BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC. For approval of a merger transaction and related matters	))))))))))))	Docket No. 04-0140

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PUBLIC UTILITIES COMMISSION

PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC.'S RESPONSES TO THE DIVISION OF CONSUMER ADVOCACY'S SECOND SUBMISSION OF INFORMATION REQUESTS

AND

CERTIFICATE OF SERVICE

ALAN M. OSHIMA, ESQ.
MICHAEL H. LAU, ESQ.
KENT D. MORIHARA, ESQ.
Oshima Chun Fong & Chung LLP
841 Bishop Street, Suite 400
Honolulu, Hawaii 96813
Telephone: (808) 528-4200
Facsimile: (808) 531-8466

Attorneys for PARADISE MERGERSUB, INC.

LESLIE ALAN UEOKA, ESQ.
BLANE T. YOKOTA, ESQ.
Verizon Corporate Services Group Inc.
P.O. Box 2200
Honolulu, Hawaii 96841
Telephone: (808) 546-3606
Facsimile: (808) 546-7621

Attorneys for GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC.

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COMES NOW, Paradise MergerSub, Inc., GTE Corporation, Verizon Hawaii Inc., Bell Atlantic Communications, Inc., and Verizon Select Services Inc., by and through their respective attorneys, hereby submit its Responses to the Division of Consumer Advocacy's Second Submission of Information Requests.

DATED: Honolulu, Hawai`i, August 27, 2004.

Alan M. Oshima
Michael H. Lau
Kent D. Morihara
Oshima Chun Fong & Chung LLP

Attorneys for Applicant
Paradise MergerSub, Inc.

Leslie Alan Ueoka
Blane T. Yokota
Verizon Corporate Services Group Inc.

Attorneys for Applicant
GTE Corporation, Verizon Hawaii Inc., Bell Atlantic Communications, Inc., and Verizon Select Services Inc.

CA-IR-68 **Ref: Verizon SEC Form 10-Q, First Quarter 2004, page 27.**

According to Verizon's 10-Q report:

> During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of $43 million ($43 million after-tax, or $.02 per diluted share) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

Please provide the following information regarding this event:

a. State whether Verizon accepted this preferred stock as part of the consideration for asset lines sold to Iowa Telecom in 2000.

Response: **[This response has been redacted as confidential subject to Protective Order No. 21034.]**

b. Explain why the ITS preferred stock was made a part of the Iowa access line sales transaction.

Response: See the response to (a) above.

c. Explain why no preferred stock consideration was made a part of the proposed sale of Verizon Hawaii.

Response: Verizon required that the purchase price be paid in cash. As a result of arms-length negotiations, the Buyer and Seller agreed that the purchase price would be paid in cash.

d. Describe how Verizon determined its original cost basis and calculated the $43 million gain upon disposition.

Response: Verizon objects to this question because the question will not lead to the discovery of admissible evidence and is not relevant to any issue in this case. In addition, the material requested is highly sensitive, competitive information, the release of which would cause substantial harm to Verizon and impair its ability to conduct its business.

Sponsor: Stephen E. Smith - Verizon

CA-IR-69 **Ref: Application, Page 12, Part D(1) Financial Fitness.**

In Hawaii PUC Docket No. 95-0051, Verizon (then GTE Hawaiian Tel) submitted testimony by Mr. Michael O'Sullivan (HTC T-4), who sponsored a study (HTC-400) captioned Outside Plant System Loss Estimate Study for Hurricanes in support of his conclusion stated at page 6:

> The analysis determined that a reasonably foreseeable worst-case hurricane event could result in reconstructive costs ranging from $48.6 million if the storm hit Kauai to $461.5 million if it hit Oahu.

Please respond to the following:

a. Please explain the financial capabilities of Verizon to fund storm restoration costs of up to $461 million, in relation to the Corporation's existing lines of credit, liquid assets and other financial resources.

Response: Verizon Hawaii and its affiliates can generate cash to pay damages from a hurricane from a variety of sources including cash from operations, short-term cash investments, existing lines of credit, and the long-term capital markets. Verizon Communications and its affiliates have the financial resources to raise the required funds for Verizon Hawaii in the case of a catastrophic event.

Another resource available to Verizon Hawaii (in the event of a major hurricane loss) would be property insurance. Verizon's property insurance would respond to the hurricane loss to the extent such losses are covered by the policies. The main terms of Verizon's property insurance coverage for a major hurricane are outlined in Verizon's response to CA-IR-40. The actual amount of insurance proceeds that Verizon Hawaii would receive would vary depending on the specific facts and circumstances of the property losses incurred.

b. Please quantify the financial capabilities of Telco Hawaii to fund storm restoration costs of up to $461 million, under the proposed new ownership and capitalization, in each year of the Exhibit 6 financial projections.

CA-IR-69 (cont.)

Response: (i) Revolving Facility - See Carlyle's response to CA-IR-42.

(ii) Operating cash flow - A portion of excess operating cash flow that is currently contemplated to be used for optional debt repayment (in Exhibit 6 of the Application) could be used to fund storm restoration costs pursuant to excess cash flow covenants to be determined.

(iii) Insurance proceeds - Aon Risk Services, Inc. has recommended a post-closing property insurance program that provides for [redacted] of coverage per loss, including direct property damage, business interruption and extra expense coverage. In the event of such loss, the Company would be required to fund the deductible, which is projected to be between [redacted] and [redacted] of property values, by location, for windstorm losses. Carlyle believes that the Company will be readily able to meet its deductible payment from the sources described herein. See the response to CA-IR-64. **[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]**

(iv) Additional equity investment from Carlyle - see the response to CA-IR-41(a).

(v) Other financial resources - see the response to CA-IR-41(c).

As noted in Carlyle's response to CA-IR-42, the Company always has the option, subject to capital markets at the time, to refinance its bank facilities and potentially increase the size of the revolving facility.

At this time, it is not possible to quantify the Company's access to capital on an annual basis during the projection period as the financial covenants have not yet been set.

c. Explain how the difference in financial capabilities between parts (a) and (b) of your response should be evaluated by the Commission with respect to whether the proposed transaction is consistent with the public interest.

CA-IR-69 (cont.)

Response: Carlyle believes that any differences in the financial capabilities between Verizon Hawaii under current ownership and Telco Hawaii under new ownership to fund storm restoration costs are not relevant to the Commission's evaluation of whether the proposed transaction is consistent with the public interest. Rather, Carlyle believes that the Commission's evaluation with respect to this issue should be focused solely on Telco Hawaii's ability under new ownership to sufficiently fund these costs. As discussed above, Carlyle believes its plans to cover losses will adequately address the effects of a catastrophic event and allow the business to recover. Furthermore, the Company will have access to adequate funds from a number of other financial resources outlined above in the response to (b).

Sponsor: Stephen E. Smith - Verizon (part a)
Susan Ko - Carlyle (parts b and c)

PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC. RESPONSES TO THE DIVISION OF CONSUMER ADVOCACY'S SECOND SUBMISSION OF INFORMATION REQUESTS DOCKET NO. 04-0140

The following information requests refer to the Financial Model Projections - General:

CA-IR-70 a. Have any Verizon Hawaii employees or any of Verizon's financial advisors in the subject transaction reviewed the financial projection model underlying Exhibit 6 for any purpose?

Response: No. Carlyle has not shared such projections with Verizon or Verizon's advisors.

b. If affirmative, please state the scope and purpose of such review and provide complete copies of all correspondence, memoranda, reports, electronic files and other documentation associated with such review.

Response: Not applicable. See response to (a) above.

Sponsor: Andrew Park - Carlyle

CA-IR-71 a. Did Verizon provide any forecasted financial information associated with the Hawaii business or assets to prospective Buyer's generally, or Carlyle in particular?

Response: No, it is our understanding that Verizon did not provide any forecasted information associated with the Hawaii business or assets to prospective buyers generally, or Carlyle in particular.

b. If affirmative, provide complete copies of all such information or reference the specific IR responses where such information has been provided.

Response: Not applicable. See response to (a) above.

Sponsor: James Brophy - Verizon

CA-IR-72 **Ref: Application, Exhibit 6.**

The Applicants' financial projections do not contain a detailed income statement for the regulated Hawaii Telco business. Please provide the Applicants' projected financial results for **each** projected year for the Telco Hawaii local exchange carrier business in the format used to report "Results of Operations" in the Verizon Hawaii Inc. column (see page 1 of HPUC Reports) to the HPUC on a quarterly basis. Please provide your response in spreadsheet format, comparing projected values to calendar year 2002 and 2003 results reported to the HPUC, with explanations of significant differences between 2003 actual results and projected revenue and expense levels, if any.

Response: Carlyle prepared financial statements for the Telco Hawaii local exchange carrier business based on Carlyle's integrated financial model (Attachment CA-IR-17 (Part 1)), using reasonable assumptions for allocating revenues and expenses and other line items. See Attachment CA-IR-17 (Part 12) filed confidentially under Protective Order for the detailed income statement.

Based on the information provided to date by Verizon, Carlyle was unable to prepare financial projections in accordance with FCC Part 32 or Part 64 regulatory accounting rules. As a result, the format for the detailed income statement is consistent with the format for the integrated financial model rather than page 1 of the HPUC Reports. Since Verizon prepared the 2002 and 2003 HPUC Reports, Carlyle cannot comment on the basis of the preparation of those financial statements, and furthermore, is not able to compare the form of its projections with that of the historical financial statements.

Sponsor: Andrew Park - Carlyle

CA-IR-73 **Ref: Verizon "Results of Operations" reports to HPUC.**

For each of the last two years of reported "GTE Hawaiian Telephone Co Inc." results in the first column of the Results of Operations report to the Hawaii PUC, please identify, explain and quantify any significant normalization adjustments required to make the reported results (inclusive of nonregulated, interstate and intrastate) representative of normal, ongoing conditions. This information is intended to be used in evaluation of your response to the immediately preceding question.

Response: In calendar year 2002, Verizon Hawaii's operating expense included the following:

1. Pension settlement losses and other severance costs. These settlement losses were attributed to lump sum payments to retirees exceeding the threshold of service and interest costs. The pension settlement losses and other severance costs totaled $27.7 million.

2. The Bell Atlantic/GTE Merger consummated in 2000 produced transition costs related to the merger. These costs were incurred to establish the Verizon Brand, integrate systems, consolidate real estate and relocate employees. The cost incurred in 2002 associated with these merger activities was $2 million.

3. Verizon Hawaii recorded $5 million in uncollectible revenue related to the MCI – World-Com bankruptcy.

In calendar year 2003, Verizon Hawaii operating expenses included the following:

1. Pension settlement losses and other severance costs of $20.5 million.

2. Verizon offered a voluntary separation plan to management which led to a $32.5 million increase in pension benefits and severance. The severance costs were recorded in accordance with FCC letter RA0 24.

Sponsor: Nancy Heuring - Verizon

The following information requests refer to the Financial Model Revenue Projections:

CA-IR-74 **Ref: Application, Exhibit 6, Description Of Schedules, Page 2 Access Lines.**

The Applicants have included residential access line reductions at a compound average growth rate of negative 1.3% for the years 2004 through 2009, shifting to a positive growth rate of 0.7% thereafter (through 2014). Please provide the following information:

a. Provide Verizon Hawaii's (residential primary, residential secondary, business, other described) actual access line statistics for each quarter of 2003 and 2004 to-date.

Response: The following is provided confidentially under Protective Order No. 21034 in response to this information request:

Attachment CA-IR-74a – Access lines

b. Verizon's most detailed projections of Hawaii access lines, as well as reflected in the Company's long term business plans and capital projections submitted to the PUC.

Response: Access line information submitted to the Commission was included in Verizon's Annual ARMIS USOA FCC Report 43-08, filed on April 15, 2004, and its 2004-2008 Construction Budget Report, filed on April 30, 2004. Verizon did not provide any projections of access lines to Carlyle.

c. State the assumptions associated with Applicant's access line growth trend projections, indicating each of the factors contributing to near-term loss rates and longer term growth rates.

Response: Carlyle determined its access line growth trend projections by developing a view of the Company's market share of the overall telephony market over time. The projections were based on various factors including the Company's historical access line growth, industry trends, Hawaii market-specific factors and Carlyle's knowledge of the fixed-line business.

i. Historical access line loss (see Attachment CA-IR-74a).

CA-IR-74 (cont.)

Although Verizon does not track reasons for access line disconnects, the Company attributed access line losses over the past three years to wireless substitution and a general downturn in economic conditions. **[The remainder of the response has been redacted as confidential subject to Protective Order No. 21034.]**

ii. Wireline industry trends (see Attachment CA-IR-74c (Part 1) filed confidentially under Protective Order).

During the past several years, large incumbent local exchange carriers ("LECs") have been losing access lines at a rate of approximately 4% per annum due to wireless substitution and wireline competition from CLECs. In contrast, access line losses by rural LECs, which operate in more favorable competitive environments, have averaged approximately 2% over the same period. **[The remainder of the response has been redacted as confidential subject to Protective Order No. 21034.]**

iii. Hawaii market-specific factors

As part of its diligence, Carlyle commissioned a primary market research study performed by Investor Group Services ("IGS") (see Attachment CA-IR-74c (Part 2) filed confidentially under Protective Order for a copy of the study). IGS surveyed over 200 residential customers in Hawaii regarding quality of service, customer satisfaction and propensity to switch to alternative services. **[The remainder of the response has been redacted as confidential subject to Protective Order No. 21034.]**

iv. Hawaii household and population growth (see Attachment CA-IR-17 (Part 2) filed confidentially under Protective Order)

Based on Global Insight 2003, households and the population in Hawaii are projected to grow 1% annually over the next 10 years. Carlyle has assumed that the number of households is an acceptable proxy for the number of primary access lines.

CA-IR-74 (cont.)

d. Provide complete copies of all studies, reports, analyses, workpapers and other documents relied upon in projecting the access line trends included in Exhibit 6.

Response: See Attachments CA-IR-74c (Parts 1 and 2) filed confidentially under Protective Order.

Sponsor: Stephen E. Smith - Verizon (parts a and b)
Susan Ko - Carlyle (parts c and d)

CA-IR-75 **Ref: Application, Exhibit 6.**

Please provide Verizon Hawaii's actual quarterly access line statistics/data for 2003 and 2004 to-date, in the format included at rows 267, 274, 282, 289 and 296 of the Buildup sheet used for the financial projections, explaining any significant deviation between the values underlying the Exhibit 6 model and the comparable actual data.

Response: Attachment CA-IR-75 filed confidentially under Protective Order provides historical access lines from Attachment CA-IR-74a in the format presented in Carlyle's detailed financial model.

The difference between the access line counts provided in Attachment CA-IR-74a and those provided in this response is that the UNE-P lines have been excluded from residential, business and public access lines. The UNE-P lines are aggregated with the UNE-L lines for a total UNE line count in the model.

The model was created prior to receipt of Q1 2004 access line information and thus, excludes such information.

Sponsor: Andrew Park - Carlyle

CA-IR-76 **Ref: Application, Exhibit 6, Description Of Schedules, Page 2 Access Lines.**

The Average Revenue Per Unit ("ARPU") values in Applicant's projections are said to be, "... based on historical revenue by product and operating metrics, such as access lines or customers." Please provide complete copies of the studies, reports, analyses, workpapers and other documents used to determine the ARPU values used in the projections.

Response: ARPU values were calculated by dividing i) historical revenues by product (Attachment CA-IR-17 (Part 4)) by ii) the corresponding operating metrics provided by Verizon (e.g., access lines, customers, etc.). The calculations of 2003 quarterly ARPUs are provided in the detailed financial model (CA-IR-17 (Part 1), columns "E-H" and rows "399-419").

No general rate increases were assumed in the financial model. As a result, ARPUs are projected to remain constant except for enterprise and special access revenues (see CA-IR-82 and CA-IR-83, respectively).

Sponsor: Andrew Park - Carlyle

CA-IR-77 **Ref: Application, Exhibit 6.**

a. Please provide a mapping of Verizon Hawaii actual recorded revenue by product for each quarter of 2003 and 2004 to-date, indicating in which rows of the financial model "buildup" sheet were each category of product included (for example, Basic Local Residential @row 427, Local Package Residential @row 432, Interstate Access @row 627, Intrastate Access @row 629, etc.).

Response: All model upstream data and corresponding rows in the detailed financial model provided in Attachment CA-IR-17 (Part 1) are provided confidentially under Protective Order in Attachments CA-IR-17 (Parts 2 through 9).

The detailed financial model was created prior to receipt of Q1 2004 financial information and thus, excludes such information.

b. Explain any adjustments made to the recorded revenues to tie totals into the financial forecast for each quarter of 2003.

Response: Revenue adjustments are provided confidentially under Protective Order in the detailed financial model (Attachment CA-IR-17 (Part 1), rows 647-650).

c. In addition, provide a reconciliation of total actual revenues to the amount reported to the HPUC for the year 2003.

Response: Applicants respectfully seek clarification of the information being sought by this information request.

Sponsor: Andrew Park - Carlyle
Stephen E. Smith - Verizon (part c)

CA-IR-78 **Ref: Application, Exhibit 6.**

Please provide supporting calculations for the actual and projected interstate and intrastate access average revenue per MOU reflected in the Applicants' projections and explain any ordered or anticipated changes in Interstate or Intrastate access tariffs in relation to such Average Revenue Per Unit ("ARPU") values.

Response: The supporting calculations for historical interstate and intrastate access average revenue per MOU are provided in Attachment CA-IR-78 filed confidentially under Protective Order. Projected interstate and intrastate access revenues are provided confidentially under Protective Order in the detailed financial model (Attachment CA-IR-17 (Part 1), rows 604-634).

Carlyle assumed that average interstate access rates would decline [redacted] in accordance with rate decreases pursuant to the FCC's Coalition for Affordable Local and Long Distance Services ("CALLS") Order. Carlyle assumed [redacted]

[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]

Sponsor: Andrew Park - Carlyle

CA-IR-79 **Ref: Application, Exhibit 6.**

Please provide historical actual Verizon Hawaii long distance customer/revenue data in the following categories for **each** quarter of 2001, 2002, 2003 and 2004 to-date, calculated on a basis consistent with the financial projections (buildup rows):

a. Number of residence long distance customers (lines).
b. Number of business long distance customers (lines).
c. Residential LD revenue.
d. Business LD revenue.

Response: **[Verizon Response]:** See Attachment CA-IR-79 filed confidentially under Protective Order. Attachment CA-IR-79 represents Verizon Long Distance customers/lines/revenues in Hawaii and does not include Verizon Hawaii toll information. Annual information for 2001 and 2002 is provided in the Attachment. Quarterly data for these years is not available at this time and will be provided at a later date to the extent available.

[Carlyle Response]: For reference, Attachment CA-IR-17 (Part 3), Tab: Long Distance (filed confidentially under Protective Order) provides the line numbers in the detailed financial model for the information provided in Attachment CA-IR-79.

Sponsor: Stephen E. Smith - Verizon
Andrew Park - Carlyle

CA-IR-81 **Ref: Application, Exhibit 6.**

Please provide historical Verizon Hawaii interstate and intrastate access minutes of use statistical data on a quarterly basis for the years 2002, 2003 and to-date 2004 and explain how such data can be reconciled to the projected MOU trends within the financial model (buildup rows 606 and 608).

Response: **[Verizon Response]: [This portion of the response has been redacted as confidential subject to Protective Order No. 21034.]**

[Carlyle Response]: The model was created prior to receipt of Q1 2004 access minutes of use information and thus, excludes such information.

Sponsor: Stephen E. Smith - Verizon
Andrew Park – Carlyle

CA-IR-82 **Ref: Application, Exhibit 6, Description Of Schedules, page 3.**

a. Please provide copies of all available support for the assumption that Carlyle can grow the average revenue per unit associated with large "enterprise" customers by 2 percent per year (buildup row 1991), indicating the specific strategies planned to accomplish this growth.

Response: Carlyle believes that a locally-branded, locally-managed company can capitalize on Hawaii market-specific factors by developing targeted advertising campaigns and promotional activities to drive sales and product penetration. To that end, Carlyle plans to [redacted] Carlyle believes that a 2% increase in enterprise ARPU is conservative vis-à-vis [redacted]

[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]

b. What has been Verizon Hawaii's historical Average Revenue Per Unit ("ARPU") associated with service to Enterprise customers in the years 2001, 2002 and 2003?

Response: **[Verizon Response]:** Verizon does not measure Average Revenue Per Unit ("ARPU") associated with service to Enterprise customers. Verizon provided historical revenue by product and operating metrics by line of business. Carlyle re-mapped the information and is providing the ARPU.

[Carlyle Response]: See Attachment CA-IR-82b filed confidentially under Protective Order. As provided in CA-IR-17 (Part 4) (filed confidentially under Protective Order), Carlyle disaggregated by product the historical Line of Business ("LOB") revenues provided by Verizon. Using the enterprise revenues from this exercise, Carlyle calculated ARPUs based on historical enterprise accounts.

Sponsor: Susan Ko - Carlyle
Stephen E. Smith - Verizon (part b)

CA-IR-83 **Ref: Application, Exhibit 6, Description Of Schedules, page 3.**

a. Please provide copies of all available support for the apparent assumption that Carlyle can grow the average revenue per unit associated with "Special Access" by 2 percent per year (buildup row 2043), indicating the specific strategies planned to accomplish this growth.

Response: No general rate increases are contemplated for special access circuits. Rather, the 2% increase in special access ARPU is driven by:

(i) Increasing demand for higher capacity circuits

Consistent with historical results, demand for higher value circuits has outpaced price decreases over the past 4 years as data and computing requirements have expanded.

(ii) Marketing and sales focus

[This response has been redacted as confidential subject to Protective Order No. 21034.]

b. What has been Verizon Hawaii's historical Average Revenue Per Unit ("ARPU") associated with special access customers in the years 2001, 2002 and 2003?

Response: **[Verizon Response]:** Verizon does not measure Average Revenue Per Unit ("ARPU") associated with special access revenue. Verizon provided historical information. Carlyle re-mapped the information and is providing the ARPU.

[Carlyle Response]: See Attachment CA-IR-83b filed confidentially under Protective Order. As provided in CA-IR-17 (Part 4) (filed confidentially under Protective Order), Carlyle disaggregated by product the historical Line of Business ("LOB") revenues provided by Verizon. Using the special access revenues from this exercise, Carlyle calculated ARPUs based on the number of historical special access lines.

Sponsor: Susan Ko - Carlyle
Stephen E. Smith - Verizon (part b)

CA-IR-84 **Ref: Application, Exhibit 6.**

Please explain the derivation of "SAB 101 Revenues" within the model underlying Exhibit 6, at row 538 of the buildup sheet and provide historical data illustrative of Verizon actual comparable experience in each quarter of 2003 and 2004 to-date.

Response: Additional information will be provided as a supplement to this response.

[Carlyle Response]: During diligence, Verizon informed Carlyle that [redacted] of total corporate revenues ([redacted] in 2003) were associated with SAB 101 (see Attachment CA-IR-84 (Part 1) filed confidentially under Protective Order) and that such revenues were recurring in nature. Thus, Carlyle estimated revenues associated with SAB 101 in 2003 were approximately [redacted]. An explanation of SAB 101 is provided in Attachment CA-IR-84 (Part 2), filed confidentially under Protective Order. **[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]**

Sponsor: Andrew Park - Carlyle
Nancy Heuring - Verizon

The following information requests refer to the Financial Model Expense Projections:

CA-IR-85 **Ref: Application, Exhibit 6, Description Of Schedules, page 3, Operating Expenses.**

a. Please provide copies of all available support for the apparent assumption that Carlyle can constrain the future growth in "headcount expense" to only "1% to 2% percent through the projection period", indicating the specific strategies planned to accomplish this cost constraint in spite of persistently increasing employee medical and retirement cost trends in recent years.

Response: From 2000 to the first half of 2003, EBITDA margins have increased from an average of 36% to 47% for large Local Exchange Carriers ("LECs") and from an average of 36% to 37% for small LECs (see Attachment CA-IR-85a (Part 1) filed confidentially under Protective Order). Cincinnati Bell, which Carlyle considers as a close comparable, is expected to decrease SG&A costs over the next two years (see Attachment CA-IR-85a (Part 2) filed confidentially under Protective Order).

Total headcount expense for the Company is comprised of three primary variables: number of employees, salaries and wages, and benefits load (including pension). In the detailed financial model provided confidentially under Protective Order in Attachment CA-IR-17(Part 1), salaries and wages are projected to increase [redacted] The benefits load is projected to increase approximately [redacted] However, headcount is expected to decline [redacted] per year due to natural attrition [redacted] As a result, on an aggregate basis, headcount expense is projected to increase 1% to 2% annually. **[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]**

CA-IR-85 (cont.)

b. What has been Verizon Hawaii's historical rate of cost growth associated with wage rates and employee benefit cost loadings in the years 2002, 2003 and 2004, to date?

Response: Verizon's average salaried merit wage increases were as follows:

2002 – [redacted]
2003 –
2004 –

Bargaining unit general wage increases in accordance with the Collective Bargaining Unit are shown below:

2.00% General Wage Increase, effective August 25, 2002
2.00% General Wage Increase, effective February 23, 2003
4.00% General Wage Increase, effective December 28, 2003
4.00% General Wage Increase, effective December 26, 2004

Additional information will be provided as a supplement to this response.

[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]

Sponsor: Susan Ko - Carlyle (part a)
Rick Wiley - Verizon (part b)

CA-IR-86 **Ref: Application, Exhibit 6, Description Of Schedules, page 3, Operating Expenses.**

a. Please provide copies of all available support for the apparent assumption that Carlyle can constrain the future growth in "non-headcount related expenses" of the business to only "1% to 2% percent through the projection period", indicating the specific strategies planned to accomplish this cost constraint.

Response: Non-headcount related expenses are projected to grow at a compound annual rate of 2% from 2004 through 2009 in the detailed financial model provided confidentially under Protective Order in Attachment CA-IR-17 (Part 1). During the same period, revenues are projected to grow at a rate of 2% per annum, so EBITDA margins are projected to remain constant at approximately 42%. Given that the base business (access lines) is projected to decline at a rate of 1.3% from 2004 through 2009, managing and controlling costs will be a key priority for the management team.

See also the response to CA-IR-85(a).

b. What has been Verizon Hawaii's historical rate of cost growth associated with comparable actual miscellaneous non-wage expenses in the years 2002, 2003 and 2004, to date?

Response: Verizon Hawaii is unable to perform a "mapping" of "non-headcount related expenses" in order to determine a historical rate of cost growth based on the information that it received from Carlyle.

Sponsor: Susan Ko - Carlyle (part a)
Nancy Heuring - Verizon (part b)

CA-IR-87 **Ref: Application, Exhibit 6.**

a. Please confirm that the "Projected Income Statement" on Schedule 2 does not reflect depreciation and amortization expense based upon the Hawaii PUC-approved accrual rates or FCC-approved accrual rates.

Response: Carlyle confirms that the "Projected Income Statement" on Schedule 2 does not reflect depreciation and amortization expense based upon the Hawaii PUC-approved accrual rates or FCC-approved accrual rates.

For financial modeling purposes, Carlyle estimated depreciation expense using the straight-line method as shown in Attachment CA-IR-17 (Part 1), pp. 43-45 or Tab: Deprec, provided confidentially under Protective Order. The net Property, Plant and Equipment per the estimated 2004 balance sheet and projected capital expenditures were allocated to [redacted] asset "buckets" with depreciable lives of [redacted] years, and depreciated on a straight-line basis over those periods. The amortization of capitalized financing costs was also calculated using the straight-line method over seven years. A further discussion of the amortization assumptions is provided in CA-IR-94. **[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]**

Carlyle expects preliminary depreciation estimates will be revised in connection with a comprehensive fair value analysis to be performed after the close of the transaction.

b. In addition, please provide a calculation of Schedule 2, after revising Line 12 "total depreciation and amortization" row of Schedule 2 based upon the Hawaii PUC-approved accrual rates.

Response: Carlyle was not provided the information required (such as detailed plant and reserve amounts by account and corresponding accrual rates) to calculate depreciation and amortization based on Hawaii PUC-approved accrual rates. As noted in response (a) above, those calculations would be subject to revision in connection with a comprehensive fair value analysis.

Sponsor: Andrew Park - Carlyle

CA-IR-88 **Ref: Application, Exhibit 6, Description Of Schedules, page 4, Other.**

Please provide the following information regarding the statement:

> The tax benefit from the amortization of the asset basis is approximately $81 million per year (based on straight line amortization over 15 years), which results in no cash taxes paid throughout the projection period.

a. Explain whether the Section 338(h)(10) election will actually result in a straight line amortization benefit, rather than a basis adjustment subject to Federal IRC rules regarding accelerated depreciation.

Response: The portion of the purchase price that is allocated to intangible assets, such as goodwill or going concern value, is amortized on a straight-line basis over 15 years pursuant to Federal IRC Section 197.

b. Provide a schedule of the anticipated tax depreciation impacts of the "tax benefit" that is expected to actually be realizable in each year of the financial projections.

Response: The tax deductions attributable to the amortization of the intangible assets are expected to be offset against income in the year the deductions are taken or create a net operating loss that will be used as an offset to income in subsequent years. See Carlyle's integrated financial model (Attachment CA-IR-17 (Part 1), Tab: Stmts, rows "745-788").

c. State whether the additional tax depreciation associated with the Section 338(h)(10) election is restricted with regard to regulatory flow-through treatment in a manner comparable to other accelerated tax depreciation timing differences.

Response: The amortization deduction for intangibles is not restricted in a manner comparable to other accelerated tax depreciation deductions.

d. Provide a calculation of the expected current and deferred income tax expenses in each projection year, assuming full tax normalization accounting for the Section 338(h)(10) tax

CA-IR-88 (cont.)

benefit, as well as the proposed accounting for Net Operating Loss carryforward and carryback provisions.

Response: It is expected that all NOLs will be used within the projection years. See Carlyle's integrated financial model (Attachment CA-IR-17 (Part 1), Tab: Stmts, rows 745-788).

e. State whether any Hawaii taxes historically paid by Verizon will be impacted by the proposed change in ownership and tax elections.

Response: The proposed transaction and section 338(h)(10) election should have the same impact for Hawaii income tax purposes as it does for federal income tax. The transaction should not impact the liability for non-income taxes (e.g., sales, excise, utility tax), except possibly for a resulting increase in property tax on non-utility property.

f. Provide an estimate of the state tax expense and payment impacts in each projection year.

Response: Like federal income taxes, any NOLs will be used within the projection years. Further, as described in (e) above, the liability for non-income taxes should remain the same.

Sponsor: Andrew Park – Carlyle

CA-IR-89 **Ref: Application, Exhibit 6, Description Of Schedules, page 4, Other.**

a. Regarding the statement:

The tax benefit from the amortization of the asset basis is approximately $81 million per year (based on straight line amortization over 15 years), which results in no cash taxes paid throughout the projection period.

Please explain whether the regulated telephone business will record and pay income taxes to the parent on a stand-alone basis under the planned intercompany tax allocation agreement or policy.

Response: Yes. Paradise MergerSub intends to establish an intercompany tax allocation agreement with its subsidiaries whereby each subsidiary, including the regulated telephone business, will record a provision for income taxes on income reported for financial reporting purposes at statutory tax rates. Recorded provisions for income tax expense will be paid to Paradise MergerSub while provisions for income tax benefits will be refunded to the subsidiary by Paradise MergerSub. Paradise MergerSub will record a provision for income tax equal to the difference between the provision for income taxes incurred by the consolidated group and the separate provisions of the subsidiaries. Paradise MergerSub will satisfy all actual income tax obligations and record deferred benefits and liabilities created as a result of differences between consolidated taxable income reported for financial reporting purposes and taxable income reflected on the group's consolidated returns.

b. If yes, provide a calculation of regulated telephone company income tax expenses for each year of the projection period.

Response: The calculation of the estimated regulated telephone company income tax expense for each projected year is provided in Attachment CA-IR-17 (Part 11), Tab: Consolidating IS, column labeled "ILEC" (filed confidentially under Protective Order).

Sponsor: Andrew Park - Carlyle

CA-IR-90 **Ref: Application, Exhibit 6, Description Of Schedules, Page 3 Non-operating Fees of $1 million to Carlyle.**

Please explain the proposed new fees to Carlyle by providing the following information:

a. State whether the fees are estimates of cost-based service charges that would comply with FCC rules regarding affiliated interest charges.

Response: The management fees to Carlyle, which would be charged to Paradise HoldCo, are based on industry standards for acquisitions by private equity investment firms. For the local exchange sector in particular, Valor (550,000 access lines) and Fairpoint (240,000 access lines) pay $1 million annually to their respective financial sponsors, Welsh Carson Anderson & Stowe and Thomas H. Lee. Carlyle will charge management fees to Paradise HoldCo only to the extent that such fees comply with FCC rules.

b. Provide a calculation of the estimated fees, indicating each component part of such charges.

Response: Not applicable. See responses to (a) and (c).

c. Explain what business needs are to be met by the fee to Carlyle and quantify the value of services to Hawaii Telco, to the extent possible.

Response: Post-closing services provided by Carlyle would include advisory services related to financing, strategic and financial planning and recruitment of senior management. In addition, a portion of the fees would be paid in lieu of Board of Directors fees, which are not charged separately.

d. Explain whether the fees would be charged above-the-line or below-the-line for purposes of determining operating income reported to the Hawaii PUC.

Response: It is currently anticipated that a portion of the fees would be charged above-the-line for purposes of determining operating income reported to the Hawaii PUC.

Sponsor: Susan Ko – Carlyle

PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC. RESPONSES TO THE DIVISION OF CONSUMER ADVOCACY'S SECOND SUBMISSION OF INFORMATION REQUESTS DOCKET NO. 04-0140

The following information requests refer to the Financial Model Balance Sheet Projections:

CA-IR-91 **Ref: Application, Exhibit 6, Description Of Schedules, page 4, Noncurrent Assets.**

Regarding the statement, "Goodwill of $924 million is not amortized for GAAP purposes," please provide the following information:

a. Explain whether this statement and the Applicants' projections assume that the recorded "goodwill" amounts do not become impaired pursuant to GAAP during the projection period.

Response: Carlyle's financial model does not assume that the preliminary calculation of goodwill in the amount of $924 million will be impaired. However, as described below and customary for transactions of this type, Carlyle expects the amount of goodwill to be adjusted in connection with a comprehensive fair value analysis to be performed after the close of the transaction.

The preliminary calculation of goodwill of $924 million was performed for purposes of preparing a projected cash flow model that was provided to Carlyle's financing sources in connection with funding the purchase of Verizon Hawaii. The $924 million amount will be revised based on a comprehensive analysis which, among other things, would involve the separate recognition of identifiable intangible assets (e.g., customer lists, technology, licenses, etc.) apart from goodwill and the adjustment to fair value of the acquired assets and liabilities of the entity (e.g., adjustment of property, plant and equipment from book value to fair market / appraised value).

In accordance with SFAS 141 *Business Combinations,* Carlyle is planning to perform the additional analysis of the acquired tangible and intangible assets and liabilities subsequent to the closing of the transaction with the assistance of an independent valuation firm and expects the $924 million of goodwill to be adjusted as a result of that analysis.

CA-IR-91 (cont.)

b. State whether or not any impairment testing has been conducted to evaluate the potential for valuation adjustments charging off goodwill.

Response: To date, no impairment testing has been performed on the preliminary goodwill balance due to the reasons discussed in the response to (a) above. Subsequent to the closing of the transaction, goodwill and other long-lived assets will be tested periodically for impairment in accordance with generally accepted accounting principles.

c. Please describe Carlyle's expectations regarding the future risk of any impairment adjustments resulting in charges to income and retained earnings of the Buyer.

Response: Carlyle is not aware of any current material risks that would cause potential adjustments.

d. Explain whether any financing covenants could be impacted by potential future impairment adjustments to recorded goodwill balances.

Response: Based on current capital market conditions, Carlyle does not expect that any of its debt covenants will be related to goodwill or any non-cash charges related to goodwill impairment.

Sponsor: Andrew Park - Carlyle

CA-IR-92 **Ref: Application, Exhibit 6, page 4.**

Please explain why the $924 million of "Goodwill" at row 27, which is larger in each projected year than the entire investment in "Net regulated telephone plant" on row 19, is thought to not be exposed to future impairment adjustment, given the existence of cost-based regulation in Hawaii, where regulated telephone assets cannot be expected to earn returns above the underlying cost of capital for sustained periods.

Response: No effort was made to perform a comprehensive allocation of the planned purchase price to specific assets and liabilities acquired as such allocation was assumed to have a minimal impact on overall valuation, income tax, financing or regulatory considerations. Upon closing, a comprehensive purchase price allocation is planned in order to estimate the fair value of financial, tangible and intangible assets acquired in accordance with Internal Revenue Code rules and regulations and guidance provided by Statement of Financial Accounting Standard No. 141. It is expected that for financial reporting purposes, a significant portion of the purchase price will be allocated to identifiable intangible assets including, but not limited to, customer list assets, and that some adjustment may be necessary to restate reported balances of other assets and liabilities to their fair values as of the acquisition date. These procedures are expected to reduce "goodwill" balances reported for financial reporting purposes.

The purchase price was developed based on our estimates of projected earnings as well as our assessment of the existing regulatory, financing, and competitive environment. Based on current expectations and assumptions, as reflected in the projections, no impairment of goodwill or other intangible assets is indicated. Periodic assessments of goodwill and other intangible assets will be performed, as required by Statement of Financial Accounting Standard No. 142, to determine the need for impairment of goodwill or other intangible assets in future periods.

Sponsor: Andrew Park - Carlyle

CA-IR-93 **Ref: Application, Exhibit 6, page 3.**

Please provide a reconciliation of the Row 38 "Capital Expenditures" amounts to the most recent estimate of capital expenditures filed by Verizon Hawaii with the Hawaii PUC, explaining the causes of each significant variance between reported versus projected amounts in Exhibit 6.

Response: Capital expenditures in Exhibit 6 of the Application, Row 38 reflect Carlyle's investment plan for the business, which was based on historical capital expenditure levels, estimated capital expenditures necessary to execute Carlyle's business plan, investments required to operate as a stand-alone company and typical capital expenditure levels for the local exchange industry.

Because Carlyle developed its financial projections independently, it is not possible to reconcile its plan with that of Verizon.

Sponsor: Susan Ko - Carlyle

CA-IR-94 **Ref: Application, Exhibit 6, page 3.**

Please provide an itemized calculation of the initial balance of "Unamortized Debt Issuance Costs" at row 23 and explain the basis for the apparent 7-year amortization of same.

Response: A detailed breakdown of debt financing costs of [redacted] was provided confidentially under Protective Order in Attachment CA-IR-34a (Part 1). To be conservative from an earnings perspective, Carlyle assumed a 7-year amortization of capitalized financing costs based on the shortest term of the debt financings. The annual amortization of debt financing costs is approximately [redacted]. **[Portions of the above response have been redacted as confidential subject to Protective Order No. 21034.]**

Sponsor: Andrew Park - Carlyle

CERTIFICATE OF SERVICE

I (we) hereby certify that copies of the foregoing document were duly served on the following parties, by having said copies delivered as set forth below:

Division of Consumer Advocacy 335 Merchant Street Room 326 Honolulu, HI 96813	6 COPIES HAND DELIVERY
GTE Corporation, Verizon Hawaii Inc., Bell Atlantic Communications, Inc., and Verizon Select Services Inc. c/o Leslie Alan Ueoka, Esq. Blane T. Yokota, Esq. P.O. Box 2200 Honolulu, HI 96814	1 COPY U.S. MAIL
Pacific LightNet, Inc. c/o Ms. Lisa Suan 737 Bishop Street Suite 1900 Honolulu, HI 96813	1 COPY HAND DELIVERY
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DATED: Honolulu, Hawai`i, August 27, 2004.

Alan M. Oshima
Michael H. Lau
Kent D. Morihara
Oshima Chun Fong & Chung LLP

Attorneys for Applicant
Paradise MergerSub, Inc.