

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

DECISION AND ORDER NO. 21696

Filed March 16, 2005
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Karen Higashi
Chief Clerk of the Commission

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KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

Karen Higashi

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DECISION AND ORDER

By this Decision and Order, the commission conditionally approves the merger transaction and other related matters described in the Application of PARADISE MERGERSUB, INC., now known as HAWAIIAN TELCOM COMMUNICATIONS, INC. ("HT Communications")¹; GTE CORPORATION ("GTE Corp."); VERIZON HAWAII INC. ("Verizon Hawaii" and upon completion of the merger transaction, Hawaiian Telcom, Inc. or "Hawaiian Telcom")²; BELL ATLANTIC COMMUNICATIONS, INC., dba VERIZON LONG DISTANCE ("VLD"); and VERIZON SELECT SERVICES INC. ("VSS") (collectively, "Applicants"), as detailed and described herein.

I. BACKGROUND

The Application requesting commission approval of Applicants' proposed change of control over Verizon Hawaii and

¹By letter dated and filed on March 3, 2005, HT Communications, through its attorney, advised the commission of its name change and the name changes of certain of its affiliates referenced in the proceeding ("March 3, 2005 Letter").

²See, March 3, 2005 Letter.

other commission-regulated lines of business and the financing obligations associated with the proposed change ("Transfer of Control" or "Merger Transaction"); pursuant to the Agreement of Merger dated May 21, 2004 ("Merger Agreement") was filed on June 21, 2004.³ Applicants filed for commission approval of their request under Hawaii Revised Statutes ("HRS") §§ 269-17, 269-17.5, and 269-19, and Hawaii Administrative Rules ("HAR") Title 6, chapter 61, subchapters 6, 9, 10, and 11 and Title 6, chapter 80, subchapter 2.

Copies of the Application were served on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate").⁴

A. Procedural History

On July 9, 2004, JEREMIAH C. GENOVIA; CHARLES K. HEKEKIA JR. (collectively, the "Retirees"); and the INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, LOCAL 1357 ("IBEW"), jointly filed a motion to intervene in this proceeding ("Retirees' and IBEW's Motion"). On July 12, 2004, the UNITED STATES DEPARTMENT

³In the Merger Agreement, Paradise HoldCo, Inc., now known as Hawaiian Telcom HoldCo, Inc. ("HT HoldCo", HT Communications' parent) (see, March 3, 2005 Letter); HT Communications; GTE Corp. (i.e., the current owner of 100 per cent of Verizon Hawaii's issued and outstanding capital stock); and Verizon HoldCo LLC ("Verizon HoldCo", a newly formed subsidiary of GTE Corp.) entered into an agreement to transfer control of Verizon Hawaii and certain other related assets through a merger, with HT Communications being the surviving entity. See, Application at 9, and Exhibit 1 of the Application.

⁴On June 4, 2004, Applicants filed a request for commission approval of their proposed stipulation for protective order, which was also executed by the Consumer Advocate, to govern the treatment of confidential documents filed in this docket. On June 7, 2004, the commission issued Protective Order No. 21034.

OF DEFENSE and ALL OTHER FEDERAL EXECUTIVE AGENCIES ("DoD/FEA") filed a petition for leave to intervene in this docket ("DoD/FEA's Petition"), while PACIFIC LIGHTNET, INC. ("PLNI") and TIME WARNER TELECOM OF HAWAII, L.P., dba OCEANIC COMMUNICATIONS ("Oceanic") (collectively, "Competitors") filed separate motions to intervene in this docket.⁵

Applicants filed a memorandum in response to the DoD/FEA's Petition on July 16, 2004. On July 19, 2004, Applicants filed separate memoranda in opposition to the Competitors' motions to intervene and the Retirees' and IBEW's Motion.

On July 23, 2004, Applicants and the Consumer Advocate submitted a proposed stipulated procedural order ("Procedural Proposal") for the commission's review and approval.

By Order No. 21226, filed on August 6, 2004 ("Order No. 21226"), the commission, among other things: (1) granted DoD/FEA's Petition and the motions to intervene filed by PLNI and Oceanic; (2) denied the Retirees' and IBEW's Motion, while permitting the Retirees and IBEW (collectively, "Participants") to participate in the proceeding to the extent set forth in Order No. 21226; (3) established a Comment Period to receive comments on the matters of this docket; (4) denied the Procedural Proposal; and (5) required Applicants, the Consumer Advocate, the DoD/FEA, the Competitors, and Participants

⁵Additionally, on July 12, 2004, the Consumer Advocate filed its Preliminary Statement of Position under HAR § 6-61-62(a)(1) stating its intent to: (1) participate in this proceeding; and (2) state its position upon the completion of its investigation.

(collectively, the "Parties and Participants") to meet to formulate and develop a stipulated procedural order to govern the proceedings of this docket within twenty (20) days of the date of Order No. 21226.⁶

Pursuant to Order No. 21226, the Parties and Participants filed their proposed stipulated procedural order on August 23, 2004 ("Stipulated Procedural Order"). By Order No. 21341, filed on September 10, 2004 ("Order No. 21341"), the commission approved and adopted the Stipulated Procedural Order, including the attached Stipulated Regulatory Schedule, subject to certain modifications.⁷

The commission accepted oral and written comments into the record through the established Comment Period, expanded through Order No. 21341, and the scheduled statewide Public Hearings. The Public Hearings were held on: (1) October 5, 2004, on the island of Oahu; (2) October 7, 2004, on the island of Kauai; (3) October 12, 2004, on the island of Maui; (4) October 13, 2004, on the island of Molokai; (5) October 14, 2004, on the island of Lanai; and (6) October 19 and 20, 2004, on the island of Hawaii.⁸ Public testimony received on this matter was diverse. While some individuals and organizations including,

⁶In the alternative, if unable to stipulate, the Parties and Participants were directed to submit proposed procedural orders for the commission's consideration by the same date.

⁷Subsequently, the Parties' and Participants' Stipulated Regulatory Schedule was amended by stipulation, as provided for in the Stipulated Procedural Order, and as memorialized in letters filed on September 23, October 14, and December 29, 2004.

⁸Official transcripts of the Public Hearings were submitted into the record on November 5 and 19, 2004.

but not limited to, the IBEW,⁹ the Kauai Economic Development Board ("KEDB"),¹⁰ and the Japanese Chamber of Commerce and Industry of Hawaii ("JCCIH"),¹¹ were in support of the proposed Transfer of Control, others expressed serious concerns with the transaction. PLNI provided public testimony pointing out various concerns regarding the proposed Transfer of Control during all of the scheduled Public Hearings, and other individuals and organizations including, but not limited to, George M. Waialeale¹² also expressed their reservations with and oppositions to the proposed transaction.

In accordance with the Stipulated Regulatory Schedule, as amended, the Parties and Participants to this proceeding conducted extensive discovery through the issuance of information requests ("IRs") and through participation in collaborative and technical meetings held on various days, including October 6 and 8, 2004, and November 9 and 10, 2004.

The DoD/FEA, PLNI, and the Participants filed their statements of position on December 15, 2004. The DoD/FEA and

⁹IBEW's public testimony in support of the proposed transaction was received into the record during the Public Hearings on Oahu, Kauai, and Molokai; however, its support of the proposed Transfer of Control was conditional.

¹⁰KEDB's testimony was received into the record during the Public Hearing on Kauai on October 7, 2004.

¹¹JCCIH's testimony in support of the proposed Merger Transaction was based on certain Applicants' representations and was received into the record on October 20, 2004, in Hilo, Hawaii.

¹²George M. Waialeale's opposition to the proposed Transfer of Control was received into the record during the Public Hearing held on Oahu on October 5, 2004.

Participants both expressed support of the proposed Transfer of Control, subject to certain conditions. PLNI did not express support for the proposed Transfer of Control nor did it recommend that the commission reject it. However, PLNI provided the commission with recommended conditions to "ensure the most optimal approach in re-establishing the incumbent network's Hawaii-based back-office [Operations Support Systems] OSS, including appropriate remedies should the merged company fail to meet any performance criteria adopted by the [c]ommission."¹³

The Consumer Advocate and Oceanic filed their respective statements of position on January 5, 2005.¹⁴ The Consumer Advocate states that it can only support Applicants' Transfer of Control and requested relief, if we adopt ten (10) regulatory conditions ("Consumer Advocate's Conditions") specified in its Statement of Position. The Consumer Advocate submits that such conditions are "necessary to address the risks and potential cost increases associated with the proposed transaction, while also providing specific tangible benefits to the public."¹⁵ Oceanic states that it believes the proposed transaction "will not have an impact on competition in telecommunications services in the State of Hawaii" if the

¹³See, PLNI's Position Statement at 5.

¹⁴On January 10, 2005, the Consumer Advocate filed replacement pages which set forth clarifying footnotes that were inadvertently not included in the earlier filed Statement of Position. The Consumer Advocate's January 10, 2005 filing will be incorporated into its Statement of Position and viewed and referred to collectively as its Statement of Position.

¹⁵See, Consumer Advocate's Statement of Position at 1.

commission adopts Oceanic's conditions regarding the four (4) outstanding issues as set forth in its Position Statement.¹⁶

HT Communications and Oceanic also filed a Stipulation on January 5, 2005 ("Oceanic Stipulation"), to document their agreements on certain conditions that relate to post-closing transition and operational matters and certain procedural matters.

On January 19, 2005, Applicants filed their Statement in Rebuttal Response to Statements of Position filed by Parties and Participant ("Rebuttal"). In their Rebuttal, Applicants: (1) find the Consumer Advocate's Conditions to be acceptable; (2) request commission approval of the Oceanic Stipulation, in its entirety without modification; (3) expressly condition their acceptance of the Consumer Advocate's Conditions and the terms and conditions set forth in the Oceanic Stipulation "upon the approval of the language of any of such conditions without modifications, and without the imposition of any other conditions"¹⁷; (4) object to the additional conditions proposed by the DoD/FEA, PLNI, Participants, and those proposed by Oceanic in their respective statements of position; and (5) request that the commission issue an order granting the specific relief requested

¹⁶See, Oceanic's Position Statement at 9.

¹⁷See, Rebuttal at 9. Furthermore, Applicants caution that if the commission imposes any other conditions to our approval of the proposed Transfer of Control or modifies the language of the Consumer Advocate's Conditions or the Oceanic Stipulation, Applicants acceptance of those terms and conditions "shall be void, and may result in conditions that are considered materially adverse under Section 6.3(b)" of the Merger Agreement. See, Rebuttal at 9-10.

in its Application, subject to the Consumer Advocate's Conditions, and with approval of the Oceanic Stipulation in its entirety, without modification.

On January 11, 2005, the commission served Applicants with IRs. Applicants filed their responses to these IRs on January 24, 2005. Subsequently, the commission served Applicants with additional IRs on February 4, 2005, and the responses to these IRs were submitted to the commission on February 11, 2005.

B. Applicants

HT Communications is a Delaware corporation, with its principal place of business currently in Washington, D.C. HT Communications, formed expressly for the purpose of consummating the proposed Merger Transaction, is wholly-owned by HT HoldCo (the "Buyer" as described in the Merger Agreement), which is a newly formed Delaware corporation controlled by affiliates of the TC Group L.L.C., dba The Carlyle Group ("Carlyle"), a Delaware limited liability company.¹⁸

GTE Corp. (the "Seller", as described in the Merger Agreement) is a New York corporation with principal offices in New York, New York. GTE Corp., which is principally owned by Verizon Communications Inc. ("Verizon Communications"), owns all of the issued and outstanding stock of Verizon Hawaii and VSS. While GTE Corp. is not a regulated telecommunications company, its local operating subsidiaries, including Verizon Hawaii and VSS, are subject to public utility regulation in the states in

¹⁸Unless specifically noted otherwise, we will refer to HT Communications, HT HoldCo, and all related Carlyle affiliates as "Carlyle" or "Buyer."

which they operate, as well as by the Federal Communications Commission ("FCC").

Verizon Hawaii, originally chartered in 1883 under the Kingdom of Hawaii, is a Hawaii corporation, with its principal offices in Honolulu, Hawaii. It is a public utility regulated by the commission under HRS chapter 269. Verizon Hawaii, an incumbent local exchange carrier ("ILEC") as defined by section 252 of the federal Telecommunications Act of 1996, provides local and intraLATA telecommunications services on a statewide basis in Hawaii. The latest FCC reports indicate that Verizon Hawaii serves approximately over 690,000 access lines in Hawaii statewide.¹⁹

VLD is a Delaware corporation with current business offices in Honolulu, Hawaii. It is a public utility regulated by the commission, and is a carrier authorized to provide telecommunications services on a resold basis in the State of Hawaii ("State") under its certificate of authority ("COA").²⁰ VLD currently provides inter-island toll service on a statewide basis in Hawaii and also provides interstate toll service on a nationwide basis under the purview of the FCC.

VSS, formerly known as GTE Card Services Incorporated, dba GTE Long Distance, is also a Delaware corporation with current business offices in Honolulu, Hawaii. VSS is a public utility under the commission's jurisdiction providing resold

¹⁹ See, Application at 7-8.

²⁰ See, Decision and Order No. 17375, filed on November 16, 1999, in Docket No. 99-0345.

intrastate services in the State under its commission-issued COA.²¹

C. Merger Transaction

Upon the satisfaction of all the terms and conditions of the Merger Agreement, including obtaining all necessary regulatory approvals, Applicants envision consummating the Merger Agreement, entered into by HT HoldCo, HT Communications, GTE Corp. and Verizon HoldCo, through a series of transactions. Initially, GTE Corp. will transfer all of Verizon Hawaii's outstanding capital stock to Verizon HoldCo.

Verizon HoldCo will form Verizon AssetCo (as a Delaware corporation) upon closing of the transaction and will hold all of its outstanding capital stock. VLD, VSS, and certain non-Hawaii regulated affiliates of GTE Corp. and Verizon Communications, GTE Corp.'s parent (collectively and generally referred to, along with any and all of its affiliates, as "Verizon"), will indirectly transfer to Verizon AssetCo their respective rights, title, and interests to the following services: (1) inter-island, interLATA, and international toll; (2) Hawaii directory publishing; and (3) internet access.

Verizon HoldCo will ultimately be merged into HT Communications. Upon merging, HT Communications shall be the surviving entity and will assume, succeed to, and own, with certain exceptions as set forth in the Merger Agreement, all of the outstanding stock of Verizon Hawaii (which will be renamed

²¹See, Decision and Order No. 15321, filed on January 21, 1997, in Docket No. 96-0466.

Hawaiian Telcom upon closing of the proposed transaction) and Verizon AssetCo (which will be known as Hawaiian Telcom Services Company, Inc. ("HT Services") upon closing of the proposed transaction). Thereafter, HT Communications will be a wholly-owned, direct subsidiary of HT HoldCo and the direct parent of Hawaiian Telcom and HT Services; and all the debts, liabilities, and duties of Verizon HoldCo will be transferred to HT Communications. Additionally, the services currently provided by VLD and VSS under their respective commission-issued COAs will be replicated by HT Services.

The base purchase price of the proposed Transfer of Control is \$1.65 billion, subject to various adjustments as set forth in the Merger Agreement. These adjustments include: (1) the amounts expended by Verizon Hawaii to comply with "Interim Capital Expenditure Obligations"; (2) the "Non-Regulated Construction Work in Process Amount"; (3) the aggregate amount of "Closing Date Indebtedness"; and (4) the amount that the "Closing Date Net Working Capital Amount" exceeds or is less than the "Target Net Working Capital Amount."

The Merger Transaction will be funded through a combination of equity and debt. Affiliates of Carlyle will make a cash contribution to HT HoldCo equal to at least seventeen and one-half per cent (17.5%) of the necessary capital to consummate the Merger Transaction and to fund up to \$100 million of the estimated necessary funds for investment in infrastructure and transition costs. This amount will be contributed to HT Communications by HT HoldCo as common equity. Additionally,

Carlyle anticipates the formation of a local investor group to co-invest in the new company.

The remainder of the funds necessary to consummate the proposed Merger Transaction will be obtained through various financing arrangements. These arrangements include the financing commitments allowing HT Communications to: "(a) obtain up to \$700 million in senior secured term financing facilities; (b) obtain a \$150 million senior revolving credit facility; and (c) issue up to \$700 million in senior subordinated and senior unsecured high yield bonds."²²

II. STANDARD FOR COMMISSION APPROVAL

The commission reviews the Application under the standards and requirements of Chapter 269, HRS, as follows.

A. HRS § 269-19

Under HRS § 269-19, the commission is vested with broad discretionary authority to review the proposed Merger Transaction by which Carlyle and its affiliates acquire control over Verizon Hawaii and other related assets from Verizon. Specifically, HRS § 269-19, requires a public utility to obtain prior commission approval before selling, assigning, mortgaging, or otherwise disposing of or encumbering the whole or any part of its property necessary or useful in the performance of its duties to the public, or directly or indirectly merging or consolidating with any other public utility corporation.

The commission has reviewed requests to transfer public utility assets and certificates of public convenience and

²²See, Rebuttal at 12-13.

necessity, pursuant to HRS § 269-19, by applying the standard of review of HRS § 269-7.5, which states that the applicant must be "fit, willing, and able properly to perform the service proposed."²³ Accordingly, when approving any acquisition of a public utility subject to the commission's jurisdiction under HRS § 269-19, the commission must find that the buyer is fit, willing and able to perform the service currently being offered by the utility being acquired, and that the acquisition is reasonable and in the public interest (collectively and generally referred to as the "Fitness and Public Interest" standards). We will continue to employ these standards in our review of Applicants' proposed Merger Transaction.

The Consumer Advocate endorses the application of the commission's standard of review, as articulated above. However, to support its position and its proposed conditions, it recommends that we apply our fitness and public interest standards based on a demonstration of "substantial net benefits" as opposed to a demonstration of "no detriment." The Consumer Advocate contends that a higher standard of review is necessary since "[c]onsiderable uncertainty is involved in predicting future events, costs and rates over a five [(5)] to ten [(10)]-year future period. The potential for error in such predictions

²³See, Decision and Order No. 19658, filed on September 17, 2002, in Docket No. 02-0060 (*In re Citizens Communications Company, Kauai Electric Division and Kauai Island Utility Co-op ("KIUC")*) at 14-15, referencing Decision and Order No. 17377, filed on November 17, 1999, in Docket No. 98-0345 (*In re GTE Corp. and Bell Atlantic Corporation ("Bell Atlantic")*) and Decision and Order No. 15899, filed on September 10, 1997, in Docket No. 97-0035 (*In re BHP Hawaii Inc., GASCO, Inc. and Citizens Utilities Company*).

argues for imposing substantial conservatism in regulatory review of this and other utility sale or merger application dockets."²⁴

Applicants argue that an adoption of the "substantial net benefits" standard is unnecessary since approval of the Consumer Advocate's Conditions (agreed to by the Applicants) will provide the assurances that the Consumer Advocate seeks. Applicants also argue that such an adoption is inappropriate and should not be imposed on an application filed under the commission's current "no detriment" standard of review. Accordingly, Applicants request that the commission continue to apply the "no detriment" standard.

We find it unnecessary to decide to adopt the "substantial net benefits" standard at this time. We agree that since Applicants have agreed to the Consumer Advocate's Conditions, we must conclude that the Consumer Advocate is satisfied that the more stringent "substantial net benefits" test would have been met.

B. HRS § 269-7(a) and Other Applicable Laws and Regulations

HRS § 269-7(a) provides the commission with the power to examine the condition of a public utility, the manner in which it is operated with reference to the safety or accommodation of the public, the issuance by the utility of "stocks and bonds, and the disposition of the proceeds thereof, the amount and disposition of its income, and all its financial transactions, its business relations with other persons, companies, or corporations, . . . and all matters of every nature affecting the

²⁴See, Consumer Advocate's Statement of Position at 18.

relations and transactions between it and the public or persons or corporations." Accordingly, the commission has the authority to examine any and all transactions of the public utility that affect or may affect the public that it serves.

HRS § 269-17 requires a public utility to obtain prior commission approval before issuing stocks and stock certificates, bonds, notes, and other evidences of indebtedness payable at periods of more than twelve (12) months after the date of issue. This section of the law restricts the purpose for which stocks and other evidences of indebtedness may be issued for, among other things, the acquisition of property, or for the construction, completion, extension, or improvement of or addition to its facilities or services.

HRS § 269-17.5 requires prior written commission approval before more than twenty-five per cent (25%) of the issued and outstanding voting stock of a public utility organized under the State be held, whether directly or indirectly, by any single foreign corporation or any single nonresident alien, or any person, unless the transaction is exempt under the section.

HAR § 6-80-17(c) requires any person or organization seeking to provide intrastate telecommunications services in the State to apply for a COA. Under HAR § 6-80-18(a), the commission will issue a COA authorizing the applicant to provide the proposed telecommunications services upon a finding that: (1) the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide the proposed telecommunications services; (2) the applicant is fit, willing,

and able to properly perform the proposed telecommunications services and to conform to the terms, conditions, and rules prescribed or adopted by the commission; and (3) the proposed telecommunications services is, or will be, in the public interest.

III. ISSUES

The following issues of this proceeding²⁵ were examined in our overall determination of Hawaiian Telcom's fitness, willingness, and ability to provide telecommunications services in the State and to determine whether the proposed Transfer of Control is reasonable and in the public interest:

1. Whether the Merger Transaction contemplated by the Merger Agreement should be approved.
2. Whether the transfer of the customer accounts and receivables associated with the inter-island toll business of VLD and VSS in connection with the proposed Merger Transaction should be approved pursuant to HRS § 269-19.
3. Whether a new COA should be issued to HT Services that contains the same authorizations currently held by VLD and VSS under their respective COAs.
4. Whether the currently approved tariffs of VLD and VSS should be separately published under HT Services' name to be effective as of the closing of the proposed Merger Transaction, with the existing tariffs of VLD and VSS to remain in effect for said entities following the closing.
5. Whether the interim transfer of Verizon Hawaii's issued and outstanding capital stock from GTE Corp. to Verizon

²⁵These issues reflect Applicants' requested relief set forth in their Application at 3-4 and the "Statement of Issues" stipulated to by the Parties and Participants set forth in their Stipulated Procedural Order at 2-4, (see, Exhibit 1 of Order No. 21341).

HoldCo, and the subsequent merger of Verizon HoldCo into HT Communications for the purpose of effectuating the proposed Merger Transaction, should be approved pursuant to HRS § 269-17.5.

6. Whether the guaranty by Hawaiian Telcom and HT Services of the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction should be approved pursuant to HRS § 269-17.
7. Whether the pledging of Hawaiian Telcom's and HT Services' respective capital stock and the grant of a security interest in and mortgages on substantially all of Hawaiian Telcom's and HT Services' respective tangible and intangible assets to secure the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction should be approved pursuant to HRS § 269-19.
8. Whether the condition imposed by the commission in Part VIII, Subpart 2 of Decision and Order No. 17377 filed on November 17, 1999 in Docket No. 98-0345 should be terminated.
9. Whether any other relief as may be just and reasonable should be granted under the circumstances.
10. Whether and to what extent the proposed Transfer of Control will have an impact on competition in telecommunications services in the State, including, but not limited to the following sub-issues:
 - (a) Whether and to what extent the proposed Transfer of Control will impact the provisioning of back office functions and systems to competitive local exchange carrier ("CLEC") Intervenor.
 - (b) Whether and to what extent the proposed Transfer of Control will impact the prices, terms, and conditions of services provided to CLEC Intervenor under tariffs.

11. Whether and the extent to which, if any, the proposed Transfer of Control will affect the Vested Benefits of the Retirees and the terms and conditions of employment of IBEW members.

IV. SUMMARY OF PARTIES' AND PARTICIPANTS' POSITIONS

The following briefly summarizes the initial positions of each of the Parties and Participants.

A. Basis for Applicants' Requested Approval

Applicants submit that Hawaiian Telcom and HT Services (collectively referred to as "Hawaiian Telcom", unless noted otherwise) will be sufficiently fit and able to provide their respective services upon closing of the proposed transaction and that their proposed Merger Transaction is in the public interest.

First, Applicants contend that Hawaiian Telcom will be financially fit to fund continuing operations and adequately meet its financial obligations as illustrated in its financial projections submitted as Exhibit 6 of the Application. Applicants also represent that Hawaiian Telcom will have the ability to tap additional funds to address unforeseen expenditures and events which include the ability to obtain capital commitments from investors of Carlyle's affiliate, Carlyle Partners III Fund. Moreover, Applicants represent that Carlyle is in the process of obtaining hurricane and other types of insurance coverage for Hawaiian Telcom.

Second, Applicants contend that Hawaiian Telcom has or will acquire the necessary human resources, management, and technical expertise to operate and maintain the utility operations currently being provided in a reliable and continuous manner. Aside from the experience of Carlyle, "one of the

world's largest private equity investment firms with approximately \$19 billion under management,"²⁶ which include various investments in the telecommunications sector globally,²⁷ Applicants highlight the vast telecommunications experience of Hawaiian Telcom's senior management and Board of Directors.²⁸

Applicants further contend that to ensure a smooth and seamless transition from Verizon to Hawaiian Telcom: (1) Carlyle has retained all current Verizon Hawaii employees and assumed Verizon's obligations and responsibilities under the current collective bargaining agreement with IBEW; (2) Applicants have organized a transition planning team to monitor progress towards the transition and to resolve any issues; and (3) Applicants have entered into a Transition Services Agreement ("TSA") for the continuation of certain Verizon functions for up to nine (9)-months after the closing to provide Hawaiian Telcom with

²⁶See, Rebuttal at 15.

²⁷Applicants represent that Carlyle's telecommunications and media investments include: (1) Casema BV, a Dutch cable TV provider; (2) Dex Media, Inc., an American directories provider; (3) eAccess, Ltd., a Japan-based broadband access provider; (4) Taiwan Broadband Communications, a Taiwanese cable TV provider; and (5) WCI Cable, Inc., a submarine fiber-optic cable company connecting Alaska to the continental United States. Ibid.

²⁸Michael Ruley, Hawaiian Telcom's appointed Chief Executive Officer, was formerly a president and chief executive officer of Nextiraone and president of XO Communications, Inc., while Hawaiian Telcom's appointed Senior Vice President and Chief Information Office, David Torline, is a former chief information officer for Broadwing Inc. and vice president for Cincinnati Bell Telephone Company. Additionally, Carlyle partners involved in the Merger Transaction include James A. Attwood, Jr., a former executive vice president for Verizon and GTE and William E. Kennard who served as chairman of the FCC. See, Rebuttal at 16-17.

adequate time to establish new and independent back office support systems in the State. Additionally, Carlyle has engaged the services of BearingPoint, Inc. ("BearingPoint") to establish the new and independent back office support systems.²⁹

Finally, Applicants contend that the proposed Merger Transaction is in the public interest since, among other things, Hawaiian Telcom, as an "independent business with a locally-based management team focused on meeting the needs of Hawaii's customers" will be in a position to better compete in the "rapidly-evolving communications industry" through services and products designed for Hawaii's market.³⁰ Applicants also allude to improved customer service that will be achieved through investment in state-of-the-art back office systems that will assist Hawaiian Telcom's representatives and managers to respond to customers' needs.

Additionally, Applicants contend that the proposed transaction will create new jobs within Hawaiian Telcom and throughout the State benefiting Hawaii's economy. Carlyle anticipates new job creation through its plans to establish Hawaiian Telcom's headquarters in the State and through relocating back to Hawaii various functions that are currently provided by Verizon affiliates in other states, including functions such as: (1) network and information technology operations; (2) sales and marketing; and (3) various staff

²⁹HT Communications and BearingPoint entered into a Master Service Agreement on February 4, 2005. See, Applicants' supplemental response to PUC-IR-3 and Attachment PUC-IR-3a.

³⁰See, Rebuttal at 20.

support functions (i.e., finance, information technology, and human resources). Additional job creation is expected through Carlyle's retention of BearingPoint to develop the back office support systems. Moreover, Applicants anticipate obtaining "modest revenue growth compared to that currently experienced by Verizon in Hawaii."³¹

B. Summary of Non-Applicants' Concerns

While none of the parties directly oppose the approval of the proposed Merger Transaction, all of them have serious concerns that they state can only be addressed by the imposition of certain specified conditions. The Consumer Advocate, the DoD/FEA, the Intervenors, and Participants (collectively, "Non-Applicants") endorse approval of the proposed Merger Transaction only if their specified conditions are imposed on Applicants. Various concerns were raised with regards to the financial fitness of Hawaiian Telcom and whether it will be able to properly provide the services currently provided by Verizon Hawaii upon cutover from Verizon.

The Consumer Advocate and the DoD/FEA both raised concerns with regards to the proposed capital structure of HT Communications, Hawaiian Telcom's direct parent, to finance the proposed Transfer of Control. The capital structure of HT Communications envisioned by Carlyle under the proposed Merger Transaction consists of approximately eighty-two and one-half per cent (82.5%) debt and seventeen and one-half per cent (17.5%)

³¹See, Rebuttal at 24.

equity.³² The Consumer Advocate cautions that if Carlyle's financial projections are proven to be overly optimistic, HT Communications' "heavily leveraged capital structure will limit its financial flexibility because its ability to acquire additional equity or debt will be diminished."³³ While the Consumer Advocate recognizes that Hawaiian Telcom's financial projections indicate that after 2005 Hawaiian Telcom will experience positive cash flow allowing for dividend payments to HT Communications, thus enabling HT Communications' gradual debt repayment, it cautions that HT Communications may be unable to satisfy its debt service, if Hawaiian Telcom's projected revenues are significantly overstated or if its anticipated costs are significantly understated.

Due to the proposed capital structure, the Consumer Advocate also anticipates a downgrading of Hawaii's ILEC's investment bond rating from "Baa1" under Verizon to "B+" under Carlyle, which will increase HT Communications' cost of debt and decrease its ability to access capital. Moreover, the Consumer Advocate is concerned that HT Communications' high debt capital structure may limit Hawaiian Telcom's ability to access additional funds, which may negatively affect customer service and rates. Due to the inherent uncertainty of Hawaiian Telcom's financial projections and concerns raised with regards to its parent's proposed capital structure, the Consumer Advocate contends that it can only support a finding that Buyer is

³²See, Application, Exhibit 6, Schedule 1.

³³See, Consumer Advocate's Statement of Position at 29.

financially and operationally fit to acquire and operate Verizon Hawaii upon the imposition of the Consumer Advocate's Conditions, which are detailed and discussed in the sections below.

The DoD/FEA states that it is greatly concerned about HT Communications' debt ratio since the "fixed obligations associated with debt could impair the company's ability to provide quality service and fund its capital expenditure program in difficult times."³⁴ Although its concerns are lessened due to certain representations made by Carlyle, including its plans to reduce HT Communications' debt ratio, the DoD/FEA recommends that we adopt specific approval conditions to monitor the debt ratio and Hawaiian Telcom's general financial condition along with other approval conditions on various matters set forth in its Position Statement.

PLNI and Oceanic are both CLECs that are dependent on Verizon's back office procedures and processes since they interconnect with Verizon's network to provide telecommunications services to their respective customers. Both express concerns with Hawaiian Telcom's ability to adequately provide services upon cutover from Verizon without adversely affecting their operations. PLNI states that Carlyle failed to demonstrate or document that Hawaiian Telcom will be able to deliver services to PLNI in a manner consistent with that provided by Verizon. PLNI contends that neither it nor the commission will be able to determine whether Carlyle and BearingPoint will be able to

³⁴See, DoD/FEA's Position Statement at 8.

develop, implement, and transfer Verizon Hawaii's back office OSS functions from the mainland and re-establish them within Applicants' nine (9)-month projected timeline and without an increase in rates. Thus, PLNI contends that commission approval of the proposed Merger Transaction should be subject to the eight (8) enumerated conditions it proposes in its Position Statement.

Oceanic, unlike PLNI, entered into a stipulation with HT Communications, which details agreed upon terms and conditions regarding various OSS-related processes and procedures, as further discussed below; however, HT Communications and Oceanic were not able to reach an agreement on all issues. Thus, in accordance with the Oceanic Stipulation, Oceanic filed its Position Statement to address four (4) outstanding issues since, as Oceanic states "the Stipulation falls short of assuring that the [proposed] Transfer of Control will not have an adverse impact on competition in telecommunications services in the State."³⁵ Oceanic contends that Hawaiian Telcom "must be required to meet specific performance standards and be subject to appropriate remedies if it fails to meet those standards" to ensure that Hawaiian Telcom's operations will not adversely impact services provided by Hawaii CLECs.³⁶ Oceanic recommends that the commission: (1) adopt Hawaii Specific Performance Standards; (2) establish appropriate remedies if Hawaiian Telcom fails to comply with those standards; (3) retain jurisdiction over Verizon; and (4) prohibit Hawaiian Telcom from recovering

³⁵See, Oceanic's Position Statement at 4.

³⁶Ibid.

the costs associated with re-establishing its back office system by increasing rates it charges CLECs.

While the Participants support the concept of the proposed Merger Transaction, they request that the commission require the entire pension plan covering Verizon Hawaii's employees under the bargaining unit be transferred from Verizon to the new plan being established by Hawaiian Telcom. Participants' request is contrary to the Merger Agreement, which only calls for the transfer of funds necessary to cover the liability of the employees being transferred in the proposed Transfer of Control. Among other things, Participants argue that the current pension plan is vastly over-funded and that if the surplus is not transferred to the new pension plan, future employee benefit increases may require a contribution from Hawaiian Telcom which will be subsidized, in part, by ratepayers.

V. ANALYSIS

As will be discussed in detail below, approval of the Application would not be in the public interest without the inclusion of certain mitigating conditions described herein.

A. Fitness and Public Interest

After reviewing the record and the Applicants' arguments that it is fit, willing, and able to perform the services required, and that the proposed merger is reasonable and in the public interest, as briefly summarized in Section IV.A., above, the commission has concerns about the fitness and ability of Hawaiian Telcom to perform the required services and whether the proposed Merger Transaction is in the public interest.

We recognize that like the prior transfer of control in *Bell Atlantic*, the Merger Transaction proposed by Applicants will affect virtually all residents and businesses of the State since this is a transfer of services and assets of the State's sole ILEC. However, this transaction is very different from the transfer in *Bell Atlantic* in several ways.

First, the transfer of control in *Bell Atlantic* involved a merger between two (2) well-established telecommunications companies. The ultimate buyer in this proceeding, Carlyle, is a private equity investment firm controlling a number of telecommunications and media businesses; none of which are ILECs. Second, in *Bell Atlantic*, the applicants were able to quantify millions in merger benefits.³⁷ Third, the transfer of control in *Bell Atlantic* did not involve the need to re-establish back office functions, which is envisioned and necessary in this proceeding since the result of the proposed Merger Transaction is a stand alone company.

The primary benefits expressed by the Applicants in this proceeding are a renewed local focus in the new telephone company, more attention to the local market, and improved customer service. All such objectives are commendable, but are largely intangible, and difficult to quantify and accomplish. Accordingly, the risks related to the Merger Transaction should be clearly understood and addressed.

We are concerned, as is the Consumer Advocate, that the projected high-debt capital structure (eighty-two and one-half

³⁷See, *Bell Atlantic* at 10.

per cent (82.5%) debt and only seventeen and one-half per cent (17.5%) equity) for the proposed Merger Transaction may cause problems in the future. As the Consumer Advocate points out, if Hawaiian Telcom's revenue projections are overly optimistic or if their anticipated costs are understated (or Hawaiian Telcom experiences unanticipated costs), HT Communications may find it difficult to satisfy its debt service obligations. This in turn would negatively affect Hawaiian Telcom's ability to provide maintenance services, make facilities improvements and investments, and to generally provide reliable and quality services to the public.

We understand that a certain amount of uncertainty exists with all projections. However, with respect to this proceeding, uncertainty regarding Hawaiian Telcom's revenues and other estimates and various factors that makeup their estimates, such as line growth or line degeneration and the effect of competition and equivalent substitutions, increases over projected future periods. Additionally, the highly leveraged capital structure of HT Communications, will increase Hawaiian Telcom's overall financial risk, by decreasing its ability to access future capital and continue investment in infrastructure, and it may also negatively affect Hawaiian Telcom's ability to respond to competitive forces.

The commission is also concerned about Carlyle's ability to re-establish all necessary back office functions within the projected nine (9)-month timeframe. Re-establishment of the back office functions that Verizon Hawaii affiliates

currently provide is, in our view, extremely difficult and complicated as evidenced, in part, by the enormous amount of documentation on the transition from Verizon-to-Hawaiian Telcom filed in the record.³⁸ If these back office functions cannot be implemented as planned or if the cutover from Verizon to Hawaiian Telcom occurs without sufficient testing or if unforeseen problems occur during the transition, services to the public and Hawaii CLECs will be negatively affected, which may, in turn, affect Hawaiian Telcom's financial performance and ability to keep rates stable.

We believe that there are risks associated with Carlyle's undertaking of re-establishing Verizon Hawaii's OSS systems in Hawaii in the projected nine (9)-month period and that these risks must be properly managed if the Merger Transaction is to proceed. If improperly undertaken, it could foreseeably lead to increased service problems for all customer sectors.

The risks and uncertainties associated with HT Communications' proposed capital structure and with Carlyle's plan to re-establish Verizon's back office functions in Hawaii within its nine (9)-month timeline are not outweighed by the benefits put forward by Carlyle in the Application. The recognized risks associated with Applicants' proposed Merger Transactions are unacceptable.

Thus, absent mitigating regulatory conditions, Hawaiian Telcom would not be fit, willing, and able to provide

³⁸See, Applicants' response to PUC-IR-17, which requested details on the transition plan.

the service proposed, and Applicants' proposed Merger Transaction would not be reasonable or in the public interest. We believe, however, that the risks associated with the proposed Merger can be mitigated with certain regulatory conditions that were proposed by the Parties and Participants in this proceeding, a number of which were agreed to by Applicants through extensive negotiations, meetings, and discussions.

1. "Agreed" Upon Conditions

Applicants state in their Rebuttal that the Consumer Advocate's Conditions are acceptable. Their decision to accept these conditions is a result of extensive negotiations with the Consumer Advocate and their understanding of the Consumer Advocate's "belief that certain regulatory conditions were required to ensure that the transaction is in the public interest and to protect against the potential risks and uncertainties resulting from the transaction[.]"³⁹

The Consumer Advocate's Conditions (agreed to by Applicants) are as follows, verbatim:⁴⁰

1. Hawaiian Telcom commits to not submit any application for a general utility rate increase that would utilize a prospective test year earlier than calendar year 2009, unless the Commission finds that a compelling financial need⁴¹ justifies the waiver of this

³⁹See, Rebuttal at 4.

⁴⁰In certain conditions, the Consumer Advocate refers to the commission as "HPUC."

⁴¹As defined and applied by the Commission in Decision and Order No. 21354, filed in Docket No. 03-0369 and HRS § 269-16[c]. The threshold for the Commission to accept such a filing for complete processing shall be Hawaiian Telcom being able to demonstrate a prima facie case that a rate increase is needed to

condition. Before any consideration shall be given to any general rate increase case using a test year earlier than calendar year 2009, Carlyle, as ultimate owner of Hawaiian Telcom, shall make an additional equity capital investment in Paradise HoldCo or Hawaiian Telcom equal to the amount of the annual revenue increase proposed by Hawaiian Telcom in that general rate increase application. In addition to the equity infusion, Hawaiian Telcom will not object to the imputation of 67% of its affiliate's revenues from local directory operations⁴² as part of Hawaiian Telcom's test year annual revenue requirement in any general rate increase case utilizing a test year earlier than calendar year 2009. In any rate case using a test period 2009 or any subsequent test period, Hawaiian Telcom, the Consumer Advocate and all other parties may present other positions on the treatment of imputed directory revenues during such cases. Notwithstanding the above, events such as acts of God (i.e., major uninsured storm losses and other events of force majeure) or damage sustained as a result of a terrorist attack would not be subject to this Condition No. 1⁴³ [("Rate Case Moratorium Condition")].

2. The general utility rate increase moratorium in Condition No. 1, above, shall not preclude the filing of proposed tariff changes for regulated services by Hawaiian Telcom that are revenue neutral. (See general discussion

meet a sudden and urgent financial need and a showing of irreparable harm resulting from a distinctive and sudden deficiency in revenue or increase in expenses which is not otherwise subject to recovery under tariffs then in effect.

⁴²The local directory revenues that will be subject to the application of the 67% imputation factor will be determined during the processing of any general rate increase case using a then current test year earlier than calendar year 2009 and using the same sources or comparable sources of directory publishing affiliate revenue data (revenue and exclusions) that were used to determine the local directory revenues in the 1995 general rate increase case, Docket No. 94-0298. The 1995 imputed local directory revenues amount, per se, will not be used for the calculation.

⁴³See, Consumer Advocate's Statement of Position at 2.

of "revenue neutral requirement" in Decision and Order No. 20620 filed on November 4, 2003 in Docket No. 03-0034.) The bundling of service offerings, including those subject to HAR § 6-80-35(e), shall not be prohibited by this condition, nor by Condition No. 1 above.⁴⁴

3. None of the transaction and transition costs incurred by the "Buyer" and "Seller" (as those terms are defined in the "Agreement" described in Section II below) (see Exhibit 1 of the Application) shall be deferred as a regulatory asset for future recovery from ratepayers. In the event transaction or transition costs are recorded as assets on the books of Hawaiian Telcom, the amortization of such assets shall be completed by December 31, 2008, for ratemaking purposes.⁴⁵
4. By the end of the fifth full calendar month following the closing of the Agreement of Merger, each residential and business retail access line customer (defined as R1, B1, Key and PBX lines) of Hawaiian Telcom on the closing date of the transfer of control who has remained a customer through the date of the bill credit shall receive a customer appreciation bill credit of approximately \$20.70 per qualifying access line on his/her/its monthly Hawaiian Telcom bill; provided however, that the aggregate amount of all such credits (plus any applicable intrastate surcharge on the amount credited payable by Applicants) shall not exceed \$12 million.⁴⁶

⁴⁴See, Consumer Advocate's Statement of Position at 2-3.

⁴⁵See, Consumer Advocate's Statement of Position at 3.

⁴⁶The \$20.70 is based on a credit per access line customer of \$18.60 plus the 11.23% intrastate surcharge. If the billing system is unable to issue a \$20.70 credit and suppress the surcharge, then Hawaiian Telcom may issue a credit of \$18.60 plus the surcharge. In either event, it is the intent to provide a credit of approximately \$20.70 inclusive of the surcharge per qualifying access line to the customer.

If the targeted \$12 million total will be exceeded or not be met using the \$20.70 per qualifying access line customer credit amount, the credit per access line shall be recalculated based on the above-mentioned access line count on the closing date of the transfer of control such that the total credit shall amount to \$12 million. This credit shall be explained in a bill insert or message as soon as practicable after the close of the transaction describing the introduction of Hawaiian Telcom as the new service provider. The bill insert or message shall also include an explanation of if and how the change of ownership can be expected to impact customers.

Promptly, but not later than 45 days, after the completion of the distribution of the credit, Applicants will submit a letter to the Commission and the Division of Consumer Advocacy summarizing the difference between the total amount actually credited to customers (plus any applicable intrastate surcharge payable by Applicants on the amount credited) and the maximum \$12,000,000 amount. If the difference is \$250,000 or greater, GTE Corporation will contribute the difference to non-profit organizations in Hawaii selected by GTE Corporation after consultation with the Consumer Advocate.⁴⁷

5. The capital stock and assets of Hawaiian Telcom that are pledged to secure debt financing of Paradise HoldCo or the borrowings of any other affiliate shall not be transferable by creditors or their agents without HPUC approval pursuant to HRS § 269-19.⁴⁸
6. Hawaiian Telcom will not object to consideration by the Commission of debt and other capital balances and cost rates used to finance Hawaiian Telcom's utility business in any future rate case proceedings, based upon any argument that such debt or other capital was actually issued by Paradise HoldCo or another affiliate, rather than the regulated

⁴⁷See, Consumer Advocate's Statement of Position at 3-4.

⁴⁸See, Consumer Advocate's Statement of Position at 4.

business entity, provided that such consideration does not preclude the consideration of other capital structures and rates, such as the hypothetical capital structures used in the past.⁴⁹

7. For a period of 48 months after the closing of the sale transaction, all recurring transactions between Paradise HoldCo, Carlyle or any affiliated entity (i.e., an entity with an "affiliated interest" with Hawaiian Telcom as defined in HRS § 269-19.5) with either Hawaiian Telcom or Paradise HoldCo will be documented by written contract and submitted to the HPUC and Consumer Advocate no more than thirty (30) days after the effective date, without regard to the expected annual transaction levels relative to the dollar thresholds codified in HRS § 269-19.5.⁵⁰
8. Hawaiian Telcom will provide a detailed reporting by entity of its transactions with Paradise HoldCo, Carlyle, and any affiliated entity (i.e., an entity with an "affiliated interest" with Hawaiian Telcom as defined in HRS § 269-19.5) by Federal Communications Commission ("FCC") Part 32 Account, type of service provided, and stating the basis of pricing for such services, as a supplement to Hawaiian Telcom's Annual Report to the Commission for 2005 and all subsequent years.⁵¹
9. Paradise HoldCo, Carlyle and all affiliated entities (i.e., an entity with an "affiliated interest" with Paradise HoldCo or Hawaiian Telcom as defined in HRS § 269-19.5) that provide services chargeable to regulated utility operations will provide complete access in Hawaii to all relevant financial and operational data during proceedings before the Commission, upon the request of the Commission or Consumer Advocate, provided that any such voluminous data that cannot reasonably be provided in Hawaii will be made available at other locations, with

⁴⁹Ibid.

⁵⁰See, Consumer Advocate's Statement of Position at 5.

⁵¹Ibid.

reimbursement by Hawaiian Telcom of any incremental costs caused by such out-of-state access.⁵²

10. If Hawaiian Telcom asserts income tax expenses for ratemaking purposes in any future rate case, the full benefits available to taxpaying affiliates of Hawaiian Telcom, that arise from Hawaiian Telcom's utility assets, operations, parent company interest deductions supportive of Hawaiian Telcom's utility assets, or any elections made under IRC Section 338(H)(10) relative to the utility assets may be considered in ratemaking, without objection by Hawaiian Telcom based upon the utility not being the actual taxpaying entity; provided, however, that Hawaiian Telcom may object on any other basis to any substantive ratemaking tax treatments proposed for consideration in any such case.⁵³

In addition, Oceanic and HT Communications also entered into the Oceanic Stipulation, which contains other agreed upon conditions. The Oceanic Stipulation is a result of collaborative meetings held by HT Communications (and its consultants) with Competitors in an effort to facilitate the exchange of information regarding the back office functions and systems that Hawaiian Telcom will be providing to CLECs. Through the Oceanic Stipulation, attached hereto and incorporated herein by reference as Exhibit 1, Oceanic and HT Communications document their agreement concerning post-closing transition and operational matters involving wholesale service functions provided to Oceanic and certain procedural matters.

The Oceanic Stipulation sets forth specific terms and conditions regarding: (1) the establishment of a collaborative

⁵²See, Consumer Advocate's Statement of Position at 5-6.

⁵³See, Consumer Advocate's Statement of Position at 6.

process; (2) a schedule for implementation; (3) specific reporting requirements; (4) a mechanism for dispute resolution; (5) implementation of electronic interfaces at cutover; and (6) various organizational interfaces and operational procedures. Additionally, the Oceanic Stipulation sets forth certain general conditions regarding systems and processes to be implemented by Hawaiian Telcom including, among other things, that "[t]he systems and processes to be implemented by Hawaiian Telcom will have the same or similar functionality as those presently provided to" Oceanic by Verizon Hawaii's mainland affiliates for wholesale services in Hawaii.⁵⁴ Moreover, Oceanic and HT Communications also agree that Hawaiian Telcom will continue to utilize Verizon's systems and processes (to the extent of the term of the TSA, unless otherwise ordered by the commission), if Hawaiian Telcom's new systems and processes are not fully tested and operational at the scheduled time for implementation.⁵⁵ While Applicants were unable to reach an agreement with PLNI, Applicants propose to extend the terms and conditions of the Oceanic Stipulation to PLNI.⁵⁶

The Consumer Advocate's Conditions and the various terms and conditions of the Oceanic Stipulation (agreed to by Applicants) mitigate many of the uncertainties and risks associated with Applicants' proposed Merger Transaction. We also note that the Consumer Advocate's Conditions appear to have been

⁵⁴See, Oceanic Stipulation at 2.

⁵⁵Ibid.

⁵⁶See, Rebuttal at 9.

crafted to benefit Hawaii customers. Thus, we find that adoption of the Consumer Advocate's Conditions and the various terms and conditions of the Oceanic Stipulation are reasonable and in the public interest.

2. Other "Proposed" Conditions

Applicants object to all other regulatory conditions advanced by the Parties and Participants in this matter. Applicants' specific objections to each condition are set forth in matrix form in Exhibit B to its Rebuttal, and certain objections are discussed in detail within the text of the Rebuttal.

In sum, the basis of Applicants' objections are that these other regulatory conditions are unreasonable, unnecessary, or inappropriate under the circumstances since the proposed conditions: (1) or the underlying basis for them are encompassed and addressed in the conditions and terms already accepted by Applicants; (2) involve matters outside of the scope of the requesting party under the Stipulated Procedural Order; (3) are irrelevant to whether or not Buyer is fit and able, and whether the proposed Merger Transaction is consistent with the public interest; and (4) are outside of the scope of this docket.

Upon review of the various conditions advanced by the Non-Applicants, we agree, in part, with the Applicants' assessment of these other regulatory conditions, as proposed. For instance, the regulatory conditions concerning rates and rate

increases proposed by the DoD/FEA⁵⁷ and PLNI⁵⁸ are addressed in an appropriate and balanced manner through some of the Consumer Advocate's Conditions; specifically Condition Nos. 1-3, 6, and 10.

The DoD/FEA's recommendation that we require Hawaiian Telcom to continue to track retail service quality indicators and report on them on a quarterly basis is, as suggested by Applicants, unnecessary since Hawaiian Telcom will be held to all the regulatory conditions and reporting requirements currently imposed on Verizon Hawaii, including the filing of reports on retail service quality standards on a monthly basis.

The Competitors' request that we establish appropriate remedies if Hawaiian Telcom fails to comply with specific performance standards and Oceanic's request to establish Hawaii Specific Performance Standards⁵⁹ have merit; however, we believe that such issues should be introduced, examined, and resolved in the commission's communications infrastructure investigation in Docket No. 7702. The current performance standards set forth in the Joint Partial Settlement Agreement were approved in Docket No. 7702.⁶⁰ Oceanic, PLNI, Verizon Hawaii, the DoD/FEA, and the Consumer Advocate are

⁵⁷See, DoD/FEA's Position Statement at 9.

⁵⁸See, PLNI's Position Statement at 15.

⁵⁹See, PLNI's Position Statement at 4 and Oceanic's Position Statement at 5-6.

⁶⁰See, Order No. 20561, filed on October 7, 2003, in Docket No. 7702.

current parties to the docket,⁶¹ and we believe that these issues should be determined with input from all Docket No. 7702 CLECs including those that are not part of this proceeding.

Participants request that the commission require Applicants to transfer all pension assets, including surpluses, currently under the Verizon Hawaii Hourly Pension Plan ("Verizon Plan") into the "new" plan being established.⁶² While we are sympathetic and understand the concerns and arguments of the Participants, adoption of this condition would not be necessary or reasonable, as long as a fully-funded plan is transferred.

This Merger Agreement provision concerning the transfer of pension assets was negotiated between the Applicants in light of the whole agreement and cannot be viewed in isolation.⁶³ Applicants' Merger Agreement provision will ensure that the new fund will be fully funded: all funds necessary to assume the liabilities for the benefit of the employees being transferred in the proposed Merger Transaction will be transferred to the "new" fund, which is consistent with federal laws and requirements.⁶⁴

The remainder of the funds (those not transferred) will be used to fund benefits of the over 1,300 retired and terminated Hawaii participants and other beneficiaries under the Verizon Plan who will not be transferred to the new plan

⁶¹Ibid.

⁶²See, Participants' Position Statement at 2.

⁶³See, Rebuttal at 28.

⁶⁴See, Rebuttal at 30-34.

sponsored by Hawaiian Telcom.⁶⁵ Requiring the transfer of the entire Verizon Plan to the "new" plan sponsored by Hawaiian Telcom cannot directly benefit ratepayers since under federal law,⁶⁶ pension assets must be used exclusively to benefit participants and beneficiaries of the plan and to pay plan administrative expenses. Additionally, since excess funds were not typically used to enhance retirement separation benefits under the Verizon Plan,⁶⁷ requiring the transfer of all pension assets will not likely benefit future pensioners and beneficiaries.

The Participants' also argue that not transferring all of the surplus pension funds may indirectly negatively affect rates in the future, which, theoretically is a possible scenario. However, we agree with the Applicants that the Rate Case Moratorium Condition mitigates these concerns. Moreover, if Applicants had agreed to transfer additional assets or the entire pension plan to Carlyle, all other factors remaining constant, the overall purchase price of the proposed Merger Transaction would likely have been higher.⁶⁸

Accordingly, we agree with the Applicants that we should not require the transfer of the entire pension plan to the "new" plan being established by Hawaiian Telcom.

⁶⁵See, Rebuttal at 28.

⁶⁶See, Rebuttal at 37, citing Employee Retirement Income Security Act of 1974, as amended §§ 403-404 and Internal Revenue Code § 401(a)(2).

⁶⁷See, Rebuttal at 32.

⁶⁸See, Rebuttal at 37.

The commission, however, believes that certain other regulatory conditions are necessary to further mitigate certain risks and concerns regarding the proposed Merger Transaction, as detailed and discussed below.

3. Additional Regulatory Conditions

Our first set of additional regulatory conditions address our concerns regarding the high-debt capital structure (eighty-two and one-half per cent (82.5%) debt and seventeen and one-half per cent (17.5%) equity) associated with the proposed Merger Transaction. We believe that the risks associated with an eighty-two and one-half per cent (82.5%) debt capital structure, as articulated above, are too great and cannot be mitigated without a condition that directly addresses these concerns.

The commission, in *In re Citizens Communications Company, dba The Gas Company, K-1 USA Ventures, Inc., and Hawaii Gas Company, L.L.C., nka The Gas Company, L.L.C. ("K-1")* found that a capital structure of sixty-five per cent (65%) debt and thirty-five per cent (35%) equity to be reasonable.⁶⁹ We believe that, if this transaction proceeds, it would be in the public interest to require Carlyle to achieve this capital structure as soon as reasonably possible. Accordingly, Carlyle must agree to immediately infuse additional equity as necessary to achieve a consolidated capital structure of seventy-six and three-tenths per cent (76.3%) debt and twenty-three and seven-tenths per cent (23.7%) equity ("Equity Commitment Condition").

⁶⁹See, Decision and Order No. 20354, filed on July 25, 2003, in Docket No. 03-0051 (K-1) at 24 and 48.

This capital structure is the same as Applicants' projected capitalization in 2009, as set forth in Schedule 1 of Exhibit 6 of the Application. Applicants otherwise do not project to reduce debt to less than sixty-five per cent (65%) until 2012, where it projects debt capitalization of sixty-one and two-tenths per cent (61.2%) under Schedule 1 of Exhibit 6 of the Application. In short, this condition requires Applicants to immediately reduce its debt to the level projected in 2009, which is the approximate duration of the Rate Case Moratorium Condition, and will hopefully enable the Applicants to reduce debt to sixty-five per cent (65%) in a shorter period of time.

Additionally, we believe that a condition on the use of dividend payments, similar to the DoD/FEA's proposed condition requiring Hawaiian Telcom to seek commission approval prior to issuing any dividends to its equity investor, until a consolidated capital structure of sixty-five per cent (65%) debt and thirty-five per cent (35%) equity is reached, is also necessary to further minimize the risks related to HT Communications' high debt capital structure. In the Rebuttal, Applicants state that the DOD/FEA's proposed condition should be rejected and remind us that Hawaiian Telcom's direct equity investor is HT Communications, and that dividends paid to HT Communications are needed by HT Communications to satisfy financial obligations associated with the Merger Transaction. Applicants also contend that certain loan covenants and conditions already restrict Hawaiian Telcom's ability to pay dividends without the imposition of this condition. While we

understand certain mandatory restrictions and covenants contained in the debt facilities do currently place limitations on Hawaiian Telcom's dividends and distributions, we are aware that debt restrictions and covenants may later be restructured and renegotiated, perhaps without notice to, or approval of, the commission.

Consequently, Applicants must agree that, unless prior commission approval is obtained, any dividend proceeds of Hawaiian Telcom shall be earmarked specifically and used only for debt repayment, and that HT Communications shall not make any dividend payments, until a target consolidated capital structure of sixty-five per cent (65%) debt and thirty-five per cent (35%) equity is achieved ("Dividend Restriction Condition"). This target consolidated capital structure is consistent with the commission's decision in K-1. Additionally, by requiring the Dividend Restriction Condition, the commission is merely formalizing Applicants' representations that all free cash flow will be used to repay debt and that no cash will be used to pay equity dividends throughout the financial forecast,⁷⁰ and that none of the debt proceeds secured by Hawaiian Telcom assets will be used to pay dividends or make distributions of any kind to Carlyle investors.⁷¹ Most importantly, the Dividend Restriction Condition does not prevent dividends from being paid to HT Communications that are needed by HT Communications to satisfy financial obligations associated with the Merger Transaction.

⁷⁰See, Applicants' response to CA-IR-20.

⁷¹See, Applicants' response to PUC-IR-26.

Accordingly, we find the Equity Commitment Condition and the Dividend Restriction Condition, as described in detail above, to be reasonable and in the public interest.

To monitor compliance with the Dividend Restriction Condition, we will require HT Communications to file the following documents with the commission and the Consumer Advocate, no later than three (3) months following the year-end close of HT Communications' financial records for the year of acquisition and no later than three (3) months following each subsequent fiscal year-end thereafter: (1) a schedule of HT Communications' consolidated capital structure as of the reporting date, similar to the Projected Capital Structure section of Schedule 1 in Hawaiian Telcom's pro forma Financial Projection, filed as Application Exhibit 6 (the schedule should contain the cumulative results by period from inception of the reporting requirement through the current reporting date); (2) a consolidated and consolidating Income Statement, Balance Sheet and Statement of Cash Flow of HT Communications and each of its affiliates by reporting period in a form similar to that contained in Confidential Attachment CA-IR-17 (Part 11); (3) a signed and sworn statement from appropriate HT Communications and Hawaiian Telcom officials confirming compliance with the Dividend Restriction Condition; and (4) any such other documents or

accountings the commission may require to determine compliance with the Dividend Restriction Condition.

Our next additional regulatory condition is similar to PLNI's enumerated condition number three (3), which calls for the establishment of an ongoing collaborative committee to resolve any back office and OSS issues. PLNI recommends that such a committee should meet for twelve (12) months following the close of the transaction and that monthly progress reports regarding transition milestones should be reported to the commission and Consumer Advocate.

In their recommendation to reject PLNI's condition summarized above, Applicants contend that: (1) the condition is beyond PLNI's intervention rights; (2) the Oceanic Stipulation sets forth a collaborative process from the transition closing date to ninety (90) days after cutover and that the Oceanic Stipulation provides for a quarterly reporting mechanism to update the commission and the Consumer Advocate on progress in meeting transition plans; and (3) HT Communications is willing to extend the terms and conditions of the Oceanic Stipulation to PLNI.

While the Oceanic Stipulation sets forth terms and conditions for collaboration between Hawaiian Telcom and Oceanic and a reporting mechanism, we do not believe that these terms and conditions are sufficient. For example, quarterly reporting within a twelve (12) month period would be insufficient for the commission to fully monitor the progress of the transition and facilitate the resolution of any concerns, as necessary.

Additionally, we believe that all affected and interested CLECs should be involved in the collaborative process to ensure that CLECs' concerns regarding OSS and back office systems are addressed. Accordingly, we will require Hawaiian Telcom to adhere to these additional requirements:

1. Hawaiian Telcom must make the various terms and conditions of the Oceanic Stipulation apply to all interconnected Hawaii carriers, as applicable, and shall invite all interconnected carriers to participate in post-closing collaborative sessions as envisioned in Section II of the Oceanic Stipulation. The first collaborative session should be scheduled no later than thirty (30) days after the close of the proposed transaction.
2. Hawaiian Telcom will conduct regular collaborative sessions as required (but no fewer than one (1) each month) to discuss its progress and any open issues to keep all participants informed and updated regarding its implementation of the transition plan. Commission staff and an individual or individuals designated by the Consumer Advocate will also be invited to participate in all collaborative sessions.
3. Hawaiian Telcom through the collaborative process will develop a testing and implementation report to be presented to the commission no later than thirty (30) days prior to cutover. Through the report, Hawaiian Telcom shall: (a) inform the commission of the requisite testing that has been completed to date; (b) describe additional testing that is contemplated prior to the cutover date; (c) describe the progress of the systems development required to achieve a seamless cutover on the anticipated cutover date; and (d) identify any open issues that may impact customers at the time of cutover. The implementation report should include a pre-established monitoring process by which customer-impacting problems can be tracked during the cutover process. This report capturing the customer-impacting problems at cutover should be available for commission review no later

than fifteen (15) days after the cutover date.

The terms and conditions of the Oceanic Stipulation, as modified by the additional conditions described above, are necessary to help ensure that Hawaiian Telcom's wholesale and retail services are not adversely affected by the proposed Merger Transaction. These additional conditions are needed for the commission and Hawaii CLECs to monitor Applicants' progress and to be aware of any outstanding concerns that may impact services to the public and adversely affect competition in the State. Accordingly, we find that the terms and conditions of the Oceanic Stipulation, as amended by the additional conditions described above, are reasonable and in the public interest.

Additionally, to further address the commission's concerns regarding the quality of telecommunications service being provided to the general public, the commission will initiate an investigation regarding service quality levels and standards approximately six (6) months after cutover from Verizon to Hawaiian Telcom. During the commission's service quality proceeding, the commission will: (1) review and update the current service quality standards that are in place; (2) investigate the need to impose any new standards, requirements, and programs such as, for example, a vegetation management program; (3) determine whether and to what extent service quality levels were impacted by the effectuation of the proposed Merger Transaction; (4) consider the establishment of a mechanism or procedures to impose reasonable and appropriate penalties and fines if Hawaiian Telcom fails to meet established

service quality standards; and (5) any other related issues and matters, as deemed necessary.

Finally, the commission is concerned that certain risk mitigating factors and benefits as provided in the Rate Case Moratorium Condition, which we find to be reasonable and in the public interest, may not be fully realized if Carlyle divests the directory assets being transferred in this proposed Merger Transaction. Thus, the commission finds it prudent and reasonable to require Carlyle to agree to obtain commission approval prior to selling, divesting, transferring, mortgaging or encumbering, in any manner, the directory assets being transferred in this proceeding, until further ordered by the commission ("Transfer Restriction Condition").⁷² Approval of the transfer of directory assets will be conditioned on, among other matters, Hawaiian Telcom's agreement to allow the imputation of revenues in an amount consistent with the Rate Case Moratorium Condition.

4. Risks Mitigated with Regulatory Conditions

We find that the risks associated with the proposed Merger Transaction are sufficiently mitigated with the adoption of the Consumer Advocate's Conditions; the terms and conditions of the Oceanic Stipulation, as amended; and through the

⁷²Cf. *KIUC* (In this Decision and Order, the commission approved, in its entirety, the July 18, 2002 Stipulation in Lieu of Preliminary Position Statements ("*KIUC* Stipulation") filed by a majority of the parties to the docket, whereby, among other things, Kauai Island Utility Co-op agrees to, as a condition of the transfer of public utility assets to a cooperative, remain under the commission's jurisdiction and not seek to reduce commission jurisdiction over its services for a specific period of time, see *KIUC* Stipulation at 30.)

Equity Commitment Condition, Dividend Restriction Condition, and Transfer Restriction Condition. Additionally, the Rate Case Moratorium Condition and certain other Consumer Advocate's Conditions are in the public interest since it should forestall the filing of a general rate case by the State's ILEC for approximately four (4) years, unless certain conditions are met. Thus, rates on regulated telecommunications services should remain constant or any rate adjustment should be revenue neutral (under Consumer Advocate Condition No. 2) for at least approximately four (4) years after the close of the proposed Merger Transaction.

Moreover, Applicants' decision to re-establish back office functions in Hawaii, which are currently provided by Verizon affiliates in other states, should result in efficiencies in procedures and processes that can benefit Hawaiian Telcom and its wholesale and retail customers. In re-establishing these functions, Carlyle plans to replace Verizon's numerous legacy systems with updated and flexible application systems. Carlyle specifically represents that it will achieve increased economies of scale and improved operating efficiencies from replacing multiple and duplicative systems with a single application.⁷³ To illustrate, Carlyle states that Verizon currently utilizes eight (8) different systems for customer billing, which it plans to replace with one (1) unified

⁷³See, Applicants' response to PUC-IR-32.

application system.⁷⁴ Finally, Applicants make the following representations, among other things:

1. Hawaiian Telcom will retain all existing Verizon Hawaii employees that support Hawaii services and will assume Verizon's obligations under the existing collective bargaining agreement with the IBEW.⁷⁵
2. Hawaiian Telcom will continue to abide by the service quality standards and conditions currently imposed on Verizon Hawaii and will continue to report on these standards on a monthly basis.⁷⁶
3. Carlyle will obtain hurricane and other types of insurance coverage for Hawaiian Telcom including, but not limited to, direct property damage, business interruption, and extra expense coverage.⁷⁷
4. Proceeds from the committed financing secured by Hawaiian Telcom's assets will be used for the proposed acquisition and to build-out Hawaiian Telcom's new back office systems and other transition costs, and none of these funds, aside from a customary closing fee, will be used to pay dividends or any distributions to Carlyle investors.⁷⁸
5. Hawaiian Telcom will be operated in a manner consistent with all applicable State laws and commission rules and orders and service quality levels as its customers expect and in adherence with generally acceptable industry standards.⁷⁹

⁷⁴Ibid.

⁷⁵See, Rebuttal at 18.

⁷⁶See, Rebuttal Exhibit B at 9.

⁷⁷See, Rebuttal at 14; see also Applicants' responses to CA-IR-40, CA-IR-64, and CA-IR-69b.

⁷⁸See, Applicants' response to PUC-IR-26.

⁷⁹See, Applicants' response to CA-IR-21.

Based on the above, as well as the various other representations made by Applicants in this proceeding, and our review of the entire record, we find Hawaiian Telcom fit, willing, and able to provide the services that are currently provided by Verizon Hawaii. Additionally, we also find that the proposed Merger Transaction is reasonable and in the public interest, provided that Applicants and HT Communications' affiliates adhere to and/or agree to comply with: (1) the Consumer Advocate Conditions, as set forth in Section V.A.1., above; (2) the terms and conditions of the Oceanic Stipulation (attached to this Decision and Order as Exhibit 1), subject to the additional conditions regarding collaboration and reporting, as set forth in Section V.A.3.; (3) the Equity Commitment Condition, set forth above in Section V.A.3.; (4) the Dividend Restriction Condition and the related reporting requirements, described in Section V.A.3.; and (5) the Transfer Restriction Condition, as set forth in Section V.A.3. Applicants' decision to effectuate the proposed Merger Transaction constitutes Applicants' acceptance and agreement with the conditions and requirements of our approval, as listed above.

Accordingly, the commission concludes that the proposed Merger Transaction should be approved, subject to the conditions and requirements, described herein.

B. Other Findings and Conclusions

In addition to the primary findings discussed above, the commission addresses the other issues in this docket as follows.

1. Grant of a COA to HT Services is
Consistent with Commission Rules

In their proposed Transfer of Control, Applicants request that we approve, pursuant to HRS § 269-19, the transfer of customer accounts and receivables associated with the inter-island toll business of VLD and VSS; and pursuant to HAR § 6-80-17, issue a new COA to HT Services that contains the same authorizations held by VLD and VSS under their respective COAs, and authorize HT Services to republish the tariffs of VLD and VSS under HT Services effective as of the close of the proposed Merger Transaction.

Our review of Applicants' request will not entail the proposed transfer of the customer accounts and receivables of VLD and VSS since the commission has traditionally held that the acquisition of a carrier's customer accounts and receivables do not require commission approval.⁸⁰ Thus commission approval of the transfer of the customer accounts and receivables of VLD and VSS under HRS § 269-19, is unnecessary.⁸¹

Based on the various representations set forth in this proceeding of both HT Services as well as Hawaiian Telcom, we find that HT Services satisfies the requirements of HAR § 6-80-18(a). Accordingly, the commission concludes that

⁸⁰See, Decision and Order No. 21400, filed on December 20, 2004, in Docket No. 04-0275 (*In re Startec Global Licensing et al.*) and Decision and Order No. 19779, filed on November 18, 2002, in Docket No. 02-0349 (*In re Cable & Wireless USA, Inc. and Primus Telecommunications, Inc.*).

⁸¹Under their respective COAs, VLD and VSS provide intrastate telecommunications services in the State on a resold basis. Services provided on a resold basis are deemed to be fully competitive.

HT Services should be granted a COA to operate as a reseller of intrastate telecommunications services in the State. However, we will reserve any decision regarding Applicants' request to allow HT Services to republish the tariffs of VLD and VSS under its own name effective as of the close of the proposed Merger Transaction, as necessary, until after HT Services files its initial tariff in accordance with HAR §§ 6-80-39 and 6-80-40.⁸²

Accordingly, we conclude that HT Services should be granted a COA to provide intrastate telecommunications services in the State on a resold basis.

2. Interim Transfer; Pledge of Capital
Stock and Security Interest

Consistent with our determination that the proposed Merger Transaction is reasonable and in the public interest, as detailed above, we find that the interim transfer of Verizon Hawaii's issued and outstanding stock from GTE Corp., a New York corporation, to Verizon HoldCo, a Delaware limited liability company, and the subsequent merger of Verizon HoldCo into HT Communications, a Delaware corporation, for the purpose of effectuating the Merger Transaction is reasonable and in the public interest. Additionally, due to the same factors, we find the pledging of Hawaiian Telcom's and HT Services' respective capital stock and the grant of a security interest in and mortgages on substantially all of Hawaiian Telcom's and HT Services' tangible and intangible assets to secure the

⁸²HAR § 6-80-40(a) states, in relevant part, that "[a] tariff for a fully competitive service is effective upon filing with the commission."

guaranty of the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction is also reasonable and in the public interest.

Accordingly, the commission concludes that: (1) the interim transfer of Verizon Hawaii's issued and outstanding stock from GTE Corp., a New York corporation, to Verizon HoldCo, a Delaware limited liability company, and the subsequent merger of Verizon HoldCo into HT Communications, a Delaware corporation; and (2) the pledging of Hawaiian Telcom's and HT Services' respective capital stock and the grant of a security interest in and mortgages on substantially all of Hawaiian Telcom's and HT Services' tangible and intangible assets to secure the guaranty of the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction, should be approved, pursuant to HRS §§ 269-17.5 and 269-19, respectively.

However, our approval under HRS § 269-19 of the various encumbrances on the assets and capital stock of Hawaiian Telcom and HT Services, as set forth above, are specifically for the purpose of effectuating the proposed Merger Transaction, and for no other purpose. Any additional and future encumbrances on Hawaiian Telcom's and HT Services' assets and capital stock will require prior commission approval under HRS § 269-19.

3. Financing is for a Permissible Purpose

The financing and credit facility arrangements are necessary to effectuate the Merger Transaction. The funds

obtained from the financing and credit facility arrangements will be used to, among other things, construct the OSS and back office functions in Hawaii and to improve and update facilities and services which are permissible under HRS § 269-17.

Accordingly, we find and conclude that the guaranty by Hawaiian Telcom and HT Services for the financing and credit facility arrangements proposed to be obtained by HT Communications should be approved, pursuant to HRS § 269-17. However, our approval under HAR § 269-17 of the guaranty by Hawaiian Telcom and HT Services for the financing and credit facility arrangements, as set forth above, is specifically for the purpose of effectuating the proposed Merger Transaction, and for no other purpose. Any additional and future encumbrance on and guarantees provided by Hawaiian Telcom and HT Services for other financing and credit facility arrangements will require prior commission approval under HRS § 269-17 by separate applications.

4. Bell Atlantic Reporting Condition is No Longer Necessary

Applicants request that we discontinue the regulatory condition in *Bell Atlantic* requiring Verizon Hawaii (formerly known as GTE Hawaiian Telephone Company Incorporated) to account for all merger related expenses, savings, and revenue enhancements attributed to the merger on an annual basis for seven (7) years after the merger or until its next rate case proceeding ("*Bell Atlantic Reporting Condition*").

On this matter, the Consumer Advocate recommends that we terminate the *Bell Atlantic Reporting Condition* since "[i]t is

no longer meaningful to attempt tracking of merger costs and savings from a business combination that will not include" the business operations of Hawaiian Telcom.⁸³ We agree with the Consumer Advocate's reasoning on this matter, and find the *Bell Atlantic* Reporting Condition to be unnecessary in light of our determinations as set forth above in this Decision and Order.

Accordingly, the commission concludes that the *Bell Atlantic* Reporting Condition should be terminated.

5. Non-Compliance with HRS § 269-30

Under HRS § 269-30, each public utility subject to the commission's jurisdiction is required to pay the commission on July and December of each year a public utility fee equal to one-fourth of one per cent (1%) of the gross income from the public utility business during the proceeding year, or the sum of \$30, whichever is greater. Our records indicate that VSS is delinquent in filing its December 2004 public utility fee. Thus, VSS is in non-compliance with the requirements of HRS § 269-30. We find it reasonable and in the public interest to require VSS satisfy the requirements of HRS § 269-30.

Based on the above, we conclude that VSS should be required to pay its December 2004 public utility fee.

VI. ORDERS

THE COMMISSION ORDERS:

1. Applicants' proposed Merger Transaction is approved, provided that Applicants and HT Communications' affiliates (including, but not limited to, HT HoldCo and Carlyle)

⁸³See, Consumer Advocate's Statement of Position at 88.

adhere to and/or agree to comply with the following regulatory conditions:

(A) The Consumer Advocate's Conditions, as set forth in Section V.A.1., of this Decision and Order.

(B) The terms and conditions of the Oceanic Stipulation (attached to this Decision and Order as Exhibit 1), as amended by the following additional conditions:

- (1) Hawaiian Telcom must make the various terms and conditions of the Oceanic Stipulation apply to all interconnected Hawaii carriers, as applicable, and shall invite all interconnected carriers to participate in post-closing collaborative sessions as envisioned in Section II of the Oceanic Stipulation. The first collaborative session should be scheduled no later than thirty (30) days after the close of the proposed transaction.
- (2) Hawaiian Telcom will conduct regular collaborative sessions as required (but no fewer than one (1) each month) to discuss its progress and any open issues to keep all participants informed and updated regarding its implementation of the transition plan. Commission staff and an individual or individuals designated by the Consumer Advocate will also be invited to participate in all collaborative sessions.
- (3) Hawaiian Telcom through the collaborative process will develop a testing and implementation report to be presented to the commission no later than thirty (30) days prior to cutover. Through the report, Hawaiian Telcom shall: (a) inform the commission of the requisite testing that has been completed to date; (b) describe additional testing that is contemplated prior to the cutover date; (c) describe the progress of the systems development required to achieve a seamless cutover on the anticipated cutover date; and (d) identify any open issues that may impact customers at the time of cutover. The implementation report should include a pre-established monitoring process by which customer-impacting problems can be tracked during the cutover process. This report capturing the customer-impacting problems at cutover should be available for commission review no later than fifteen (15) days after the cutover date.

(C) To infuse additional equity as necessary to achieve a consolidated capital structure of seventy-six and three-tenths per cent (76.3%) debt and twenty-three and seven-tenths per cent (23.7%) equity.

(D) Unless prior commission approval is obtained, any dividend proceeds of Hawaiian Telcom shall be earmarked specifically and used only for debt repayment, and that HT Communications shall not make any dividend payments, until a target consolidated capital structure of sixty-five per cent (65%) debt and thirty-five per cent (35%) equity is achieved. To monitor compliance with this condition, HT Communications must ensure the filing of the following documents with the commission and the Consumer Advocate, no later than three (3) months following the year-end close of HT Communications' financial records for the year of acquisition and no later than three (3) months following each subsequent fiscal year-end thereafter:

- (1) A schedule of HT Communications' consolidated capital structure as of the reporting date, similar to the Projected Capital Structure section of Schedule 1 in Hawaiian Telcom's pro forma Financial Projection, filed as Application Exhibit 6 (the schedule should contain the cumulative results by period from inception of the reporting requirement through the current reporting date);
- (2) A consolidated and consolidating Income Statement, Balance Sheet and Statement of Cash Flow of HT Communications and each of its affiliates by reporting period in a form similar to that contained in Confidential Attachment CA-IR-17 (Part 11);

- (3) A signed and sworn statement from appropriate HT Communications and Hawaiian Telcom officials confirming compliance with the Dividend Restriction Condition; and
 - (4) Any such other documents or accountings the commission may require to determine compliance with the Dividend Restriction Condition.
- (E) To obtain commission approval prior to selling, divesting, transferring, mortgaging or encumbering, in any manner, the directory assets being transferred in this proceeding, until further ordered by the commission.

Applicants' decision to effectuate the proposed Merger Transaction constitutes Applicants' acceptance and agreement with the conditions and requirements of our approval, as set forth above. Additionally, upon close of the proposed Merger Transaction, Hawaiian Telcom shall, among other things, be accountable for any and all of Verizon Hawaii's: (1) unpaid public utility fees due to the commission, pursuant to HRS § 269-30; (2) annual financial reports that are required to be filed with the commission in accordance with HAR § 6-80-91; and (3) unpaid telecommunications relay service ("TRS") contributions, pursuant HRS § 269-16.6 and Order No. 21049, filed on June 10, 2004, in Docket No. 04-0070 ("Order No. 21049").

2. HT Services is granted a COA to provide intrastate telecommunications services in the State as a reseller. Accordingly:

- (A) As the holder of a COA, HT Services shall be subject to all applicable provisions of HRS chapter 269, HAR

chapters 6-80 and 6-81, any other applicable State laws and commission rules, and any orders that the commission may issue from time to time.

- (B) HT Services shall file its tariffs in accordance with HAR §§ 6-80-39 and 6-80-40. HT Services' tariffs shall comply with the provisions of HAR chapter 6-80. In the event of a conflict between any tariff provision and State law, State law shall prevail.
- (C) HT Services shall conform its initial tariff to the applicable provisions of HAR chapter 6-80. An original and eight (8) copies of the initial tariff shall be filed with the commission, and two (2) additional copies shall be served on the Consumer Advocate. Applicant shall ensure that the appropriate issued and effective dates are reflected in its tariffs.
- (D) Within thirty (30) days from the date of this Decision and Order, HT Services shall pay a public utility fee of \$60, pursuant to HRS § 269-30. The business check shall be made payable to the Hawaii Public Utilities Commission, and sent to the commission's office at 465 S. King Street #103, Honolulu, HI, 96813.
- (E) Within thirty (30) days from the date of this Decision and order, HT Services shall also pay a TRS contribution of \$10.00, established pursuant to HRS § 269-16.6 and Order No. 21049. The business check shall be made payable to "Hawaii TRS", and sent to the Hawaii TRS Administrator, NECA Services, Inc.,

80 S. Jefferson Road, Whippany, NJ 07981. Written proof of payment shall be sent to the commission.

3. The interim transfer of Verizon Hawaii's issued and outstanding stock from GTE Corp., a New York corporation, to Verizon HoldCo, a Delaware limited liability company, and the subsequent merger of Verizon HoldCo into HT Communications, a Delaware corporation for the purpose of effectuating the proposed Merger Transaction, is approved, pursuant to HRS § 269-17.5.

4. The pledging of Hawaiian Telcom's and HT Services' respective capital stock and the grant of a security interest in and mortgages on substantially all of Hawaiian Telcom's and HT Services' tangible and intangible assets to secure the guaranty of the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction, is approved, pursuant to HRS § 269-19.

5. The guaranty by Hawaiian Telcom and HT Services for the financing and credit facility arrangements proposed to be obtained by HT Communications for the purpose of effectuating the proposed Merger Transaction, is approved, pursuant to HRS § 269-17.


6. The Bell Atlantic Reporting Condition is terminated.

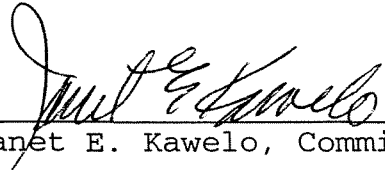
7. Within thirty (30) days of the date of this Decision and Order, VSS shall fully comply with the requirements of HRS § 269-30 by paying its December 2004 public utility fee.

8. Applicants shall timely comply with all the regulatory conditions and other requirements set forth above, as applicable. Failure to timely comply with any of these regulatory conditions and requirements may constitute cause to void this Decision and Order, and may result in further regulatory action, as authorized by State law and commission rules and regulations.

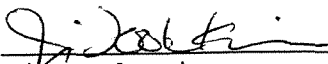
DONE at Honolulu, Hawaii this MAR 16 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By 
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:


Ji Sook Kim
Commission Counsel

04-0140.eh

of

For approval of a merger transaction and related matters

Docket No. 04-0140

PUBLIC UTILITIES
COMMISSION

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FILED

**STIPULATION
EXHIBITS A THROUGH C
AND
CERTIFICATE OF SERVICE**

Attorneys for PARADISE MERGERSUB, INC.

**Attorneys for TIME WARNER TELECOM OF
HAWAII L.P. DBA OCEANIC COMMUNICATIONS**

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

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

STIPULATION

WHEREAS, PARADISE MERGERSUB, INC. ("MergerSub") and GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC. d/b/a VERIZON LONG DISTANCE and VERIZON SELECT SERVICES INC. (collectively, the GTE/Verizon Entities) jointly filed an application in this proceeding seeking Commission approval to certain transactions involving the transfer of control of Verizon Hawaii Inc. ("VZH") to MergerSub;

WHEREAS, TIME WARNER COMMUNICATIONS OF HAWAII, L.P. dba OCEANIC COMMUNICATIONS ("TWTC") and PACIFIC LIGHTNET, INC. ("PLNI") were granted permission to intervene in this proceeding to address, among other things, the limited issue of whether and to what extent the proposed transfer of control will impact the provisioning of the back office functions and systems to TWTC and PLNI (collectively the "CLECs");

WHEREAS, in an effort to facilitate a better exchange of information concerning the provisioning of the back office functions and systems to the CLECs by the post-closing VZH ("Hawaiian Telcom"), MergerSub and its consultants conducted collaborative meetings with the CLECs on October 6th and 8th, 2004;

WHEREAS, as a result of the progress made during these initial collaborative meetings, the parties agreed to continue their collaborative meetings during the week of October 18, 2004 to further discuss the wholesale service functions and timing of the reestablishment of the back office systems under MergerSub's ownership;

WHEREAS, based on these collaborative meetings, subsequent discussions between MergerSub's representatives/consultants and TWTC's representatives, and the exchange of certain information between the parties, MergerSub and TWTC desire to document an agreement relative to (a) the post-closing transition and operational matters involving the wholesale service functions provided to TWTC and (b) certain procedural matters involving the ongoing proceeding.

NOW, THEREFORE, the parties agree to the following:

I. **GENERAL STANDARD.**

A. The systems and processes to be implemented by Hawaiian Telcom will have the same or similar functionality as those presently provided to TWTC by VZH's mainland affiliates ("Verizon") for wholesale services in Hawaii.

B. If the new systems and/or processes are not fully tested and operational at the scheduled time for implementation, Hawaiian Telcom will continue to use Verizon's systems and/or processes but only to the extent of the term of the Transition Services Agreement entered into between MergerSub and the GTE/Verizon Entities, unless otherwise ordered by the Commission.¹

C. During the period that new systems and/or processes are being tested, TWTC recognizes that wholesale service orders will be processed on the Verizon systems

and/or processes but that some service orders may be tested on Hawaiian Telcom's systems and /or processes.

D. Except to the extent that a term or condition is an ongoing requirement under an existing interconnection or other applicable agreement or by order of the Commission, the terms and conditions set forth in this Agreement shall be applicable from the closing date of the transaction between MergerSub and the GTE/Verizon Entities (the "Transaction Closing Date") and shall expire ninety (90) days following the actual implementation of all systems and processes for provisioning wholesale service orders ("Cut-over").

II. COLLABORATIVE PROCESS.

A. As part of this process, the parties will endeavor to periodically update each other with any information that may be relevant to the development and implementation of the wholesale back office systems. The parties agree to continue to collaborate on the following matters following the Transaction Closing Date and up to the Cut-over :

1. Hawaiian Telcom and TWTC will identify systems and process requirements.
2. Hawaiian Telcom will develop and refine testing and implementation schedules.
3. Hawaiian Telcom will provide to TWTC information on the systems, processes, interfaces, business rules and other supporting documentation that will be utilized to provide the wholesale service functions to TWTC.

¹ Any such order shall be final and non-appealable and be binding upon all affected parties.

4. Hawaiian Telcom will establish new functional work groups (where such functions are currently performed by Verizon on the mainland), and make such work groups available to TWTC on a reasonable basis.

III. TIMING.

BearingPoint, Inc. ("BearingPoint"), MergerSub's consultant, has prepared a draft document entitled "Hawaiian Telcom CLEC Collaborative Transition Planning Draft Schedule" which outlines the approach and tentative timelines that BearingPoint will be undertaking to implement the wholesale back office systems. A copy of that draft document is attached hereto as Exhibit "A" and incorporated herein by reference (the "Schedule"). The parties recognize that because a key aspect of the Schedule is tied to when closing of the transaction will occur, the Schedule is preliminary and subject to modification from time to time.² The parties agree to cooperate to update and revise the Schedule as necessary.

The Schedule generally divides the tentative timelines into five (5) periods. These five (5) periods are, for planning purposes, identified as Planning, Mobilization, Interconnect, Testing, and Production Support. Recognizing that the closing date of the transaction is uncertain, the timeline period milestones are keyed to when the "Cut-over" of the actual service function may occur. Therefore, the five (5) periods shown on Exhibit "A" are calculated in reverse sequence starting from the "Cut-over" time period.

IV. REPORTING REQUIREMENTS.

A. Hawaiian Telcom will submit quarterly reports to the Commission commencing on the first month after the Transaction Closing Date and ending upon the Cut-over of the systems and processes for the wholesale service functions and processes. The

report will include any updates to the Schedule, a listing of accomplishments or milestones achieved to date, and any outstanding issues between Hawaiian Telcom and TWTC.

Concurrently with the submission of the report to the Commission, Hawaiian Telcom will serve a copy of the report on TWTC and the Consumer Advocate. TWTC will have the right to file a response with the Commission (and will serve a copy of the response to Hawaiian Telcom) if it disagrees with any part of the report.

B. Report Format. The parties have agreed upon the format of the reports. A sample of the proposed report form is attached hereto as Exhibit "B" and incorporated herein by reference.

C. Confidential Treatment of Reports. Unless otherwise agreed upon by the parties, the information contained in the reports shall be deemed to be confidential and shall be filed subject to Protective Order No. 21034. No disclosure of the reports to any other party or any person (including those persons that may have already executed a Protective Agreement in this proceeding) may be made without the prior written approval of MergerSub.

V. DISPUTE RESOLUTION.

If, during the course of the development and implementation of any system or procedures, the parties disagree on any matters, the parties agree to use reasonable efforts to resolve any such disagreements on an informal basis.

Notwithstanding the foregoing, if (a) Hawaiian Telcom intends to implement any system, process or procedure not agreed upon by TWTC that TWTC reasonably believes

² The Schedule may also change due to conditions or requirements that may result from any order issued by the Commission in this proceeding.

will be materially harmful to TWTC's operations or (b) Hawaiian Telcom fails to comply with this agreement or any schedule or process agreed to hereunder and such failure will result in a material delay or cause material harm to TWTC's operations, TWTC can submit the matter for resolution to the Commission. For purposes of this Section V., "materially harmful" or "material harm" shall mean (a) where TWTC will incur an additional, cumulative cost of \$40,000 in order to implement one or more systems or processes or to change one or more existing systems or processes, that would not be incurred but for the transfer of control from the GTE/Verizon Entities to MergerSub or (b) where the change in system or process would significantly impair or harm TWTC's ability to deliver existing or proposed services to its customers. In addition, a "material delay" shall mean a 20% increase in the standard due date or processing time for submission of an order or maintenance request.

TWTC shall serve a copy of any such filing by hand delivery or other readily acceptable electronic means upon Hawaiian Telcom on the same day of the filing. Hawaiian Telcom will have ten (10) days following TWTC's filing in which to file a reply memorandum or similar document detailing its position on the matter. The parties agree that any request for resolution by the Commission will include a request for an expedited ruling by a date certain to avoid any unreasonable delay in the Cut-over.

In addition to the foregoing, Hawaiian Telcom will also have the right to invoke the dispute resolution process described above to the extent Hawaiian Telcom believes that TWTC is (a) unreasonably preventing or delaying Hawaiian Telcom from completing the Cut-over or (b) otherwise failing to comply with this Agreement in good faith. Similar to the rights afforded to TWTC in the preceding paragraph, Hawaiian Telcom may also submit the matter for resolution to the Commission and the process, procedures, and time periods described in the preceding paragraph shall apply in that case.

VI. PERFORMANCE STANDARDS

Unless otherwise agreed by the parties or ordered by the Commission, upon Cut-over to Hawaiian Telcom's systems and processes, Hawaiian Telcom agrees to comply with the performance standards (the "Standards") set forth in the California Joint Partial Settlement Agreement ("JPSA"), as the same may be amended from time to time and adopted by the Commission. Nothing herein shall obligate Hawaiian Telcom to offer services that are not currently offered or are currently offered under different terms than as required by the JPSA.

VII. ELECTRONIC INTERFACES ("DEFINITES").

A. Electronic Wholesale Interfaces. Hawaiian Telcom agrees to make available at Cut-over (whether through its own development and implementation or through partial or total outsourcing) the following electronic wholesale interfaces:

1. Pre-Order -- Graphic User Interface (GUI) for the retrieval of customer service records ("CSRs") and other available customer network information.
2. Ordering and Provisioning -- Access Service Request (ASRs): The ASR gateway will conform to specifications of the Ordering and Billing Forum (OBF), currently supporting ASOG forms that include the general ASR form and those for Trunking, Transport, End-User Special Access, Feature Group A, Multi-point Services Leg, Service Address Location Information, Additional Circuit Information, End-Office Detail, Firm Order Confirmation and Design Layout Record.
3. Ordering and Provisioning -- Local Service Request (LSRs) Graphic User Interface (GUI).

4. Maintenance -- Graphic User Interface (GUI) for the submission and status of trouble tickets for both high capacity circuits and local exchange switched services.

5. Billing Disputes - Graphic User Interface (GUI) for the submission and status of billing disputes for both local and special/switched access services.

B. System Business Rules and Documentation. Hawaiian Telcom agrees to prepare and distribute the wholesale system business rules and documentation at least forty-five (45) days before GUI System Cut-over and sixty (60) days before EDI type System Cut-over. These rules and documentation shall cover the GUI interfaces and EDI type interfaces.

C. System Testing and Training. The parties agree to develop a joint testing plan that will be implemented during the testing period. Prior to Cut-over, Hawaiian Telcom agrees to provide a one-time system training to those TWTC employees responsible for the coordination and processing of wholesale service requests. All such employee training shall be conducted in Honolulu, Hawaii or via electronic interfaces unless otherwise agreed upon by the parties. Written training materials shall be made available at the time of the system training.

**VIII. ORDERING AND PROVISIONING: ORGANIZATION INTERFACES/
OPERATIONAL PROCESSES & PROCEDURES.**

A. Hawaiian Telcom agrees to establish a wholesale ordering organization; provided, however, that a separate organization will not be required if Hawaiian Telcom documents and files with the Commission its plan to establish, and maintain adequate safeguards to ensure that wholesale ordering information is not shared with Hawaiian Telcom's retail operations.

B. Unless otherwise specified in the JPSA or in TWTC's interconnection agreement, wholesale provisioning shall be performed at comparable service quality levels as retail provisioning.

C. Hawaiian Telcom will provide to TWTC standard intervals associated with special access, porting and LSR related services to the extent that such intervals are currently published by Verizon or in TWTC's interconnection agreement.

D. Hawaiian Telcom will provide TWTC with organizational contacts and escalation lists at least 5 business days prior to any system or organizational conversion date.

IX. MAINTENANCE: ORGANIZATION INTERFACES/ OPERATIONAL PROCESSES & PROCEDURES.

A. Hawaiian Telcom will provide to TWTC one organizational contact point for all repairs at least 5 business days prior to any system or organizational conversion date.

X. BILLING PROCESSES AND PROCEDURES.

Hawaiian Telcom agrees to the following billing processes and/or procedures, which will be in effect from and after the Cut-over:

A. Provide a mutually agreeable method for the distribution of electronic bills.

B. Maintain the existing billing account number (BAN) structure.

C. Maintain billing in a standard CABS format.

D. Develop a Credit and Collection Policy/Process consistent with Commission Rules and Regulations.

E. Provide a written statement of the wholesale services practices and procedures applicable to TWTC.

XI. ANCILLARY SERVICES PROCESSES AND PROCEDURES.

Hawaiian Telcom agrees to the following ancillary services processes and/or procedures:

- A. Establish local contact and process for Collocation.
- B. Maintain ancillary arrangement for Operator Services and Directory Assistance (OS/DA) services.
- C. Establish Directory Listing/Yellow Pages contacts and procedures.
- D. Development of a process to allow TWTC to directly input station identification information for its customers into the 911 database.

XII. OTHER ORGANIZATION INTERFACES/ OPERATIONAL PROCESSES & PROCEDURES.

Hawaiian Telcom agrees to identify the following contacts at least 5 business days prior to any system or organizational conversion date:

- A. CLEC Account Manager
- B. Collocation Manager
- C. Outside Plant Services Manager (Poles/Conduit)

XIII. OTHER INFORMATION.

BearingPoint developed a draft decomposition model which provides information necessary to create "swim lane" diagrams. These "swim lane" diagrams for the wholesale operations will be developed in the future. To the extent required by the Commission, copies of the "swim lane" diagrams can be provided at a future date.

BearingPoint has also prepared a draft of the proposed back-office wholesale architecture which illustrates the system interfaces and applicable workflow processes. A copy of the proposed architecture is attached hereto as Exhibit "C" and incorporated herein by reference. Again, the technical requirements for the systems and processes have not been finalized and, therefore, are subject to change based upon negotiations with TWTC and the collaborative process. The draft back-office wholesale architecture is not intended to modify any of the agreements of the parties under this Stipulation.

XIV. INTERCONNECTION AGREEMENT.

The parties agree that negotiations between TWTC and Verizon for a new interconnection agreement are ongoing and may not be completed prior to the Transaction Closing Date. In that event, Hawaiian Telcom will agree to commence discussions with TWTC for a new interconnection agreement after the Transaction Closing Date. Until a new interconnection agreement is agreed upon, Hawaiian Telcom agrees to allow TWTC to operate, as an interim measure, under the existing interconnection agreement and all subsequent operational agreements as if said agreements had not expired (subject to Hawaiian Telcom's rights under those agreements to modify the agreements in certain circumstances). The parties further agree to establish a resolution process to address individual issues that may arise prior to the negotiation of a full interconnection agreement.

XV. OTHER REGULATORY MATTERS.

In consideration of entering into this Stipulation, the parties agrees that some, but not all of the limited issues TWTC has been permitted to address as an intervenor in this proceeding (the "CLEC Intervenor Issues") have been addressed in the collaborative and subsequent meetings and discussions with MergerSub and its consultants, or are addressed in this Stipulation. However, the parties were not able to reach agreement on all issues. TWTC therefore shall have the right to discuss in its Position Statement matters related to the CLEC Intervenor Issues that are not addressed in this Stipulation, including, without limitation, whether and to what extent performance measure standards, incentives and/or penalties should be initiated and implemented as a condition to approval. Subject to MergerSub's (and Hawaiian Telcom's) compliance with the terms and conditions set forth in this Stipulation, and subject to any conditions to approval TWTC may recommend in its Position Statement, TWTC agrees to file a Statement of Position with the Commission on or before January 5, 2005 (a) supporting the proposed transaction between MergerSub and the GTE/Verizon Entities and (b) indicating that the transfer of control will not have an impact on competition in telecommunications services in the State of Hawaii. Hawaiian Telcom will similarly be permitted to include within its Rebuttal Statement its position on any issue raised by TWTC in its Position Statement.

The parties acknowledge that the design, development, and implementation of the back office systems involving the wholesale service functions is complex and complicated. To that end, each party has allocated and expended considerable time, effort, and resources during the respective collaborative sessions and the subsequent meetings and discussions. Based on this collective efforts, this Stipulation reflects an agreed upon set of provisions and conditions that the parties believe are reasonable. The parties therefore

agree that, except as discussed below, the provisions and conditions of this Stipulation will be binding as between them with respect to the specific issues and matters addressed herein.

Notwithstanding the foregoing, each provision of this Stipulation is in consideration and support of all other provisions, and is expressly conditioned upon acceptance by the Commission of the matters expressed in this Stipulation in their entirety. In the event the Commission declines to adopt parts or all of the matters agreed to and as set forth in this Stipulation, the parties agree that either party may, in its sole discretion, elect to not be bound by particular provisions and conditions set forth in this Stipulation.

In all respects, it is understood and agreed that the agreements evidenced in this Stipulation represent compromises by the parties to fully and finally resolve the various issues that are addressed in the Stipulation and is not meant to be an admission by any of the parties as to the acceptability or permissibility of matter stipulated to herein. Furthermore, the parties agree that nothing contained in this Stipulation shall be deemed to, nor interpreted to, set any type of precedent in any future regulatory proceeding or docket, except as necessary to enforce this Stipulation.

XIV. CHANGE IN LAW.

If any final and non-appealable legislative, regulatory, judicial or other legal action, including a change in applicable law, materially affects any of the terms or conditions of this Agreement, or the ability of either party to perform any material terms of this Agreement, then upon notice to the other party, the superceded terms or conditions shall no longer be applicable. In that case, the parties agree to renegotiate in good faith within sixty (60) days

following the issuance of such notice such mutually agreeable new terms and conditions as may be required.

DATED: Honolulu, Hawaii January 5, 2005



ALAN M. OSHIMA
MICHAEL H. LAU
KENT D. MORIHARA

Attorneys for PARADISE MERGERSUB, INC.



J. DOUGLAS ING
PAMELA J. LARSON

Attorneys for TIME WARNER
COMMUNICATIONS OF HAWAII, L.P.



Hawaiian Telcom CLEC Collaborative Transition Planning Draft Schedule

11/9/04

Agenda



- 1. Approach**
- 2. Proposed Meeting Schedule**
- 3. Tentative Timeline**
- 4. Periods and Related Cooperative Activities**
- 5. Carlyle/BearingPoint Milestones**

- **The Scheduling of cooperative activities for Transition is dependent on the specific transaction Close date and the Transition Period Cut-over date.**
- **In order to communicate planning information with CLEC parties in this environment BearingPoint will employ terminology of Phases and Periods**
- **Definitions:**
 - A Phase is a logical grouping of related project activities that are performed only by BearingPoint
 - A Period, for purposes of the Transition, is a time range during which certain cooperative activities will occur
 - A Milestone will serve as the demarcation between Periods

Initial Proposed Meeting Schedule



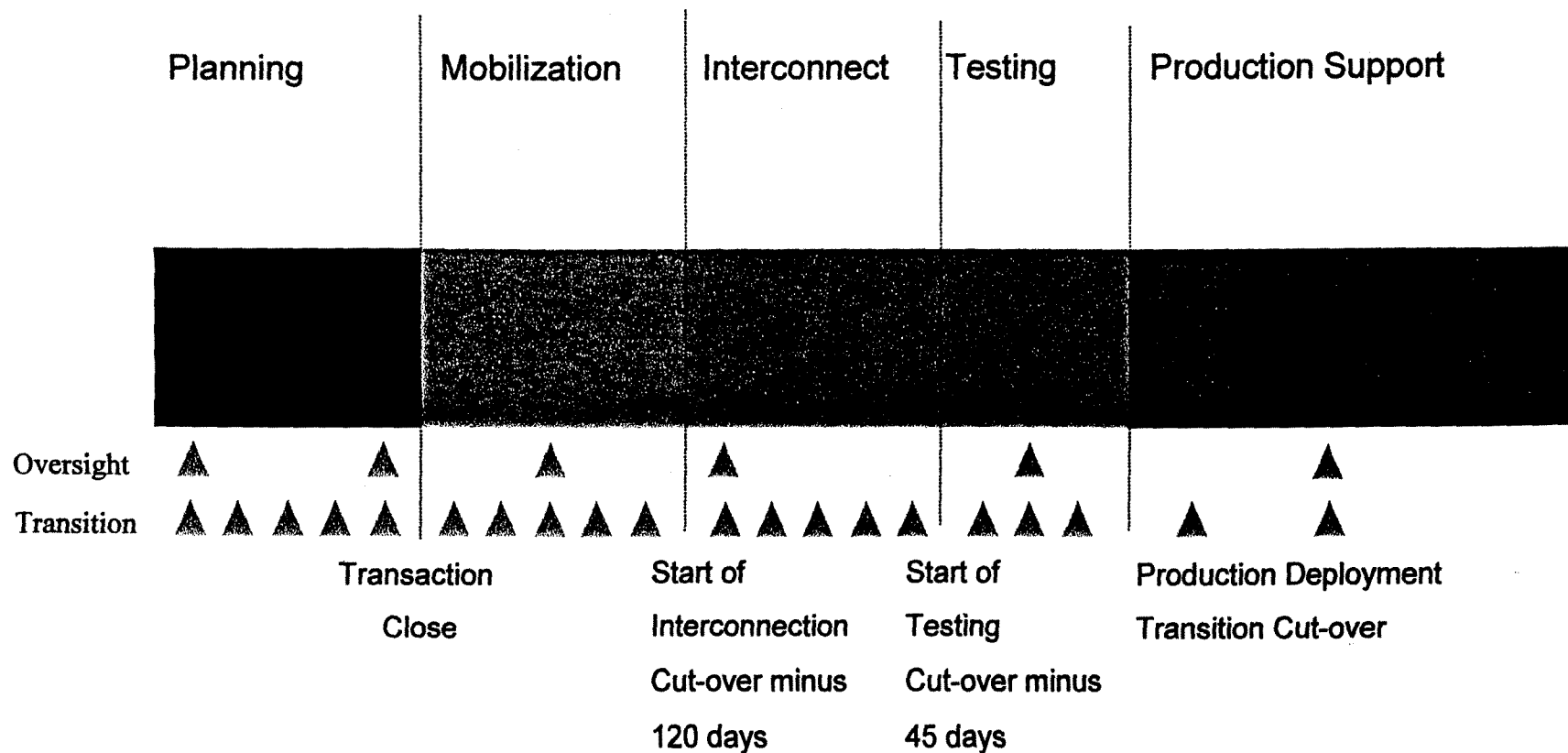
■ Oversight Committee

- Quarterly meetings

■ Transition Team

- Planning and Mobilization Periods
 - Monthly
- Testing Period
 - Every 2 weeks
- Production Support Period
 - Per Change Control process
 - As needed for support

Period Timeline (Tentative)



Periods and Related Cooperative Activities



■ Planning

- Oversight Meeting
- Collaborative Transition Planning with CLECs
- Current State Investigation with CLECs
- Process Review with CLECs
- Solution Review with CLECs
- Milestone 1 – Close of Sale

■ Mobilization

- Oversight Meeting
- Transition Team status updates
- Draft User Documentation Distribution and Review with CLECs
- Test Design with CLECs
- Milestone 2 – Start of Testing

■ Interconnection and Testing

- Oversight Meeting
- Transition Team status updates
- Establish network connectivity with CLECs
- Interconnectivity Testing with CLECs
- Interoperability Testing with CLECs
- Milestone 3 –Deployment to Production

■ Production Support

- Deployment into Production and Cutover
- Ongoing Issue Management with CLECs
- Ongoing Release Management with CLECs

First Milestone



- The first Milestone for this cooperative Transition is the Close of the sale transaction
- At Close the parties, Hawaiian Telcom and the CLECs, will transition from the Planning activities to those of the Mobilization Period
- Periodic meetings will be scheduled by Hawaiian Telcom to communicate status updates to CLECs. In addition, these meetings will be used to plan for their participation in the Interconnect and Testing Periods
- Initial draft User Documentation, such as Interface Specifications will be distributed during the Mobilization period in support of the move to Interconnection and Testing
- Test Design activities, such as scenario selection, will begin during the Mobilization Period

Second and Third Milestones



- The second Milestone for this cooperative Transition will be the initiation of network interconnection activities, anticipated to begin approximately four to five months prior to the cut-over date
- This Milestone will signal the beginning of the Interconnection Period
- Hawaiian Telcom and the CLECs will cooperate during this Period to establish physical network connectivity to the test environment and establish system connectivity
- The shift to the Testing Period will begin with the execution of interoperability tests using defined test scenarios
- Test scenarios will be developed to cover each business functional area and exercise a wide array of product types and service offerings

- The final Milestone for this cooperative Transition is the cut-over of operations and deployment of the Interconnection solution into the production environment
- This Milestone will define both the end of the Testing Period and the beginning of the Production Support period
- Hawaiian Telcom and the CLECs will cooperate during the Deployment to ensure that connectivity to the production environment is established between CLEC and Hawaiian Telcom systems, and that basic functionality is operational
- Once Deployment is successfully completed, Hawaiian Telcom will begin CLEC interconnection support activities including processing of CLEC service requests, response to CLEC support inquiries, and Release Management

CONFIDENTIAL – SUBJECT TO PROTECTIVE ORDER NO. 21034
EXHIBIT "B"

BI-MONTHLY REPORT OF HAWAIIAN TELCOM
DOCKET NO. 01-0140

Date of Report: _____

Schedule Revisions:

1. _____
2. _____
3. _____

Accomplishments or Milestones Achieved From Last Report

1. _____

2. _____

3. _____

Outstanding Issues:

1. _____

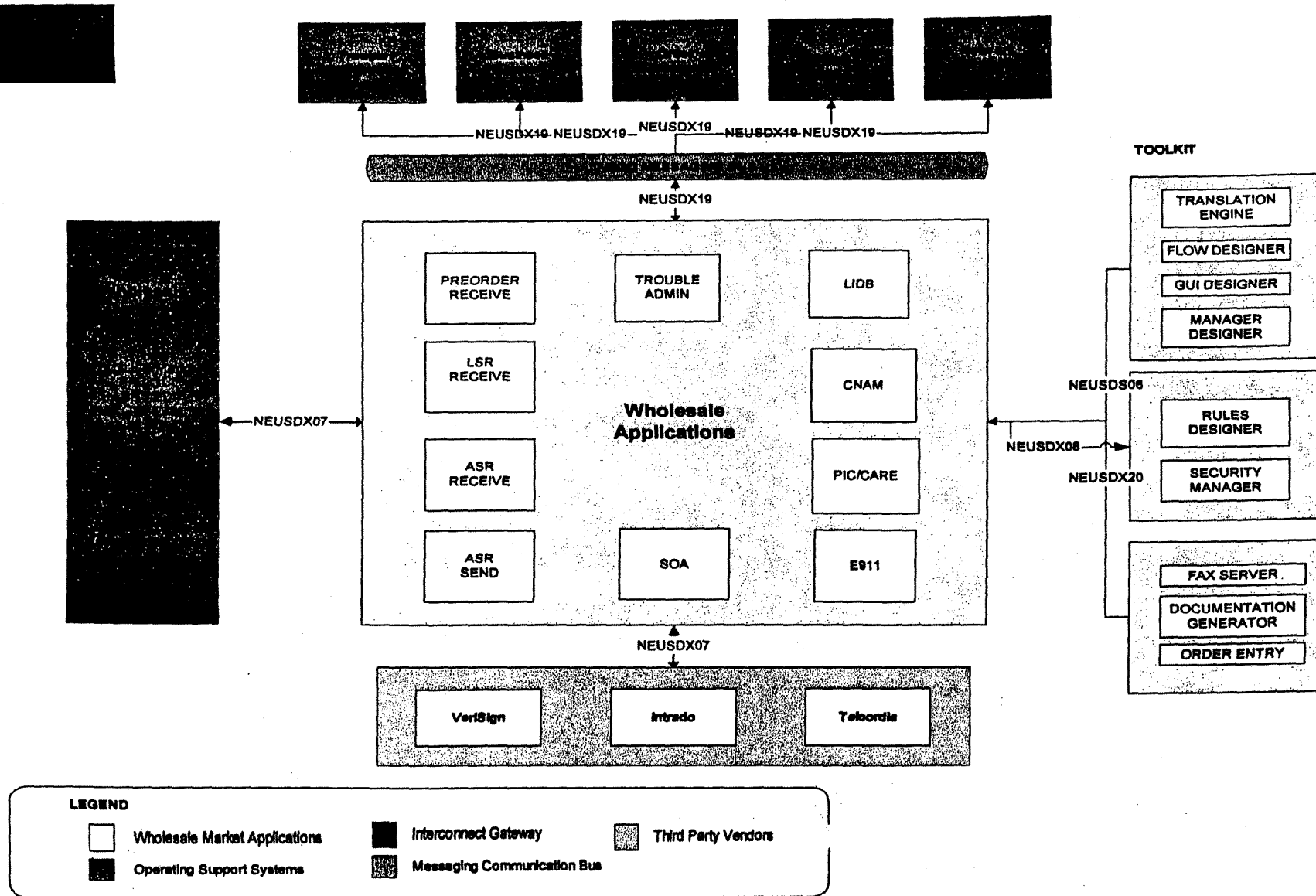
2. _____

3. _____

DRAFT Wholesale Application Architecture



EXHIBIT C



CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Stipulation upon the following Parties and Participant by hand delivery or by mail, postage prepaid and properly addressed.

| | |
|--|----------|
| DIVISION OF CONSUMER ADVOCACY 335 Merchant Street Room 326 Honolulu, HI 96813 | 3 copies |
|--|----------|

| | |
|--|----------|
| GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC. c/o P.O. Box 2200 Honolulu, HI 96841 Attn: Mr. Joel K. Matsunaga | 2 copies |
|--|----------|

| | |
|---|--------|
| STEPHEN S. MELNIKOFF, ESQ. General Attorney Regulatory Law Office Office of the Judge Advocate General U.S. Army Litigation Center 901 N. Stuart Street, Suite 700 Arlington, Virginia 22203-1837 | 1 copy |
|---|--------|

| | |
|--|--------|
| LAURA A. MAYHOOK, ESQ. J. JEFFREY MAYHOOK, ESQ. Mayhook Law, PLLC 34808 NE 14 th Avenue La Center, WA 98629 | 1 copy |
|--|--------|

| | |
|--|--------|
| WILLIAM M. TAM ALSTON HUNT FLOYD & ING 1001 Bishop St., 18 th Floor Honolulu, HI 96813 | 1 copy |
|--|--------|

| | |
|--|--------|
| J. DOUGLAS ING, ESQ. PAMELA J. LARSON, ESQ. Watanabe Ing Kawashima & Komeiji LLP First Hawaiian Center 999 Bishop Street, 23 rd Floor Honolulu, HI 96813 | 1 copy |
|--|--------|

HERBERT R. TAKAHASHI
STANFORD H. MASUI
DANNY J. VASCONCELLOS
REBECCA L. COVERT
Takahashi, Masui, Vasconcellos & Covert
345 Queen Street, Room 506
Honolulu, HI 96813

1 copy

Dated: January 5, 2005



ALAN M. OSHIMA
MICHAEL H. LAU
KENT D. MORIHARA

Attorneys for PARADISE MERGERSUB,
INC.

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

DISSENTING OPINION OF WAYNE H. KIMURA, COMMISSIONER

I respectfully dissent from the Majority's Decision and Order in this docket. In sum, I do not agree with the Majority's decision to conditionally approve the proposed merger transaction and other related matters (hereinafter referred to as "Transfer of Control.") described in Applicants' Application.

First off, my appreciation goes to the Applicants and the Parties and Participants for their diligence in compiling what I consider to be a comprehensive record supporting the commission's review of this Application.

Verizon Hawaii (aka, existing company) is presently the primary provider of telecommunications services in the State. The impact of this Application is significant as it defines the future of what may be considered to be the most important core component of the State's telecommunications infrastructure. In my view, the consummation of the proposed Transfer of Control described in Applicants' Application would result in the transfer of assets from one of the nation's largest companies in the

business of communications, Verizon, to a large private-equity investment company, Carlyle (aka, new company), with a publicly-stated short-term investment horizon.

Overall, I find that the potential risks and potential benefits in the record, particularly those identified by the Parties and Participants, indicate that the proposed Transfer of Control is not in the public interest. The proposed Transfer of Control does not seem to present an improvement over the finances and services of the existing Verizon Hawaii ownership. Instead, I believe that the components of the transaction impose new and substantial risks on residential, commercial, retail and wholesale ratepayers statewide - now and for many years to come.

This is a complex transaction, and while the conditions imposed and adopted by the Majority are designed to mitigate some of the additional risks, they are not altogether a cure. At this time, I do not find anything in the record to indicate that there is a consensus and acceptance by all Parties and Participants of all conditions; including those conditions initially proposed in the record, and new conditions included in this decision and order. I believe that, in this instant Application, the new conditions substantially change the Application and compound the complexity of the transaction without the agreement of the Parties and Participants. As such, I believe that it would be fairer to the Parties and Participants, including the Applicants, for the commission to provide a clear, unconditional decision (i.e., approval or disapproval).

The stated benefits of the transaction include Hawaii focus, local management, local investors, job creation, customer

service, stand-alone entity, competitive environment, customer appreciation bill credits, and conditions for no increase in rates. As discussed by the Consumer Advocate and the other Parties and Participants, I view the vast majority of any stated benefits as marginal or intangible in nature. It is even uncertain whether some of the benefits will actually be achievable. On the other hand, the risks identified by the Consumer Advocate and the other Parties and Participants have been characterized as significant and real.

To further illustrate my concerns of the proposed Transfer of Control, I offer the following observations and opinions:

- The highly leveraged transaction (i.e., eighty-two and one-half per cent (82.5%) debt capital structure) results in a heavy debt burden that must be borne by the ratepayers. The new debt is much higher than the existing company's debt. The assets of the new company will be pledged against the debt, and much of the new company's free cash will be tied up in servicing debt.
- There will be limited financial flexibility due to the debt burden. Limited access to new capital could hinder the new company's ability to respond to the demands of customer service, new technologies, system development and maintenance, and unforeseen financial events. Any necessary infusion of additional capital from the parent company will be discretionary and not automatic. In my opinion, any new borrowing would come at a higher price due to a lower rating of the company's debt from investment grade to "junk" status. The debt burden may pressure future rate increases. Again, in any case, the new company's debt will be borne by the ratepayers.
- The new company has to create an entirely new replacement system for all the back office systems for services now provided by Verizon Hawaii's affiliates, including customer service, billing, records management, information technology (aka, IT) functions, facility management, inventory, payroll, business management, etc. The work will have to start from scratch, and be completed within nine (9) months after closing of the transaction; if not, the new company will have to continue to rely on Verizon to provide services, albeit at a negotiated increased cost. My reading of the record indicates that the Parties

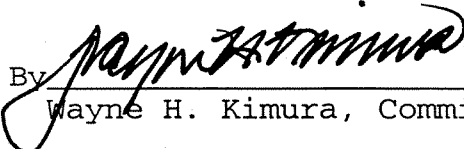
and Participants have recognized that this transition is a risky undertaking from both customer service and financial perspectives, exacerbated by the nine (9) month timeframe. Problems in making the transition could detrimentally affect continuity in customer service and the operation of the new company, may lead to higher operating and capital costs, and result in the loss of economies of scale and efficiencies of the existing centralized system.

- The retention by Verizon of some of the pension assets may expose the new company and its hourly employees to additional future risks that may have been mitigated by keeping the pension surplus. Also, expenses of the new company may be increased due to the loss of the surplus.
- In my view, there is still a question regarding the reasonableness of the purchase price and the premium paid to Verizon by the new company. There is also an uncertainty over how realistic the financial projections are for revenues and expenses
- Finally, I believe that the proposed Transfer of Control may negatively impact our State tax revenues.

For these reasons, I do not concur with the Majority's Decision and Order in this docket. Based on the record, I do not believe that the conditional approval of the sale of Verizon Hawaii from Verizon to Carlyle would be in the interest of the public. Nevertheless, I look forward to working with the new company towards making it the success that it needs to be for Hawaii's telecommunication future.

DONE at Honolulu, Hawaii MAR 16 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Wayne H. Kimura, Commissioner

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21696 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

WILLIAM E. KENNARD
HAWAIIAN TELCOM COMMUNICATIONS, INC.
(fka HAWAIIAN TELCOM MERGERSUB, INC. AND
PARADISE MERGERSUB, INC.)
c/o THE CARLYLE GROUP
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2505

JOEL K. MATSUNAGA
GTE CORPORATION
VERIZON HAWAII INC.
BELL ATLANTIC COMMUNICATIONS, INC.
VERIZON SELECT SERVICES INC.
P. O. Box 2200
Honolulu, HI 96841

KENT D. MORIHARA, ESQ.
MICHAEL H. LAU, ESQ.
Davies Pacific Center
841 Bishop Street, Suite 400
Honolulu, HI 96813

LESLIE ALAN UEOKA, ESQ.
BLANE T. YOKOTA, ESQ.
VERIZON CORPORATE SERVICES GROUP INC.
P. O. Box 2200
Honolulu, HI 96841

Certificate of Service

Page 2

STEPHEN S. MELNIKOFF, ESQ.
REGULATORY LAW OFFICE
OFFICE OF THE JUDGE ADVOCATE GENERAL
U.S. ARMY LITIGATION CENTER
901 N. Stuart Street, Suite 700
Arlington, VA 22203-1837

HERBERT R. TAKAHASHI, ESQ.
STANFORD H. MASUI, ESQ.
DANNY J. VASCONCELLOS, ESQ.
REBECCA L. COVERT, ESQ.
TAKAHASHI, MASUI, VASCONCELLOS & COVERT
345 Queen Street, Room 506
Honolulu, HI 96813

J. DOUGLAS ING, ESQ
PAMELA J. LARSON, ESQ.
WATANABE ING KAWASHIMA & KOMEIJI LLP
First Hawaiian Center
999 Bishop Street, 23rd Floor
Honolulu, HI 96813

LAURA A. MAYHOOK, ESQ.
J. JEFFREY MAYHOOK, ESQ
MAYHOOK LAW, PLLC
34808 NE 14th Avenue
La Center, WA 98629

WILLIAM M. TAM
ALSTON HUNT FLOYD & ING
1001 Bishop Street, 18th Floor
Honolulu, HI 96813



Karen Higashi

DATED: MAR 16 2005