# ANAYLSIS OF THE PROPOSED SALE OF VERIZON'S MAINE, NEW HAMPSHIRE & VERMONT PHONE OPERATIONS TO FAIRPOINT

**CWA-IBEW**

**November 8, 2007**

The Chairman of the New Hampshire Public Utility Commission, Getz, provided a statement that identifies the basic regulatory decisions to be made concerning the proposed sale of Verizon's Northern New England (NNE) operations to FairPoint.

> "We have a momentous decision to make here. The record is extensive and the facts and arguments are voluminous and complex. The proposed transaction before us is fundamentally different from the situation the commission faces when a larger company with more resources seeks to acquire a smaller company and it can be relatively assured that there are the financial, technical and managerial capabilities within that new entity to address any outstanding operating concerns or any other issues of risk…
>
> We are left with difficult and interrelated questions. Most apparently, is the proposed transaction, the transfer of control from Verizon to FairPoint in the public interest? That question has at least two aspects. <u>Is it in the public interest for Verizon to discontinue service in New Hampshire and to be relieved of all of its statutory obligations and is it in the public interest for FairPoint to assume control of the Verizon franchise?</u>
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> With respect to FairPoint, we must determine, among other things, whether it has the financial, managerial and technical capabilities to operate as a telecommunications public utility… A related inquiry goes to the question of what does the public interest require of Verizon. For instance, does the public interest and do the facts in this case require that Verizon provide assurances that its successor in interest is in a position to meet all its statutory obligations, and what form would such assurances take. [emphasis added, November 1 statement)

## PART ONE: Public Interest Harms from FairPoint's Assumption and Verizon's Abandonment of its Northern New England Operations

The ratepayers and residents of Verizon's Northern New England (NNE) region will be worse off than they are today if the transaction is approved.

**FairPoint will be weaker financially than Verizon NNE.** While FairPoint argues that somehow this transaction will make it stronger, the issue for Northern New England is how much weaker it will make Verizon's operations.

- Added debt: FairPoint will add $1.7 billion in debt.
- Higher Debt to Equity Ratio. In 2006, the debt to equity was 0.59 for Verizon and 2.70 for FairPoint. However, it was 7.81 for the combined FairPoint-VZ NNE operations.
- FairPoint does not have and does not foresee having a minimum investment grade bond rating.
- FairPoint has not yet obtained funding for nearly half of the purchase price it must pay to Verizon, and it does not have a commitment for that funding. FairPoint also cannot say what the interest rate will be on that debt, or what other terms and conditions might be required for that debt by the underwriters. This is a serious gap in FairPoint's financing, and the Commission should not be misled into glossing over the seriousness of this situation.
- FairPoint's shareholder equity will steadily decline, go negative and then continue to decline by hundreds of millions of dollars – within the next eight years.
- FairPoint will be much less able to raise capital or obtain credit on reasonable terms.

**FairPoint Plans to invest LESS in Northern New England and divert MORE resources out of the region than Verizon.**

- FairPoint's projected capital expenditures through 2015 are consistently $50 million to $60 million per year LESS than Verizon actually spent annually from 2002 through 2006.
- If the terms on FairPoint's new loans are the same as current restrictions then FairPoint would not be able to increase it annual capital expenditures by $50 million – and thus spend the same as Verizon had – it would be in default of its loans because of limits placed by lenders.
- FairPoint's outflow of resources to dividends is much higher than Verizon's. In 2006, Verizon's dividends amounted to 76% of its net income while FairPoint paid out 178%.
- FairPoint plans a cumulative dividend that is 279% greater than its net income through 2015 – specifically, FairPoint would pay out $1.1 billion in dividends but only obtain $290 million in net income – a payout of $4 in dividends for every $1 in net income.
- The outflow of money can also be illustrated by FairPoint's dividend yield of 9%, one of the highest in the industry, compared to Verizon's 3.9%

**FairPoint plans to employ FEWER workers than Verizon**

- Within five years, FairPoint projects that its workforce will be smaller than VZ's NNE workforce is today even though FairPoint has to hire 675 new people to perform functions currently performed by Verizon in states outside NNE.

**FairPoint will have LESS ability to provide safe and reliable service than Verizon**

- FairPoint has had the worst customer complaint rate in Vermont for six out of the last seven years and for the past three years in Maine.
- Verizon's service quality has eroded significantly since 2001 in all three states.
- FairPoint's lower capital expenditures and workforce levels, along with its shaky financial condition will make it less able to provide safe and reliable service than Verizon.

**FairPoint will have LESS ability to provide high speed internet than Verizon.**

- Currently, FairPoint provides slower broadband speeds at a higher price. FairPoint provides DSL with a maximum speed of 1.5 Mbps down and 512 Kbps upstream for $44.95 and 1.5 Mbps down and 1 Mbps up for $79.95. Verizon currently provides DSL with a maximum speed of 3 Mbps down and 768 Kpbs up for $29.99. Verizon's FiOS is provides speeds of 5 to 15 Mbps down and 2 Mbps up for $39.99 and $49.99 respectively.
- FairPoint's broadband plans will be impaired significantly by its weak financial resources.
- FairPoint has not specified any timetable for the provision of DSL in specific locations or identified the specific speeds that will be offered. FairPoint states that its advanced products could reach speeds of up to 20 Mbps – however, this pales in comparison with Verizon's FiOS that can provide speeds of up to 100 Mbps.
- FairPoint's DSL proposal is "anemic" according to Maine PUC Chairman Adams.
- Plans for the provision of competitive video offerings are very vague and speculative.
- FairPoint refuses to make any specific commitment to provide fiber to the home.

**FairPoint's operational capacity is weaker than Verizon.**

- FairPoint will have to replicate the functions provided by 600 proprietary administrative, operational and support systems.
- FairPoint ran into significant problems when it attempted to create and integrate a new billing system. Yet, FairPoint will be confronted with dozens of such systems if the transaction is approved.

- Hawaiian Telcom provides an example of what could go wrong with such transitions.
- Many of Verizon's most experienced workers will leave the company if the transaction is approved – 80% of pension eligible workers stated that they are seriously considering retirement if the deal is approved.

**Higher customer rates**

- FairPoint has only committed to a one year rate freeze.
- FairPoint is seeking immunity from rate reductions that would apply to Verizon in Maine – a reduction that could amount to $32 million.

**Public Interest Harms Overwhelm any Supposed Benefits**

- "The [**Maine] Public Advocate** recommends that the transaction, as proposed, be rejected because the potential adverse impacts lead to a finding that this reorganization is not consistent with the interests of ratepayers…" (Brief of the Maine Public Advocate, November 5, 2007)

- "After nine months of careful review and consideration, the **[Vermont] Department [of Public Service]** on balance has concluded that the transaction as defined by the Joint Petitioners should not be approved by the Vermont Public Service Board." (Brief of the **Vermont Department of Public Service**, October 17, 2007, p. 1).

- "Although serious problems exist with Verizon NH's present operations, acquisition by FairPoint would be yet worse for New Hampshire's consumers. The risks to consumers of FairPoint acquiring Verizon NH's operations are high; the benefits are speculative; the magnitude of the proposed transaction is substantial; the transaction itself would be irreversible; and FairPoint's plans are vague, still evolving, not based on full and complete due diligence and reliant on a highly leveraged capital structure." (Testimony on behalf of the **New Hampshire Consumer Advocate** filed by Susan Baldwin, August 1, 2007, p. 9.)

- Based on our analysis, **Staff [of the New Hampshire Public Utility Commission]** 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." (Supplemental Testimony on behalf of the Staff of the New Hampshire Public Utility Commission by John Antonuk, September 10, 2007 p. 2)

## There are alternatives if the transaction is denied

- If Verizon still wants to sell these assets, then it should have to find a buyer that would actually have the financial resources, operational capacity and experience needed to operate successfully and promote the public interest.
- After all, Verizon chose FairPoint because it could qualify for the Reverse Morris Trust tax loophole and avoid $600 million in taxes.
- If Verizon would continue to own the assets, then it would have to live up to its previous commitments to improve service quality and expand broadband build out. After all, Verizon expanded its FiOS offerings in the Buffalo, Syracuse, and Albany areas after the company failed in its 2004 attempt to sell its upstate New York access lines.

## PART TWO: CONDITIONS TO ACCOMPANY ANY APPROVAL

FairPoint simply is not a qualified purchaser of Verizon's NNE operations. The deficiencies with FairPoint are too pervasive to be cured through the Commission'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's NNE properties.

In the event that the Commission disagrees, however, the CWA and IBEW recommend that the Commission consider several, stringent conditions. However, we emphasize that these conditions would <u>not</u> 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. In our judgment, taken as a whole the conditions would not result in a transaction that promotes the public good. They would only lead to a transaction that is less harmful to the public than the transaction that would exist if the application were granted as proposed by FairPoint and Verizon.

### 1. Expand Broadband Build Out and Video Services

Currently, Verizon does not provide broadband services to approximately 38% or nearly 400,000 of the residential access lines in its NNE service territory. To date, FairPoint's plans to expand broadband have been vague and unremarkable. The Chairman of the Maine PUC stated that FairPoint's broadband plan was "anemic." The staff of the Vermont Department of Public Service stated, "The Department does not believe that FairPoint has made any commitments to materially expand broadband service in Vermont beyond Verizon's present obligations."

Even worse, FairPoint has refused to make any commitment to provide video. This does not bode well for the provision of fiber to the home or fiber to the node or even effective competition with cable in the three states.

The FCC should condition any approval on the following requirements for FairPoint:

- Broadband access will be expanded in the NNE service area according to the following timeline:
  80% of access lines within 2 years
  90% of access lines within 3 years
  100% of access lines within 4 years
- DSL speeds should, at a minimum, be no less and prices no more than what Verizon offered when the sale was announced. Specifically, DSL at 3 Mbps down and 768 Kbps up for $29.99 a month for a year commitment.
- Maintain fiber to the home for all those who currently have access to Verizon's FiOS service.
- Build fiber to the home or fiber to the node to an additional 80,000 households in the region each year. This is what Verizon did in New Hampshire before it decided to abandon its NNE region.
- Offer competitive video services to all DSL and fiber broadband customers within two years.
- Create a special Broadband Infrastructure Fund.

Verizon should be required to provide $600 million to finance the Broadband Infrastructure Fund. This is the same amount of money that Verizon will avoid in taxes on the transaction due to the Reverse Morris Trust tax loophole. Broadband of course costs money and FairPoint's finances are shaky. Furthermore, the deployment of broadband in the region has been retarded by past Verizon decisions.

Initial estimates indicate that $600 million would be enough to provide DSL service to the remaining 400,000 residences currently without such service in the NNE region AND provide fiber to the home to more than 350,000 homes – more than a third of the residential lines in NNE region.

**2. Improve Service Quality**

If the transaction is approved, FairPoint would have to improve not only its own deficient quality of service but also Verizon's. For example, Verizon's service in Maine, New Hampshire and Vermont has eroded from 2001 to 2006 in terms of the duration of it residential out-of-service repair intervals as measured by the FCC in its ARMIS data reports. The Commission should not only continue to monitor FairPoint's performance in this area but also adopt a specific benchmark of an 18 hour out-of-service repair interval - a level that Verizon met in all three states in 2000. As an incentive, FairPoint's dividends to stockholders should be restricted if it fails to meet this benchmark.

### 3. Enforcement and Improved Finances

FairPoint's finances are shaky not only because it is taking on $1.7 billion in additional debt but also because it will take out a lot of cash from the region in the form of dividends. While this policy may make shareholders happy and provide a basis for future acquisitions, it will harm the residents of the NNE region.

The lack of resources is critical because it will undermine FairPoint's ability to build out broadband and improve service quality.  FairPoint's current financial model is at fault. As previously mentioned FairPoint projects that it will pay a cumulative dividend that is 279% greater than its net income through 2015 – specifically, FairPoint would pay out $1.1 billion in dividends but only obtain $290 million in net income – a payout of $4 in dividends for every $1 in net income. FairPoint is taking almost $800 million out of the region.

The Commission should require that FairPoint pay out no more than 76% of its net income in dividends (the same percentage as Verizon paid out in 2006) UNTIL it has met its full build out commitments and its service quality target. Thereafter, the dividend limit would be reinstituted for a full year whenever the annual service quality target is missed.

This condition will ensure that FairPoint obtains the capital needed to fund its broadband and service quality commitments.