

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: GLOBAL CROSSING LTD. AND FRONTIER CORPORATION	DOCKET NO. SPU-99-24
--	----------------------

**ORDER APPROVING SETTLEMENT AGREEMENT,
ESTABLISHING REPORTING REQUIREMENTS,
AND TERMINATING DOCKET**

(Issued September 24, 1999)

PROCEDURAL HISTORY

On May 7, 1999, Global Crossing Ltd. (Global Crossing) and Frontier Corporation (Frontier) (collectively, Applicants) filed a "Proposal For Reorganization" pursuant to IOWA CODE § 476.77 (1999) (the Application). The Applicants requested Utilities Board (Board) approval to transfer control of Frontier's Iowa operating subsidiaries to Global Crossing. The Board docketed the Application as Docket No. SPU-99-16.

If the proposed reorganization is approved, Global Crossing will exchange a specified number of shares of its common stock for each outstanding share of Frontier stock. Global Crossing will become the holding company for Frontier, which will be a wholly-owned subsidiary.

On May 26, 1999, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a "Motion To Dismiss And To Reject Defective

And Insufficient Filing" (the Motion to Dismiss). Consumer Advocate argued that many of the material allegations contained in the Applicants' Application, even if true when made, were substantially changed as a result of the announcement of a proposed merger between Global Crossing and U S West, Inc. (U S West), making the Application defective and insufficient.

On June 25, 1999, the Board granted Consumer Advocate's motion and dismissed the Application. The Applicants were given the option of either re-filing their application with additional information about the anticipated impact of the proposed U S West merger or re-filing in conjunction with any proposed reorganization involving U S West.

On July 15, 1999, the Applicants filed an application for rehearing, asking the Board to withdraw the order granting the motion to dismiss and to establish a procedural schedule for the expeditious completion of this docket. In support of their requests, the Applicants argued (among other things) that the potential U S West transaction is irrelevant to this docket and should be considered in a separate docket at the appropriate time. In the alternative, the Applicants supplied additional information for the record concerning the anticipated impacts of the U S West transaction. Finally, the Applicants requested expedited consideration of their application, as supplemented.

On July 20, 1999, the Applicants filed an amendment to their application for rehearing, informing the Board that the merger agreement between Global

Crossing and U S West had been canceled. Thus, there was no longer any significant effect from that transaction to be considered in connection with the Frontier operations in Iowa. Applicants renewed their request for rehearing, for withdrawal of the order granting the motion to dismiss, and for an order setting an expedited procedural schedule.

On July 22, 1999, Consumer Advocate filed a resistance to the application for rehearing. Consumer Advocate offered various arguments in support of the Board's order dismissing the application. Consumer Advocate joined in the Applicants' request for a procedural schedule; however, Consumer Advocate argued the Board should do so in a new docket, considered to have commenced with the filing of the amended application for rehearing on July 20, 1999.

On July 30, 1999, the Board issued its "Order Docketing Application, Providing Notice of Hearing, Taking Official Notice, and Setting Procedural Schedule," docketing the application as Docket No. SPU-99-24, taking official notice of all documents and orders filed in Docket No. SPU-99-16, and setting a procedural schedule. On the same day, the Board issued an order denying the Applicants' request for rehearing in Docket No. SPU-99-16.

On August 11, 1999, Applicants and Consumer Advocate filed a proposed settlement agreement, a joint motion for approval of the settlement, and a request to hold the procedural schedule in abeyance. On August 13, 1999, the Board issued an order suspending the procedural schedule, and on August 26, 1999, the

Board directed the parties to file additional information in support of the proposed settlement. At the same time, the Board scheduled a hearing for September 14, 1999, to consider the new information and the proposed settlement.

The parties filed additional information, in the form of verified responses to Board questions, on September 1, 1999. On September 10, 1999, the Board issued an order requiring supplemental information to clarify the benefits alleged to be associated with the merger and rescheduled the hearing to September 21, 1999. The Applicants then filed their second round of additional information on September 15, 1999. A hearing for consideration of the application for reorganization, the proposed settlement, and the two rounds of additional information was then held as scheduled.

STATUTORY FACTORS

Pursuant to IOWA CODE § 476.77(2) (1999), "[a] proposal for reorganization shall be deemed to have been approved unless the board disapproves the filing within ninety days after the filing." IOWA CODE § 476.77(3) lists the following factors the Board may consider in its review of a proposal for reorganization:

- a. Whether the board will have reasonable access to books, records, documents, and other information relating to the public utility or any of its affiliates.
- b. Whether the public utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is impaired.

- c. Whether the ability of the public utility to provide safe, reasonable, and adequate service is impaired.
- d. Whether ratepayers are detrimentally affected.
- e. Whether the public interest is detrimentally affected.

The standards for review in section 476.77 indicate some of the important questions for the Board's consideration in any proposed utility reorganization, including the impact of the reorganization on the utility's ability to attract capital, the potential effect of the merger on the utility's ratepayers, and the public interest generally. The Board's rules further explain the application of these statutory factors, see IOWA ADMIN. CODE 199-32 (1999).

ANALYSIS OF STATUTORY FACTORS

1. IOWA CODE § 476.77(3)“a”: WHETHER THE BOARD WILL HAVE REASONABLE ACCESS TO BOOKS, RECORDS, DOCUMENTS, AND OTHER INFORMATION RELATING TO THE PUBLIC UTILITY OR ANY OF ITS AFFILIATES.

In the "Proposal for Reorganization," the Applicants have stated they will continue to provide full access to the books and records. Records and books for Frontier Communications of Iowa (Frontier-Iowa) will be available in its Fort Dodge, Iowa, offices. Records for Frontier Communications of Schuyler (Frontier-Schuyler) will also be available until the closing of that sale transaction.¹ (Proposal for Reorganization, May 7, 1999, p. 15)

¹ At the time the Proposal for Reorganization was filed, Frontier-Schuyler was finalizing the sale of its only exchange to Minburn Telecommunications, Inc. The sale was allowed by the Board in Docket No.

In the August 11, 1999, Settlement Agreement at Article VII, Paragraph 10, the Applicants again agree to make all records available within the state of Iowa pursuant to IOWA ADMIN. CODE 199-31.2. If access to relevant records of affiliates in Iowa is not commercially practical, the Applicants agree to reimburse any costs incurred by Consumer Advocate or the Board and its employees or contractors in accessing such records outside the state.

The Board finds that these provisions are adequate to ensure the Board will have reasonable access to the books, records, documents, and other information relating to Frontier-Iowa and its affiliates.

2. IOWA CODE § 476.77(3)“b”: WHETHER THE PUBLIC UTILITY’S ABILITY TO ATTRACT CAPITAL ON REASONABLE TERMS, INCLUDING THE MAINTENANCE OF A REASONABLE CAPITAL STRUCTURE, IS IMPAIRED.

When considering whether Frontier’s capital structure, costs, or availability will be negatively impacted by the reorganization, the Board will review, among other things, the additional financial and business risks that may exist under the proposed merger.

It appears from the record that Frontier provides good service to customers in Iowa, has been a financially strong company as a whole, and historically has had investment grade bond ratings. However, its bond rating has been downgraded recently. This downgrade is mainly attributed to the proposed merger with Global Crossing.

Global Crossing, in contrast, is a recently formed (1997) company pursuing an aggressive growth strategy using both acquisitions and extensive construction. The company faces significant competition and has yet to show a profit. Both the financial risk and business risk of Global Crossing are in excess of Frontier's. Its bond ratings have been below investment grade. Unlike Frontier, the announcement of the proposed merger had a positive effect on Global Crossing's bond rating.

The Applicants assert the proposed reorganization will not affect the financial structure of either utility or impair access to financial resources. With the exception of the imposition of Global Crossing as the parent corporation, Frontier's internal corporate structure is alleged to be unaffected by the proposed reorganization. (Application for Reorganization, pp. 17, 23.)

The Board is not so certain. The Board is concerned that the business and financial risks of Global Crossing are greater than those of Frontier, giving rise to higher capital costs. This concern is at least alleviated by the Applicants' assurances in the Settlement Agreement that any future developments at the parent level will not adversely affect the Iowa utilities' ability to raise capital and maintain an appropriate

paragraphs (conditions) of Article VII of the Proposed Settlement that are particularly germane to the cost of capital and capital structure issues.

Paragraph 1 of the Proposed Settlement provides that customers of Frontier-Iowa and Frontier-Schuyler² are to be insulated from any adverse impacts on their rates, services, or service quality that may result directly from the merger. This is a general statement of protection that buttresses the more specific assurances described below, including those tailored to insulate the utilities from any possible financial and business problems of the new parent.

Paragraph 2 of the Proposed Settlement provides that the merger shall not adversely affect the cost of capital as reflected in Frontier-Iowa and Frontier-Schuyler rates. When determining the cost of capital in any future earnings analysis or rate base/rate of return rate case, it will be based on the risk attendant to the regulated operations of Frontier-Iowa and Frontier-Schuyler without merger effects. The merger shall not be allowed to adversely affect the future calculation and allowance for cost of capital of either Frontier-Iowa or Frontier-Schuyler, taking into account cost of equity, debt rates, and capital structure. The recent decline in Frontier's bond rating provides evidence of the need to protect and insulate Frontier's capital structure. If needed, a hypothetical capital structure will be used. There is no time

² Again, it should be noted that since the execution and filing of the Proposed Settlement, Frontier has closed a transaction transferring its Frontier-Schuyler assets to another local exchange carrier. In order to accurately describe the contents of the Proposed Settlement, however, the Board will continue to include references to the properties that have been sold.

limit on this commitment. Monitoring of this condition would be conducted within any rate case that was filed.

Paragraph 3 of the Proposed Settlement limits the dividend payout ratio for Frontier-Iowa and Frontier-Schuyler to 78 percent for each of the next five years. The Applicants propose filing an annual report on March 31 of each year specifying dividend payout for the prior year.

Paragraph 4 of the Proposed Settlement limits the annual dividend payout ratio to 60 percent if the equity ratio for the consolidated Global Crossing (with all its subsidiaries, including the Iowa utilities) falls below 40 percent. The limitation applies for the next five years. The Applicants propose filing an annual report on March 31 of each year specifying end-of-year common equity ratio.

Paragraph 5 of the Proposed Settlement limits the investments and financial relationships between Frontier-Iowa, Frontier-Schuyler, and the other affiliates. It includes explicit prohibitions against the lending or investing of utility funds in affiliates or in assuming any responsibility for guaranteeing loans for the benefit of affiliates. The Applicants propose, for the first three years following the merger, to file, by March 31 of each year, a statement of compliance for the prior year regarding this condition. Thereafter, the Board or Consumer Advocate can request compliance information as necessary.

Paragraph 8 of the Proposed Settlement includes a commitment that the financial soundness and integrity of Frontier-Iowa and Frontier-Schuyler shall not be

compromised by transactions between any affiliates and themselves. The Applicants propose the Board and Consumer Advocate monitor compliance with this commitment through Frontier's reporting of affiliate transactions in compliance with the Iowa Code and Board rules.

The Board finds that these conditions provide reasonable assurance that the business and financial risks of Global Crossing will not adversely impact the ability of Frontier-Iowa to raise capital and maintain an appropriate capital structure.

3. IOWA CODE § 476.77(3)“c”: WHETHER THE ABILITY OF THE PUBLIC UTILITY TO PROVIDE SAFE, REASONABLE, AND ADEQUATE SERVICE IS IMPAIRED.

The Applicants allege that this reorganization involves only a transfer of the Frontier parent corporation and will not change the operations of Frontier's incumbent local exchange carrier (ILEC) subsidiaries. Frontier claims to be strongly committed to providing its services at a high quality level. Global Crossing also states that it will not take any action that would erode the trend of improved service quality in the Frontier operations in Iowa. To further ensure continuous quality of service, Global Crossing and Frontier have made a number of additional commitments through the Proposed Settlement that appear to be intended to protect against any negative impact on local services as a result of this merger. The Applicants believe those commitments will ensure that Frontier's Iowa local exchange customers will experience no adverse changes of any significance from the merger.

These commitments can be described as follows:

- The existing Iowa local exchange management team will remain in place.
- The incumbent Iowa local exchange companies will retain the Frontier name.
- The combined entity will maintain its investment in the network.
- Workforce levels will be maintained at levels that are required to provide good service quality to customers.
- The merger will not result in requests for local rate increases.

(Application for Reorganization, pp. 23-24.)

The Board finds that these commitments are sufficient to establish that the ability of Frontier-Iowa to provide safe, reasonable, and adequate service is not impaired by the proposed reorganization.

4. IOWA CODE § 476.77(3)“d”: WHETHER RATEPAYERS ARE DETRIMENTALLY AFFECTED.

According to the Applicants, the proposed reorganization will not affect the rates charged by Frontier’s Iowa utilities and will have no financial impact on them. The reorganized entity will continue prudent investment in areas of emerging technology to build for an evolving marketplace, assuring that customers will not shoulder unnecessary costs or rate increases. (Application for Reorganization, pp. 24-25.)

In addition, the Applicants agree in Paragraph 1 of Article VII of the Proposed Settlement to insulate the ratepayers from “any adverse impact on the rates, services or service quality” resulting directly from the merger. Paragraph 11 explicitly prohibits charging merger-associated expenses against the Iowa operating utilities.

The ratepayer issue can be viewed as a cost and benefit issue. In prior reorganizations, which have often involved a utility (or its holding company) merging with a similar utility (or its holding company), the focus of the Board's analysis has been on comparing the projected net dollar savings from the proposed merger with the costs of the proposed merger. Here, that analysis is not as useful because the reorganization partners claim benefits that are complementary, not overlapping. The merger is not expected to yield savings through the elimination of redundancies in employee or capital expenditures. However, the Applicants believe benefits will accrue to ratepayers due to the integrated offerings that will be available from a more competitive world-class telecommunications provider.

There is still the underlying question of whether the merger will impose costs on the utilities, thereby putting upward pressure on rates. If there are merger-related costs, additional assessments, or even indirect increases in the utility costs due to the new association, the merger might be judged as detrimental to ratepayers if costs exceeded benefits. The Proposed Settlement seeks to assure the Board and Frontier's Iowa ratepayers that none of these costs will be imposed upon the Iowa utilities.

Paragraph 11 of the Proposed Settlement prohibits the Applicants from charging identified expenses to Frontier-Iowa or Frontier-Schuyler or any other regulated Iowa entity without prior Board approval. The prohibited charges include merger transaction and implementation costs, any acquisition premium associated

with the merger, certain contributions, and costs from offshore operations. This provision protects the utilities by proscribing the attribution of a fairly extensive list of possible expenses associated with the merger. In addition, the Applicants' response states that "all merger-related costs will be accounted for separately and will be retained at the holding company."

The Board finds that the proposed reorganization is unlikely to detrimentally affect the Frontier-Iowa ratepayers.

5. IOWA CODE § 476.77(3)"e": WHETHER THE PUBLIC INTEREST IS DETRIMENTALLY AFFECTED.

As defined in IOWA ADMIN. CODE 199-32.4(4)"c," "public interest means the interest of the public at large, separate and distinct from the interest of the public utility's ratepayers." The Board's focus is on the effect of the "merger on the economy of the state and the communities where the utility is located."

The primary features of the Proposed Settlement that appear to address this factor are the representations of the Applicants concerning employment levels and charitable contributions. The Applicants represent that they will not disproportionately reduce the number of employees in the state for the next five years. In response to the Board's written questions, they responded that Frontier-Iowa currently has 84 employees while Frontier-Schuyler has one employee in Woodward and a half-person equivalent assigned from Frontier's Illinois operations. Also in response to the Board's written questions, Frontier defined the word "disproportionately" to mean the relationship between any work force reductions in

Iowa and overall corporate-wide work force reductions. Thus, the Applicants' representation means that if there are company-wide work force reductions after the merger, the Iowa operations will not experience a greater percentage reduction than the combined Frontier-Global Crossing corporation as a whole.

The Applicants suggest that the Board can monitor Iowa employment levels through the annual reports filed by Frontier's ILECs, including the Form TR-1. The Board will direct Frontier-Iowa to continue to file the Form TR-1 for five years, beginning with 2001.

As for charitable contributions, the Applicants agree, as a part of the Proposed Settlement, that they will not reduce charitable contributions, community activities, or civic support efforts as a result of the merger. No time limit is specified. In response to the Board's second set of questions, the Applicants clarified their commitment by stating that they are committing to an average annual charitable contribution of at least \$25,000 over the next five years.

To help the Board monitor Frontier's compliance with this commitment, Frontier proposes to file an annual report, by March 31 of each year, describing the total charitable, community activities, and civic support efforts for the prior year. The reports would be filed for the first three years after the merger; thereafter, the Board or Consumer Advocate "could request compliance information as necessary."

Since Global Crossing has no Iowa operations, the proposed reorganization is not expected to reduce competition within the Iowa market. (Application for Reorganization, pp. 20-22.)

The Board finds that the proposed reorganization is unlikely to have a detrimental effect on the public interest.

CONCLUSION

The Board finds, based upon the record in this proceeding and the terms and conditions of the Proposed Settlement, that it should not disapprove the proposed merger described in the "Application for Reorganization," as amended to date, and that it should grant the joint motion for approval of the Settlement Agreement. Therefore, the reorganization will be permitted to take place by operation of law.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The motion to approve the proposed Settlement Agreement filed by Global Crossing Ltd., Frontier Corporation, and Consumer Advocate on August 11, 1999, is granted and the settlement is approved.
2. Docket No. SPU-99-24 is terminated. The joint application for reorganization filed by Global Crossing Ltd. and Frontier Corporation on May 7, 1999, and originally identified as Docket No. SPU-99-16, is not disapproved.

3. Frontier and Global Crossing shall promptly file with the Board any material changes to the proposed reorganization. Any such filing shall include an analysis of the impact of any changes.

4. On or before March 31 of each year, beginning in 2001 and continuing for each of the next four years, Applicants shall file the following:

a. Annual shareholder reports of Global Crossing and Form TR-1 for Frontier-Iowa and any successor corporations.

b. Thirteen-month average capital structure for Global Crossing, Frontier Corporation, and Frontier-Iowa (and any successor corporations) on a stand-alone basis.

c. Annual report showing compliance with the dividend payout ratio commitments of Article VII, Paragraphs 3 and 4, of the Settlement.

d. Annual report showing compliance with the affiliate transaction commitments of Article VII, Paragraph 5, of the Settlement.

e. A copy of an outside auditor's final audit report which must include a statement that no expenses related to this merger were paid by or charged to Frontier-Iowa, showing compliance with the commitments of Article VII, Paragraph 11, of the settlement.

f. Annual updates of the information filed in Exhibit 2 in this docket for Frontier-Iowa, Frontier Corporation, and Global Crossing and their successors.

g. Annual reporting on service quality measurements, structured in a format that is consistent with IOWA ADMIN. CODE 199-22.6.

h. Annual report showing compliance with the charitable contribution commitments of Article VII, Paragraph 13, of the Settlement.

5. Motions or objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comment.

UTILITIES BOARD

/s/ Allan T. Thoms

/s/ Susan J. Frye

ATTEST:

/s/ Raymond K. Vawter, Jr.
Executive Secretary

/s/ Diane Munns

Dated at Des Moines, Iowa, this 24th day of September, 1999.