PUC Staff Testimony).

- The assumption that FairPoint will benefit from synergies amounting to over $60 million a year.

- The capital expenses assumed necessary to attain increased broadband availability.

- The capital expenses necessary to attain a satisfactory level of customer service.

- The costs that will mount under a Transition Services Agreement that may extend significantly past the projected four months after closing that FairPoint claims

Other expert witnesses for the Maine Public Advocate, the New Hampshire Consumer Advocate, the Vermont Department of Public Service and the CWA/IBEW have questioned these as well as other assumptions involving revenues, DSL customers, reduced capital expenditure requirements, the ability of FairPoint to replace and replicate the functions of 600 Verizon back office systems and more. Not one of the witnesses in the state proceedings has produced a financial analysis that results in FairPoint being a viable company with a bond rating that even approaches investment grade. In terms of the proposed transaction FairPoint is not a financially viable purchaser of Verizon's NNE operations.

FairPoint's own financial projections show the company's financial condition worsening each year.

- **FairPoint will "cannibalize" itself by paying out more in dividends than it earns**. FairPoint will continually pay out two to three times as much in dividends to stockholders as it actually earns on its operations. In effect, FairPoint will "cannibalize" Verizon's NNE operations – using all of the earnings (and much more) generated by the business to pay dividends to stockholders instead of reinvesting in the telecommunications infrastructure. FairPoint's own investment advisor, Deutsche Bank, projected that through 2015, FairPoint would obtain $290 million in cumulative profits while paying out $1.1 billion in dividends – a ratio of $4 in dividends for every $1 in projected profits. FairPoint already pays the highest dividend in the industry.

- **Financial condition of acquired operations will be weaker**. FairPoint is adding $1.7 billion in new debt. The post-merger company will be much weaker financially than Verizon. In 2006, the debt to equity ratio was 0.59 for Verizon and 2.70 for FairPoint. However, it was 7.81 pro forma for the combined FairPoint-Verizon NNE operations. While FairPoint argues that somehow this will make it stronger, the issue for Northern New England is how much weaker it will make the acquired Verizon operations in those states. In addition, FairPoint's executive Vice President stated that the company had no plans to obtain an "investment-grade" bond rating.

- **Lower levels of capital expenditures**. FairPoint projects that it will spend $50 million to $60 million less on capital expenditures each year than Verizon spent in 2006. This money would leave Northern New England and flow to FairPoint's stockholders.

- **Negative shareholder equity**. FairPoint's shareholder equity will turn negative by 2010 and will decline by hundreds of millions of dollars.

- **Projected $60-$75 million expense savings are in doubt**. The entire deal revolves around FairPoint's ability to cut costs by $60-$75 million through a 25-30% reduction in back office and network operating expenses. Yet, FairPoint has not demonstrated an ability to drive down operating expenses in its own subsidiaries: its unit operating expenses are higher than Verizon's NNE operations and its unit costs are increasing at the same level as NNE's.

- **FairPoint's Operational and Managerial Capacity is Inadequate**. There is a significant risk that FairPoint will run into delays and cost overruns when it replaces Verizon's 600 operational, support and administrative systems. After all, FairPoint ran into significant problems when it attempted to create and integrate one new billing system in Maine. Hawaiian Telcom (HT) provides an example of what could go wrong with such transitions. However, the HT transition was on a smaller scale and HT was backed by the deep pockets of the Carlyle Group - FairPoint has no pockets.

- **30% reduction in workforce**. FairPoint touts its promise to add 675 jobs in the region to replace the network operations, call center, and other back office operations currently provided for Verizon NNE by Verizon affiliates in other states. However, this is not the whole story. FairPoint was required by the Vermont Public Service Board to make public its plans to actually REDUCE employment by as much as 150 jobs or 4.5% each

> year. Within five years, FairPoint's "added" jobs will disappear. Within seven years, FairPoint's workforce will be reduced by more than 1,000 jobs or almost 30%.

As these projections make clear, FairPoint's ability to achieve acceptable service quality performance and expanded broadband build-out will be impaired by a lack of adequate resources, the potential loss of experienced workers and the significant risks posed by FairPoint's creation and implementation of dozens of new operational, support and administrative systems.

III. FairPoint's Purported Public Interest Benefits Evaporate After Analysis

The brief filed by the Staff of the Vermont Department of Public Service (DPS Staff) provides a clear example of the critical importance of an extensive review for a determination of the transaction's public interest benefits and harms. The Vermont DPS Staff reached the following conclusions after it analyzed FairPoint's proffered public interest benefits of a price freeze, service quality improvements, employment increases and expanded broadband deployment: [6]

- "FairPoint's proposal on prices is nothing more than the status quo, not an enhancement."
- "…the Department is unable to agree with FairPoint that the Proposed Transaction will deliver the public benefit of improved service quality."
- "…it is difficult to conclude that the Proposed Transaction will necessarily net a real and enduring increase in employment in Vermont that can be counted as a public benefit accruing to Vermont from this transaction…FairPoint is projecting an annual employee attrition rate over the next few years of 4 to 4.5%."
- "The Department does not believe that FairPoint has made any commitments to materially expand broadband service in Vermont beyond Verizon's present obligations."

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[6] Docket No. 7270, Initial Brief of the Vermont Department of Public Service, October 17, 2007 pages 97-103.

The DPS Staff did not follow FairPoint's "trust us" dictum. Instead, the Staff utilized expert witnesses and a well developed public record to reach its conclusions. Even if one does not agree with its analysis and/or conclusions, it is important to recognize the importance of an extensive review.

IV. The New Hampshire Consumer Advocate, the Maine Public Advocate, the Staff of the New Hampshire Public Utility Commission, the Vermont Department of Public Service and the CWA/IBEW All Recommend that the Transaction Be Denied as Proposed

The staff of the New Hampshire Public Utility Commission recommended that the New Hampshire PUC deny the proposed transaction unless 16 specific enforceable conditions are attached to any approval (see attachment).

> "Based on our analysis, Staff concludes that the risks, particularly with respect to the financial viability of FairPoint far outweigh the benefits of the transaction as proposed and that in its current form, the transfer from Verizon to FairPoint cannot be found to be for the public good. However, we believe that with the addition of certain protective conditions, the transaction would be in the public interest and we would recommend approval."[7]

The Maine Public Advocate also recommended that the Maine PUC deny the proposed transaction unless 23 specific conditions are attached to any approval (see attachment).

> "The Public Advocate will recommend that the Commission not approve this acquisition unless it adopts all 23 specific conditions to offset the likely adverse consequences for consumers. The recommended conditions fall into seven general categories. These include FairPoint's financial viability, FairPoint's obligation to provide high quality service to customers, prices for telephone and broadband services, FairPoint's technical ability to successfully create and

[7] NH PUC Staff Testimony, p. 2

> implement new operational systems, FairPoint's ability and commitment to deliver DSL broadband service throughout Maine, FairPoint's continued delivery of all necessary wholesale network services to competitive carriers, and FairPoint's obligations to maximize federal support to keep telephone rates as low as possible."[8]

The CWA/IBEW in the attached brief submitted to the Vermont Public Service Board stated the following.

> Labor Interveners strongly recommend that the Board reject the proposed transaction... FairPoint simply is not a qualified purchaser of Verizon's NNE operations. The deficiencies with FairPoint are too pervasive to be cured through the Board's usual practice of imposing conditions. Conditions cannot make FairPoint financially viable. Conditions cannot give FairPoint the resources necessary to provide reliable service to customers. Conditions cannot fully protect the public against the likely adverse consequences of allowing FairPoint to own and operate Verizon Vermont.
>
> In the event that the Board disagrees, however, Labor Interveners recommend...that the Board adopt several stringent conditions. Labor Interveners would emphasize that these conditions would not make this transaction beneficial to the public, or even ensure that the public is not harmed by the transaction. Rather, even the most stringent conditions would only be an attempt to insulate the public from some of the serious risks posed by the proposed transaction. [9]

The conditions proposed by the Maine Public Advocate, the New Hampshire Consumer Advocate, the staff of the New Hampshire PUC and the CWA/IBEW generally require a reduction of the sales price of Verizon's NNE operations in order to reduce FairPoint's debt, a restructuring of the Transition Services Agreement, fully functional back office systems before cutover, expanded broadband build-out provisions, service quality

[8] Maine Public Advocate, Public Advocate Announces Recommendations to PUC in FairPoint's Proposed Acquisition of Verizon-Maine, October 11, 2007.
[9] Docket No. 7270, Direct Brief of CWA and IBEW" to the Vermont Public Service Board, October 17, 2007, pp. 3-4.

improvements, requirements for Verizon to pay a significant share of capital expenditures, retail and wholesale price restrictions, and adjustments to FairPoint's corporate policies.

These conditions basically would require a restructuring not only of the transaction with Verizon but also of FairPoint's business model as an acquisition firm. For example, the Maine Public Advocate recommends that Verizon lower its price by $600 million. Furthermore, FairPoint's ability to use the NNE operations as a cash cow to fund high dividends and future acquisitions would be circumscribed by limits on dividends and inter-affiliate transactions. For example, the staff of the New Hampshire PUC would prohibit FairPoint from paying any dividends if its leverage ratio is above 5.0 to 1. The CWA/IBEW recommends that dividends be prohibited if FairPoint fails to meet specific service quality standards. These conditions would require FairPoint to change the way it does business. It would no longer be able to function primarily as an acquisition firm that takes on huge amounts of debt and uses its telecommunications subsidiaries as a source of cash to pay high dividends in order to acquire more companies. The conditions and limits proposed would require FairPoint to pay more attention to the needs of its telecommunications operations in relation to capital expenditures, workforce levels and service quality. The conditions also would cost Verizon hundreds of millions of dollars through a reduction in the price it would obtain from the deal and an increase in capital expenditures required to correct problems with its plant.

V. FairPoint's Ostrich Strategy in relation to the Probable Loss of a Significant Number of "Well-trained, highly skilled" Workers

The CWA/IBEW presented the Commission with the results of a survey to which 40% of the union-represented NNE workforce responded.[10] Fifty-six percent of respondents stated that they are seriously considering leaving the company if the proposed transaction is approved while only 7% are considering leaving if the transaction is not approved.

FairPoint's response is that the survey presents "no particular cause for alarm here."[11] FairPoint dismisses the probability that many experienced workers will leave. Yet, 80% of the pension eligible workers surveyed stated that they are seriously considering retirement if the transaction is approved. The magnitude of the response and the comments made in the survey responses concerning FairPoint indicate a strong possibility that many experienced workers will leave if the transaction is approved.

FairPoint's ostrich-like response will not benefit the consumers in Maine, New Hampshire and Vermont if the transaction is approved. While FairPoint has stated its "intention" to hire some additional workers dealing with service quality, the Company has not, to our knowledge, developed any plans to maintain current workforce levels. The public interest would not be well served if FairPoint took over Verizon's operations only to find that it faced a major jobs crisis without adequate plans to rectify the problems in a timely and successful manner.

Finally, FairPoint's statement that its management team "has substantial experience working with organized labor" cannot be left without comment. There are 127 union-represented workers currently employed by FairPoint representing just 13% of its total workforce.[12] FairPoint has indicated that it would acquire 2,800 employees overall – a 294% increase. Of this total, 2,500 would be union represented – a

[10] Letter from Kenneth R. Peres for CWA/IBEW to Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No. 07-22 filed September 7, 2007.
[11] FairPoint October 11, 2007 *Ex Parte*
[12] FairPoint Form 10 K/A filed with the SEC on May 30, 2007 for the period ending December 31, 2006.

2,000 % increase over the current represented workforce. The union represented workforce would balloon from 13% to 70% of the total workforce.

FairPoint has developed some significant problems with the current represented workforce. Don Rahm, the business manager of IBEW Local 236 represents the workers at FairPoint's largest unionized subsidiary, Taconic Telephone. Mr. Rahm stated that labor management relations were fine for three decades. However, this period ended when FairPoint acquired Taconic. Since then negotiations and enforcement of the contract have become "a nightmare on a daily basis." One of the major problems faced by workers is that call center jobs have been shifted from Taconic to out-of-state non-union subsidiaries.

The other problem area concerns FairPoint's campaign against union organizing at its Ellensburg Telephone subsidiary in Washington State. IBEW Local 89 Business Agent Matt Carroll stated that the local's "experience with FairPoint has been anything but positive." The Local had conducted an organizing campaign at the FairPoint subsidiary and had filed a representation petition at the National Labor Relations Board. He called Ellensburg's Human Resources Director, Lisa Llewellyn, to "extend our hand and discuss how we might help contribute to their success."

The next day Lisa informed Matt: "We don't talk to unions." FairPoint then conducted an anti-union campaign that included distributing a question and answer sheet to every worker that included such statements by Llewellyn as "having to deal through a union would place an outsider between management and our employees. This doesn't help communication." Llewellyn also explained that the company "doesn't want a paid outsider trying to interfere in FairPoint Communications dealings with its own employees."

The Commission obviously does not have a role to play in labor-management relations. However, a firm proposing to take over Verizon's entire northern New England service territory should be prepared to manage its union relations constructively in the interests of consumers. FairPoint's relative lack of experience with a large, highly-unionized workforce, its unsatisfactory efforts to date to work with its own unions and the unions representing Verizon workers, and the expressed concerns of Verizon workers with the prospect of FairPoint ownership, all further suggest that FairPoint is not qualified to take over Verizon's Northern New England operations.

Sincerely,

Kenneth R. Peres

Kenneth R. Peres, PhD.
Research Economist
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cc: Daniel Gonzalez
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