STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7599

Joint Petition of Northern New England Telephone Operations LLC, Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications, Enhanced Communications of Northern New England, Inc., and FairPoint Vermont, Inc. (collectively, "FairPoint") for: (1) approval of an indirect acquisition of a controlling interest; (2) approval of a Settlement between the Department of Public Service and FairPoint; (3) approval of the modification of certain Certificates of Public Good issued in Docket 7270; and (4) approval of certain other transactions	)))))))))))	Hearings at Montpelier, Vermont May 10–12, 2010

Order entered: 6/28/2010

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1. On April 28, 2010, Level 3 filed a Motion to Withdraw as a party. The Motion is granted.

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I. Introduction

In this proceeding, the Vermont Public Service Board ("Board") considers a request by Northern New England Telephone Operations LLC, Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications, Enhanced Communications of Northern New England, Inc., and FairPoint Vermont, Inc. (collectively, "FairPoint" or the "Company") for (1) approval under 30 V.S.A. § 107 of the indirect acquisition of a controlling interest by the new owners of FairPoint upon emergence from bankruptcy; (2) approval of a Settlement between the Department of Public Service ("Department" or "DPS") and FairPoint; (3) approval under Section 231 of the modification of certain conditions in the Order and Certificates of Public Good ("CPGs") that we issued in Docket No. 7270; and (4) authorization for FairPoint, under Sections 108 and 232, to pledge the assets of its Vermont properties.

These requests arise from FairPoint's filing for protection under Chapter 11 of the federal Bankruptcy Code in October 2009 and the subsequent development of a Plan of Reorganization. As is well-known, during 2009, FairPoint's financial status deteriorated substantially. Much of this deterioration arose after FairPoint developed significant problems when it put in place new systems to operate its business at the beginning of February 2009, replacing the systems that its predecessor, Verizon New England Inc., d/b/a Verizon Vermont ("Verizon"), had used.[2] FairPoint has now developed a Reorganization Plan that would substantially reduce its debt (from $2.7 billion to $1 billion). As part of that Plan, FairPoint has entered into a Regulatory Settlement with the Department under which broadband expansion commitments would be delayed approximately six months, ratepayers would forego nearly $12 million in penalties for poor service quality during 2008 and 2009, and FairPoint may request use of federal High-Cost Universal Service Funds ("USF") that now provide ratepayers a monthly bill credit of $1.57 toward the normal monthly dial-tone charge of $13.65.

After careful consideration of FairPoint's requests, the Board concludes that FairPoint has not demonstrated that the approvals would promote the general good of the state. Specifically,

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2. The transfer of operations from Verizon's systems to FairPoint's new back-office systems is generally referred to as the "cutover." The systems at issue encompass a wide range of functions, including customer accounts, internal ordering and processing, repair dispatch, and wholesale functions ranging from preordering to maintenance and repair. They also include billing systems.

based upon the record before us, we cannot find that FairPoint has demonstrated the financial capability to meet its obligations under Vermont law and its CPG as a telecommunications carrier.

Under the Reorganization Plan, FairPoint would substantially reduce its debt levels. These reduced debt levels could be expected to materially reduce FairPoint's expenses relative to the levels that the Company faced prior to bankruptcy and represent a major benefit of the Plan. FairPoint has presented financial projections that indicate the Company can meet its obligations under the new debt agreements and substantially improve its financial performance. These projections, however, are based upon the assumption that FairPoint's losses in local revenue due to competition will be less than the Company has experienced recently, that it can increase revenues from broadband services and special access services faster than it has recently, and that operating costs will trend downwards relative to recent experience. FairPoint has not demonstrated that these assumptions are reasonable. If we assume that the recent past is a reasonable indicator of trends in the telecommunications industry, rather than accept projections that assume substantial improvement on that past, FairPoint's projections suggest that the Company may not be able to meet its debt covenants as early as 2011.[3]

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3. Exh. Board-2. Following hearings the Board requested that FairPoint provide some additional model runs that incorporated assumptions that the future looked more like the recent past as opposed to the assumptions that FairPoint used. We also provided other parties an opportunity to submit additional analyses or comments based upon FairPoint's filings. The Board stated that it intended to incorporate this material, and an updated analysis that we requested the Department to supply, into the record and provided parties an opportunity to comment or object; no comments upon or objections to the admission of the additional material were received. FairPoint submitted its additional analyses on June 2, June 7, and June 21. The Board will admit these documents as exhibits Board-1, Board-2, and Board-3, respectively. The Department submitted its analysis on June 10. It is admitted as exhibit Board-4.

FairPoint and the Department filed these four exhibits as confidential information; they subsequently provided redacted versions. FairPoint requested that the Board keep the information confidential. The information submitted by FairPoint and the Department is similar to other financial analyses that the Board has treated as confidential and is covered by our April 2, 2010, Order granting confidential treatment to prefiled testimony and exhibits. Since we are admitting the additional analyses into the record, we find good cause to extend that Order to apply to the unredacted version of these exhibits.

The Board also notified parties on June 24, 2010, that it intended to admit FairPoint's 2009 10-K and first quarter 2010 10-Q as exhibits. The Board provided parties an opportunity to object, which no party did. These documents are admitted as exhibits Board-5 and Board-6, respectively.

These analyses raise the same concerns that caused us to reject FairPoint's original petition seeking approval to acquire Verizon's northern New England service territories. At that time, the Board found that FairPoint had not demonstrated that its assumption of 6% access line losses was reasonable; after incorporating a 10% figure, the Board found that FairPoint might fail its covenants, leading to the conclusion that FairPoint had not demonstrated financial soundness. Experience proved that even the alternative, 10%, figure was conservative. We approved a revised transaction only after FairPoint restructured its arrangement in a way that effectively reduced its debt obligations.

We have the same concern here. We understand that the risk of financial failure rests most directly upon the new owners of FairPoint (the previous bank debt holders and their successors). However, the possibility of future financial difficulties affect Vermont ratepayers in several ways. First, as part of the Regulatory Settlement, ratepayers are asked to forego a substantial refund that they are owed by FairPoint for the substandard service quality they have received since cutover. Second, a major benefit that FairPoint promised as part of its acquisition and continues to put forward here is the expansion of broadband services in Vermont, both through serving new areas and by increasing bandwidth. If FairPoint faces financial difficulties, its ability to fulfill these commitments may be diminished. Moreover, under the Reorganization Plan, broadband expansion in some presently unserved areas would be delayed by six months (and for some customers, longer). Ratepayers should not be asked to accept these concessions if FairPoint has not demonstrated that it can prosper, that it can provide service quality consistent with its commitments in Docket No. 7270, and that it will not face more financial stress in the next several years.

It is, therefore, in the best interest of both ratepayers to ensure that FairPoint emerge from bankruptcy protection on a firm financial footing. We are convinced that it is also in the best interest of FairPoint and its new owners. FairPoint faces competition from a variety of sources including cable and wireless carriers. To compete, FairPoint will need to have the resources to expand broadband availability and bandwidth, roll out new products and bundles, and offer high-quality service. A FairPoint that may be close to defaulting on its debt covenants may be constrained in its ability to meet these obligations.

FairPoint has made significant strides towards fixing its systems. Its retail service quality is nearing the point where it would fully comply with the service quality standards that govern it — an accomplishment that Verizon was unable (or unwilling) to achieve. Wholesale service quality still lags well behind pre-cutover performance substantially, but is improving. FairPoint has also deployed its new VantagePoint network, under which it will offer higher broadband speeds. These trends offer the prospect that FairPoint can meet the expectations for quality service we had when we approved its acquisition of Verizon's wireline business.

Financial difficulties could imperil these benefits. FairPoint bears the burden of demonstrating either that its assumptions are reasonable or that it will be financially sound over a range of reasonable assumptions. It has not done so. FairPoint has provided virtually no explanation as to why its projections are reasonable. In fact, FairPoint's testimony and exhibits do not even specifically reference the assumptions that it employed in developing its financial models – only the Department's testimony filed just before hearings laid out this information. FairPoint also has not demonstrated why its assumptions, which vary materially from past performance, should be considered reasonable – we have only generalized assertions that the Company expects to reduce operating costs, increase sales of other services, and reduce the declines in local service revenues. For these reasons, we conclude that FairPoint has not demonstrated that approval of the transactions would promote the general good.

Although we cannot grant the approvals based upon the evidence before us, we would welcome a new proposal that addresses our concerns. FairPoint could restructure its financial arrangements to reduce its debt obligations such that it can meet its debt covenants over a range of reasonable scenarios. In defining the range of reasonable scenarios, FairPoint must provide justification for its projections. The Board is prepared to consider a renewed request from FairPoint expeditiously.

II. BACKGROUND

A. Events Leading to Petition

In 2007, Verizon and FairPoint entered into an arrangement under which FairPoint would acquire Verizon's wireline telecommunications assets in Northern New England. These entities

then sought approval from the Board in Vermont, as well as from the utility regulation commissions in Maine and New Hampshire. After hearings on the proposed acquisition in the fall of 2007, the Board issued an order in December 2007 denying the request and concluding that the proposed transaction would not promote the general good of the state. In large part, the Board was concerned that the proposed acquisition led to FairPoint taking on too much debt, approximately $2.7 billion. In addition, the Board was concerned that FairPoint's financial modeling relied upon relatively optimistic assumptions; incorporation of more reasonable assumptions into FairPoint's models suggested that FairPoint would be unlikely to meet its debt obligations.

FairPoint and Verizon then revised their proposal, submitting a modified agreement that had the effect of lowering FairPoint's debt load by approximately $300 million, more than 10%. FairPoint had also entered into a Memorandum of Understanding with the Department, under which the Department supported the proposed acquisition and FairPoint agreed to additional conditions related to service quality, broadband build-out, and financial capability.

The Board held additional hearings on the modified petition. On February 15, 2008, the Board issued an order approving the modified petition. The Board found that the revised proposal had several enhancements designed to address the Board's previous concerns about FairPoint's financial capability. The primary enhancement was the effective reduction of the debt load, which occurred through Verizon's agreement to contribute $247.5 million in additional working capital. In addition, the revised transaction had other conditions designed to provide FairPoint with more cash. The Board noted that, notwithstanding the modified financial arrangements, FairPoint still faced risks from the loss of telephone lines to competitors that could undermine its ability to meet its financial obligations.[4] The Board also adopted a number of conditions that applied to the transfer, addressing issues such as financial capability, service quality, broadband build-out, and ensuring that FairPoint met its obligations to maintain a fair competitive environment.[5]

FairPoint closed the transaction on March 31, 2008. Since that time, FairPoint experienced operational and financial difficulties. Some of these pressures arose from

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4. *See*, Docket No. 7270, Order of 2/15/10 at 4–6, 10–20.
5. Docket No. 7270, Order of 2/15/10 at 39–56.

competition by cellular and cable companies. The world-wide instability of financial markets also harmed FairPoint, leading to higher cost debt than anticipated,[6] and making it more difficult to deal with the financial difficulties FairPoint faced refinancing debt or obtaining additional investment.[7] But a significant part of FairPoint's financial difficulties arose after the cutover from Verizon's systems to FairPoint's newly designed systems at the end of January 2009. Following the cutover to these new systems, which were developed by Capgemini U.S. LLC ("Capgemini"), FairPoint experienced significant difficulties in a number of areas, including ordering, billing, repair, and wholesale services. These difficulties were severe enough to trigger the maximum amount of penalties under the Amended Retail Service Quality Plan ("RSQP"). It also led to penalties under the Performance Assurance Plan ("PAP")[8] that were more than an order of magnitude higher than the penalty amounts typical for Verizon and, prior to cutover, FairPoint. The performance difficulties also helped competitors gain customers, to FairPoint's detriment. Significantly, the performance problems led to large increases in operating expenses as FairPoint attempted to resolve the problems, through the hiring of additional personnel, employment of more consultants to identify system problems and remedies, and through continuation of Capgemini's work on developing FairPoint's new systems.[9]

The severity of the service quality and billing issues prompted the Department to file a petition, on July 14, 2009, requesting an investigation and an order requiring FairPoint to show cause why its CPG should not be revoked. The Board opened Docket No. 7540 to consider the Department's request, held a prehearing conference in that proceeding, and established a schedule.[10]

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6. *See*, Docket No. 7270, Order of 3/31/08.

7. [Giammarino] Hood pf. at 7. FairPoint originally filed prefiled testimony from Alfred C. Giammarino. Mr. Giammarino subsequently left the Company. His testimony was adopted by other FairPoint witnesses. In this Order, we cite to the testimony of Mr. Giammarino in brackets and include the name of the FairPoint witness who adopted the cited portion of Mr. Giammarino's prefiled testimony.

8. The PAP and the Carrier-to-Carrier ("C2C") metrics measure the adequacy of the wholesale services that FairPoint provides to its competitors. The PAP provides for payments to competitors and, in some cases, the Vermont Universal Service Fund, if FairPoint does not provide service that meets the standards.

9. Tr. 5/10/10 at 113–114 (Allen).

10. Docket No. 7540 was stayed at the request of FairPoint and the Department following the bankruptcy filing.

The pressures from the financial markets and the cutover problems created financial strain for FairPoint. Despite efforts to expand service offerings and restructure debt, on October 26, 2009, FairPoint filed for protection under Chapter 11 of the Bankruptcy Code. Subsequent negotiations with creditors resulted in the development of a Plan of Reorganization, under which new owners will acquire controlling interest in FairPoint. FairPoint also negotiated the Regulatory Settlement with the Department. Approval of the Regulatory Settlement and corresponding regulatory settlements in Maine and New Hampshire are conditions precedent to the effectiveness of the Plan of Reorganization.[11]

B. Procedural History of This Proceeding

FairPoint initiated this proceeding by filing its petition on February 19, 2010, seeking: (1) approval of an indirect acquisition of a controlling interest in FairPoint by unspecified new owners; (2) approval of a Settlement between the Department and FairPoint; (3) approval of the modification of certain CPGs issued in Docket No. 7270; and (4) approval of certain other transactions. FairPoint amended its Petition on February 24, 2010, to further explain the events that caused the Company to experience financial difficulties and ultimately require the bankruptcy filing. The petition before us seeks approval under several provisions of Title 30 of the Vermont Statutes Annotated, but in essence, FairPoint seeks approval of its Chapter 11 restructuring plan and the Regulatory Settlement with the Department.

We convened a prehearing conference on March 4, 2010, at which time we established a schedule for this proceeding. At the prehearing conference, the Board granted intervention requests, on a permissive basis, from National Mobile Communications, d/b/a Sovernet Communications ("Sovernet"), One Communications ("One Comm") and a group of Vermont electric distribution utilities.[12] The Board subsequently granted, also on a permissive basis,

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11. FairPoint Brief at 7; exh FP-6.

12. The distribution utilities are: Vermont Electric Cooperative, Inc.; Central Vermont Public Service Corporation; Green Mountain Power Corporation; Barton Village, Inc. Electric Department; Village of Enosburg Falls Water & Light Department; Town of Hardwick Electric Department; Village of Hyde Park Electric Department; Village of Jacksonville Electric Company; Village of Lyndonville Electric Department; Village of Morrisville Water & Light Department; Town of Readsboro Electric Department; Swanton Village, Inc. Electric

(continued...)

intervention requests from Comcast Phone of Vermont, LLC ("Comcast"), the City of Burlington Electric Department, Level 3 Communications, LLC ("Level 3"), segTEL, Inc. ("segTEL"), and the Communications Workers of America and International Brotherhood of Electric Workers System Council.[13]

The schedule we adopted at the prehearing conference was extremely condensed, particularly given the complexity and significance of the issues raised by FairPoint's petition. FairPoint and the Department both advocated a schedule that called for a final Board decision by June 24, 2010. The Regulatory Settlement stated that it was voidable if the Board had not acted by that date. This left less than four months to complete the investigation; by comparison, the schedule for Docket No. 7270 in which we considered FairPoint's acquisition of the Verizon wireline business extended for nearly a year and still necessitated follow-on hearings after our original rejection of FairPoint's petition. The short period was made more difficult by the absence of sufficiently detailed testimony presented on many issues and the fact that the Department's analysis was not scheduled to be filed until very late in the process. The Board sought to address the shortage of information by requesting additional testimony on a large number of matters, but we were still forced to take the unusual step of requesting additional evidence after hearings.

The Board held a workshop on March 31, 2010, to examine issues related to the process before the Bankruptcy Court. On the same day, the Board conducted a public hearing using the Vermont Interactive Television network. No members of the public spoke.

The Board convened evidentiary hearings on May 10–12, 2010. Parties filed proposed findings and briefs on May 24, 2010.

Also on May 24, FairPoint filed an amended petition and a Motion to Amend the Petition to Conform to the Evidence.

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12. (...continued)
Department; and Town of Stowe Electric Department.

13. Level 3 later withdrew as a party.

C. FairPoint Motion to Conform Pleadings to Evidence

FairPoint's original petition sought approval for the acquisition of a controlling interest, since the previous owners of FairPoint will be replaced by the new owners (i.e., the previous debt holders and their successors in interest). FairPoint's petition did not specify any particular entity that it asserted would own more than 10% of the Company's securities (the threshold under 30 V.S.A. § 107). Just before hearings, FairPoint filed testimony that identified Silver Oak Capital, LLC ("Silver Oak") as an entity that was expected to hold more than 10% of the reorganized FairPoint's common stock. During hearings, FairPoint offered supplemental live testimony that presented information on Silver Oak.

On May 24, 2010, FairPoint filed its Motion to Amend the Petition as well as the amended petition. FairPoint asserts that the amendment is permissible under Board Rule 2.204(G)(1) and Rule 15(b) of the Vermont Rules of Civil Procedure. The latter rule allows amendments to conform to the evidence and states:

> When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues.

No party responded to FairPoint's Motion.

Board Rule 2.204(G)(1) states as follows:

> Proposed amendments to any filing may be made at any time. If unobjected to by any party within ten days of filing or at the commencement of any hearing in which the amended matter is at issue, whichever is earlier, such amendments shall be deemed effective, except that the Board may at any time dismiss any proposed amendments which it finds to have the effect of unreasonably delaying any proceeding or unreasonably adversely affecting the rights of any party.

In this proceeding, no party objected to FairPoint's motion; the ten-day period specified in the rule has elapsed, with no objection from other parties. Moreover, we do not conclude that FairPoint's

proposed amendment would unreasonably delay the proceeding or adversely affect the rights of any party. Accordingly, we will grant FairPoint's motion.[14]

III. Positions of the Parties

A. FairPoint

FairPoint asks that the Board grant the requested regulatory approvals without "additional conditions that could jeopardize approval of FairPoint's Plan of Reorganization."[15] FairPoint argues that its petition presents a relatively simple choice. According to FairPoint, the Regulatory Settlement preserves essentially all of the regulatory conditions that the Board adopted in Docket No. 7270, allows FairPoint to shed $1.7 billion in debt, and represents a reasonable resolution of the issues arising from FairPoint's Chapter 11 filing.[16] Moreover, FairPoint stresses that approval of the Regulatory Settlement is necessary to enable FairPoint to emerge from bankruptcy quickly and is thus in the interests of consumers in Vermont. The alternative to approval, argues FairPoint, is the substantial risk that the bankruptcy proceeding would be prolonged and that the "litigated result in the U. S. Bankruptcy Court may not be as favorable to consumer interest as that presented in the Regulatory Settlement."[17]

As to the service-affecting issues that have arisen since FairPoint acquired Verizon's wireline service on March 31, 2008, FairPoint maintains that it "has made significant strides through management changes and short, intermediate and long term process and systems initiatives to correct post-cutover issues and return customers to stable and acceptable service levels."[18] FairPoint submits that with continued progress, FairPoint can return to and sustain

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14. It is not clear, however, that we could grant FairPoint's Motion under Rule 15(b). Other than the simple mention of Silver Oak in rebuttal testimony filed just before hearings, FairPoint's testimony contains no information on Silver Oak. The only evidence introduced was through redirect of a witness on issues not raised by any party. It is not clear that the parties actually litigated issues related to Silver Oak. Moreover, allowing parties to try new issues in live redirect testimony undermines the Board's practice which depends heavily on parties prefiling testimony. We do not need to reach this issue as we find valid grounds for granting the motion under Rule 2.204(G)(1).

15. FairPoint Brief at 1.

16. FairPoint Brief at 8.

17. FairPoint Brief at 9.

18. FairPoint Brief at 3.

acceptable service levels. The Reorganization Plan, asserts FairPoint, will result in a company that is stable and able to meet its commitments.

B. Department

The Department recommends granting the approval FairPoint seeks. The Department observes that, over the last six months, FairPoint's service quality has improved greatly, although it still falls short of acceptable levels.[19] The Department asserts that FairPoint "remains committed to remediating the service quality and systems issues that still remain;"[20] the Department expects that FairPoint will ultimately succeed in delivering high-quality and new services to its customers. However, the Department argues that FairPoint cannot succeed until it emerges from bankruptcy.

On specific issues, the Department remains concerned about the retail service quality that FairPoint is providing. The Department, therefore, proposes a series of conditions that it recommends the Board adopt to ensure that service quality and customer service will reach an acceptable level. The Department concludes that FairPoint will be financially sound. This conclusion is based upon the Department's assessment of FairPoint's financial analysis and FairPoint's subsequent agreement to develop and use a Business Plan.

The Department also supports adoption of the Regulatory Settlement. It asserts that the broadband build-out obligations from Docket No. 7270 remain "essentially" unchanged, even though FairPoint is not required to complete the build-out for six months longer than under FairPoint's existing CPG (or more for some customers). As to the reduction in service-quality penalties for 2008 and 2009, the Department argues that a restoration of acceptable customer service is more important to FairPoint's customers than what it characterizes as a small refund of RSQRP penalties. Similarly, the Department concludes that allowing FairPoint to use federal

19. DPS Brief at 16.
20. DPS Brief at 16.

High Cost Universal Service funds for three years to upgrade infrastructure would provide a greater benefit than the present credit on customer's bills.[21]

C. Sovernet

Sovernet argues that to find that the proposed reorganization promotes the public good, the Board must impose a number of conditions on the transaction. These include extending interconnection agreements, preserving and reaffirming the existing PAP and C2C standards, auditing those mechanisms, imposing a limit on backbilling, and requiring that the Board continue the role of the independent monitor.[22] Sovernet submits that FairPoint has had significant systems and process problems since the cutover; these problems have been so significant that competitive local exchange carriers ("CLECs") have not received the benefit of the pro-competitive conditions the Board imposed in Docket No. 7270. In addition, Sovernet maintains that it and other CLECs have had to devote additional time and resources to issues arising from FairPoint's problems, which has added costs to those companies.

Sovernet also asserts that the performance issues make it essential that the Board continue and affirm the existing wholesale service quality standards (the PAP and C2C metrics). According to Sovernet, this includes affirming the penalty amounts at issue and denying FairPoint's request for relief in Docket No. 7539 (in which FairPoint seeks a reduction in the PAP maximum penalties).

D. One Comm

One Comm contends that the Board should consider the question of whether the reorganized FairPoint can perform at the levels that the Board anticipated at the time it approved the acquisition. One Comm argues that the evidence suggests that FairPoint is not providing

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21. DPS Brief at 13–15. The monthly local service rate for residential customers is presently $13.65. At this time, the USF provides a credit of $1.57 monthly.

22. In Docket No. 7270, at the recommendation of the Department and with the agreement of FairPoint, the Board directed FairPoint to hire an independent monitor to oversee the transition from Verizon to FairPoint, including to the new FairPoint back-office systems. The Department, working with the other northern New England states, hired Liberty Consulting to serve that function. Liberty continues to work on the issues that arose following cutover.

adequate service to its competitors, and that its reporting may not accurately reflect the actual performance or comply with existing legal requirements. As a result, One Comm asks that the Board require an independent audit of the PAP and C2C metrics, including the reporting methods and penalty calculations.

One Comm also echoes Sovernet's concern that wholesale carriers did not receive the full benefit of the conditions the Board adopted in Docket No. 7270 related to interconnection arrangements. To remedy this, One Comm asks the Board to further extend the three-year stand-still conditions we had adopted for an additional three years beyond their current expiration date.

Finally, One Comm asserts that because FairPoint's systems still do not function properly, the Board should continue to require that the Department employ the independent monitor.

E. segTEL

segTEL argues that FairPoint has not provided parity between wholesale and retail service quality, which segTEL maintains is required by federal law. segTEL contends that FairPoint's systems are not providing adequate service to CLECs; segTEL asserts that nothing in the Regulatory Settlement will assure that these disparities will be addressed. Overall, segTEL contends that, without appropriate conditions, FairPoint "will likely continue to offer a competitive carrier products and services in a discriminatory and anti-competitive manner."[23] Therefore, segTEL recommends that the Board deny FairPoint's request for approval of the Regulatory Settlement until it addresses the concerns of wholesale customers. In the alternative, segTEL requests that the Board adopt several conditions to "mitigate and reverse" the present wholesale performance.

F. Comcast

Comcast argues that, to mitigate the potentially disruptive impact of the proposed transaction on FairPoint's wholesale customers and competitors, the Board should require FairPoint to continue to comply with conditions in FairPoint's existing CPG that relate to competition. Comcast argues that these conditions promote the stability of the competitive

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23. segTEL Brief at 3.

framework and that the Board has already determined they are necessary for the public good. Further, Comcast contends that neither the Department nor FairPoint have requested modification of any of these conditions.

IV. Legal Standard

A. Standard of Review

FairPoint's proposed Reorganization Plan requires Board approval under several different sections of Vermont law. The Reorganization requires approval under Section 107, which requires advance approval for any company that acquires a "controlling interest in any company subject to the jurisdiction of the public service board."[24] In addition, FairPoint and the Department request modification of FairPoint's existing CPG; the Board issued this CPG on February 15, 2008, as part of our approval of FairPoint's acquisition of Verizon's wireline telecommunications operations in Vermont. The Board issued this CPG under Section 231 of Title 30. FairPoint also seeks approval under Sections 108 and 232 for a pledge of the membership assets of Telephone Operating Company of Vermont LLC by Northern New England Telephone Operations LLC.

Each of these statutory sections has different specific requirements, but all essentially require the Board to determine whether the proposed transaction would promote the public good of the state.[25] In seeking to determine whether a particular proposal is consistent with the general good, the Board has examined fifteen criteria.[26]

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24. Section 107 provides as follows:

> (a) No company shall directly or indirectly acquire a controlling interest in any company subject to the jurisdiction of the public service board, or in any company which, directly or indirectly has a controlling interest in such a company, without the approval of the public service board. Nothing in this section shall be deemed to affect the direct or indirect acquisition of a controlling interest in a company as defined in subdivision 501(3) of this title. The direct acquisition of the voting securities of a company defined in subdivision 501(3) shall continue to be regulated pursuant to section 515 of this title.

25. *See* 30 V.S.A. §§ 107(b), (c)(4)("promote the public good"), 109 ("promote the general good of the state").

26. Docket No. 7213, Order of 3/26/07 at 10. The fifteen criteria are:
    1. Legal authority for the transaction from the Federal Communications Commission;
    2. Availability of emergency services;
    3. Compatibility with neighboring systems;

(continued...)

In Docket No. 7270, we concluded that the appropriate review structure would focus on six major categories. We employ the same basic framework here. However, we do not need to consider one of those categories here — the manner in which the transition from the old company to the new company will be handled — since no such transition will occur.[27] Under the proposal, FairPoint's management, personnel, plant, and systems are expected to be unaffected by the restructuring. The scope of our review in this Order thus focuses on the remaining five categories from the Docket No. 7270 framework.

1. Whether the new company is competent. This includes examining whether:
    a. the new company's management is competent;
    b. the new company is technically competent;
    c. the new company has a good business reputation; and
    d. the new company has obtained all necessary regulatory approvals.
2. Whether the new company is financially sound.
3. Whether the new company will act as a fair partner in business transactions with the citizens of Vermont. This includes examining whether:
    a. terms and conditions of service will be fair and reasonable;

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26. (...continued)

4. Terms and conditions of service would be just and reasonable;
5. Service quality;
6. Customer Service;
7. Quality of the facilities;
8. Rate of capital investment;
9. Financial stability and soundness;
10. Control of affiliate interests;
11. Competence of management;
12. Technical knowledge, experience and ability;
13. Business reputation;
14. Transaction should produce efficiencies;
15. Transition should not impair competition.

Docket 5900, *Joint Petition of New England Telephone & Telegraph Company d/b/a NYNEX, NYNEX Corporation, and Bell Atlantic Corporation for approval of a merger of a wholly-owned subsidiary of Bell Atlantic Corporation into NYNEX Corporation*, Order dated 2/26/97 at 8–9.

27. Obviously, FairPoint has had significant issues arising from its acquisition of Verizon and subsequent cutover to its own systems. We have carefully considered FairPoint's past and continuing efforts to remedy the deficiencies that have occurred and factored it into our assessment.

b. service quality will be adequate;

c. customer services will be adequate;

d. emergency services will be adequate;

e. investment will be adequate; and

f. the company has complied and can be expected to comply with Vermont law, including conditions in its CPG, and fulfill its commitments to the state.

4. Whether the new company will create new benefits for the state.[28] This includes examining whether the proposal will:

a. provide a better, stronger, more capable or more ubiquitous network;

b. produce efficiencies in operation; and

c. provide economic benefits to the state economy or other benefits.

5. Whether the transaction will impair or obstruct competition.[29]

In its brief, FairPoint asserts that, in the context of a bankruptcy reorganization, the Board's scope of review is "somewhat unique" in that the choice presented is between a company operating under the uncertainty of Chapter 11 bankruptcy and the same company ready to emerge from bankruptcy under what it characterizes as a reasonable plan of reorganization. FairPoint asserts that in this context, the Board should focus on the more narrow question of whether the plan is viable and in the public good and whether customers will see negative changes as a result of approval.[30] FairPoint contends that the appropriate scope of review in this proceeding encompasses whether the Company has demonstrated financial soundness and whether the company has the ability to continue to provide and improve services to its retail customers.[31]

In general, we agree with FairPoint that the primary focus is upon financial soundness and the services that FairPoint will be providing its customers, both retail and wholesale. In fact, all

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28. Our analysis of these issues is not broken out separately, but rather is merged with our discussion of other issues.

29. Joint Petition of Green Mountain Power Corporation, Northern New England Energy Corporation, a subsidiary of Gaz Metro of Quebec, and Northstar's Merger Subsidiary Corporation for approval of a merger, Docket No. 7213, Order of 3/26/07 at 9–10; Joint Petition of Bell Atlantic Corp. and GTE Corp. for approval of Agreement and Plan of Merger, Docket No. 6150, Order of 9/13/99 at 48–49.

30. FairPoint Brief at 11–12.

31. FairPoint Brief at 14.

of the criteria the Board has developed in the past are directed at these basic questions. However, we do not consider the choice to be as simple as FairPoint suggests: either a company that is still in bankruptcy or one that has emerged from bankruptcy. The stability provided by successful emergence from bankruptcy is only desirable if it results in a company that is financially and technically capable of fulfilling its obligations and committed to do so. Furthermore, the narrow focus on the restructured as opposed to non-restructured company urged by FairPoint is a short-term comparison; even if the present Reorganization Plan is not approved, FairPoint is not likely to remain in bankruptcy for a protracted period of time. Instead, FairPoint, its creditors, the Bankruptcy Court, and the state commissions will either develop a revised plan of reorganization or decide to liquidate the Company. Our evaluation looks to the benefits to Vermont over a period of time, not simply in the short term and we do not adopt FairPoint's characterization of the choice. In this proceeding, we are considering a company that has recently had serious performance problems, whose management had difficulties addressing these issues, and whose new owners have chosen to retain the present management structure. These considerations, and the fact that the Regulatory Settlement requires Vermont consumers to forego or delay service quality compensation and broadband deployment that they had a right to expect, requires us to assess whether the new owners have in place an organization that is capable of effectively operating the company once it emerges from bankruptcy.

V. FINDINGS AND DISCUSSION

A. The Proposed Transaction

1. Findings

1. FairPoint acquired, through a merger transaction, the northern New England wireline operations of Verizon New England Inc. ("Verizon") in March 2008 (the "Merger"), which transaction was approved by the Board in Docket No. 7270. Docket No. 7270, Orders of 2/15/08 and 3/31/08.

2. Subsequent to its acquisition of the northern New England wireline telecommunications operations from Verizon in 2008, FairPoint's financial performance deteriorated. A significant contributor to FairPoint's financial performance was the cutover of systems from Verizon to

FairPoint, which adversely affected FairPoint's ability to adequately fulfill many aspects of its service, including ordering, billing, repair service, and provision of services to competitors. [Giammarino] Hood pf. at 7–9.

3. The cutover issues forced FairPoint to incur increased costs to address them. They also prompted a larger loss of customers than FairPoint had anticipated. [Giammarino] Hood pf. at 9.

4. FairPoint also faced financial pressures arising from the high, approximately $2.7 billion, debt load it took on to acquire the northern New England properties, and the turmoil in the financial markets. [Giammarino] Hood pf. at 7–9.

5. Ultimately, these financial pressures led to FairPoint being unable to service the approximately $2.7 billion in debt obligations that it undertook as part of the acquisition. [Giammarino] Hood pf. at 7.

6. For the first nine months of 2009, FairPoint's consolidated revenues totaled $879.5 million and it incurred a net loss of $103.9 million. [Giammarino] Hood pf. at 9.

(a) The Proposed Reorganization Plan of FairPoint

7. As of the petition date, FairPoint had approximately $2.7 billion of total funded debt outstanding, including approximately $2.1 billion of Prepetition Credit Agreement claims (consisting of approximately $2.0 billion owed under the Credit Facility and approximately $99 million owed under interest-rate-swap agreements), and approximately $575 million in senior unsecured notes, including accrued interest. [Giammarino] Hood pf. at 27.

8. Under the pre-petition debt structure, FairPoint estimates it would have incurred more than $200 million in interest costs during 2009, of which $165 million was incurred during the first nine months of that year. The Company is not paying any debt-service costs during the pendency of the Chapter 11 cases. [Giammarino] Hood pf. at 27.

9. FairPoint has developed a Chapter 11 Reorganization Plan (as amended, the "Plan") that was filed with the Bankruptcy Court on February 8, 2010, and amended on February 11, 2010. [Giammarino] Hood pf. at 22–23; *see* exhs. FP-1, FP-2, FP-3, FP-6, FP-7, FP-8, and FP-10.[32]

10. The Plan would result in a capital structure for the Company that is expected to significantly strengthen its financial condition and liquidity by permitting it to shed a significant amount of debt. [Giammarino] Hood pf. at 23.

11. FairPoint's reorganization is premised upon effecting a substantial deleveraging and strengthening of the balance sheet through the conversion of a substantial portion of FairPoint's pre-petition indebtedness into "New Common Stock," as defined in the Plan. [Giammarino] Hood pf. at 32.

12. Under the Plan, when FairPoint emerges from Chapter 11, its total debt will be reduced by approximately 63% (from $2.7 billion to $1 billion), thereby providing FairPoint with a substantial improvement in financial strength and flexibility. [Giammarino] Hood pf. at 23, 32.

13. With the balance sheet restructured and its debt-service costs reduced, the Company expects to be able to focus its efforts on customers, employees and strategic growth plans, thus enabling it to maintain and improve its position as a provider of voice and data communications services. [Giammarino] Hood pf. at 24.

14. Under the Plan, FairPoint's creditors (and their successors) will become the new owners of the Company. Each secured creditor will receive its pro rata share of 90% of the common stock; unsecured creditors will receive most of the remainder of the common stock. [Giammarino] Hood pf. at 24; exh. FP-6 at § 5.4.

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32. The First Amended Joint Plan of Reorganization, the Amended Disclosure Statement for the Debtors' First Amended Joint Plan of Reorganization, both dated February 11, 2010, and the Plan Supplement, were appended to the Amended Petition filed on February 24, 2010. The Petitioners have subsequently updated the record in the proceeding as follows:

> The Debtors' Second Amended Joint Plan of Reorganization and Debtors' Second Amended Disclosure Statement, both dated March 10, 2010; the Plan Supplement to Debtors' Plan of Reorganization, dated April 23, 2010; and the First Supplement to the Plan of Reorganization, the Modified Credit Agreement (Item 7 to the Plan Supplement), and the Debtors' Modified Second Amended Plan of Reorganization, are respectively Exhibits FP-1, FP-2, FP-3, FP-6, FP-7, FP-8 and FP-10.

15. Secured creditors will also receive a pro rata share of new term loans in the aggregate principal amount of $1 billion and a pro rata share of cash in an amount equal to all cash of FairPoint on the effective date in excess of $40 million after taking into account all cash payments required to be made or reserved under the Plan on the effective date. [Giammarino] Hood pf. at 24; exh. FP-6 at § 5.4.

16. A portion of the new common stock will be reserved for issuance pursuant to a Long-Term Incentive Plan. [Giammarino] Hood pf. at 25.

17. Certain other claims, as defined by the Reorganization Plan, are unimpaired and will receive 100% recovery on their allowed claims. [Giammarino] Hood pf. at 25–26.

18. The remaining claims and interests, which comprise those of the Class 9 Subordinated Securities Claims and Class 11 Equity Interests (FairPoint stock outstanding as of the bankruptcy filing) are fully impaired under the Plan and will receive no distributions at all. [Giammarino] Hood pf. at 26.

19. The pre-petition FairPoint stock will be cancelled under the plan. [Giammarino] Hood pf. at 26.

20. The reorganized FairPoint will have up to a nine-person board of directors. Initially, up to seven of the new board members will be nominated by the Lender Steering Committee, with residents of Maine, New Hampshire and Vermont among the candidates. [Giammarino] Hood pf. at 27.

(b) Chapter 11 Plan Supplement

21. On April 23, 2010, FairPoint filed its Chapter 11 Plan Supplement with the Bankruptcy Court. Hood reb. pf. at 7.

22. Under the Plan Supplement, FairPoint will not reject any wholesale agreements with competitive local exchange carriers, e.g., Section 252 interconnection agreements, wholesale tariffs, "commercial agreements" such as Wholesale Advantage Agreements or VISTA Agreements, or settlement agreements related to its acquisition of Verizon's assets in Docket No. 7270. This does not necessarily mean that FairPoint has approved any or all claims based on those agreements. FairPoint also reserves the right to terminate and/or renegotiate those

agreements in accordance with the terms of those agreements, as amended or as modified by other applicable agreements. Hood reb. pf. at 7.

23. FairPoint also could reject one or more of those agreements if it is unable to reach agreement on a "cure" amount to resolve outstanding claims. Tr. 5/10/10 at 25–31, 79–83 (Hood).

24. The Plan Supplement provides that the Success Bonus Plan for participating FairPoint management will be based on the attainment of certain performance measures, as determined by the Compensation Committee of the board of directors, weighted as follows:

> I. 67% for Cumulative EBITDAR,[33] and
>
> ii. 11% for each of "Calls Answered within 20 Seconds;" "Monthly Average of Installation Appointments Not Met for Company Reasons;" and "Monthly Average of Repair Appointments met on time."

Id. at 8–9.

25. The "New Term Loan Agreement" and the "New Revolving Facility" (collectively with all related loan documents, the "New Credit Agreements") contain substantially the same material terms and conditions as contained in the Plan Support Agreement on file with the Bankruptcy Court as of
October 26, 2009. Hood reb. pf. at 9.

(c) Approval of the Chapter 11 Plan

26. Under the Chapter 11 process, the vote of the creditors, described in Section VII of the Second Amended Joint Plan of Reorganization, ended on April 28, 2010. Hood reb. pf. at 9.

27. The vote of creditors is complete and all classes of creditors entitled to vote on the Plan (Secured Creditors and Unsecured Creditors) have overwhelmingly approved the Plan. Hood reb. pf. at 9; tr. 5/10/10 at 61–62 (Hood).

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33. EBITDAR is Earnings Before Interest, Taxes, Depreciation, Amortization, and Restructuring Costs.

(d) Silver Oak Capital

28. FairPoint expects that Silver Oak Capital, a holder of secured indebtedness of FairPoint, will acquire approximately 15% of the reorganized FairPoint Communications, Inc.'s common stock upon FairPoint's emergence from bankruptcy. Hood reb. pf. at 11.

29. Silver Oak Capital is a Delaware limited liability company that since its inception in 1995 has functioned solely as the nominee and record holder of interests held for funds managed by Angelo, Gordon & Co., L.P. ("Angelo, Gordon"), and/or its principals. Angelo, Gordon directs all investment decisions and exercises all voting rights on behalf of the funds. Hood reb. pf. at 11.

30. FairPoint is not aware of an entity holding secured indebtedness of FairPoint other than Silver Oak Capital in a quantity that would make it an indirect owner of ten percent or more of the voting securities of FairPoint upon implementation of the Plan of Reorganization. Tr. 5/10/10 at 77–78 (Hood); Hood reb. pf. at 11.

(e) Vermont Regulatory Settlement

31. The Regulatory Settlement would preserve the majority of the Docket No. 7270 merger conditions. Skrivan 4/13/10 pf. at 12; O'Brien pf. at 5.

32. Under the Regulatory Settlement, payment of service quality penalties for 2008 and 2009 would be deferred until December 31, 2010. If FairPoint meets specified service objectives in ten performance areas (specified in Attachment 1 to the Regulatory Settlement) on average over the twelve-calendar months in 2010, the 2008 and 2009 penalties would be waived.[34] Exh. FP-AG-4; exh. FP-1 at § 2.1 of Exhibit F; [Giammarino] Skrivan pf. at 54.

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34. The ten performance areas specified in Attachment 1 to the Regulatory Settlement are:
    1. Network Trouble Report Rate
    2. % Residence Troubles Not Cleared in 24 Hours
    3. % Business Troubles Not Cleared in 24 Hours
    4. % Calls Not Answered in 20 Seconds, Residence
    5. % Calls Not Answered in 20 Seconds, Business
    6. Repair Centers - Busy Rate
    7. Repair Centers - % Calls Not Answered in 20 Seconds
    8. % Installation Appointments Not Met - Company Reasons
    9. % Installation Orders Held - Residence & Business - Miss Install Rate
    10. % Installation Orders Held - Residence & Business - Average Delay Days

    Exh. FP-1 at Attachment 1 to Exhibit F.

33. If FairPoint meets the service objectives for some but not all of these ten performance areas, the penalties would be reduced by 10% for each performance area specified for which FairPoint meets specified service levels on average over the twelve-calendar months in 2010. Exh. FP-AG-4; exh. FP-1 at § 2.1 of Exhibit F.

34. The set of ten criteria specified by the Regulatory Settlement as triggers for the service quality waivers reflects not simply the areas in which service quality has been deficient, but also the areas that have been at issue since cutover. The set of ten criteria therefore tie any waiver to success in responding to the issues that arose following cutover. Skrivan 4/13/10 pf. at 9.

35. Under the Regulatory Settlement, FairPoint agrees to adhere to the broadband milestone penalties prescribed in the Docket No. 7270 Final Order; however, if FairPoint files a broadband permitting and construction plan with the appropriate regulatory body by May 1, 2010, files all necessary permit applications by October 1, 2010, and undertakes commercially practicable efforts to implement the plan, FairPoint would be granted a six-month extension of the broadband build-out requirements, until June 30, 2011.[35] Exh. FP-AG-4; exh. FP-1 at § 2.3 of Exhibit F.

36. The broadband permitting and construction plan would at a minimum identify tower sites and set a schedule for permitting and construction. Exh. FP-AG-4; exh. FP-1 at § 2.3 of Exhibit F.

37. Under the Regulatory Settlement, FairPoint would undertake to deploy broadband services to 95% of all access lines in those exchanges that have been identified for 100% broadband availability in the Docket No. 7270 Final Order (the "100% Exchanges") by June 30, 2011. Exh. FP-AG-4; exh. FP-1 at § 2.4 of Exhibit F.

38. With respect to the remaining 5% of lines in the 100% Exchanges, FairPoint would deploy broadband to any requesting customer using an extended service interval of 90 days from the date of the receipt of the order from the customer, provided such order is made no sooner than June 30, 2011. Failure to meet such requirements would require FairPoint to waive certain service charges. Exh. FP-AG-4; exh. FP-1 at § 2.4 of Exhibit F.

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35. The May 1, 2010, date has passed. We do not know whether FairPoint filed the broadband permitting and construction plan by this date.

39. The Regulatory Settlement requires that FairPoint "use commercially reasonable efforts to notify customers in the affected exchanges not served by the 95% coverage requirement of such service availability, including providing written notice by June 30, 2011." Exh. FP-6 at § 2.4 of Exhibit F; Skrivan 4/13/10 pf. at 10–11.

40. The Regulatory Settlement also specifies that FairPoint would request that the Board authorize FairPoint to use USF funds for three consecutive years to upgrade plant and infrastructure in the 100% Exchanges, in order to improve FairPoint's service quality and network reliability. If the Board authorizes FairPoint to use the USF, and to the extent permitted by Federal Communications Commission ("FCC") rules, FairPoint would invest the USF in network infrastructure that would support the deployment of broadband services to an additional 5% of access lines on a timeline that varies depending on the date of the Board's authorization. Exh. FP-AG-4; exh. FP-1 at § 2.5 of Exhibit F.

41. Under the Regulatory Settlement, FairPoint would have the option to resell terrestrial- (non-satellite) based service providers' broadband service offerings in order to fulfill FairPoint's broadband build out and/or service requirements as contained in the February 15, 2008, Order in Docket No. 7270, provided that the services meet or exceed all requirements of that Order as modified by the Vermont Regulatory Settlement, and the resold services are purchased through and serviced by FairPoint. Exh. FP-AG-4; exh. FP-1 at § 2.6 of Exhibit F.

42. The Regulatory Settlement specifies that penalty amounts resulting from any failure to meet broadband deployment requirements would be managed by FairPoint with funds deposited into an escrow fund, which would reimburse FairPoint for costs incurred for additional network projects completed within 18 months of the date of the penalty, subject to the approval of the DPS. Exh. FP-AG-4; exh. FP-1 at § 2.8 of Exhibit F.

43. Under the Regulatory Settlement, FairPoint must continue to meet the capital investment requirements of the Docket No. 7270 Final Order. Exh. FP-AG-4; exh. FP-1 at § 2 of Exhibit F.

44. Under the Regulatory Settlement, the financial conditions set forth in paragraph numbers 29, 30, 31, and 33 of "Attachment 1 to the Certificate of Public Good" (and the corresponding provisions in the Board's Order) are replaced by the terms of the Vermont Regulatory Settlement

and Reorganization Plan. Exh. FP-AG-4; exh. FP-1 at § 3 of Exhibit F; Skrivan 4/13/10 pf. at 13; O'Brien pf. at 14; exh. DPS DOB-1; tr. 5/12/10 at 120.

45. Under the Regulatory Settlement, FairPoint has agreed that any management bonuses would be based on a combination of EBITDAR (EBITDA plus restructuring costs) and service metrics goals and the weighting for each of these categories would be computed and clearly stated for the incentive and bonus plans for each individual and for FairPoint in total. Exh. FP-AG-4; exh. FP-1 at § 4.6 of Exhibit F.

46. Under the Regulatory Settlement, FairPoint's new Board of Directors must consist of a supermajority of newly appointed independent directors and at least one member of the new Board would reside in northern New England. Exh. FP-AG-4; exh. FP-1 at § 4.2 of Exhibit F.

47. The new Board would appoint a "regulatory sub-committee" that would monitor compliance with the terms of the February 15, 2008, Order in Docket No. 7270, as modified by the Vermont Regulatory Settlement, and all other regulatory matters involving the States of Vermont, New Hampshire and Maine. Exh. FP-AG-4; exh. FP-1 at § 4.2 of Exhibit F.

48. The Regulatory Settlement specifies that FairPoint would maintain a state president who would provide a senior regulatory presence in Vermont and be able to reasonably respond to various future FairPoint-based dockets or regulatory issues relating to telecommunications. Exh. FP-AG-4; exh. FP-1 at § 4.4 of Exhibit F.

49. Under the Regulatory Settlement, FairPoint agreed to continue its search for a Chief Information Officer with a goal of having a Chief Information Officer in place by June 30, 2010. Exh. FP-AG-4; exh. FP-1 at § 4.1 of Exhibit F.

50. The Regulatory Settlement specifies that FairPoint would reimburse the State of Vermont for its costs and expenses in the Chapter 11 cases. Exh. FP-AG-4; exh. FP-1 at § 4.3 of Exhibit F.

51. The Regulatory Settlement contains a "most-favored-nation clause" which provides that FairPoint would not agree with Maine or New Hampshire to materially different terms taken as a whole pertaining to the Plan or, if applicable, to any related approval for a change in control without first offering them to the Department and/or Board. Exh. FP-AG-4; exh. FP-1 at § 4.5 of Exhibit F.

52. During the first two years following the effective date of the Plan, FairPoint would be barred from paying dividends if FairPoint is in material breach of the Vermont Regulatory Settlement. Exh. FP-AG-4; exh. FP-1 at § 4.7 of Exhibit F.

53. Contingent on FairPoint's compliance with the terms of the Vermont Regulatory Settlement and other applicable laws, the Department would request that the proceeding in Docket No. 7540, regarding revocation or modification of FairPoint's CPG, be terminated and the docket closed. Exh. FP-AG-4; exh. FP-1 at § 2.2 of Exhibit F.

54. The Vermont Regulatory Settlement is conditioned on the Department receiving and finding acceptable a business plan demonstrating FairPoint's ability to meet its obligations under the Vermont Regulatory Settlement and its feasibility to operate as a going concern over the long term in a manner consistent with Vermont utility regulation. Exh. FP-AG-4; exh. FP-1 at § 4.9 of Exhibit F.

55. Some conditions of the Regulatory Settlement have already been fulfilled: Wayne Wilson, a New Hampshire resident, has been nominated to be a member of the new board of directors; FairPoint's Chief Information Officer, Kathleen McLean, has been in her position since mid-March; and Michael Smith was appointed FairPoint's Vermont President at the beginning of 2010. *See* exh. FP-1 at Item 3; McLean/Weatherwax 4/13/10 pf. at 1–2; [Giammarino] Hood pf. at 21.

56. Approval of the Regulatory Settlement (in Maine, New Hampshire, and Vermont) is a condition precedent to the effectiveness of the Plan of Reorganization. FairPoint may waive this condition. *See* exh. FP-6 (Modified Second Amended Joint Plan of Reorganization) at §§ 12.1(I), 12.2.

B. FairPoint's Technical Competence

1. Findings

(a) Management Competence

57. FairPoint has made a number of organizational changes since the beginning of July 2009 intended to strengthen and align the company's operations in northern New England. [Giammarino] Hood pf. at 18.

58. The organizational changes include appointment of a new Chief Operating Officer ("CEO"), change in responsibilities for a number of management personnel, restructuring various portions of FairPoint's organization, and creation of a Chief Information Officer. [Giammarino] Hood pf. at 20; Allen pf. at 3–5.

59. The new FairPoint Board will initially include up to nine members of which a supermajority must be independent directors and of which (in accordance with section 8.6.2(b)) at least one member of the new Board will be a resident of northern New England. Exhibit FP-6 at Sections 8.6.2(b), 8.6.4, and Exhibit F to Joint Plan of Reorganization at § 4.4; [Giammarino] Hood pf. at 26.

60. Aside from FairPoint's CEO and one representative nominated by the unsecured lenders, the new Board is nominated by the Lender Steering Committee. Exh. FP-2, Sections 1.72, 8.6.2(b) and (c).

(b) Technical Knowledge, Experience and Ability to Provide the Intended Services

(1) Capgemini

61. FairPoint had engaged Capgemini to build a back-office infrastructure to allow FairPoint to migrate off of Verizon's systems. [Giammarino] Hood pf. at 7.

62. FairPoint extended the original cutover date of September 2008 several times leading up to the final date of January 2009. [Giammarino] Hood pf. at 7.

63. Following the cutover, FairPoint experienced increased processing time by customer service representatives for new orders, increased processing time for customer invoices, and an inability to execute automated collection efforts. [Giammarino] Hood pf. at 7.

64. These issues negatively impacted customer satisfaction and resulted in large increases in customer call volumes into FairPoint's customer-service centers. [Giammarino] Hood pf. at 7.

65. The failure of systems was due to failures by both FairPoint and Capgemini. The two companies worked together in the overall system designs. Tr. 5/10/10 at 51–52, 57 (Hood).

66. There are areas within the systems that Capgemini designed properly; other areas within the systems that Capgemini designed, in particular the billing systems, had significant problems. Tr. 5/10/10 at 55 (Hood).

67. In some cases, Capgemini did not design the systems appropriately or in the manner that FairPoint requested. These errors were the fault of Capgemini. In other instances, FairPoint and Capgemini may not have effectively communicated regarding the requirements for the systems. Tr. 5/10/10 at 115–116 (Allen).

68. In addition, the data that FairPoint received from Verizon did not work properly with some systems. Tr. 5/10/10 at 116–117 (Allen).

69. In the summer of 2009 (after the systems difficulties became apparent), FairPoint made a decision to continue working with Capgemini to remedy the system defects. FairPoint concluded that replacing Capgemini would negatively affect the Company in its remediation efforts. Tr. 5/10/10 at 114–115 (Allen).

70. Just prior to the bankruptcy filing, FairPoint owed Capgemini approximately $49.8 million under various contracts. [Giammarino] Hood pf. at 16.

71. At that time, FairPoint had already paid Capgemini $130 million since the beginning of the contract in 2007. Tr. 5/11/10 at 54–55 (McLean).

72. Capgemini is continuing to receive payments for work performed subsequent to the bankruptcy filing. Tr. 5/10/10 at 59 (Hood).

73. In consultation with its attorneys, FairPoint's leadership reviewed the contract and the performance of the parties and agreed to settle. Hood 4/13/10 pf. at 3; tr. 5/11/10 at 55 (McLean).

74. On October 9, 2009, FairPoint entered into a Settlement Agreement and Release (the "Capgemini Settlement Agreement") with Capgemini. [Giammarino] Hood pf. at 16.

75. Pursuant to the Capgemini Settlement Agreement, Capgemini agreed to continue to provide services to FairPoint in exchange for FairPoint paying Capgemini ongoing fees plus $30 million of the total $49.8 million, with FairPoint paying $15 million upon execution of the Capgemini Settlement Agreement and an additional $15 million initially due on December 31, 2009 (pending Bankruptcy Court approval of the settlement). The Capgemini Settlement

Agreement also allowed Capgemini to assert an allowed unsecured claim against FairPoint for $19.8 million. [Giammarino] Hood pf. at 16.

76. As a result of the Capgemini Settlement Agreement, FairPoint will have paid Capgemini $161 million of the $180 million billed by Capgemini prior to the time of the bankruptcy filing, despite the significant defects in the systems. Tr. 5/11/10 at 55 (McLean).

77. On May 4, 2010, the Bankruptcy Court issued an Order approving the Capgemini Settlement Agreement. The Bankruptcy Court's Order also approved FairPoint's assumption of certain contracts with Capgemini, but disallowed Capgemini's unsecured claim. Hood reb. pf. at 10.

(2) Cutover Problems and Efforts to Remediate

78. While many of the cutover issues were anticipated and FairPoint implemented manual workarounds to address the issues, the magnitude of the difficulties experienced exceeded FairPoint's expectations. [Giammarino] Hood pf. at 8–9.

79. Consequently, in the first nine months of 2009, FairPoint incurred $28.8 million of incremental expenses in order to operate its business, including third-party contractor costs and internal labor costs in the form of overtime pay. [Giammarino] Hood pf. at 9.

80. FairPoint retained Accenture, LLP ("Accenture") in connection with its enterprise-wide effort to improve its organization capabilities and the performance of its systems and processes. Accenture's work involved an assessment of four areas: customer relationship management ("CRM"); wholesale order in-take and fulfillment; flow-through and provisioning; and billing. Weatherwax pf. at 8.

81. Accenture prepared a final report which describes fifteen projects, including 112 specific subprojects, that are being implemented as part of FairPoint's Customer Delivery Improvement Program ("CDIP"). Weatherwax pf. at 10; *see* exhs. FP-VW-3 (Confidential) (CDIP Program Roadmap) and FP-VW-4.

82. Most of the CDIP initiatives are planned to be completed by June 2010, with 70 percent completed by May 2010. Some CDIP initiatives will extend until September. Tr. 5/10/10 at 102 (Allen).

83. To date, FairPoint has resolved many of the cutover-related issues, but FairPoint had been required to devote significant financial resources and employee time to resolving those issues. This reduced FairPoint's ability to implement its business plan, improve customer satisfaction, and compete effectively in the marketplace. [Giammarino] Hood pf. at 9.

84. The cutover to new FairPoint systems resulted in a higher than anticipated failure rate in orders flowing through the systems. These orders needed to be handled through manual provisioning processes, often causing delays, which were sometimes significant, in the completion of orders. Lamphere pf. at 3.

85. FairPoint has undertaken efforts, including the establishment of a Business Architecture Team, to address problems with order flow-through, provisioning, and on-time installation. These efforts are identifying how orders are flowing, how systems are functioning and how an organization is working. Lamphere pf. at 3.

86. FairPoint has taken steps to identify and correct data inconsistencies in the Company's network and systems, arising largely as a result of the cutover to new Capgemini-designed FairPoint systems from Verizon systems earlier this year that affected customer billing and other system operations. Nolting pf. at 2–3.

87. Completion of FairPoint's data synchronization efforts is expected to improve order flow-through. Lamphere pf. at 8.

88. FairPoint's CDIP Program also includes several projects designed to improve service order flow-through, increase ability to identify orders that fall out of normal processing, and thus improve on-time service delivery performance. Lamphere pf. at 8–10.

89. FairPoint also has a large number of late pending orders that it is attempting to resolve. Lamphere pf. at 11.

90. After cutover, FairPoint started last year with approximately 22,000 late pending orders. By mid-September 30, 2009, FairPoint had 4,800 late orders and as of January 31, 2010, FairPoint had approximately 1,800 late orders. The total number of late pending orders has now fallen to below pre-cutover levels. Lamphere pf. at 10–11; Lamphere reb. pf. at 4–5.

91. FairPoint is attempting to reconcile the data across the ordering, inventory, provisioning and billing platforms. Lamphere reb. pf. at 3–4.

92. Since mid-2009, FairPoint has implemented numerous changes, fixes or enhancements to its systems. Weatherwax pf. at 5; tr. 5/11/10 at 15–16 (Weatherwax), 34–35 (McLean).

93. The systems improvements undertaken by FairPoint do not represent a ground-up rebuilding of the systems designed, tested, and deployed by Capgemini. McLean/Weatherwax 4/13/10 pf. at 8.

94. The performance improvements thus far appear to be the result of the underlying systems or delivery mechanisms having been fixed. The areas most in need of continued work are directory listings in the wholesale area and billing. Tr. 5/12/10 at 14–15 (King); tr. 5/11/10 at 49–53 (McLean).

(c) Other Regulatory Approvals

95. Under the Chapter 11 process, the vote of the creditors, described in Section VII of the Second Amended Joint Plan of Reorganization, ended on April 28, 2010. Hood reb. pf. at 9.

96. The vote of creditors is complete and all classes of creditors entitled to vote on the Plan (Secured Creditors and Unsecured Creditors) have overwhelmingly approved the Plan. Hood reb. pf. at 9; tr. 5/10/10 at 61–62 (Hood).

97. The Reorganization Plan is not effective until approved by the Bankruptcy Court. Exh. FP-3, Section 12.1.

98. FairPoint also must obtain regulatory approval from the states of Maine and New Hampshire. Exh. 2, Section 12.1; [Giammarino] Allen pf. at 54–60.

2. Discussion

The Board assessed FairPoint's technical competence in the context of the Company's petition to acquire Verizon. We found that:

> FairPoint's management team is competent, well-respected and qualified to run Verizon's northern New England operations. FairPoint's senior management is experienced and is qualified to manage the combined and much larger company. .

> . we are satisfied that the upper management of the company is well-qualified and appropriately dedicated to making this acquisition successful.[36]

We also found that FairPoint had a good business reputation.[37] FairPoint was also diligently seeking all appropriate regulatory approvals.

As to the technical knowledge and capability, we determined that FairPoint was an experienced telecommunications carrier. The Company had successfully carried out acquisitions previously. Moreover, FairPoint appeared to be well-positioned to avoid the problems that had arisen in Hawaii when a similar acquisition and new system deployment had occurred.[38] In particular, FairPoint had employed Capgemini to assist with the acquisition. The Board was informed that Capgemini had thirty years of experience in telecommunications and system conversion.[39] Capgemini had significant experience with integrating multiple software products, as was planned by FairPoint. FairPoint also testified that it had a negotiated a flat fee arrangement so Capgemini could focus on the system designs.

Since that time, serious questions about FairPoint's technical competence have arisen. Most significant were the problems that arose at the cutover. As this Order describes in some detail, following the cutover to FairPoint's new back-office systems, the Company experienced serious problems in a number of areas. These areas affected the delivery of both retail and wholesale services, resulting in FairPoint not meeting its relevant service quality standards and triggering large penalties.

The difficulties arose directly from failures in the new systems, failures which were attributable to both FairPoint and Capgemini. The two companies worked together in the overall system designs.[40] Portions of the systems were designed appropriately. Other elements of the systems, including the billing system, were not designed properly and had significant problems.[41] In some cases, FairPoint and Capgemini may not have effectively communicated on the

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36. Docket No. 7270, Order of 12/21/07 at 34.
37. Docket No. 7270, Order of 12/21/07 at 42–43.
38. Docket No. 7270, Order of 12/21/07 at 188.
39. Docket No. 7270, Order of 12/21/07 at 37.
40. Tr. 5/10/10 at 51–52, 57 (Hood).
41. Tr. 5/10/10 at 54 (Hood) and 115–116 (Allen).

requirements for the systems.[42] In addition, the systems did not properly process the data that FairPoint received from Verizon.[43] The various performance issues also adversely affected FairPoint's business reputation, which was reflected in a substantial number of customers choosing other alternatives.

Whatever the relative allocation of responsibility between FairPoint and Capgemini, FairPoint's management bears substantial responsibility and the results raise questions about its abilities. Equally troubling was FairPoint's difficulty in remedying the problems. FairPoint developed several plans following cutover that were insufficient to address the problems.[44] The retail and wholesale service quality indexes reflect FairPoint's inability to develop a remedy.[45] Payments to CLECs under the PAP declined by only a small percentage over the first six months after cutover. Retail service quality showed similar trends, and in some cases worsened over time (such as for the repair standards).

Beginning in June 2009, FairPoint began a series of organizational and management changes. The Company hired a new Chief Executive Officer. It has since hired several senior managers with direct responsibility for identifying systems problems and remedying them. Among the new managers is a Chief Information Officer, who was very candid in responses to Board inquiries. FairPoint also changed the organization's structure. The Department concludes that these changes have resulted in a strengthening of FairPoint's top management.[46]

Recent performance suggests that these changes are having an effect. FairPoint has developed plans, such as the CDIP, intended to modify the systems so that they work effectively and can enable FairPoint to provide service on time and accurately bill its customers. FairPoint's performance over the last six months has shown substantial improvement. We can reasonably infer that the management and organizational changes played a role in this improvement. The Company is now getting closer to meeting its retail and wholesale service quality standards, although the wholesale systems appear to be lagging. It appears that the improvement in results

42. Tr. 5/10/10 at 115–116 (Allen).
43. Tr. 5/10/10 at 116–117 (Allen)
44. *See* tr. 5/10/10 at 100–102 (Allen).
45. Exhs. FP-TPN-2 and FP-JWA-2.
46. Tr. 5/12/10 at 118–119 (Darr).

arises from actual corrections to the systems rather than simply the effect of employing additional personnel (which may not produce sustainable results).[47]

Based upon the changes to FairPoint's management and organization and the improvement in its performance, we find that FairPoint has shown sufficient technical knowledge, experience and ability to provide telecommunications services and comply with its regulatory requirements.

The Board does have two areas of concern, however, arising from the settlement with Capgemini. It is undisputed that the primary cause of the performance problems was the failure of the systems that Capgemini designed and developed. Since the beginning of the transition planning, Capgemini has billed FairPoint $180 million. Yet notwithstanding the significant system failures, FairPoint reached a settlement with Capgemini just prior to filing for reorganization in which the parties agreed that Capgemini would forego only $20 million of this total. We understand that FairPoint bears some of the responsibility for the system failures.[48] It provided the specifications for the systems; it is not clear whether FairPoint ordered systems that were sufficiently robust to handle the demands of its business.[49] FairPoint also apparently failed to adequately oversee the system development, so that the failures following cutover were a surprise to it. And as FairPoint's witnesses candidly acknowledged, following the system failures, FairPoint management determined that the optimum approach to fixing the systems was to continue to rely upon Capgemini for the modifications.[50] This decision doubtless undercut FairPoint's negotiating position relative to Capgemini.

The result of the Capgemini settlement is troubling, particularly in light of the Regulatory Settlement. Here, customers, who bear no responsibility for the system failure, are being required to forego service quality compensation in both 2008 and 2009 that was designed to compensate them whenever FairPoint was unable to deliver adequate service. The Regulatory Settlement provides that all of that compensation is waived, assuming FairPoint can deliver adequate service in 2010. Meanwhile, Capgemini was responsible for designing the systems that did not function properly and clearly did not design all of the systems in the manner FairPoint expected, leading to

47. Tr. 5/12/10 at 14–15 (King); tr. 5/11/10 at 49–53 (McLean).
48. Tr. 5/10/10 at 57 (Hood).
49. Tr. 5/11/10 at 57 (McLean).
50. Tr. 5/10/10 at 114–115 (Allen).

significant system problems. Yet it receives almost 90% of the money that it charged FairPoint prior to the bankruptcy filing and all of the total amount it has charged after that date.[51] This result also seems incongruous in light of FairPoint's future financial position (which we discuss in the next section). It would seem that a more equitable distribution of the costs would have tracked more closely to the relative responsibility of the participants.

The second area of concern relates to FairPoint's and Capgemini's planning for the data conversion. As described by FairPoint, a major contributor to the system problems was the data that FairPoint received from Verizon, which did not come into FairPoint's systems consistently.[52] Yet FairPoint, and we presume Capgemini, knew prior to cutover that Verizon's systems contained conflicting data.[53] Nonetheless, the incorporation of the data produced significant errors — errors that are still being corrected today.[54] It is difficult to fathom how the system designs did not adequately take into account the known data issues. This reinforces our conclusion that FairPoint's settlement with Capgemini appears too generous in light of the causes of the problems.

Finally, FairPoint amended its petition after hearing to request approval of the acquisition of a controlling interest by Silver Oak Capital, which will acquire 15% of FairPoint Communication, Inc's. common stock upon emergence from bankruptcy. Our decision not to approve the broader issues in the proceeding makes this request moot. Nonetheless, we would not be inclined to approve FairPoint's request relative to Silver Oak Capital in any event. FairPoint has presented limited information on what Silver Oak Capital is, and the Company has presented no information that would support a conclusion that Silver Oak Capital's acquisition of a controlling interest would promote the general good. FairPoint has provided far less information on the entity that would be the largest voting shareholder than should be provided in a petition under Section 107 of Title 30.

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51. Tr. 5/10/10 at 115–116 (Allen).

52. Tr. 5/10/10 at 116 (Allen).

53. Tr. 5/10/10 at 116–117 (Allen).

54. One of FairPoint's initiatives is the data synchronization project intended to fix these problems. Nolting pf. at 2–3.

C. Financial Soundness

1. Position of the Parties

(a) FairPoint

FairPoint maintains that upon emerging from Chapter 11 bankruptcy its financial position and ongoing liquidity will be substantially strengthened, thus positioning FairPoint as a financially healthy and viable company in the competitive telecommunications marketplace.[55] Based largely on a substantial reduction in overall indebtedness of $1.7 billion (to be converted into equity to be held mostly by the lenders under the Prepetition Credit Agreement, i.e., the Class 4 claims under the Plan), which in turn will result in a 69% reduction in annual interest expense from approximately $208 million to approximately $65 million, FairPoint is projecting a substantial improvement in cash flows for the post-bankruptcy company.[56] FairPoint projects its free cash flow to steadily improve over its four-year forecast period building up to more than $400 million by the end of 2013 after giving effect to $700 million in cumulative capital expenditures ("CAPEX") over the same time period.[57] FairPoint refers to this build-up of cash as a "cushion" which will be available for additional debt reductions or investment in new projects, and asserts that the magnitude of the cushion is a reflection of the new FairPoint's financial strength.[58] The Company argues that this new capital structure will result in financial ratios that compare favorably with those of other companies in FairPoint's industry peer group.[59] Thus FairPoint argues that the new company will be financially sound.[60]

FairPoint maintains that its future success is also based on four business initiatives contained in the Plan: (a) continued improvement in its new back-office systems platform; (b) projected cost efficiencies and other operating cost reductions; (c) implementation of the settlement agreements; and (d) continued build-out of FairPoint's next generation network.[61]

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55. [Giammarino] Hood pf. at 3–4.
56. *Id.* at 32.
57. *Id.*
58. *Id.*
59. *Id.* at 46.
60. *Id.* at 51-52. *See* exh. B "Projections," Debtor's Modified Second Amended Joint Plan of Reorganization, "Projected Consolidated Statement of Cash Flows."
61. *Id.* at 40–41.

FairPoint asserts that it is in a much better position today to achieve the goals of the Plan because the overall risk profile of the company has improved compared to the time of the Verizon transaction.[62] FairPoint argues that this improvement is demonstrated by the following developments: (a) the Northern New England integration is essentially complete, (b) FairPoint's senior management team has been strengthened, (c) FairPoint's operating systems are stable, and (d) the build-out of the Vantage Point network is well underway.[63]

FairPoint projects a continued loss of voice access lines to competitors throughout the four-year projection horizon.[64] Nevertheless, FairPoint argues that growth in broadband and special access business revenue will partially offset, and eventually exceed, the loss of traditional voice service revenue.[65] Even if line losses are greater than expected, as reflected in FairPoint's sensitivity analysis, FairPoint argues that it will still have more than sufficient cash flow to fund all of its operating costs and capital expenditures.[66]

Under the Plan, FairPoint will refinance $1 billion of its pre-petition debt into a "New Term Loan" with its existing pre-petition secured lenders. The Plan also contemplates the issuance of a post-bankruptcy revolving credit facility of up to $75 million for FairPoint which will provide the Company with additional liquidity.[67] FairPoint assumes that it will be able to repay nearly $350 million of the new $1 billion Term Loan by the end of 2013 and meet or exceed the repayment covenant benchmarks imposed by its lenders.[68] FairPoint does not plan to pay any dividends following its emergence from bankruptcy, and is precluded from doing so under the terms of the New Term Loan until its leverage ratio is below 2.0 times at the beginning of a fiscal year.[69]

In addition, FairPoint argues that its key financial metrics are reasonably projected to improve to those of an investment grade (BBB) company by the 2011-2012 time frame. FairPoint

62. *Id.* at 50.
63. *Id.* at 51.
64. [Giammarino] Hood pf. at 48.
65. *Id.* at 44.
66. *Id.* at 47.
67. *Id.* at 32–33.
68. FairPoint Brief at 22.
69. [Giammarino] Hood pf. at 34.

bases this argument on the analysis of its financial advisor, Rothschild, and on the analysis and testimony of the Department's witness Stephan Darr who concluded that FairPoint's projected capital structure of approximately 50% debt and 50% equity places it in a significantly better position financially than FairPoint's peers, and that its projected liquidity ratios will exceed the industry median in the 2010-2013 time period.

(b) Department

The Department asserts that reorganized FairPoint will have the financial ability to meet its obligations under the Regulatory Settlement and the Board's prior merger approval Order in Docket No. 7270.[70] Further, the Department concludes that the degree of financial cushion provided by the post-bankruptcy write-down of $1.7 billion of debt indicates that FairPoint will be able to meet its financial covenants and capital commitments to the states,[71] and that FairPoint's financial projections under the Plan show that the reorganized Company "will be an immediate and long term financially viable operating entity consistent with Vermont utility regulations and service requirements,"[72] and thus "will be financially stable and sound."[73]

In reaching its conclusion, the Department relies on the analysis of its financial expert, Mesirow Financial ("Mesirow ") which reviewed the accuracy of FairPoint's financial projections.[74] Mesirow found that, despite some deficiencies, the Plan projections were reasonable, were supported by the Company's recent history, and provided sufficient margin for error for the Company to be able to perform its commitments.[75] Mesirow points to the following factors as indications that reorganized FairPoint will be financially viable:[76]

(i) FairPoint's projected capital structure of 50% debt-50% equity, and projected liquidity ratios, exceed that of industry peers;

(ii) a projected compounded annual growth rate in net profit of 1.2%; and

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70. DPS Brief at 10.
71. O'Brien pf. at 6.
72. DPS Brief at 11 (proposed finding no. 30).
73. *Id.* at 13.
74. DPS Brief at 11–12.
75. Tr. 5/12/10 at 71, 85-87, 96, 101 (Darr).
76. DPS Brief at 11; exh. DPS-SD-2 at 15.

(iii) projected operating EBITDA and free cash flow of $437.3 million and $334.2 million, respectively, by the end of 2013.

Mesirow also performed a "sensitivity analysis" of the Plan projections under different scenarios involving various levels of projected revenues to assess the Company's ability to comply with its financial covenants.[77] Mesirow's conclusion from that analysis is that FairPoint will be able to maintain compliance with its financial covenants and its CAPEX plans if actual revenues as a percentage of projected revenues are at least 90.5%, 85.4%, 84.2%, and 81.6% for the years 2010 through 2013.[78] The Department characterizes this analysis as a "stress test" which "thoroughly" subjects the Plan projections to a series of "worst case scenarios."[79] The Department asserts that this review shows that a deleveraged FairPoint will have a significant financial cushion and will be able to meet its commitments under a variety of scenarios.[80]

The Department also states that it considered some of the deficiencies in the Plan projections found by Mesirow during the course of Mesirow's analysis, and that it discussed those concerns with FairPoint management.[81] As a result of those discussions, and to further increase the likelihood of the Company achieving the levels of performance reflected in the Plan projections, the Department and FairPoint agreed to a set of post-bankruptcy reporting requirements involving the development and adoption by FairPoint, on an annual basis, of a detailed business plan.[82] The proposed business plan is to report on and outline the assumptions and procedures implemented by FairPoint's management to achieve its performance goals and will include, among other things, a report on any material changes which may affect implementation of the business plan.[83]

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77. Exh. DPS-SD-2 at 21.
78. *Id.* at 22.
79. O'Brien pf. at 7.
80. *Id.* at 6.
81. DPS Brief at 12.
82. *Id.*
83. *Id.*

(c) One Comm

One Comm did not provide specific testimony, evidence, or proposed findings on the likelihood of reorganized FairPoint's financial soundness. However, One Comm cautions the Board to look twice at FairPoint's current proposals and not take FairPoint's assertions at face value given that FairPoint's previous assurances to the Board regarding its readiness to "step into Verizon's shoes" prior to the merger, and its subsequent readiness for cutover, both proved to be false and contributed to FairPoint's "free-fall" into bankruptcy.[84] Accordingly, One Comm is concerned that FairPoint's prolonged inability to "right the ship" raises serious concerns about the effect that FairPoint's systems issues will have on the viability of CLEC competition in Vermont following FairPoint's emergence from bankruptcy.[85]

(d) Sovernet

Like One Comm, Sovernet does not offer specific testimony or evidence on the issue of FairPoint's financial soundness after emerging from bankruptcy. However, Sovernet argues that cutover issues, in particular the inadequacies of FairPoint's back-office systems, played a major role in FairPoint's financial downfall and that the promised stability of FairPoint's systems have not yet materialized.[86] Although Sovernet asserts that extending the original CPG conditions from Docket No. 7270 relative to the CLECs will not place an undue financial burden on post-bankruptcy FairPoint,[87] Sovernet argues that FairPoint's financial well-being depends on its ability to achieve revenues from both its retail and wholesale operations, and not lose both retail and wholesale revenues if customers desert FairPoint for the service provided by a competitive cable company.[88] Sovernet raises concerns that FairPoint remains unable to gauge the amount of improvement that has been achieved in its initiatives to solve the myriad of problems that continue to exist in its systems,[89] and that FairPoint has not budgeted resources to fund continued

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84. One Comm Brief at 2.
85. *Id.* at 11.
86. Sovernet Brief at 3, 5.
87. *Id.* at 7.
88. *Id.* at 11.
89. *Id.* at 26–27.

remediation efforts after 2010.[90] As a result, Sovernet asks the Board to require FairPoint to establish an escrow to retain funds that may be needed to complete cutover-related remediation work if FairPoint does not complete all such projects.[91] Sovernet argues that this would be a reasonable way for the Board to assure FairPoint does have the financial resources to finish the necessary systems development projects.[92]

(e) segTEL

segTEL did not offer specific testimony or evidence on FairPoint's financial soundness after emerging from bankruptcy. However, based on segTEL's review of the Plan projections, segTEL asserts that FairPoint is apparently projecting an increase in wholesale revenue, but argues that FairPoint's wholesale revenue cannot increase if the problems with FairPoint's Operations Support System are not addressed as part of the Settlement.[93]

2. Findings

(a) Financial Restructuring Under the Amended Plan for Reorganization

99. As of the petition date, FairPoint had approximately $2.7 billion of total funded debt outstanding, including approximately $2.1 billion of Prepetition Credit Agreement claims (consisting of approximately $2.0 billion owed under the Credit Facility and approximately $99 million owed under interest rate swap agreements), and approximately $575 million in senior unsecured notes, including accrued interest. [Giammarino] Hood pf. at 27.

100. FairPoint's reorganization is premised upon effecting a substantial deleveraging and strengthening of the balance sheet through the conversion of a substantial portion of FairPoint's pre-petition indebtedness into "New Common Stock," as defined in the Plan. When FairPoint emerges from Chapter 11, its total debt will be reduced by approximately 63% (from $2.7 billion to $1 billion), thereby providing FairPoint with substantial improvement in its financial strength and flexibility. *Id.* at 32.

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90. *Id.* at 28.
91. *Id.* at 29.
92. *Id.*
93. segTEL Brief at 4.

101. The significant reduction in debt resulting from the restructuring plan will reduce the Company's minimum debt service requirements by approximately $175 million annually. This substantial reduction in annual debt service requirements will provide increased liquidity for meeting FairPoint's operating and capital expenditure requirements in the future. [Giammarino] Allieri/Newitt pf. at 50.

102. Under the Plan, the $1 billion in debt left on reorganized FairPoint's balance sheet will consist of a new term loan in an equal amount ("New Term Loan"). The Plan also contemplates the issuance of a post-bankruptcy revolving credit facility of up to $75 million which will provide FairPoint with additional liquidity. The terms of the Revolving Credit Facility are described more fully in the Plan. *Id.* at 24, 32-33.

103. The New Term Loan will include the following material terms:

- The New Term Loan shall be secured by the same or substantially the same collateral as the collateral which secures the DIP Financing, and will include the pledge by Northern New England Telephone Operations LLC of the membership interest of Telephone Operating Company of Vermont LLC (subject to FairPoint obtaining any necessary regulatory approvals).
- 5 year maturity.
- Interest at LIBOR + 4.50%, with a LIBOR floor of 2.00%.
- No upfront fee.
- Mandatory prepayment at par, upon conditions to be determined in the Plan Supplement.
- Optional prepayment at anytime at par.
- Amortization Schedule – Year 1: 1% annually, Year 2: 1% annually, Year 3: 5% annually, Year 4: 15% annually and Year 5: 15% (5% per quarter for the first 3 quarters) with 63% bullet payment in 4th quarter.
- Amortization occurs quarterly commencing upon the first full quarter after the effective date of the Plan.
- If FairPoint's consolidated leverage ratio is above 2.0 times at the end of the fiscal year, FairPoint shall be subject to a sweep of 75% of its "Excess Cash Flow" as defined in the Plan, based upon an annual test and paid in the subsequent quarter with the first test occurring for fiscal year 2010 for the period from the effective date of the Plan through the end of 2010 and payable in fiscal 2011. If FairPoint's consolidated leverage ratio is below 2.0 times at the end of the fiscal year, the sweep shall be reduced to 50% of FairPoint's Excess Cash Flow.

- If FairPoint's consolidated total leverage ratio is below 2.0 times at the end of the fiscal year, FairPoint will be permitted to pay dividends with its share of Excess Cash Flow.
- Financial covenants will only include interest coverage and leverage ratio tests. Such tests will first occur in the first full quarter following the effective date of the Plan.

[Giammarino] Hood pf. at 34–36.

104. Annual interest costs will be reduced by approximately 69% (from approximately $208 million to $65 million) and total leverage will be reduced from approximately 7.5 times adjusted operating EBITDAR (defined as earnings before interest, taxes, depreciation and amortization and restructuring costs) to approximately 2.7 times. [Giammarino] Hood pf. at 32.

105. Under the Plan, the holders of Prepetition Credit Agreement Claims totaling approximately $2.1 billion, which are identified as Class 4 in the Plan, will be satisfied in full by: (i) a pro rata share of new term loans in the aggregate principal amount of $1 billion; (ii) a pro rata share of cash in an amount equal to all cash of FairPoint on the effective date in excess of $40 million; (iii) a pro rata share of 47,241,436 shares (90%) of the new common stock in the reorganized FairPoint (subject to dilution); and (iv) by a pro rata share of 55% of the Litigation Trust Interests. [Giammarino] Hood pf. at 24; exh. FP-6 at § 5.4.

106. Under the Plan, holders of Class 7 Unsecured Claims, as defined in the Plan, representing approximately $635 million will be satisfied in full by: (i) a pro rata share of 4,203,352 shares of the new common stock; (ii) a pro rata share of the new warrants to purchase 7,164,804 shares of the new common stock; and (iii) a pro rata share of 45% of the Litigation Trust Interests. [Giammarino] Hood pf. at 25; exh. FP-6 at § 5.7.

107. Other claims, comprising those of Class 1 Other Priority Claims, Class 2 Secured Tax Claims, Class 3 Other Secured Claims, Class 5 Legacy Subsidiary Unsecured Claims, Class 6 NNE Subsidiary Unsecured Claims, Class 8 Convenience Claims and Class 10 Subsidiary Equity Interests are unimpaired and will receive 100% recovery on their allowed claims, except for the Subsidiary Equity Interests (*i.e.* stock of subsidiaries held by parent companies), which will simply be reinstated. [Giammarino] Hood pf. at 25–26.

108. The remaining claims and interests, which comprise those of the Class 9 Subordinated Securities Claims and Class 11 Equity Interests (FairPoint stock outstanding as of the bankruptcy

filing) are fully impaired under the Plan and will receive no distributions at all. [Giammarino] Hood pf. at 25–26.

109. The pre-petition FairPoint stock will be cancelled under the Plan. [Giammarino] Hood pf. at 25– 26.

110. FairPoint has no plans to pay dividends following its emergence from Chapter 11 and under the terms of the New Term Loan, the Company will be precluded from paying any dividends until its leverage ratio is below 2.0 times EBITDAR at the beginning of a fiscal year (and even then, it is only permitted to pay dividends with its share of Excess Cash Flow). [Giammarino] Hood pf. at 34.

111. Under the Chapter 11 process, the vote of the creditors, described in Section VII of the Second Amended Joint Plan of Reorganization ended on April 28, 2010, and all classes of creditors entitled to vote on the Plan (Secured Creditors and Unsecured Creditors) have overwhelmingly approved the Plan. Hood reb. pf. at 9; tr. 5/10/10 at 61–62 (Hood).

(b) Plan Projections

112. In connection with the planning and development of the Plan, FairPoint prepared financial projections to present the anticipated impact of the Plan on the future performance and operations of the Company after emergence from bankruptcy. Exh. FP-6, exh. B "Projections."

113. FairPoint's financial projections were developed based on recent historical customer, revenue and expense results and projecting forward by applying FairPoint-specific and industry trends to these historical results as well as applying FairPoint's expectations of the impact of its strategic business initiatives. The projected revenue, expense, capital expenditure and profitability results were then benchmarked, where possible, against historical and projected peer group data, to assess the reasonableness of the projections. [Giammarino] Allieri/Newitt pf. at 41-42; exh. DPS-SD-2 (Confidential) at 12.

114. FairPoint used the following key assumptions in preparing its financial projections:

(1) The projections assume that the Plan will be confirmed and consummated on June 30, 2010.

(2) For local and long distance revenue, the projections assume that FairPoint will continue to lose local and long distance voice customers to wireless substitution,

wireline competition from competitive local exchange carriers, cable operators and alternative technologies such as VOIP. The projections assume that average monthly revenue per customer for voice local and long distance services will remain relatively flat or decline slightly over the four-year period from 2010 through 2013.

(3) For access revenue, both interstate and intrastate switched access revenues are assumed to continue to decline, consistent with industry trends, as switched access minutes of use traveling across the network decline and per minute usage rates also decrease. Special access revenues, comprised of special circuits such as DS3s and OCNs, are projected to increase significantly over the four-year projection period. FairPoint expects this growth to be driven by FairPoint's investment in the VantagePoint network.

(4) Broadband service is a key element of FairPoint's growth strategy and is also enabled by the VantagePoint network. The projections assume considerable growth in data subscribers over the forecast period, with customer penetration reaching the levels attained currently in the pre-merger FairPoint markets by 2013.

(5) Cost of goods sold, which primarily includes access charges paid to other telephone companies and long distance carriers for voice traffic and third party ISP service costs for data customers, is expected to increase over the projection period reflecting the growth in revenue from new products and services that generally have lower gross margins.

(6) Operating expenses, other than cost of goods sold, are expected to decline during 2010 and 2011. All integration and cutover-related costs are expected to be eliminated in 2010. In addition, 2010 includes the benefit from certain cost-savings initiatives expected to occur throughout the year, with a full year's benefit being realized beginning in 2011. In 2012 and 2013, the projections assume flat to slightly increasing operating expenses consistent with modest inflation, offset by continued cost controls and expected productivity improvement.

[Giammarino] Allieri/Newitt pf. at 42–44.

115. FairPoint's line losses have been in the 10% range and the Company's assumptions take that into account, but assume the line-loss rate will decrease after 2010 and over the remainder of the projection period. Tr. 5/10/10 at 72–74, 76–77 (Newitt).

116. Overall, local line-loss rates are projected to be partly offset by an anticipated increase in average revenue per unit ("ARPU") which is attributed primarily to increased product bundling. Exh. DPS-SD-2 (Confidential) at 8.

117. FairPoint projects net revenue will increase from $1.16 billion in 2010 to $1.23 billion in 2013. This reflects the assumption that increases within access revenue and data services will be partially offset by declines in local revenue. Exh. DPS-SD-2 (Confidential) at 7.

118. The Company projects that its operating expenses will decrease from $732 million in 2010 to $665 million in 2013, primarily related to employee expenses, contracted services, building-related expenses, network expenses, and other expenses. *Id.* at 10.

119. FairPoint's anticipated pro forma capital structure of approximately 50% debt and 50% equity would be significantly better than its peers with respect to debt to EBITDAR ratios, EBITDAR less CAPEX to interest expense ratio, and EBITDAR to interest expense ratio. *Id.* at 7, 17.

120. FairPoint projects that its liquidity ratio will be above the industry median for 2010, and remain above the median level through 2013. *Id.* at 15.

121. FairPoint's CAPEX projections reflect total capital expenditures of approximately $700 million over the four-year period 2010 through 2013. In 2010, capital expenditures are projected to be $200 million. [Giammarino] Allieri/Newitt pf. at 45.

122. FairPoint's projected aggregate capital expenditures of $700 million over the next four years reflect FairPoint meeting all of its broadband build-out commitments as well as its minimum capital expenditure commitments in Maine, New Hampshire and Vermont. In the near term, FairPoint's CAPEX spending is projected to be above median industry levels largely because of its investment in the VantagePoint network. The Company's CAPEX measures are projected to trend closer to industry median levels by 2013. *Id.*; exh. DPS-SD-2 (Confidential) at 18.

123. FairPoint's projections indicate that the Company will be able to comply with its financial covenants and capital expenditure plans. The Company is projected to have EBITDA from operations and cumulative free cash flow of $437.3 million and $334.2 million, respectively, by the end of 2013. Exh. DPS-SD-2 (Confidential) at 6; [Giammarino] Allieri/Newitt pf. at 45–47.

124. FairPoint's financial advisor compared the company's projections with the ratings scale generally utilized by Standard & Poor for companies operating in businesses similar to FairPoint. This analysis indicates that FairPoint's key financial metrics will be in line with a BB-rated company at emergence from Chapter 11 and may improve to an investment grade (BBB) level by the 2011-2012 timeframe. [Giammarino] Allieri/Newitt pf. at 46–47; exh. DPS-SD-2 (Confidential) at 20.

125. The review of FairPoint's Plan projections by the Department's expert, Mesirow, included a "sensitivity analysis" which tested FairPoint's results under the following scenarios:

> Scenario 1: Baseline, using Plan projections.
>
> Scenario 2: Maintains all Plan-projected revenue components except for a projected decrease in local revenues resulting in the removal of $353.4 million of cumulative net revenue through 2013.
>
> Scenario 3: Uses all Plan-projected revenue components at actual 2009 levels with a projected decrease in local revenues resulting in the removal of $496.2 million of cumulative net revenue through 2013.
>
> Scenarios 2a and 3a: Projects a 5% year-over-year annual revenue decline to sensitize results obtained in Scenarios 2 and 3. These annual declines were applied to each revenue component sequentially and also on a total net revenue basis.

Exh. DPS-SD-2 (Confidential) at 21.

126. Under some sensitivities run by the Department's expert, FairPoint may reach investment grade by 2013. Exh. DPS-SD-2 (Confidential) at 20.

127. Although interest rates are at historic lows, rising interest rates may not have a material impact on FairPoint's projected performance. Because the New Term Loan will contain a LIBOR floor of 2%, until LIBOR exceeds 2% from its current level of approximately 0.25%, the interest expense reflected in the business plan will not be impacted. [Giammarino] Allieri/Newitt pf. at 48.

128. Based upon a sensitivity analysis run by FairPoint's financial advisors, for each one percent increase in LIBOR above the floor level of 2% reflected in the business plan for 2010, annual 2010 interest expense would increase by approximately $10 million. [Giammarino] Allieri/Newitt pf. at 49.

129. In terms of liquidity and the financial covenants in the New Term Loans, FairPoint's projections indicate the potential for a significant cushion that may enable FairPoint to meet its commitments under a variety of scenarios. The financial cushion assumes the repayment of nearly $350 million of the new

$1 billion Term Loan by the end of 2013 as well as the steady build-up of cash to more than $400 million by the end of 2013. *Id.* at 51–52.

130. The projected build-up of cash (to more than $400 million by 2013) occurs even after giving effect to the $700 million of capital expenditures contained in the projections and reflects the potential size of the cushion provided in the financial projections. *Id.* at 52; O'Brien pf. at 6.

(c) Deficiencies: Projections and Analysis

131. FairPoint developed its projected results for 2010 based on actual revenues recorded by the Company for the three months ended May 2009, and actual operating expenses for the five months ended July 2009. Projected results for 2011 through 2013 were then projected using anticipated trends in revenue and expenses as applied to the 2010 projections. FairPoint used the shortened time periods as a basis for its projections because it did not believe the financial information from prior periods to be sufficiently reliable. Exh. DPS-SD-2 (Confidential) at 12; tr. 5/12/10 at 80 (Darr).

132. FairPoint was unable to provide the Department's expert, Mesirow, with personnel or supporting documentation that could justify the reasonableness of the significant underlying assumptions used by FairPoint in compiling its projections. As a result, for the purposes of its review, Mesirow was forced to rely on information obtained from other personnel not directly involved in the compilation of the projections. Exh. DPS-SD-2 (Confidential) at 12; tr. 5/12/10 at 82–87 (Darr).

133. FairPoint's projections do not reflect the impact of a previously reported decline in revenue, due to billing errors, of approximately $25 million (3%) for the first three quarters of 2009. FairPoint has filed amended Form 10-Q's with the SEC for those quarters and does not consider the decline in revenue to be material. Exh. DPS-SD-2 (Confidential) at 12; tr. 5/12/10 at 90–92 (Darr).

134. FairPoint developed its projections on a top-down, "company-wide" basis as opposed to a bottoms-up, "business unit" basis. Bottoms-up projections are more in-depth and are generally considered to be more reliable indicators of future performance, especially for organizations undergoing significant change. FairPoint did not have adequate financial data to prepare a bottoms-up projection due to systems-related issues involving the cutover from Verizon's systems. Exh. DPS-SD-2 (Confidential) at 13; tr. 5/12/10 at 93–94 (Darr).

135. The Company was unable to provide Mesirow with the underlying source for, or quantify, the variety of anticipated cost savings included by FairPoint in its projections. In the absence of source documentation, and to measure the reasonableness of FairPoint's projected cost savings, Mesirow relied on discussions with FairPoint personnel and outside advisors who were unable to relate specific cost savings to specific line items. Exh. DPS-SD-2 (Confidential) at 13; tr. 5/12/10 at 93–96 (Darr).

136. In conducting its sensitivity analysis, Mesirow considered, but did not include, FairPoint's actual line losses for the 2008 and 2009 time periods which exceeded 10%. Instead, Mesirow conducted a "worst case" analysis (Scenario 2a and 3a) using a 5% year-over-year annual decline in revenue as a stress factor to stress test projected revenues and coverage ratios. Exh. DPS-SD-2 (Confidential) at 21–22; tr. 5/12/10 at 67, 79, 107–109 (Darr).

137. Mesirow's sensitivity analysis reveals that FairPoint would breach its interest coverage and leverage ratios in 2012 and 2013 if the underlying assumptions for Scenarios 2a and 3a are realized. Exh. DPS-SD-2 (Confidential) at 22.

138. The telecommunications companies Mesirow chose to include in its industrial peer comparison analysis comprised companies that are substantially larger than FairPoint. Tr. 5/12/10 at 98–100 (Darr).

139. FairPoint's Plan projections for CAPEX do not budget for continued expenditures on systems improvements and cutover-related costs beyond 2010. Giammarino pf. at 43; tr. 5/12/10 at 52–54 (Darr).

(d) Supplemental Filings

140. Pursuant to the Board's memorandum of May 27, 2010, FairPoint recalculated its financial model using the actual rate of change from 2009 vs. 2008 in the following areas: Scenario 1: access revenue; Scenario 2: data services revenue; Scenario 3: local revenue; Scenario 4: operating expenses; and Scenario 5: all variables combined ("Board-1"). FairPoint does not accept these projections as a realistic representation of its future operating performance. Exh. Board-1(Confidential) at 9.

141. The recalculation contained in Board-1 shows a significant loss of local access revenue between 2008 and 2009. *Id.*

142. The Board-1 modeling shows that covenant breaches occur in 2012 and 2013 when the rate of change in local revenue is considered, and that breaches occur in 2010-2013 when all variables are considered. *Id.* at 21, 27.

143. Pursuant to the Board's memorandum of June 3, 2010, FairPoint performed a second recalculation ("Board-2") of its financial model under two additional scenarios: Scenario 6: using a local revenue loss rate of 10% per year throughout the forecast period keeping all other variables in line with the Plan projections;[94] Scenario 7: using an all variables scenario factoring in the 10% local revenue loss rate plus the actual rate of change from 2009 vs. 2008 for access revenue, data services revenue, and operating expenses. FairPoint does not accept these projections as a realistic representation of its future operating performance. Exh. Board-2 (Confidential) at 4, 7.

144. The Board-2 modeling shows that FairPoint will be able to comply with its financial covenant ratios in all years of the projection period under Scenario 6. Under Scenario 7, FairPoint covenant breaches occur in the years 2010-2013. *Id.* at 6, 9.

145. The Department filed Mesirow's response to Board-1 and Board-2 on June 10, 2010. Mesirow concludes that Scenarios 3, 4, 5, and 7 are not probable outcomes and reaffirms its conclusions and recommendations from its original report contained in Exh. DPS-SD-2. Exh. Board-4 (Confidential) at 4–5.

146. Pursuant to the Board's memorandum of June 18, 2010, FairPoint performed a third recalculation ("Board-3") of its financial model assuming a local line loss rate of 7% and using all other modeling assumptions under Scenario 7 as a basis. FairPoint also provided, as part of this request, additional model runs for years 2011-2013 showing the maximum amounts of local service revenue loss possible to keep FairPoint in line with its financial covenant ratios. All of these model runs resulted in seven additional scenarios: Scenario 8 through Scenario 14. FairPoint does not accept these projections as a realistic representation of its future operating performance. Exh. Board-3 (Confidential) at 3–16.

147. The Board-3 modeling shows that FairPoint breaches its covenants in 2011 under Scenario 8, and in 2012 under Scenarios 9 and 12. Exh. Board-3 (Confidential).

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94. FairPoint disclosed in its 2009 Form 10-K that its actual local line loss rate for 2009 was approximately 11.3%. Exh. Board-5 at 64.

3. Discussion

In evaluating FairPoint's request for transfer of ownership out of Chapter 11 Bankruptcy, FairPoint must show that the reorganized company will be financially sound. In doing so, the Company must establish that it has the financial capability to maintain service quality, make suitable improvements to its plant, and grow its revenue base while at the same time satisfying its financial obligations to the states and its creditors. In short, FairPoint must establish that its emergence from bankruptcy will be successful and that the Company will remain financially viable over the long term.

FairPoint argues that the significant deleveraging of its balance sheet as part of the Chapter 11 reorganization will result in a company that is stable, financially viable, and able to meet its regulatory and debt-service commitments. Fairpoint asserts that the $1.7 billion write-down of its existing debt, and the corresponding reduction (69%) of its annual interest expense, will provide it with a substantial cash flow cushion enabling the Company to fund all of its capital and debt servicing commitments for the foreseeable future. In support of its claims, FairPoint relies on its Plan projections which it argues are conservative, reasonable and supported by the Company's recent history. FairPoint also relies heavily on the analysis and testimony of the Department's financial expert, Mesirow Financial, who also found the Plan projections to be reasonable and consistent with FairPoint's history. FairPoint asserts that with its systems and debt-servicing issues behind it, the projections envision a healthy company with a stable future characterized by moderate revenue growth, annual declines in operating and capital expenditures, and a substantial buildup of free cash flow.

The Board has an extensive working history with FairPoint which provides us with some insight for evaluating the plausibility of FairPoint's financial projections and key assumptions. Accordingly, a key part of our evaluation must include a look back at FairPoint's financial position and expectations at the time of its 2008 acquisition of the northern New England territory from Verizon, and how it has performed in fulfilling those expectations since that time up to the time of its bankruptcy filing in October of 2009. Given FairPoint's recent history, no one disputes the fact that the Company's performance has been less than satisfactory, and that many of its problems were self-inflicted. Because historical performance is oftentimes the best indicator of

future performance, and since FairPoint has presented us with a new set of projections and expectations for its post-bankruptcy future, it is especially important to appraise the Company's viability from this perspective.

In the following subsections, we analyze the quality and reasonableness of FairPoint's Plan projections and also the Department's analysis. For the purposes of this evaluation, we accept as significant the potential financial benefits of the $1.7 billion write-down of FairPoint's existing debt, and the prospective financial cushion it provides. Determining the reliability of this cushion, along with that of FairPoint's projection assumptions concerning revenue growth, line losses, capital expenditures, and reduced operating costs, will be critical for us to conclude that FairPoint is financially sound. However, for the reasons explained above, our historical experience with the Company also prompts us to approach FairPoint's numbers with a skeptic's eye. First we consider the reliability of FairPoint's past assurances and projections at the time of its acquisition of the northern New England operations from Verizon.

(a) The 2008 Merger and Acquisition

On March 31, 2008, FairPoint consummated its merger and acquisition of Spinco (Verizon's NNE operations) resulting in FairPoint as the surviving entity. Previously, on December 21, 2007, we issued our first order in Docket No. 7270 initially denying FairPoint's request to acquire Spinco. During the course of our proceedings leading up to that decision, FairPoint submitted a substantial amount of testimony and information in support of its argument that it was financially ready to step into Verizon's shoes. In general, FairPoint made the following key assertions:[95]

(a) Initial annual line loss of 6.2%, gradually tapering off to 2.3% per year.

(b) Line-loss increases will be sufficiently offset by the build-out and sale of DSL service.

(c) Cutover to FairPoint's new systems will be achievable within five months of closing.

(d) Transition expenses under the Transfer of Service Agreement ("TSA") with Verizon will not exceed $100 million and will not extend beyond 2008.

95. Docket No. 7270, Order of 12/21/07 at 55-82.

(e) Synergies resulting from new systems integration and replacement of Verizon's higher cost functions will result in additional cost savings of $65-75 million in 2008.

(f) Average year-to-year increases in operating expenses not to exceed 1% .

(g) Annual reductions in employee count of 4% to 4.5% resulting in additional cost savings for salary and wage expense.

(h) Unforseen increases in operating or capital expenditures will be sufficiently offset by a reduction or elimination of shareholder dividends.

(i) Free cash flow will be relatively stable at approximately $200 to $220 million annually over the first five years after closing.

(j) An annual free cash flow cushion after dividends of $70 million will be available for unforseen financial difficulties.

Based upon the substantial historical record contained in Docket No. 7270, a record which spans FairPoint's progression through the merger transaction, subsequent cutover, and eventual bankruptcy, it is abundantly clear that FairPoint failed to realize any of the above forecasts. Even with the enhancements to FairPoint's financial metrics provided by the revised merger transaction, which we approved on February 15, 2008, those enhancements (reduced purchase price and reduced leverage) were not sufficient to allow FairPoint to achieve its projections. For example, we now know that: (i) line losses were substantially greater than projected for 2008 and 2009; (ii) systems functionality issues delayed cutover for an additional five months resulting in substantial increased operating costs; (iii) FairPoint's suspension of its dividend in March 2009 was not sufficient to assist FairPoint in meeting its debt-servicing requirements; (iv) customer service issues caused FairPoint to staff-up in 2009 as opposed to staffing down; and (v) ongoing systems issues in 2009 resulted in a $28.8 million increase in operating expenses. We note that then, like now, FairPoint maintained that its projections were reasonable, conservative, and provided for a sufficient margin of error.

In addition, as part of our 2008 review of the modified merger transaction in Docket No. 7270, we required FairPoint to provide a revised set of projections based on our most pessimistic assumptions concerning line losses, operating expenses, and capital expenditures (the "VoIP Scenario").[96] Likewise, as noted above, we made similar requests in this proceeding for Fairpoint

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96. Docket No. 7270, Order of 2/15/08 at 11.

to produce additional model runs to stress its base assumptions concerning line losses and expenses which FairPoint submitted under seal as represented by Exhs. Board-1, Board-2, and Board-3. In the case of the VoIP scenario, FairPoint argued that the Board's assumptions were highly unlikely and unrealistic.[97] Nevertheless, FairPoint's actual performance throughout 2008 and 2009 turned out to be worse than the Board's most pessimistic assumptions. Similarly, as with the VoIP scenario, FairPoint protests that the Board's latest assumptions, and the modeled outcomes of the June supplemental filings, are unrealistic.[98]

(1) The Department's Analysis

It is clear to us that Mesirow's analysis does not constitute a critical review of the Plan projections. Mesirow essentially took FairPoint's operating assumptions at face value, verified the math and basic methodology, but did not undertake a diligent effort to evaluate risk or examine FairPoint's vulnerability to changing conditions. Indeed, even though Mesirow's sensitivity analysis reveals that FairPoint will breach its covenant ratios in 2012 and 2013 under Scenarios 2a and 3a (which feature a year-over-year revenue loss factor of 5%), Mesirow does not analyze those outcomes nor does it consider the results in its overall conclusion. Further, we do not accept Mesirow's sensitivity analysis as a true "stress test" which sufficiently considers the limits of FairPoint's numbers given FairPoint's historical performance. A more reasonable historical correlation is contained in FairPoint's supplemental filings (Exhs. Board-2 and Board-3), particularly under Scenarios 7 and 8, which contemplate line losses (10% and 7%, respectively) and growth in operating expenses that are more in line with FairPoint's actual experience during the 2008-2009 time frame. Under these scenarios it is apparent that, given FairPoint's historical operating performance, and despite the cash-flow cushion provided by the post-bankruptcy deleveraging, FairPoint would not be able to meet its financial covenants with its creditors. Nevertheless, despite these results and the closer historical correlation, Mesirow, in its

97. Docket No. 7270; Leach supp. pf. 1/24/08 at 5.

98. Exh. Board-1 (Confidential) at 6; exh. Board-2 (Confidential) at 7.

supplemental report, characterizes the supplemental runs as improbable and remains confident in the conclusions of its original report.[99]

We are also concerned that in some instances, as we found above, Mesirow was unable to review or verify the reasonableness of FairPoint's base assumptions because much of the source documentation for the financial model could not be located by FairPoint. Instead, Mesirow was forced to rely on discussions with FairPoint's personnel and outside advisors who had no direct involvement in developing the Plan projections. Based on our own expertise in this area, in order to judge whether a company's prevailing assumptions about the future are consistent with possible scenarios and respective probabilities, the analyst must be able to examine all available evidence both within and external to the construction of a forecast. In the present case, Mesirow based much of its review on external sources but did not have complete access to internal information which formed the basis for FairPoint's projections.

We also question the reasonableness of Mesirow's peer-group selection as a basis for its conclusion that FairPoint's performance, under the Plan projections, will exceed that of peers on nearly all levels of measurement (except for net profit margin). In a nutshell, Mesirow concludes that FairPoint will outperform the median level for the peer group on measures of liquidity, capital structure, gross profit margin, and EBITDAR coverage ratios. We note, however, based on Mesirow's testimony, that many of the companies contained in Mesirow's peer group are substantially larger than FairPoint.[100] As such, these companies have already completed most of their DSL build-out, have greater numbers of subscribers, and have ready access to the capital markets.[101] In short, none of these companies face the same financial and operational challenges as FairPoint. Although we appreciate FairPoint's ambitious expectation that it will be able to perform up to the same level as many of these larger companies, we also view such a notion as unrealistic given the facts, and one more indication that FairPoint's projections may be overly optimistic.

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99. Exh. Board-4 (Confidential) at 4-5.

100. Mesirow includes in its peer group such large-cap companies as Windstream Corp., CenturyLink, Frontier Communications Corp., and tw telecom. Exh. DPS-SD-2 (Confidential) at 15.

101. Tr. 5/12/10 at 98-100 (Darr).

(2) FairPoint's Current Economic and Competitive Landscape

Aside from FairPoint's substantial debt servicing costs, FairPoint attributes its inability to execute its original business plan to: (i) vigorous and growing competition in the Northern New England telecommunications marketplace; (ii) the credit crisis and recent recessionary effects on employment and consumer spending; (iii) continued significant capital expenditures to remain competitive and to satisfy regulatory obligations; and (iv) FairPoint's limited access to the capital markets.[102] While we do not dispute the validity of these factors and their impacts, FairPoint has not provided us with any evidence that demonstrates how these factors are less relevant now or how they will have less of an impact in FairPoint's post-bankruptcy future.

FairPoint continues to face intense competition in local calling, long distance, and internet services in a majority of areas within its Northern New England territory. Indeed, while FairPoint was plagued by systems and service quality issues in 2008 and 2009, it increasingly lost market share to its cable competitors and fell behind in offering customers high-speed internet service, resulting in deteriorating revenues.[103] According to FairPoint's own assessments, the Company's significant losses in voice access lines resulted mainly from competition from bundled offerings provided by cable companies.[104] FairPoint also estimates that a majority of its customers have access to local calling, long distance and internet services through a cable television company.[105] In addition, wireless competitors continued to expand their networks in those market areas placing additional pressure on FairPoint's local calling and long distance services. Internet service providers, satellite companies, and electric utilities have also begun to compete in FairPoint's service territory.[106] As technology and economies of scale improve, competition from all of these providers is expected to increase and intensify in the near future.[107] Since FairPoint receives approximately 40% of its revenue from local calling services,[108] FairPoint's inability to stem the tide of continued line losses to its competitors is a primary area of concern for us and one which

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102. [Giammarino] Hood pf. at 12.
103. *Id.* at 7-10.
104. Exh. Board-5 at 47.
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 62.

we believe, based on our additional model runs, will continue to negatively impact FairPoint's ability to grow its business to the levels reflected in its projections. In fact, this continuing trend was recently reinforced with the filing of FairPoint's Form 10-Q for the first quarter of 2010 which discloses a line loss in local access of 12.4% that FairPoint attributes to ongoing competitive pressures and technology substitution.[109] Although FairPoint's next generation broadband strategy may help it retain existing access line customers, we are not convinced that it will necessarily help FairPoint win back sufficient numbers of prior customers who were lost to cable, or assist in significantly increasing FairPoint's subscriber base with new customers who now have a variety of providers to choose from.

In addition, FairPoint has not demonstrated that it can achieve its projected reductions in operating costs or realize additional cost savings from systems improvements and new networks that have yet to be completed. As we have found above, a major source of these costs have been FairPoint's ongoing systems issues which have persisted since cutover and contributed greatly to FairPoint's eventual financial downfall. FairPoint has undertaken a considerable effort, most recently its CDIP initiatives, involving the deployment of significant financial resources and personnel to address these issues.[110] As a result, FairPoint asserts that many of its problems have been fixed and that the costs associated with these issues will be behind the Company after September 2010 when it expects its systems to be performing at pre-cutover levels.[111] While we accept FairPoint's assertion that it has made strides in resolving many of these problems, system defects remain and manual workarounds continue to serve as temporary solutions until automated processes can be designed and implemented. Moreover, we are aware that there have been instances where FairPoint assumed a problem to be fixed only to have that problem reappear at a later time.[112] Although FairPoint's management expresses confidence that its systems will be performing at pre-cutover levels by the third quarter of 2010, FairPoint's own Information Technology experts testified that a definite completion date for the CDIP initiatives could not be predicted with certainty and that the degree of improvements achieved would not be known until

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109. Exh. Board-6 at 58.
110. [Giammarino] Hood pf. at 9.
111. *Id.* at 43, 51; tr. 5/11/10 at 17 (Weatherwax).
112. Tr. 5/12/10 at 31–32 (King).

an overall assessment has been performed.[113] For these reasons, we are skeptical of FairPoint's base assumptions that its systems issues will be resolved by October and that the services of its outside consultants, and related costs, will no longer be a financial burden going forward. Although we acknowledge that such an effort may yield some improvements down the road, and that FairPoint's resources have limitations, we have received no evidence, or guarantees from FairPoint, that would lead us to conclude that these remediation efforts will not need to be continued beyond 2010 or even 2011.

FairPoint's geographic concentration in the Northern New England market area is an additional consideration that may affect the Company's future financial performance. As of year-end 2009, approximately 86% of FairPoint's access line equivalents were located in Maine, New Hampshire, and Vermont.[114] As a result, any deterioration in economic conditions in these markets, particularly housing and employment, will provide further downward pressure on demand for the Company's services which in turn will result in continuing losses of access lines that could have a material adverse affect on FairPoint's financial condition.[115] Based on our own knowledge and monitoring of current economic conditions in Vermont and Northern New England in general, we understand that a robust recovery has not materialized and that conditions for growth in employment, housing, and consumer spending may remain subdued for an extended period. As noted above, FairPoint acknowledges the recent economic recession as one of the primary factors contributing towards its financial failure. Nevertheless, it is apparent that FairPoint did not consider this known variable to be a factor when it prepared its Plan projections.

(3) FairPoint's Supplemental Filings

In our analysis of the credibility of FairPoint's projections, we find the information provided by the additional model runs we requested from FairPoint to be compelling since these additional runs were based largely on assumptions concerning the Company's historical performance. FairPoint submitted this information (Exhs. Board-1, Board-2, and Board-3) under seal; therefore the specific contents of the reports remain confidential. However, in general terms

113. McLean/Weatherwax reb. pf. at 3.
114. Exh. Board-5 at 48.
115. *Id.*

for the purposes of this discussion, we requested additional model runs that took into account both nominal and extreme cases for line loss, plus some points in between. We also requested, in some scenarios, inclusion of historical year-to-year increases in operating expenses as well as assumptions regarding potential decreases in those expenditures. Overall, in reviewing the outputs of these runs, we observed that under the variety of scenarios tested it is likely that FairPoint will breach its financial covenants in 2011, and possibly beyond, if elevated trends, or even moderate trends, in line loss and operating expenses materialize.[116] Although FairPoint protests that our assumptions and the modeling results are unrealistic, we conclude that FairPoint's Plan projections are not sufficiently consistent with its past performance and that the supplemental runs provide a more plausible basis for projecting FairPoint's future financial success and soundness.

We also had the opportunity to consider FairPoint's actual operating results for the first quarter of 2010 as reported in its recently filed Form 10-Q with the SEC. As we reference above, FairPoint is relying heavily on the deleveraging aspect of its emergence from bankruptcy to provide it with a substantial cash cushion to meet additional operating and capital expenditure needs. However, upon review of FairPoint's Form 10-Q, it is apparent that FairPoint's cost structure and ongoing declines in gross revenue continue to negatively impact its operations and its prospects for financial viability. This is especially evident given that FairPoint was still under bankruptcy protection during this period of time and thus not subject to most of its normal debt-servicing and trade-credit obligations which will re-surface once FairPoint emerges from bankruptcy. Specifically, FairPoint's Consolidated Statements of Operations for the months ended March 31, 2010, show that FairPoint's operating expenses of $95 million remain historically high at 35% of gross revenue, down only slightly from 37.8% reported at year-end 2009.[117] In addition, the Company continues to experience declining gross revenues due to a high rate of line loss for local access which came in at 12.4% for quarter-end.[118] Also noteworthy is the continued

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116. Exh. Board-1(Confidential) at 19–21, 25–27; exh. Board-2 (Confidential) at 7–9; exh. Board-3 (Confidential) at 3–19.

117. Exh. Board-5 at 47; exh. Board-6 at 58.

118. *Id.* (Board-6).

decline in data and internet subscribers which dropped by 4.8% from year-end 2009.[119] With these declines, operating income continued to trend into the negative at -$20.8 million for the quarter (operating income at year-end 2009 was -$89 million).[120] These costs, when combined with other expenses, including reorganization costs of $55 million, caused FairPoint to end the quarter with a negative net profit of -$75.5 million.[121] Admittedly, reorganization costs will not be a recurring expense that will impact FairPoint's future bottom line; however, using operating income as one measure of FairPoint's current and future performance, and given FairPoint's bankruptcy protection status, we fully expected to see some improvement in these metrics. Unfortunately, it appears that FairPoint continues to struggle with line losses and continues to maintain a high cost structure, the combination of which is not sustainable over the long term despite deleveraging. Consequently, in light of FairPoint's actual performance while still under Bankruptcy Court protection, we reiterate our general conclusion that FairPoint's Plan projections appear to be unduly optimistic and not a credible predictor of future financial performance.

(b) Conclusion

FairPoint's financial soundness and ultimate success depends almost exclusively on whether or not it can achieve and realize the key assumptions on which its Plan projections are based, namely, that its operating systems and cutover-related issues will be resolved this year, that increases in loss of access lines will be significantly reduced, that operating expenses will be controlled and substantially reduced, and that the build-out of VantagePoint will be completed on time and increase FairPoint's subscriber base. However, as we discussed above, we find that FairPoint's projections are neither plausible nor consistent with the Company's historical trends. We acknowledge the substantial benefits that deleveraging imparts to FairPoint's post-bankruptcy balance sheet; but beyond those benefits, FairPoint has been unable to substantiate the reasonableness of its assumptions, in particular, reduced line losses and declining operating expenses. FairPoint argues that its operating systems and cutover issues are behind it; however,

119. *Id.*

120. *Id.*

121. *Id.* Even after discounting $34.6 million in interest expense which may or may not be an allowable claim out of bankruptcy, net profit is still negative at -$40.9 million.

we have not received any testimony or evidence which demonstrates that to be true. The model runs that the Board requested FairPoint to make show that FairPoint will experience difficulty if historical trends in line losses and operating expenses continue. In fact, it is likely that FairPoint could fail to meet its financial covenants with its lenders as early as 2011 if FairPoint's optimistic forecasts are not realized. As a result, there is the foreseeable risk that FairPoint may also face liquidation as early as 2011 or thereafter. Because FairPoint has not demonstrated the reasonableness of its projections, we are not persuaded that FairPoint will be financially sound after emerging from bankruptcy.

As we stated above, we would welcome a revised proposal from FairPoint that addresses the concerns we have identified. In particular, a revised petition would need to address three basic concerns. Going forward, FairPoint still faces substantial costs associated with its debt. A reduction in the level of the debt or other restructuring of FairPoint's financial obligations could reduce its expenses to a level that would allow it to be financially sound under a range of plausible scenarios.

FairPoint also must ensure that its analysis uses reasonable and supportable inputs for future revenues. As we have explained, FairPoint's revenue assumptions vary from recent trends. Other than a generalized comparison to other telecommunications carriers (performed by the Department, not FairPoint), we received no evidence demonstrating why we should expect such improvement. Moreover, even if we assume that FairPoint can reduce the rate of decline in local service revenues that it has recently experienced, FairPoint's supplemental model runs raise questions about FairPoint's ability to meet its debt loads. Any revised petition should either assess the Company's financial soundness on the assumption that future performance on revenues will be similar to the past or adequately support a projected improvement in that performance.

We have a similar concern with FairPoint's projections of operating expenses. As discussed above, FairPoint's projected financial viability is significantly dependent on whether the Company can substantially reduce its operating expenses. To date, FairPoint has not substantiated its projection of a large reduction in operating expenses. The Company has made a generalized reference to a reduction in costs due to completion of efforts to fix its systems, but the record evidence contains no quantification of these reductions. For example, even if Capgemini finally

remedies the system problems, we have no evidence showing the extent to which FairPoint's operating expenses would decline. Moreover, given the length of time that system problems have persisted and FairPoint's past overly optimistic projections about resolution of those problems, we remain skeptical that the systems corrections will be completed as quickly as FairPoint projects. If FairPoint is underestimating the time and/or resources necessary to finally overcome its systems deficiencies, operating cost reductions would be further delayed. For these reasons, in any revised petition FairPoint must demonstrate the reasonableness of its operating cost assumptions and justify any substantial improvement over recent trends.

D. Fair Point as a Fair Partner in Business Transactions

1. Findings

(a) Just and Reasonable Terms and Conditions

148. FairPoint's restructuring will not affect the delivery of products or terms and conditions of service because the restructuring is financial in nature rather than operational. Tr. 5/10/10 at 20–22 (Hood); [Giammarino] Hood pf. at 17.

149. The restructuring will not have an adverse impact on rates, terms, service and operations of Telephone Operating Company of Vermont LLC. Tr. 5/10/10 at 48–49 (Hood).

150. FairPoint's Regulatory Settlement with the Department preserves the majority of the conditions imposed in Docket No. 7270. O'Brien pf. at 6.

(b) Adequate Service Quality (Retail)

151. FairPoint's service quality is measured by the RSQP. Allen pf. at 6; tr. 5/11/10 at 144 (Mills).

152. For the RSQP, compliance is measured on an average year-to-date basis against the specified baseline standard. Allen pf. at 6.

153. In 2009, FairPoint failed to meet 10 of the 18 performance standards in the RSQP. This performance triggered 1470 service quality compensation points and resulted in an obligation to provide service quality compensation of $10,515,650.[122] Exh. FP-4.

154. Based upon FairPoint's reporting, certain areas of its service meet or exceed acceptable levels. Call center performance is very good as it relates to contact service levels including calls answered within 20 seconds, average handle time, and abandonment rate. Network Performance has also been good as measured by the Network Trouble Report Rate and several other network metrics which have positively surpassed their baselines for at least the past several months. Mills pf. at 4; exh. FP-JWA-4.

155. Other areas of FairPoint's service have improved significantly, but require additional improvement and stability to meet both FairPoint's objectives and acceptable standards. Examples include Percent Residence and Business Not Cleared in 24 Hours, and Percent Installation Commitments Not Met – Company Reasons. Mills pf. at 4; exh. FP-JWA-4.

156. Other areas of FairPoint's service remain problematic and either do not show signs of significant improvement or early improvements have leveled. These include late orders for retail and wholesale, late disconnects, billing errors and adjustments, and customer complaint escalations. Mills pf. at 4–5; Mills reb. pf. at 6; tr. 5/10/10 at 17–18 (Hood).

157. Late Orders for DSL service, local service requests ("LSRs") from competitors, and access service requests ("ASRs") remain higher than normal, although FairPoint has recently had some improvement in retail late orders. Mills pf. at 12–13; Mills reb. pf. at 8–9.

158. Automated flow-through for orders designed to flow-through to provisioning and billing without manual intervention has not improved to acceptable levels and exacerbates other problem areas. Order fall-out requires unplanned manual effort, which reduces the ability of staff to address other issues. It also increases the chance that an order will be late. Mills pf. at 5–6.

159. In the last several months, FairPoint has made progress in a number of areas that had previously been problematic. It is not clear whether these improvements will be lasting. Mills reb. pf. at 6–10, 22.

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122. This figure represents the maximum amount of service quality compensation in a single year and is based upon a plan maximum of 300 compensation points. FairPoint's actual compensation points, which reflect service quality performance, were far higher.

160. Beginning with the October RSQP Report filing, FairPoint was able to provide data for three metrics that had not previously been reported. Allen pf. at 12.

161. Through April 2010, FairPoint was meeting all except one of eighteen metrics — "Percent Installation Appointments Not Met — Company Reasons." Exh. FP-9; tr. 5/10/10 at 105-108 (Allen); Allen reb. pf. at 2.

162. Historically, FairPoint and Verizon had difficulty meeting the "Percent Residence Troubles Not Cleared in 24 Hours" metric. FairPoint managed to meet this metric the last three months. Allen reb. pf. at 2; exhs. FP-JWA-10 and 11.

163. Through the first quarter of 2010, FairPoint's results are trending better than Verizon's historical performance in 10 of the 18 RSQP metrics. Allen reb. pf. at 6; exh. FP-JWA-10.

164. FairPoint has made "very significant improvements since the time of cutover" and service quality is much improved over the situation following cutover. Tr. 5/12/10 at 8–9 (King).

165. The independent monitor, Liberty Consulting, expects that the achievements FairPoint has made are sustainable because underlying systems or delivery mechanisms have been fixed. Tr. 5/12/10 at 14–15 (King).

166. After the CDIP projects are completed in the third quarter of 2009, FairPoint expects to be at pre-cutover levels of service. Tr. 5/10/10 at 103 (Allen).

167. The Department estimated that FairPoint will reach stabilization and acceptable performance levels across the board within the next three to six months. Mills reb. pf. at 22; tr. 5/11/10 at 164 (Mills).

(1) Billing

168. Known billing errors and billing adjustments remain high. Billing errors exist to some extent in most legacy billing systems. Incorrect products, rating, and sales taxation are not uncommon, but are often not discovered once they are in place for extended periods of time. Mills pf. at 6.

169. Billing errors and adjustments have shown little substantive improvement and must be considered excessive. Mills reb. pf. at 12.

170. Known billing errors increased in January. Exh. DPS-WCM-2.

171. Some number of the known billing errors and adjustments are likely the result of problems in upstream systems and processes, including faulty service-order data entry, late disconnections, and inconsistent or unsynchronized data as examples. Mills pf. at 6.

172. The level of known FairPoint billing errors and billing adjustments are resulting in billing-related customer complaints 400% to 500% higher than during Verizon's operations. Mills pf. at 6; exh. DPS-WCM-3.

173. FairPoint has implemented a multi-tiered plan to identify and address retail billing issues. Allen pf. at 19; Nolting pf., generally.

174. This plan consists of: (1) a Bill Review Team that proactively examines a sampling of approximately 1,500 bills; (2) regular meetings between a billing team and customer service representative teams from the retail call centers to track billing issues that have been raised by customers with call center representatives; (3) continued efforts to correct the billing and other systems to address systemic and billing issues; and (4) completion of a number of the CDIP projects recommended by Accenture to address billing issues. Allen pf. at 19–20.

175. FairPoint also has put in place a Wholesale Billing Team, which is specifically dedicated to CLEC billing issues and is available to CLEC customers to address any questions or inquiries. Allen pf. at 23–24.

176. FairPoint is pursuing intermediate- and long-term data synchronization, systems and process solutions and has targeted portions of its CDIP and IT Roadmap initiatives to address billing problems. FairPoint expects these initiatives to provide benefits to business customers in terms of the quality and accuracy of bills. Despite these efforts, billing has shown little improvement recently and errors remain at unacceptably high levels. Mills reb. pf. at 12; Allen pf. at 23.

177. FairPoint is taking steps to identify and fix the system issues that were causing multiple-location customers to receive inaccurate bills. Allen pf. at 21.

178. At this time, it is not known whether FairPoint's initiatives will address all billing issues. Mills reb. pf. at 17.

(2) Performance Enhancement Plan Funds

179. During 2008, 2009 and to date in 2010, FairPoint has triggered $37.5 million in Performance Enhancement Plan ("PEP") penalties for missing certain Service Quality Performance Areas and Service Quality Events as defined in the PEP. Allen 4/13/10 pf. at 2.

180. To date, FairPoint has set aside $36.0 million in PEP funds for defined projects. Plans for the remaining $1.5M will be filed throughout 2010 as additional projects are identified. A total of 197 PEP projects have been identified to improve service quality performance: 49 in 2008, 68 in 2009, and 80 to date in 2010. Allen 4/13/10 pf. at 2; tr. 5/10/10 at 127–128 (Allen).

181. These projects provide for a variety of equipment and infrastructure enhancements and include interoffice and exchange fiber-cable-placement projects, the replacement of deteriorated and/or outdated exchange plant, the placement of fiber cable and optical digital loop carrier ("ODLC"), the repair of vault entrances at 5 Central Offices, the replacement of digital carrier backup batteries at 300 digital carrier locations and the purchase of 49 emergency generators, as examples. Allen 4/13/10 pf. at 2; tr. 5/10/10 at 127–128 (Allen).

182. Once completed, the 197 projects will represent the replacement of approximately 510 poles and 360,240 feet of copper cable, the placement of 1,983,009 feet (or 375.5 miles) of fiber, and the installation of 101 ODLC systems. Allen 4/13/10 pf. at 2.

183. Through the end of 2009, FairPoint had expended $11.8M of its 2008 and 2009 PEP set-aside funds. As of March 31, 2010, FairPoint had completed 57 projects. Allen 4/13/10 pf. at 2; exh. FP-JWA-7.

184. The Board's Order in Docket No. 7270 required Verizon to set aside $25 million to fund PEP projects. Docket No. 7270, Order of 2/15/08 at 44; tr. 5/10/10 at 127 (Allen).

(c) Adequate Customer Service

185. Vermont customer complaint escalations, in which a customer unsatisfied with FairPoint's response to a complaint initiates a complaint with the Department, remain at consistently higher levels than Maine and New Hampshire. Mills pf. at 7.

186. Monthly and open complaints for Vermont have declined since the cutover from Verizon, but they remain at higher than pre-cutover levels with unresolved complaints remaining consistently high. Mills pf. at 7.

187. Since the beginning of 2010, the total incoming escalations are averaging approximately 130 per month. This is down considerably (34%) from 2009, but still approximately three times higher than pre-cutover levels, which were an average of 44 escalations per month. Allen reb. pf. at 6–7.

188. Complaints for billing, disconnections, "other," and service orders remain above levels experienced before cutover. Mills pf. at 8–9.

189. Through April 22, 2010, approximately 54% of the new escalations are billing related. This has increased since cutover, as the total percent of escalations received with billing issues during 2009 was 38.3%. Allen reb. pf. at 7.

190. The pre-cutover average, for years 2006 to 2008, for billing escalations was approximately 35% of the total escalations received. The volume of billing and collection complaints peaked in August 2009 and has been trending downward since that time. Although still higher than normal, the billing escalations are decreasing month-over-month in 2010. Allen reb. pf. at 7.

191. FairPoint and the Department have disagreed on the number of escalations to the Department. To remedy this, FairPoint and the Department have agreed on a process to track open escalation numbers. When FairPoint considers a complaint resolved, it will note that in the subject line of the e-mail back to the Department. The official FairPoint Escalation Tracker will indicate the date this resolution was sent in the "Resolved" column. After the Department completes its required actions, a Department representative will send an e-mail back to FairPoint stating that the complaint is officially resolved. FairPoint will then close the complaint on the Escalation Tracker. Allen reb. pf. at 7.

192. FairPoint continues to focus on system and process improvements, which are expected to have a positive impact on the reduction of billing complaints. Allen reb. pf. at 4.

(d) Availability of Emergency services

193. FairPoint's restructuring will not affect the delivery of emergency services because the restructuring is financial in nature rather than operational. Tr. 5/10/10 at 20–22 (Hood); [Giammarino] Hood pf. at 17.

(e) Adequate Rate of Investment

194. FairPoint has committed to meet the capital investment requirements of the Docket No. 7270 Final Order and the Company's projections contemplate approximately $700 million in capital investment for the period 2010–2013. Exh. FP-AG-2; exh. FP-1 at § 2 of Exhibit F; [Giammarino] Allieri/Newitt pf. at 45; O'Brien pf. at 6.

(f) Compatibility with Other Systems

195. After restructuring, FairPoint expects to provide the same products and services that it now provides. Thus, the interconnection with other systems should be unaffected because the restructuring is financial in nature rather than operational. Tr. 5/10/10 at 20–22 (Hood); [Giammarino] Hood pf. at 17.

196. FairPoint's provision of wholesale services to CLECs still does not meet acceptable levels, as measured by the Performance Assurance Plan ("PAP"). FairPoint is continuing to work to address these issues. *See* findings 217–225, below.

(g) Compliance with Conditions in Docket No. 7270

(1) Dual Poles

197. In Docket 7270, the Board ordered FairPoint to remove all of the dual poles (approximately 8658) in its system within 30 months. Docket No. 7270, Order of 2/15/08 at 47.

198. FairPoint has removed approximately 5,000 of the dual poles and intends to finish on time or would provide the Board with a remediation plan. Tr. 5/10/10 at 125–126 (Allen); exh. FP-5.

(2) Switch-to-Bill Audit

199. FairPoint has completed a Switch-to-Bill audit in Vermont, as required by the CPG issued to FairPoint in Docket No. 7270. Nolting pf. at 12.

200. The Switch-to-Bill Audit consisted of a review of the Vermont telephone numbers ("TN's") served by the eight 5ESS switch centers located in Vermont and an assessment of the match rate of retail telephone number records found in the switch with those found in the billing system. Nolting pf. at 12.

201. The results of the Switch-to-Bill Audit demonstrate that the relationship between the switch and the billing system is sound with an overall error rate of approximately 1%, which is within industry norms. Nolting pf. at 13.

(3) Broadband Expansion

202. In Docket No. 7270, the Board required FairPoint to extend broadband service to provide 100% broadband availability in half of its telephone exchanges. Docket No. 7270, Order of 2/15/08 at 42.

203. FairPoint still expects to meet its broadband deployment commitments for 2010. Tr. 5/10/10 at 124 (Allen).

204. FairPoint has invested heavily in its VantagePoint network, which in the near term will offer broadband speeds of up to 15 MB/second, compared to maximum speeds of 7 MB/second with the existing Asynchronous Transfer Mode network. Allen pf. at 25.

205. The VantagePoint Next Generation Network will provide bandwidth that can support an array of new products, such as IPTV (internet protocol television), fiber to the home and other advanced services. It will also be designed to be scalable, providing the capability for bandwidth to be increased quickly to provide products and services to meet future business and residential customer demands. Allen pf. at 25.

206. Work on the core VantagePoint network is complete and FairPoint is now deploying it to remote terminal sites in all three states and is signing up residential customers for the service. FairPoint also expects to be able to offer wholesale and business customers a new high-speed product. Tr. 5/10/10 at 121–122 (Allen).

207. As of the end of the first quarter of 2010, FairPoint had extended broadband service to 78% of its access lines in Vermont. It had only one exchange with 100% broadband availability. Exh. FP-5.

208. The Regulatory Settlement extends and modifies FairPoint's obligation to provide 100% broadband coverage to half of its Vermont exchanges. *See* findings 35–39, above.

2. Discussion

In addition to our expectation that FairPoint would demonstrate technical competence and an interest in offering telecommunications services in Vermont (which Verizon lacked), we approved FairPoint's acquisition of Verizon's Vermont wireline operations because we expected that FairPoint would improve service quality, expand broadband deployment, and offer a broader range of services than had its predecessor. FairPoint would use the same facilities that Verizon had, so that the actual delivery of telecommunications service was expected to be unchanged. FairPoint also agreed to be bound by the same regulatory commitments that applied to Verizon, including the Alternative Regulation Plan and the Amended RSQP (which was a part of the Plan). FairPoint and the Department both testified that the financial penalty provisions of the RSQP would serve as a significant incentive to meet state standards for customer service.[123] FairPoint committed to deploy new back-office systems to operate the business; it was expected that these systems would be more efficient and provide FairPoint increased capability.

Certain elements of these expectations have proven to be accurate. The network has continued to operate properly (although cutover created a few problems for existing customers, primarily related to broadband services). FairPoint's rates, terms and conditions, which are regulated by the Alternative Regulation Plan, have not changed except as permitted by that Plan.

In other areas, however, FairPoint's performance has lagged expectations. Most noticeable has been the service quality and customer service obligations. As we described above, cutover produced significant problems with FairPoint's systems and led directly to the Company being unable to comply with service quality standards. In 2009, FairPoint triggered the maximum amount of compensation to its customers that is authorized by the RSQP; the service quality

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123. Docket No. 7270, Order of 12/21/07 at 105.

would actually have triggered even higher compensation except for the cap set out in the RSQP. The system failure also produced a large increase in customer complaints to the Department, which reflected the service that customers were receiving and FairPoint's inability to address the complaints.

More recently, FairPoint's service quality performance has improved, although it remains substandard. The last three months, FairPoint achieved almost all of the standards in the RSQP; we do not yet know whether this will continue, but it is a large improvement over the past. Customer complaints to the Department are also fewer, but still much greater than prior to cutover.

FairPoint's performance of the commitments and mandates in Docket No. 7270 also shows a mixed record. In the area of service quality, FairPoint and the Department agreed to the PEP, under which FairPoint would invest additional money in the network if it failed to meet certain additional service quality criteria (beyond the RSQP). The Board even required Verizon to set aside $25 million of the maximum $37.5 million under the PEP to fund performance. Yet despite triggering the maximum amount of PEP set asides, as of the hearings, FairPoint had expended only $11.8 million of the required funds.[124] FairPoint has plans for expending the remainder, but the Board would have expected to see the investment occur more quickly.

FairPoint has expanded broadband services, increasing the percentage of access lines with broadband availability from 69.5 percent in the third quarter of 2008 to 78 percent at the end of the first quarter in 2010. The bulk of this change occurred in the fourth quarter of 2008, with only slight increases since that time. As to the specific requirement that FairPoint achieve 100 percent broadband availability in half of its exchanges, to date FairPoint has only met this goal in one exchange (which it achieved early).[125] Finally, FairPoint is behind schedule in its removal of dual poles, although the Company still expects to meet its target.[126]

FairPoint's obligations are also affected by the Regulatory Settlement with the Department. Under that Settlement, FairPoint's obligation to provide customers with over $11 million in refunds for substandard service quality would be waived. These penalty amounts could be

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124. Allen 4/13/10 pf. at 2; exh. FP-JWA-7.
125. Exh. FP-JWA-7.
126. Exh. FP-JWA-7.

partially (or, theoretically, completely) restored depending upon FairPoint's performance in 2010.[127] Customers who were adversely affected by FairPoint's difficulties thus would forego compensation owed them under the RSQP.

The Regulatory Settlement also relaxes FairPoint's broadband build-out commitment. The December 31, 2010, deadline for meeting the 100% availability requirement in half of the exchanges would be extended by six months. The 100% availability would also be reduced to 95%, although FairPoint would be required to extend broadband service to any of the remaining 5% of customers within 90 days of a request.

Finally, the Regulatory Settlement permits FairPoint to request (in a separate proceeding) use of federal USF funds for infrastructure projects. These funds now provide a material, $1.57 monthly credit to ratepayers.

The net effect of the Regulatory Settlement is delayed broadband expansion, loss of over $11 million in refunds, and the possibility of what amounts to an increase in local rates.

FairPoint maintains that considering its improvement in service quality and its other commitments, FairPoint will be a fair partner for Vermont under the Reorganization Plan and Regulatory Settlement. In particular, FairPoint points to the choice between a stable FairPoint, reorganized under the bankruptcy process, and a company facing uncertainty because its first plan for reorganization was not approved. FairPoint argues that the former is preferred.

The Department supports FairPoint's request, but during hearings and in its brief, the Department urged that we adopt a series of conditions to help ensure improvement in service quality.[128] On June 22, 2010, the Department filed a letter stating that it was concerned that

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127. Ten percent of the waived service quality compensation is restored for each of ten specified service quality standards that FairPoint exceeds in 2010. A number of these standards are likely to be met based upon past performance.

128. The Department recommended the following conditions:

1. FairPoint shall create new service quality reporting to include metrics and baseline reporting for retail billing errors and adjustments. Baseline performance metrics would be defined in conjunction with Department staff.

2. Following the completion of CDIP initiatives, FairPoint shall institute a new service improvement program with projects for each under-performing service area with sub-initiatives to be completed by year-end 2010. These projects should include: Billing Errors, Billing Adjustments, Late Orders - Retail, Very Late Orders - Retail, Late Orders - LSR, Very Late Orders - LSR, Late Orders - ASR, Very Late Orders - ASR, Late Disconnect Orders - Retail, Late Disconnect Orders - Wholesale, Percent Installation Commitments Not Met - Company Reasons, and

(continued...)

"there was a strong probability" that the additional measures it recommended "would be challenged."[129] As a result, the Department recommends that any service quality remediation efforts be dealt with in a separate proceeding later this summer.

Our task in this proceeding is to determine whether FairPoint will be able to provide quality service at reasonable rates to its consumers and whether approval of the transaction offers tangible benefits for those customers. Certain benefits are apparent, most noticeably further expansion of broadband services and improved bandwidth. Although FairPoint's Docket No. 7270 commitments are extended by six months, FairPoint will be providing nearly all customers in half of its exchanges with broadband services. We cannot be certain that this would occur if FairPoint remains in bankruptcy. We also cannot be certain that the broadband improvements would transpire if FairPoint emerges from bankruptcy with questions about its financial

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128. (...continued)
Vermont Complaint Escalations for at least Billing and Disconnections.

3. FairPoint shall institute a Late Order Task Force(s) for both retail and wholesale orders with the objective to reduce late orders to 10% or less for all order types by third quarter 2010. This task force would have an executive sponsor, a clearly defined work plan with monthly objectives, and results would be reported through existing reporting and the new Service Quality reporting described above. The task force would remain in place until all late order categories reached the stated objective.

4. The billing focus groups that are in place today, as described in Mr. Jeffrey Allen's and Mr. Thomas Nolting's prefiled direct testimony, should remain in place at least until known billing errors from prior months reach 0%, and average daily adjustments reach $30,000 for 3 consecutive months.

5. FairPoint shall continue to provide a credit of $5.00, established under the Merger Order in Docket No, 7270, for each month in which a bill provided to a customer contains an error. Such credits will continue until such time as FairPoint's known billing errors from prior months reach 0% and average daily adjustments reach $30,000 for three (3) consecutive months.

6. FairPoint shall provide a credit of $5.00 to any retail customer whose bill is not rendered within seven (7) calendar days of the customer's scheduled billing cycle. Retail customers whose bills are not rendered within thirty (30) calendar days of the customer's scheduled billing cycle shall receive a credit of $25.00. In the event of a final bill, the credit will be $25.00 or the account balance, whichever is greater.

7. FairPoint shall participate with the Department in weekly telephone conference calls to address service quality and customer impacting issues. These calls shall continue through December 31, 2010, unless and until both parties are in agreement to alter or eliminate the scheduled calls. These calls may be conducted in conjunction with current calls involving the Vermont Department of Public Service, the New Hampshire Public Utilities Commission, the Maine Public Utilities Commission, and the Liberty Consulting Group.

8. FairPoint shall hire an Auditor, which is acceptable to it and the Department, to conduct an audit of its reporting and related systems to assure that measures are calculated and reported correctly. The specific scope of work will be developed jointly between FairPoint and the Department and will include, but not be limited to, a review and assessment of FairPoint's processes and systems.

129. DPS Letter of 6/22/10 at 1.

soundness; our concern about the financial soundness, discussed above, thus raises questions about whether Vermont consumers can expect FairPoint to be in a position to meet its commitments.

FairPoint customers also should be able to expect further improvement in service quality. The independent monitor assures us that the service quality gains to date reflect real corrections in the underlying systems. We do not yet have a sustained period of performance from which to judge, but the improvements are encouraging.

Assuming FairPoint can emerge from bankruptcy financially sound, the Company should also be able to offer its customers more service options. FairPoint's broadband services are likely to be more competitive with those of other providers than the Company has been in the past.

Against these potential and expected benefits, we must weigh the Regulatory Settlement and the continued concerns about service quality. In particular, ratepayers are asked to forego direct refunds and, if we later approve it, a material credit on local service rates. If we were convinced that FairPoint would be, and would remain, financially sound and would deliver services consistent with customer expectations, we might find the Regulatory Settlement to be a reasonable concession. However, we are not persuaded that it is reasonable to waive the service quality penalties if FairPoint's financial soundness is in question (thus raising the possibility that ratepayers might not receive the expected benefits or might face further adverse consequences).[130]

We have two other areas of concern. The first area is the continued service quality, consumer protection, and billing problems. The Department originally proposed a number of conditions to address these matters. In general, we find these conditions, with some minor modifications, to be reasonable and would adopt them if we were to approve the Reorganization Plan and Regulatory Settlement. The proposed conditions are directed at existing problems and should create incentives for FairPoint to further improve its systems.

The second concern is the PEP. FairPoint agreed to the PEP program as an incentive to improve service quality. It is surprising that only about one-third of the funds allocated to the

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130. We note that the RSQP and the compensation to ratepayers is not a stand-alone plan. The RSQP is an integral part of the Alternative Regulation Plan. FairPoint has received direct benefits from operating under that Plan. It has continued to receive those benefits during bankruptcy. Absent good cause, FairPoint should be expected to comply with its obligations under the Plan as well.

PEP program have been spent, particularly since Verizon had placed in escrow two-thirds of the total potential PEP expenditures, so the availability of capital would have been unaffected by the financial difficulties FairPoint faced. In light of the service issues, we expect FairPoint to move quickly to complete its obligations under the PEP program.

E. Effect on competition

1. Findings

(a) FairPoint's Wholesale Service Quality

209. Competitors rely upon FairPoint to provide high-quality, non-discriminatory service, accurate and timely billing, and complete and accessible information regarding the services it provides. This includes information such as the status of installations, trouble reports, repairs, and the availability of facilities, as well as timely provision of services such as repair and installation. Lackey pf. at 5–6.

210. Following cutover, wholesale customers experienced problems with pre-order processes, poorly explained error messages during order placement, orders "falling out" of the system and failing to be processed, directory listing orders not properly flowing through the system, and billing errors. Many of the order flow-through issues affected FairPoint's retail customers as well. Murtha pf. at 4.

211. The cutover to FairPoint's systems in February 2009 adversely affected competitors. Mullholand pf. at 2–3.

212. Significant problems in providing services to CLECs still remain. Mullholand pf. at 4, 6–7.

213. FairPoint has seen an improved level of on-time performance for its wholesale operations. At the end of 2009 FairPoint had approximately 1,000 late wholesale orders; by May 2010, FairPoint had only about 530. Similarly, order flow-through improved from 49% in February 2009 to 89% in December 2009. Tr. 5/10/10 at 208 (Murtha); Murtha pf. at 5.

214. Substandard wholesale service quality can directly affect competitors, consuming competitors' staff time, delaying competitors' ability to provide service to customers, and generally adversely affecting competitors' relationship with their customers. Lackey pf. at 10–11.

215. It does not appear that FairPoint is providing a different level of service to the CLECs than it provides to its own retail operations, though there are aspects that are unique to the way the CLECs operate and there are types of orders that are unique to wholesale operations. Tr. 5/12/10 at 22 (King).

216. Most of FairPoint's failures in meeting wholesale metrics have been in benchmark measurements rather than parity measurements.[131] Tr. 5/10/10 at 211–212 (Murtha).

217. Due to the bankruptcy filing, wholesale customers have had to go through extra efforts to collect monies owed them by FairPoint. Tr. 5/10/10 at 20–21 (Hood).

(b) Performance Assurance Plan

218. The Performance Assurance Plan ("PAP") was established to measure FairPoint's wholesale performance. As part of the acquisition of Verizon, FairPoint agreed to comply with the PAP; the Board's Order approving the acquisition required such compliance as a condition of approval. Lackey pf. at 7; Docket No. 7270, Order of 2/15/08 at 54.

219. The PAP does not measure all aspects of wholesale service, but covers many elements important to CLECs. Lackey pf. at 7.

220. When PAP penalties are triggered, it is (to a very high degree of statistical confidence) because FairPoint's wholesale service is either deficient relative to the standards in the PAP or discriminatory in favor of FairPoint's retail service. Lackey pf. at 8.

221. Starting in February 2009, the PAP penalties were far in excess of pre-cutover levels. Lackey pf. at 8.

222. These increased PAP penalties and the performance deficiencies that the penalties reflect arose due to cutover of systems. Tr. 5/10/10 at 197 (Murtha).

223. More recently, PAP penalties have trended downward, but they remain well above pre-cutover levels, indicating that FairPoint's wholesale service continues to fall short of levels FairPoint was achieving before cutover and that Verizon had achieved before the transaction. In

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131. Benchmark measures assess performance based upon a specified standard, such as a mandate to fulfill an order within a specified number of days. Parity measures assess performance by comparing FairPoint's performance of the same function for wholesale and retail services, with failure representing wholesale performance that is worse than corresponding retail performance.

Vermont, PAP/C2C penalties dropped from almost $400,000 in November 2009 to just over $100,000 over the last two reporting periods. Lackey pf. at 8; exh. FP-TPN-2; exh. Cross OneComm-13; *see* also Murtha reb. pf. at 4–5.

224. FairPoint hopes to have PAP penalties back to normal levels or near zero by the end of September. Tr. 5/10/10 at 198 (Murtha).

225. FairPoint has not paid all amounts owing under the PAP. FairPoint paid $594,635 for Mode of Entry ("MOE") penalties to the Vermont Universal Service Fund ("VUSF") on April 8, 2010. FairPoint has not paid the VUSF $2,092,159 for MOE penalties that accrued prior to the filing of the bankruptcy petition. FairPoint also has not paid all amounts owed to CLECs under the PAP. Tr. 5/10/10/ at 23–24 (Hood); Nolting 4/13/10 pf. at 2–3; exh. FP-TPN-2.

226. FairPoint expects to pay all outstanding PAP penalties in conjunction with approval of its restructuring plan. Tr. 5/10/10/ at 23–24 (Hood); Nolting 4/13/10 pf. at 2–3.

(c) Interconnection Obligations

227. Interconnection agreements are the foundation for non-incumbent carriers to make use of FairPoint's network for the provision of telecommunications service. They specify the physical interconnection arrangements as well as provide for the exchange of traffic. Lackey pf. at 14.

228. FairPoint has stated that it would not reject any interconnection agreements as part of the restructuring. However, FairPoint still maintains the ability to reject such contracts in the final reconciliation process if it and each competitor cannot agree on the appropriate amount to "cure" past owed amounts from either party. Hood reb. pf. at 7; tr. 5/10/10 at 25–31, 79–83 (Hood).

229. Even absent an interconnection agreement, FairPoint is obligated to comply with the federal Telecommunications Act and FairPoint plans to continue to offer services under the terms of a rejected agreement until a new agreement is in place. Tr. 5/10/10 at 144–149, 154, 156 (Skrivan).

230. The Statement of Generally Available Terms ("SGAT") also needs to remain in place to support competition. Lackey pf. at 15.

231. FairPoint's present CPG contains a number of conditions related to competition that were necessary to a fair competitive marketplace. Failure to preserve these conditions could adversely affect competitors. Lackey pf. at 15.

232. The terms of the "Stipulated Settlement Terms" by and among FairPoint Communications, Inc. and a number of CLECs would remain unchanged after approval of the Plan. Skrivan 4/13/10 pf. at 6.

(d) Efforts to Address Wholesale Problems

233. In September 2009, FairPoint reorganized its wholesale business group to help address problems. Murtha pf. at 2.

234. To address CLEC concerns, FairPoint held four "CLEC Face to Face Forums." These were full-working-day sessions with wholesale customers in Portland, Maine, which were attended by 22 representatives from the CLEC community, representing 16 different CLECs. The forums addressed twelve specific "Focus Items" and generated 162 action items. Murtha pf. at 6; tr. 5/10/10 at 190–191 (Murtha); tr. 5/11/10 at 24–25 (Weatherwax).

235. As of the end of April 2010, one item (Data Synchronization) is scheduled to be completed in September 2010 as part of the CDIP Program. FairPoint expects to complete the remaining items between May and June 30, 2010. Murtha reb. pf. at 3; tr. 5/10110 at 191–192 (Murtha).

236. When these items are complete, FairPoint plans to hold an additional face-to-face session with the wholesale community so that the Company can work cohesively with the CLECs and can validate updated processes and functionality of systems. Murtha reb. pf. at 3.

237. Accenture has recommended long-term system and process improvements for the wholesale business. FairPoint is currently working to implement Accenture's recommendations as part of the Customer Delivery Improvement Program. Murtha pf. at 3.

238. FairPoint also plans to implement CDIP projects that will provide additional benefit to wholesale customers. Murtha reb. pf. at 9.

239. FairPoint's Cross Systems Data Synchronization project also is expected to improve all aspects of the customer order experience, including flow-through, customer on-time delivery,

average handling time, order rejection and billing accuracy. The Cross Systems Data Synchronization could measurably improve both on-time order completion and billing errors. Murtha reb. pf. at 9; Mills pf. at 17.

240. FairPoint continues to work directly with CLECs to understand and resolve issues they have working with FairPoint systems. Murtha reb. pf. at 9.

241. The Wholesale User Forums were helpful and FairPoint expects to continue them. Tr. 5/11/10 at 24–25 (Weatherwax).

242. FairPoint expects that with the completion of the wholesale-related CDIP work and the work from the Wholesale User Forums, the wholesale part of its business will be stabilized. Even then, FairPoint plans to continue to upgrade its systems and improve processes as it moves forward. Tr. 5/10/10 at 192, 198, 216 (Murtha).

(e) Effect of the Reorganization Plan and Regulatory Settlement

243. The Plan of Reorganization itself is not expected to adversely affect wholesale customers. For this reason, the proposed change of control that is associated with FairPoint's Reorganization is not expected to have a detrimental effect on competition in the state of Vermont. Murtha reb. pf. at 2.

244. To the extent that competitors identify aspects of the operations that do not reflect parity between retail and wholesale operations, FairPoint intends to investigate the root cause and implement processes and/or system enhancements to address the concerns. Murtha reb. pf. at 2.

245. Overall, the Reorganization itself will be largely transparent to the CLECs and it is not expected to have an impact on FairPoint's business relationship with its wholesale customers because the restructuring is financial in nature rather than operational. Murtha reb. pf. at 2; tr. 5/10/10 at 20 (Hood).

246. FairPoint also plans to continue to work with CLECs on a simplified PAP so that the CLECs have appropriate input into any new PAP proposed by FairPoint. Murtha reb. pf. at 2.

247. FairPoint expects that the Reorganization will have demonstrable benefits for all FairPoint customers because FairPoint will emerge as a financially stronger and more viable company. Murtha reb. pf. at 2.

248. Essentially all of the regulatory conditions imposed in the Final Order in Docket No. 7270 would remain if the Board approves the Regulatory Settlement; only the condition related to broadband deployment and certain financial conditions would be changed. O'Brien pf. at 5; exh DPS-DOB-1.

2. Discussion

The Board has consistently established policies designed to open the Vermont telecommunications market to competition, with the expectation that competitive pressures will lead to a broader range of service choices and lower prices for consumers. A significant component of this effort has been the requirement that FairPoint (and its predecessor, Verizon) provide interconnection to competitors, including access to unbundled network elements at their long-run incremental cost. This requirement is also embodied in federal law.

Since FairPoint acquired the former Verizon systems, it has provided services to CLECs in accordance with interconnection agreements, other commercial arrangements, and state-mandated standards. However, even prior to cutover, competitors faced some increased difficulties as FairPoint service representatives took over for Verizon's. With the cutover to FairPoint's own systems, CLECs experienced much more widespread problems. The magnitude of these problems is reflected in FairPoint's PAP performance as well as the underlying C2C metrics. Following cutover, FairPoint triggered penalty payments under the PAP that were well over an order of magnitude higher than they had been previously.[132] These performance issues had a direct effect upon CLECs, forcing them to take extra steps to ensure that they received the necessary services from FairPoint.

As FairPoint has worked to modify its systems, CLECs have received better service. But unlike the RSQP, where FairPoint appears to be meeting its service quality commitments, PAP results still show payments much higher than before cutover, suggesting that there are still significant changes needed to ensure that FairPoint is providing adequate wholesale services. The evidence does not suggest, however, that FairPoint is now discriminating against CLEC services as some CLECs have argued; FairPoint's performance on parity metrics (i.e., measures in which

132. Lackey pf. at 8.

FairPoint directly measures the retail and wholesale services in the same way and compares the results) has been relatively good. Nonetheless, the PAP results do reflect the difficulty that many CLECs have faced as a result of cutover.

In light of the substandard performance that they have received, CLECs now ask the Board to adopt a number of conditions. In response to CLEC concerns, FairPoint asks the Board to "reject the CLEC parties' attempt to use this docket to impose unwarranted competition-based conditions on FairPoint, thereby altering contractual and legal rights that are better addressed in other venues."[133] FairPoint contends that the adoption of any conditions could undermine the Regulatory Settlement and Reorganization Plan.

FairPoint also argues that the CLECs have not submitted any evidence showing that the results of approving the Reorganization Plan and Regulatory Settlement would adversely affect wholesale service quality or obstruct competition.[134] FairPoint contends that CLEC customers are important to it and that it has worked with those customers to address the service quality concerns arising from the cutover. As a result, FairPoint asserts that service quality "has improved substantially and continues to improve."[135] FairPoint also suggests that granting the regulatory approvals would be "largely transparent" to CLEC customers.

We examine each of the proposed conditions below.

(a) Extension of Docket 7270 Regulatory Commitments

In Docket No. 7270, CLECs expressed concern that FairPoint's acquisition of Verizon's northern New England properties could disrupt existing CLEC interconnection arrangements and use of the Operational Support Systems ("OSS") under which Verizon then provided services to CLECs. To alleviate these concerns, FairPoint agreed to a number of conditions that were intended to maintain the status quo and allay any concerns about the effect of the acquisition on competition. Our December 21, 2007, Order described FairPoint's commitments as follows:

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133. FairPoint Brief at 37.
134. FairPoint Brief at 33–34.
135. FairPoint Brief at 35.

- FairPoint will assume all contracts and interconnection agreements governing service in the state of Vermont, and where that is not possible FairPoint will adopt contracts with substantially the same rates, terms and conditions.
- FairPoint will agree to extend in writing all inter-carrier agreements (including interconnection agreements) in effect as of the closing date for three years following their stated expiration date.
- In addition, for interconnection and other inter-carrier agreements with expired terms that are continued only on a month-to-month basis as of the closing, FairPoint will agree to extend the then-current rates and other terms in writing for three years following the transaction closing.
- FairPoint will assume Verizon's rights and obligations under the terms of the Incentive Regulation Plan (including the applicability of the PAP for wholesale customers), and the SQ Plan, including the agreement under the Incentive Regulation Plan not to raise rates in tariffs for existing regulated intrastate telecommunications services during the term of the Incentive Regulation Plan (through December 31, 2010).
- FairPoint will agree that the newly certificated acquired operations will not assert rural exemptions under Section 251(f)(1) of the federal Communications Act. In addition, FairPoint has proposed that it will not seek any suspension or modification of any 251(b) or (c) obligation pursuant to Section 251(f)(2) of the Communications Act.
- FairPoint will provide any item on the 14-point "competitive checklist" set forth in section 271(c)(2)(B) of the federal Communications Act that Verizon would be required to provide under the law, pursuant to the applicable pricing standard adopted by the FCC, even though FairPoint is not a Bell Operating Company (BOC) and will not be a BOC after closing.
- FairPoint will implement systems that conform to industry standards.
- FairPoint will agree not to recover transaction expenses from end users or wholesale service provider customers. FairPoint expects to capitalize certain costs such as certain conversion and systems development costs that it reserves the right to seek recovery of in future rate cases.
- FairPoint will install and test systems and provide CLECs an opportunity for training on such systems before cutover.
- FairPoint will continue to offer all CLECs (and wholesale customer) services required to be offered by Verizon immediately prior to closing (including under wholesale tariffs, agreements, and the Statements of Generally Available Terms and Conditions ("SGAT")), including access to E911 systems, back-office support systems, directory listings, automated directory assistance, published network specification sheets, CLEC User forum information, and a CLEC handbook.

- FairPoint will cap existing rates under wholesale tariffs in effect as of the closing at then-current levels for a period of three years following the transaction closing, and FairPoint will also freeze the wholesale discount offered under total service resale ("TSR") tariffs in effect as of the transaction closing date at then-current levels for three years after the transaction closing, unless FairPoint is required by law to modify such rates (for example, due to a mandated revenue-neutral rate rebalancing).
- FairPoint agrees that it will not withdraw any interstate or intrastate special access service or seek to increase any of its interstate or intrastate tariffed special access rates to be effective within three years after the transaction closing, unless required by law.
- FairPoint will also assume SGAT in Vermont and agrees that the Vermont SGAT shall remain in place with rates capped at then-current levels for three years following the transaction closing.
- FairPoint will prorate all volume pricing provided for in inter-carrier agreements, so such volume pricing terms will be deemed to exclude volume requirements from states outside of the three-state area following the closing. Verizon is contractually bound to do the same with respect to services it will continue providing in states outside the three-state area acquired by FairPoint.[136]

Sovernet, segTEL, and One Comm request that the Board extend interconnection agreements and other commitments for a period of between three and five years (different parties provide different recommendations on the appropriate length of the extension). One Comm argues that there is at least as much reason now as previously to provide CLECs with some stability. Sovernet asserts that extending the conditions would have no adverse financial impact upon FairPoint. Sovernet also contends that extending the conditions is in FairPoint's economic self-interest, since it will help FairPoint generate wholesale revenues from UNE-based CLECs; Sovernet maintains that these customers might otherwise have gone to a wireless or cable-based competitor in which case FairPoint would not receive the same wholesale revenues. Sovernet adds that, at a minimum, FairPoint must extend interconnection agreements to provide part of the benefit that CLECs had a right to expect under the Docket No. 7270 conditions.

Comcast requests that the Board maintain all conditions in FairPoint's existing CPG that relate to competition; according to Comcast, these consist of Conditions 8, 10, 14, 51–63, 65–71, 73–75, and 77 and 78. Comcast asserts that maintaining these conditions would include requiring FairPoint to honor existing interconnection agreements. Comcast contends that, notwithstanding

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136. Docket No. 7270, Order of 12/21/07 at 206–208 (citations omitted).

Fairpoint's claim that it could reject certain interconnection agreements, the Board continues to have authority to require FairPoint to honor such agreements for purposes of ensuring Vermont residents' access to telecommunications services, including emergency services.[137] Comcast further argues that, if the Board extends the terms of interconnection agreements, such extension should apply to all agreements, not solely those of parties advocating such an extension in this docket.

There is little question that the CLECs have been adversely affected by systems issues; some of these are still continuing. The magnitude of the difficulties that the CLECs have faced also means that they have not received the full benefit of the agreements they reached with FairPoint in Docket No. 7270; since cutover, there has not been a sustained period of stability. Thus, we conclude that to restore the benefit that the CLECs had a right to expect, it would be appropriate to modify certain of the competitive conditions that were intended to provide stability during the transition from Verizon to FairPoint. And, as FairPoint itself acknowledged, interconnection agreements are different from normal contracts. FairPoint has a duty under federal law to enter into such agreements with its competitors and to make available the wholesale unbundled services for purchase by CLECs. FairPoint's obligation in these areas is directly subject to the oversight of the Board as part of our traditional regulatory jurisdiction over the adequacy of service by FairPoint.[138] We also note that, even if FairPoint rejected interconnection agreements, it would still need to enter into new agreements that would be subject to the Board's jurisdiction.

At the same time, the CLECs have not demonstrated that the three-year or five-year extensions of interconnection agreements and other commitments is needed. FairPoint provided services without significant disruptions between the acquisition and cutover. Even after cutover, CLECs still received services, albeit with less reliability and much more effort required by the CLECs. The PAP performance indicates that FairPoint was providing substandard wholesale services from the time of cutover through May, a period of approximately fifteen months. Therefore, we conclude that, if we were to approve FairPoint's petition, a fifteen-month extension

137. Comcast Brief at 4.

138. *See* tr. 5/10/10 at 145 (Skrivan); *see* 47 U.S.C. § 252.

would be warranted for each of the conditions that had a three-year duration from closing (for a total of 51 months following closing).

FairPoint also must continue to honor existing interconnection agreements. In testimony, FairPoint stated its intent to do so. But FairPoint also indicated that it still retained the right to reject some agreements under the Reorganization Plan if FairPoint and the relevant CLEC could not reach agreement on a "cure" amount to compensate each other for past amounts owed. We want to make clear that, if we were to approve FairPoint's proposals, it would be very difficult, if not impossible, to conclude that the proposed transactions were not anti-competitive, and would promote the general good unless we were assured that interconnection agreements would remain in place.

(b) PAP-Related Conditions

Sovernet, One Comm, and segTEL raise several requests with respect to the PAP. Generally, Sovernet urges us to reaffirm the PAP as the minimum standards that apply to wholesale services. One Comm argues that FairPoint has failed to live by its obligation under Docket No. 7270 to adopt and freeze in place the PAP, but has instead not complied with it. One Comm and Sovernet ask that the Board require FairPoint to withdraw its request in Docket No. 7539, in which FairPoint seeks to substantially reduce the dollars-at-risk subject to performance penalties. Sovernet also asks that the Board examine a more comprehensive set of C2C metrics for measuring FairPoint's performance. Finally, Sovernet, One Comm and segTEL all request that we require an audit of the PAP, citing FairPoint's performance; in particular, segTEL questions whether the PAP accurately measures all metrics that it is supposed to measure.

In 2002, the Board accepted a proposal by FairPoint's predecessor, Verizon, to adopt the PAP as the mechanism for providing compensation to wholesale customers and customers generally when Verizon's performance fell below the standards set out in the PAP. As part of its proposed acquisition of Verizon in Docket No. 7270, FairPoint agreed to abide by the PAP; we affirmatively required such compliance as a condition in that proceeding.

Following cutover, FairPoint informed us that its newly designed systems could no longer measure all PAP metrics and requested a waiver of the PAP for these metrics. In an Order in

Docket No. 7506, we denied this request.[139] FairPoint has also asked that we reduce the dollars-at-risk under the PAP; the Board is considering this request in Docket No. 7539. FairPoint has also begun discussions about developing a simplified PAP (also under the aegis of Docket No. 7506).

We want to make clear to FairPoint that our Order in Docket No. 7270 meant what it said: the PAP is the present mechanism for providing compensation for wholesale service quality performance issues and FairPoint is obligated to comply with the PAP until the Board affirmatively approves a change. FairPoint should also be prepared for the possibility that the Board will not grant the relief it has sought in those other dockets. Nonetheless, none of the CLECs have demonstrated that it is either necessary or appropriate to make rulings with respect to the PAP in this docket and as a condition related to approval of FairPoint's proposals. The Board can address issues related to PAP simplification and dollars-at-risk in other proceedings; as the bankruptcy issues move towards resolution, we would expect to issue rulings in those dockets shortly.

We also are not persuaded that a full audit of the PAP is necessary as a condition in this proceeding. We are concerned about the CLEC allegations that PAP metrics are not being correctly measured or reported. But those issues can be addressed in Docket No. 7506 and we recommend that the CLECs raise them there.

(c) Escrow to Fund Unfinished Remediation

Sovernet observes that, although FairPoint has plans to fully remedy its systems, many wholesale service quality issues remain unresolved. Sovernet argues that, although the reorganized FairPoint will be more financially sound, it will not have unlimited resources. In addition, Sovernet asserts that FairPoint and its managers may not have incentives to fully remedy all systems that affect CLECs. Sovernet asserts that cutover-related issues caused FairPoint to incur an incremental $28.8 million in expenses during the first nine months of 2009.[140] Accordingly, Sovernet requests that the Board require FairPoint to escrow funds that may be

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139. Docket No. 7506, Order of 8/6/09.

140. Sovernet Brief at 30, citing [Giammarino] Hood pf. at 9.

needed to complete cutover-related remediation work. Sovernet recommends that the Board require an escrow of $3 million.

The Board is obviously concerned that FairPoint continue its remediation efforts until the systems provide an acceptable level of service to all customers, including the CLECs. As Sovernet contends, this may entail a substantial financial commitment. We do not, however, find it necessary to require FairPoint to set aside an escrow amount as Sovernet recommends. First, we have factored the potential expense associated with systems work into our consideration of FairPoint's operating cost projections (as discussed above in the financial analysis). Second, the escrow amount is small in relation to FairPoint's total annual operating costs. As such, it is not clear that it would actually provide any real benefit in an operating budget the size of FairPoint's. The Company should be able to generate $3 million to complete work if needed.

(d) Backbilling

Sovernet states that FairPoint is now reviewing past bills and is issuing backbills to its wholesale customers. Sovernet contends that these backbills present a significant problem for CLEC wholesale customers; review of backbills is time-intensive argues Sovernet. Moreover, Sovernet contends that, as a practical matter, CLECs cannot pass back-billed charges through to retail customers since it would create an incentive for those customers to leave the CLEC. Sovernet proposes that, as a remedy, the Board impose a limit on backbilling. Sovernet acknowledges that FairPoint has stated that it would not backbill wholesale customers beyond one year, but Sovernet argues that this is discriminatory since FairPoint will not backbill its own retail customers for more than six months.

In general, both retail and wholesale customers are expected to pay the amounts that they owe for the services they use. This includes amounts that a company may bill for past charges after it finds that it has incorrectly billed a customer. As we recently stated in Docket No. 7571:

> The general rule, in most jurisdictions, is that a person who receives goods or services from a regulated utility must pay for them at the tariffed price, no matter

> what the impact upon the customer may be and no matter how careless the utility may have been in its billing.[141]

As we explained, this principle is based upon considerations of fairness to other customers who had to pay fully for their services. Applying these principles, we would typically not place a limit on FairPoint's ability to bill its customers for past charges as it continues to correct the errors from its billing systems.

FairPoint's plans, as characterized by Sovernet, unfairly treat its competitors relative to its own retail customers. FairPoint would limit the backbilling of its own customers to six months, thus foregoing potential revenue from prior periods. However, FairPoint would seek to recover underbilled amounts from CLECs for a longer, one-year period. To be made whole, CLECs would typically seek to recover service amounts from their customers (although Sovernet has suggested that it may not do so), including for past-due amounts. Thus, any CLEC that sought to pass on additional charges arising from FairPoint's backbilling would be charging its customers for up to twelve months of prior service. The result is that FairPoint's customers (by FairPoint's own choice) would be exposed to up to six months of past charges whereas similarly situated retail customers of CLECs could face up to one year of past charges. This outcome is anti-competitive.

Since we do not grant FairPoint's petition, we do not adopt a specific condition at this time. FairPoint may continue to bill its retail and wholesale customers for past underbilled amounts. But for the reasons set out above, we conclude that unless FairPoint applies the same time-period to both retail and wholesale customers, it is engaging in anti-competitive behavior. Thus, if FairPoint determines that it is appropriate to limit back-billing to six months for its own retail customers, we would expect it not to use a longer time period in its assessment of CLECs.

(e) Independent Monitor

One Comm contends that FairPoint's prolonged inability to fix its systems "raises serious concerns about the effect that FairPoint's systems issues could have on the viability of CLEC

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141. Petition of Raymond Belanger vs. Village of Morrisville Water & Light Department, Docket 7571, Order of 6/2/10 at 6, (quoting *Petition of Dick Brady vs. Citizens Utilities Company In RE: dispute concerning metering and billing charges related thereto*, Docket 5499, Order of 11/8/91 at 4).

competition in Vermont."[142] One Comm acknowledges that FairPoint has represented that it is making progress towards returning to acceptable service levels, but it argues that the Board should continue to assure independent verification of and reports on FairPoint's progress. One Comm points to the fact that without the involvement of the independent monitor (Liberty Consulting) to date, much information related to FairPoint's performance and progress in correcting deficiencies would not be available to the Board.[143] As a result, One Comm requests that the Board continue to require the employment of Liberty as the independent monitor. Sovernet makes similar arguments and a similar recommendation.

We agree with the CLEC recommendations. We adopted the requirement for an independent monitor at the recommendation of the Department. In our Order, we required FairPoint to hire an independent monitor acceptable to it and to the Department. The scope of work was to be defined by an agreement between the three northern New England states, which we examined during Docket No. 7270.

The independent monitor has provided a useful function in overseeing transition issues. As the Department stated at hearing, this function is not yet completed since issues arising from the cutover remain.[144] The requirement from Docket No. 7270 remains in place. In fact, Liberty Consulting has recently met with CLECs to identify further issues. If we were to approve FairPoint's petition, we would make several adjustments to the Docket No. 7270 condition. First, we would modify the requirements related to the scope of work to make clear that the monitor should remain in place until we determine that FairPoint has achieved the expected level of performance. Second, we would modify the conditions to allow the Department to work with FairPoint to redefine the scope of work. It is our understanding that Liberty is near the end of its contract with the Department and the Maine and New Hampshire Commissions. We do not know whether the three states plan to jointly continue the monitoring function. Moreover, the original scope of work focused heavily on pre-cutover activities; it needs to be adjusted to reflect continued monitoring until FairPoint fixes its systems and returns to acceptable performance levels. The modified condition would provide the Department with flexibility to employ a

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142. One Comm Brief at 11.
143. One Comm Brief at 12.
144. Tr. 5/10/10 at 204 (Hofmann).

monitor either with, or separately from, the other two states or employ a different monitor. Third, we would specifically require periodic (at least monthly) reports from the monitor.[145] If, in the future, any party believes that FairPoint has reached the service level that would warrant eliminating the monitoring function, the party could file an appropriate motion and we would reassess the need for the monitor.

(f) SGAT as Tariff

segTEL requests that the Board require FairPoint to transform the SGAT into a Vermont wholesale tariff. This would allow CLECs to purchase colocation and unbundled network elements directly from the SGAT without the requirement that the CLEC negotiate an interconnection agreement with FairPoint.[146] segTEL contends that FairPoint has filed such a tariff in New Hampshire.

It is possible that converting the SGAT to a tariff would help competitors, primarily by reducing their costs of pursuing interconnection arrangements. It is also not clear that there is a downside to such a filing. Nonetheless, we are not persuaded that this proceeding is the appropriate forum for deciding such an issue. segTEL has not made sufficient showing that conversion of the SGAT would be necessary in this proceeding to redress competitive harm. segTEL is free to file such a request in another proceeding.

(g) Other segTEL requests

segTEL also requests that the Board adopt two additional conditions: (1) requiring FairPoint, within thirty days of approval of the reorganization plan, to update its dark fiber offering in Vermont to comply with FCC rules for the provision of dark fiber as a UNE; and (2) ordering FairPoint to cease collection efforts and threats of disconnection on all pre-petition CLEC invoices. segTEL also asks that the Board petition the FCC to revoke FairPoint's Section

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145. We want to remind parties that Condition 48 of our February 15, 2008, Order specifically required that the Department file copies of all written reports from the independent monitor. It is our understanding that the independent monitor was already providing reports at least monthly. The new condition would simply clarify our expectation that we would be receiving regular reports.

146. These interconnection agreements typically do little more than incorporate by reference the relevant SGAT provisions.

271 authority to provide interLATA services unless and until FairPoint can show that its CLEC operational support system is functioning in complete compliance with relevant service guidelines that had applied prior to cutover.

The Board understands segTEL's concerns, but we cannot find that these additional conditions are needed as a condition of approval of FairPoint's requests in this docket. segTEL and other parties remain free to petition the Board to address each of these issues in separate proceedings.

VI. CONCLUSION

FairPoint has made substantial progress in addressing the system issues that arose following cutover and improving the retail and wholesale service quality for customers. More work must be done before we can conclude that FairPoint is performing, and will likely continue to perform, at acceptable levels, but the organizational, managerial, and other changes FairPoint has put in place appear to be having a positive effect. If FairPoint had demonstrated that it would be financially sound, we would likely have granted the regulatory approvals FairPoint sought on the basis of this progress.

FairPoint has not, however, met its burden of demonstrating that the Company that emerges from bankruptcy protection will be financially sound. FairPoint presented us with projections that it maintains show that the Company can meet its financial obligations and will improve profitability over time. But FairPoint did not support the projections with evidence that showed the reasonableness of its assumptions about future costs and revenues that provide the essential inputs to those projections. This is problematic since in several critical areas (operating expenses, local service revenue, broadband revenue, and access revenue), FairPoint's assumptions vary substantially from past performance. This variance was not adequately explained, and analysis of FairPoint's finances, assuming that FairPoint cannot significantly improve its performance in these areas, suggests that FairPoint will face financial difficulties in the future.

The Board, therefore, concludes that we must deny FairPoint's request. FairPoint may submit a revised proposal that addresses our concerns and demonstrates its financial soundness; we are prepared to consider such a proposal expeditiously.

VII. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The Joint Petition of Northern New England Telephone Operations LLC, Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications, Enhanced Communications of Northern New England, Inc., and FairPoint Vermont, Inc. (collectively, "FairPoint") for (1) approval of an indirect acquisition of a controlling interest, (2) approval of a Settlement between the Department of Public Service and FairPoint, (3) approval of the modification of certain Certificates of Public Good issued in Docket 7270, and (4) approval of certain other transactions is denied.

2. The Amended Petition by FairPoint for approval of an indirect acquisition of a controlling interest by Silver Oak Capital, LLC, is denied.

Dated at Montpelier, Vermont, this 28th day of June, 20109.

s/ James Volz	)	
	)	PUBLIC SERVICE
	)	
s/ David C. Coen	)	BOARD
	)	
	)	OF VERMONT
s/ John D. Burke	)	

OFFICE OF THE CLERK

FILED: June 28, 2010

ATTEST: s/ Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.