State of Minnesota
Before the
Minnesota Public Utilities Commission

Katie Sieben	Chair
Valerie Means	Commissioner
Matt Schuerger	Commissioner
Joseph K. Sullivan	Commissioner
John Tuma	Commissioner

In the Matter of a Commission Inquiry into Frontier Communications' Virtual Separation Analysis

Docket No. P-405,407,5316/CI-21-150

INFORMATIONAL FILING

OF
FRONTIER COMMUNICATIONS OF MINNESOTA, INC. AND CITIZENS TELECOMMUNICATIONS OF MN, LLC

October 29, 2021

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Frontier Communications of Minnesota, Inc. ("Frontier-MN"), Citizens Telecommunications Company of Minnesota, LLC ("CTC-MN"), and Frontier Communications of America, Inc. (collectively "Frontier") hereby submit this Informational Filing in response to the Commission Order Setting Inquiry Scope and Schedule ("Inquiry Order"), dated September 29, 2021.

I. INTRODUCTION AND BACKGROUND:

From its inception, the accounting analysis referred to as the "Virtual Separation" was ill-named, and misuse of the term has frequently been a source of confusion. Notwithstanding the misnomer, Frontier undertook the virtual separation work to better understand, monitor, and improve its overall operating performance. The goal was to improve Frontier's ability to evaluate and operate its business and identify and isolate individual state-related costs across its 25-state footprint. Through the completed virtual separation analyses, Frontier accomplished a disciplined review of its cost structure and cost allocation methodology and implemented internal reporting mechanisms that allow management to better understand the economics of Frontier's various state-level operations.

Prior to completing the virtual separation accounting analysis, Frontier allocated all indirect costs (e.g., costs of operating its call centers) among its state operations using a single-factor allocator based on relative revenue levels between states. The virtual separation analysis involved Frontier evaluating and now using **[NON-PUBLIC DATA BEGINS** [redacted] **NON-PUBLIC DATA ENDS]** to replace the single-factor allocation based on relative revenues**.** The result of this analysis is that Frontier can more precisely allocate indirect costs to its operations across its 25 states. Following the completion of the analysis, the Minnesota allocation of indirect costs was reduced and its allocation reflects approximately **[NON-PUBLIC**

DATA BEGINS [redacted] **NON-PUBLIC DATA ENDS]** in indirect costs incurred by Frontier. Frontier implemented the results of the virtual separation analysis into its accounting systems starting in May 2021 following the Company's emergence from Chapter 11.

This Informational Filing includes (as Exhibit 1) a NON-PUBLIC copy of the Virtual Separation Report (the "Report") that was prepared and delivered to Frontier's bondholders on April 30, 2021 as part of Frontier's Chapter 11 restructuring and emergence from bankruptcy. The Report shows (consistent with Frontier's explanation) that the virtual separation review was an accounting exercise undertaken to better allocate indirect costs among Frontier's operating companies and provide more precise financial data across Frontier's 25-state footprint.

While an important management step, this accounting analysis was not directed to determining future investments, and is not a driver of Frontier's future investment plans. Rather, numerous variables, including the widely varying market conditions among Frontier's various service areas, will determine Frontier's future investment.

In that context, it is important to note that over the last year or so, Frontier has completed a substantial fiber project that made Fiber-to-the-Premises ("FTTP") gig-capable service available to approximately **[PROTECTED DATA BEGINS** [redacted] **PROTECTED DATA ENDS]** in Minnesota**.** As explained below, the use of fiber technology (and the level of fiber investment) is not necessary to provide high quality regulated voice service. Moreover, to the extent FTTP is deployed in Minnesota by Frontier, voice service will be provided over the fiber via voice over internet protocol ("VoIP), which the Commission does not regulate. Because FTTP will not be used to provide regulated voice service, the level of any additional FTTP investment by Frontier is irrelevant to the provision of regulated telephone service.

Copper technology has worked effectively and efficiently for telephone voice service for decades and will continued to be used by Frontier (and other telephone companies) to provide regulated voice service, including in Minnesota. Further, unlike the situation that existed prior to the Service Quality Agreement ("Settlement Agreement"),[1] Frontier's telephone service quality in Minnesota using its copper network is now very high (as shown by filings in the Service Quality docket).

A. Statutory Considerations.

Minn. Stat. 237.081 provides guidance for this investigation. Subdivision 1 provides authority to conduct investigations "relating to any telephone service." Subdivision 2 provides that "a contested case hearing be conducted" if a "significant factual issue has not been resolved to the Commission's satisfaction" by investigation. Subdivision 4 provides the standards for issuance of an order by the Commission if: (1) "a [telephone] service that can be reasonably demanded cannot be obtained"; (2) "any … practice, act, or omission affecting … telephone service" is "unreasonable, insufficient, or unjustly discriminatory'; or (3) "any [telephone] service is inadequate." Frontier's performance under the Settlement Agreement in the Service Quality Docket is now providing high quality telephone service in Minnesota.

B. Frontier's Improved Service Quality

Some parties to this docket have suggested that Frontier's telephone service quality is sub-standard, and have expressed concerns that Frontier's telephone service quality will be adversely impacted by the "virtual separation" work completed by Frontier during its Chapter 11 restructuring. These concerns are unwarranted. Frontier has improved its telephone service

[1] *In the Matter of a Commission Inquiry into the Service Quality, Customer Service, and Billing Practices of Frontier Communications*, Docket No. P407, 405/CI-18-122, Order Approving Settlement as Modified (Jan. 22, 2020).

quality over the past two years since the Settlement Agreement was initially implemented. Its improvement is well documented in the periodic reporting on the service quality metrics included in the Settlement Agreement, which became effective on January 1, 2020. Indeed, for many of the service quality metrics in the Settlement Agreement, Frontier has been meeting the standard ever since the Settlement Agreement became effective.

The Settlement Agreement identified ten separate metrics, which are the yardstick to determine if Frontier is "substantially compliant" with the provisions of the Settlement Agreement. In all cases, the standards imposed by the Settlement Agreement for these metrics exceeds the Commission's service quality rules. For some metrics, results for Frontier's Metro area and Non-Metro area exchanges are separately monitored, reported, and evaluated.[2] Six of the metrics directly measure aspects of telephone service for customers:

- Installation of primary service (Metro / Non-Metro measured separately),
- Restoral of out of service conditions (Metro / Non-Metro measured separately),
- Trouble rates (Metro / Non-Metro measured separately),
- Repeat troubles (Metro / Non-Metro measured separately),
- Held orders (Metro / Non-Metro measured separately), and
- Repair appointments met (Metro / Non-Metro measured separately).

For three of the six metrics (Installation of primary service, Repeat troubles, and Held orders), Frontier has consistently met the Settlement Agreement standards for both Metro and Non-Metro areas for all seven consecutive quarters since the January 1, 2020 (the start of the quarter in which the Settlement Agreement became effective).

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[2] The Metro exchanges are: Apple Valley, Belle Plaine, Burnsville, Cannon Falls, Delano, Farmington, Lakeville, Jordan, Maple Plain, Mayer, Mound, New Germany, Rosemount, Scandia-Marine, St. Bonifacius, and Watertown. All other exchanges are part of the Non-Metro group.

For two of the six metrics (Trouble rate and Repair appointments met), Frontier has met the Settlement Agreement standards in the Metro area for all seven consecutive quarters since the January 1, 2020 effective date of the Settlement Agreement. In the Non-Metro areas, Frontier has met the Trouble rate standard for four of the seven quarters since January 1, 2020. This standard was not met in three quarters based on isolated issues—in two of the quarters a single exchange out of Frontier's 116 exchanges missed the standard and in the other quarter only two exchanges out of 116 missed the standard.[3] In other words, even with the technical noncompliance in three quarters, in each of these quarters at least 114 of Frontier's 116 Non-Metro exchanges or 98% of the Non-Metro exchanges have met the Trouble rate standard. Frontier has also met the Repair appointments standard in Non-Metro areas for the last 4 quarters.

For the remaining service quality-related metric (Restoral of out of service conditions), Frontier has made continuing improvements in its performance since entering into the Settlement Agreement. Frontier has undertaken several actions during 2020 and 2021, which have enhanced its ability to promptly respond and restore service for customers. These actions include: (1) hiring additional technicians; (2) improving internal monitoring and tracking systems to ensure prompt action on out-of-service trouble tickets; and (3) increased focus on prioritizing restoral of voice service. These actions have resulted in improved results.

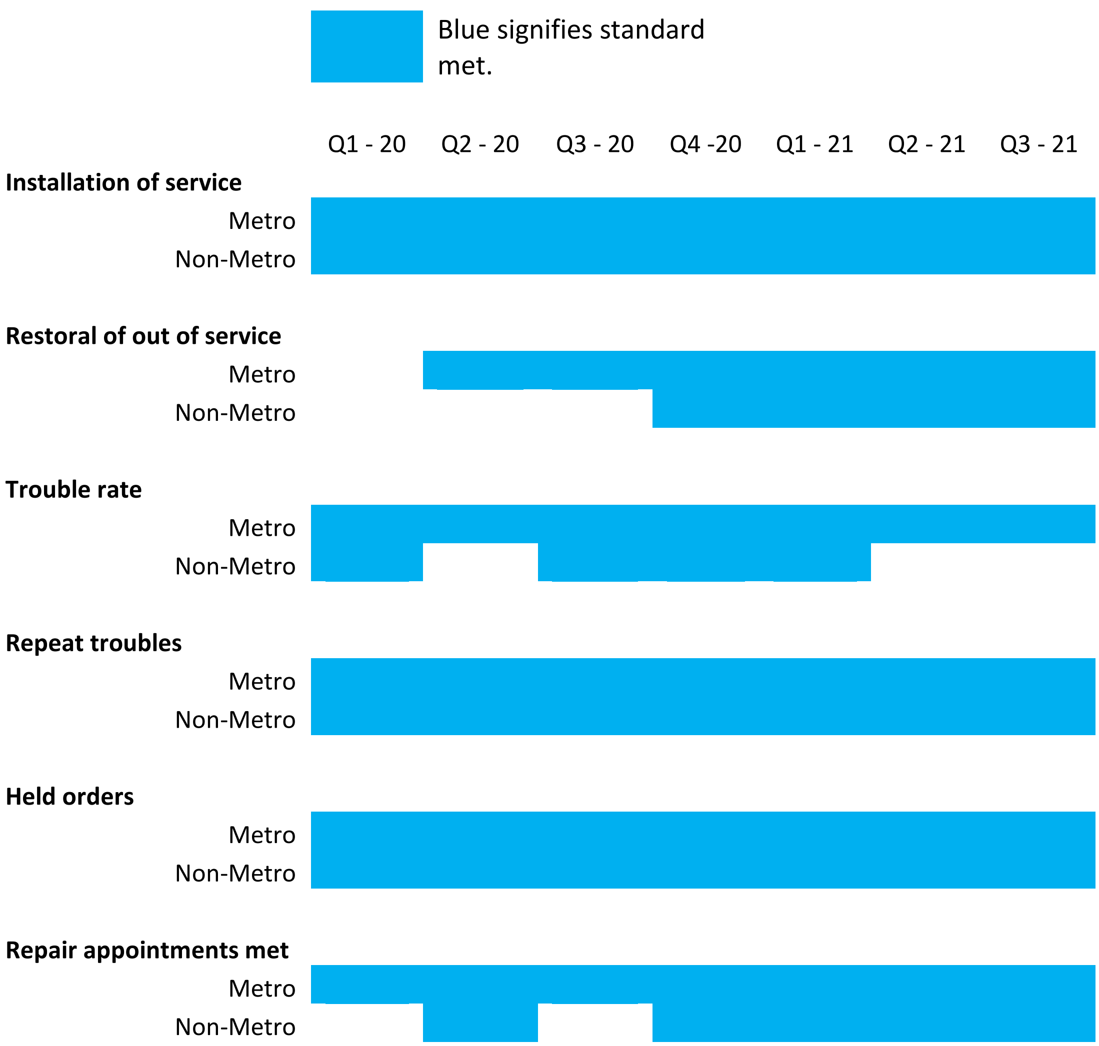
In the Metro area, in the first quarter of 2020 Frontier restored 93% of out-of-service conditions within 24 hours, which was slightly below the standard of 95% restored within 24 hours. Since that time, Metro area results have met the 95% within 24 hours standard the following six quarters. In the Non-Metro area, for the first three quarters of 2020 Frontier did not meet the

[3]Moreover, the situation involving these Non-Metro exchanges not meeting the Trouble report rate was largely due to the fact that there are very few access lines in the exchange and a very small number of troubles results in a miss of the standard.

standard of 95% restored within 24 hours (89% in the first quarter, 86% in the second quarter, and 89% in the third quarter). However, in the fourth quarter of 2020, the Non-Metro area results exceeded the standard by restoring 96% of out-of-service conditions within 24 hours. Since that time, Non-Metro area results have met the 95% within 24 hours standard for the following four quarters.

These results for the six metrics measuring service quality are summarized below:

Frontier Performance Metrics, 2020-2021



Frontier's results show compliance and continuing improvement using its existing network. The actions that Frontier has taken to achieve these substantial service quality improvements remain in place, and are not impacted in any way by the virtual separation accounting analysis as evidenced by the fact that Frontier's performance improved both before and after its implementation of the virtual separation analysis to more precisely allocate indirect costs across its 25-state operating area.

C. Frontier investment in Minnesota.

Between late 2020 and 2021, Frontier completed a substantial FTTP project in certain of Frontier's Metro Area exchanges, which made gig-capable service available to approximately **[PROTECTED DATA BEGINS** [redacted] **PROTECTED DATA ENDS].** Frontier has expended more than **[PROTECTED DATA BEGINS** [redacted] **PROTECTED DATA ENDS]** to complete this deployment.

Frontier has also completed the deployment of broadband access to more than 46,775 locations in CAF-II eligible census blocks in Frontier exchanges under the CAF-II program and will complete deployment to the required number of CAF II locations by the December 31, 2021, which is the Federal Communications Commission deadline. In connection with these CAF-II projects, Frontier has also deployed broadband to an additional **[PROTECTED DATA BEGINS** [redacted] **PROTECTED DATA ENDS]** locations.

In terms of its future broadband deployment, every company engages in capital allocation assessments to determine whether and where to target capital expenditures. Frontier has finite capital and it cannot deploy fiber or otherwise expand broadband to every customer location in its service territory. Frontier will continue to invest and improve its network operations throughout its operating territory, including in areas that are not identified for FTTP deployment. This will include expenditures to repair, maintain, and upgrade network infrastructure to provide improved services.

In addition to Frontier-funded investments, it is possible that additional broadband investments could be made if: (1) federal or state investment funding for parts of Frontier areas become available; and (2) Frontier can qualify for that funding on terms that are financially sound. However, Internet access is a highly competitive service with multiple providers in Minnesota, many of which do not provide regulated telephone service. The availability of federal or state funding and the use of that funding by other companies will enable a variety of other providers to deploy expanded broadband services. For example, Frontier did not obtain any federal support under the Rural Digital Opportunity Fund ("RDOF") program in Minnesota, which will result in more than $400 million in broadband deployment funding in the state over the next decade. In fact, other Internet service providers will receive federal RDOF funding of approximately $140 million to deploy broadband services to approximately 77,000 locations in Frontier telephone service areas in Minnesota.

D. Fiber optic facilities are not needed to provide any regulated telephone service and meet all applicable quality requirements.

As explained in the Declaration of Mark Shannon, a copy of which is attached as Exhibit 2, Frontier existing network is fully capable of providing quality voice telephone service. The Declaration explains: (1) copper has been and continues to be a reliable, efficient and effective technology to provide voice telephone service; (2) fiber facilities are not needed to provide regulated telephone service in Minnesota that meets the service quality requirements that apply to regulated telephone service in Minnesota; and (2) no additional fiber facilities are needed by Frontier to provide regulated telephone service that meet all service quality requirements that apply to regulated telephone service in Minnesota. Rather, Frontier can meet all applicable requirements through the continued use of Frontier's existing network in Minnesota with no increase in investments beyond the routine additions, repair, and selective replacement of individual portions of its copper facilities. There is also no basis to assume that such routine addition, repair, and selective replacement of individual portions of facilities would not continue into the future.

II. RESPONSE TO SPECIFIC QUESTIONS FROM INQUIRY ORDER

The following are Frontier's responses to the primary topics and purposes identified in the Inquiry Order:

a. *To clarify what "virtual separation" means as used by Frontier Communications of Minnesota, Inc.; Citizens Telecommunications Company of Minnesota, LLC; and Frontier Communications of America, Inc.*

Virtual separation was an analysis Frontier completed to better identify, assign, and track its indirect costs and financial expense data across its 25-state operations, including Minnesota, which represented approximately **NON-PUBLIC DATA BEGINS** [redacted] **NON-PUBLIC DATA ENDS]** by revenue of Frontier's 25-state operations. Over the course of approximately one year, Frontier reviewed hundreds of general ledger accounts and more than **[NON-PUBLIC DATA BEGINS** [redacted] **NON-PUBLIC DATA ENDS]** in indirect costs incurred across its 25-state footprint and made changes to its chart of accounts, accounting practice(s), and expense allocation methodologies across its 25 states to simplify and enhance accuracy of its financial tracking and reporting. The Minnesota share of these indirect costs is approximately **[NON-PUBLIC DATA BEGINS** [redacted] **NON-PUBLIC DATA ENDS]** The culmination of the review was the Virtual Separation Report Frontier prepared and delivered to its bondholders in preparation for its emergence from Chapter 11 on April 30, 2021. Frontier has provided a NON-PUBLIC copy of the Report as Exhibit 1. Following its emergence from Chapter 11 on April 30, 2021, Frontier began using the more precise accounting methodology derived from the virtual separation analysis for allocating indirect costs across its 25-state operating area.

b. *To understand why Frontier has elected to use virtual separation.*

Historically, Frontier allocated its indirect costs from separate cost centers on a state-by-state basis using only a percentage of revenue allocation methodology. In other words, if State A generated 10% of Frontier's total revenues, then 10% of Frontier's indirect costs from all indirect cost centers would be allocated to State A. While this approach has the advantage of simplicity, it does not accurately capture the differences in cost-causation of individual states, e.g. those particular service requirements or operational circumstances that drive indirect costs and which may be greater or smaller based on the individual characteristics of a given state.

The purpose of the virtual separation exercise was to review the old methodology used to allocate indirect expenses to each state Frontier operates in, and institute a more detailed and precise methodology for determining state-level costs. The old approach for allocating indirect expenses to the state operating entity was to use state level revenue (one single driver) to determine the share of total indirect expenses to be allocated to the state operations. The revised approach identifies and uses data regarding the activities that drive operating expenses at the cost center level to determine the share of total indirect expenses to be allocated to the state operating entities. The revised activity-based approach provides more precision than the prior revenue-based approach.

c. *To better understand the origins of virtual separation and the extent to which Frontier has vetted the approach to anticipate its positive or negative affect on telecommunications service quality in Minnesota*.

The limitations of the allocation of indirect costs by revenue generated approach were initially recognized in the context of the divestiture of Frontier's operations in four states (WA, OR, ID, MT) in the Pacific Northwest. As a result, an effort was undertaken to develop an allocation approach that more appropriately allocated indirect costs to the states based on the underlying activities that drive them. Virtual separation does not involve a structural or legal separation of costs, financial results, facilities, or operations between Frontier's corporate or operating entities. Rather, the virtual separation analysis provided Frontier's management with a method to better understand the costs of different activities and allows management to have a more precise view of Frontier's indirect costs through the analysis of activity-based costs, as opposed to the prior methodology in which those costs are based more summarily on the percentage of net revenue.

As explained above, the virtual separation analysis was completed across all of the Frontier 25 states to implement a more accurate method of allocating indirect costs. As a result, it was not evaluated or implemented with respect to positive or negative effects on any single state, including Minnesota.

Moreover, the virtual separation analysis had and has no impact on how costs are incurred. Virtual separation does not directly drive future investment. Hence, virtual separation itself will neither positively nor negatively affect telecommunications service quality in Minnesota. As noted above, however, Frontier has taken numerous actions recently in the context of the Settlement Agreement that have substantially improved its service quality in Minnesota. That improvement is borne out in the service quality reports Frontier files quarterly with the Commission.

d. *To understand why Frontier has not elected to use virtual separation prior to its reorganization.*

As noted above in section (b) above, in the past Frontier has used an "allocation by revenue" approach for indirect costs.

e. *To understand how Frontier intends to use virtual separation in other states.*

As explained above and in the Report, Frontier has implemented changes in its accounting processes resulting from the virtual separation analysis to allocate indirect costs among all of its 25-state operations.

f. *To understand how virtual separation works as an accounting approach for a multi-state telecommunications corporation*.

The use of multiple cost-causative factors to individually allocate indirect cost centers is explained in the Report.[4] As also explained in the Report, the revised activity-based approach now used provides significantly more precision than the former single factor revenue-based approach.

g. *To understand how virtual separation relates to Frontier's decisions to designate a state as an "InvestCo" or an "ImproveCo" state.*

While the "InvestCo" and "ImproveCo" terminology was used with bondholders involved in the early stages of Frontier's Chapter 11 restructuring, Frontier stopped using that terminology and it has no applicability to Frontier's planned investment decisions. Frontier will continue to invest and improve its network operations throughout its operating territory. This will include expenditures to repair, maintain, and upgrade network infrastructure to provide improved voice and broadband services.

[4] Report at pages 10 and following.

h. *To understand the advantages and disadvantages virtual separation will impose on "ImproveCo" and "InvestCo" states.*

As explained above and in the Report, the virtual separation analysis was completed to better and more accurately allocate indirect costs than the prior "allocation by revenue" approach. The new allocation methodology has been applied to all of Frontier 25-state operations, and imposes no advantages or disadvantages on any particular state beyond how indirect costs are allocated.

i. *To determine if virtual separation will divert/impact investment in Minnesota, including the deployment of infrastructure for higher speeds and greater capacity for voice, video, and data*.

As explained above and in the Report, the virtual separation analysis resulted in a more precise methodology for allocating indirect costs. The virtual separation analysis is not directly relevant to capital deployment decisions. In terms of specific investment decisions, Frontier weighs a host of criteria, including but not limited to its financial/funding capabilities, legal and regulatory obligations, expectations of population/customer growth, ability to capture market share, and its ability to expand/upgrade facilities in light of other customary considerations like existing/committed capital for ongoing and future projects, personnel, network maintenance, reliability, and operation expenses, sound fiscal management, and execution of its fiduciary obligations.

In terms of its capital deployment for expanded broadband services, Frontier has finite capital resources and like every company, engages in capital allocation assessments to determine whether and where to target its capital expenditures. Frontier utilizes all relevant data available to the company including cost information, expenses, competitive information, revenues, etc. in its capital decision-making. Frontier must make capital allocation decisions in a way that ensures that it can generate revenues and a return on its investment, so that Frontier can continue to use those returns to further expand services and maintain its network.

j. *To determine if the virtual separation approach will divert financial resources away from maintaining and provisioning voice service in Minnesota, especially in less densely populated areas*.

As explained above, the virtual separation analysis and resulting indirect cost allocation merely identify and do not directly affect the costs that are incurred or network investments and ongoing maintenance. As a result, the virtual separation analysis has no direct effect on and does not divert financial resources away from maintaining and provisioning voice service in Minnesota, including less densely populated areas.

k. *To understand how virtual separation will be used to determine future workforce needs*.

As explained above, the virtual separation analysis and resulting indirect cost allocation merely identify and do not directly affect the costs that are incurred or network investments and ongoing maintenance. Similarly, the virtual separation analysis does not impact future workforce needs in Minnesota. Rather, Frontier plans for future workforce needs by determining expected future workload quantities and sizes its workforce based on customer demand.

In addition, the workforce costs (employee compensation, etc.) for the Frontier Minnesota Companies are *direct* costs, not indirect costs, which were the focus of the virtual separation analysis.

l. *To understand how virtual separation will be used to determine investment plans and whether Frontier's virtual separation analysis will change what is invested in Minnesota.*

As explained above, the virtual separation analysis was completed to better allocate indirect costs. It does not affect future investment decisions or actions. As a result, this analysis has no direct effect on future investment plans nor does it change what is invested in Minnesota. As noted above, over the last year, Frontier has significantly expanded its FTTP deployment in Minnesota.

m. *Other issues relating to how virtual separation will impact Frontier's Minnesota operations.*

The impact of the virtual separation analysis was to better allocate indirect costs based on cost generators. The more precise allocation of indirect costs has resulted in the reduction of the percentage or amount allocated to Minnesota relative to other state operations in Frontier's 25-state footprint. Virtual separation has no direct impact on costs incurred or the investments Frontier makes in Minnesota. At this time, Frontier is not aware of any other impacts of the virtual separation analysis on Minnesota operations.

n. *For purposes of this investigation, "virtual separation" includes any subsequent investment plans that will impact Minnesota service quality*

Both the virtual separation analysis and Frontier's investment decision making process are explained above.

III. CONCLUSION.

Through the virtual separation analysis, Frontier completed a disciplined review of its cost structure and cost allocation methodology and implemented internal reporting mechanisms that allow management to better understand the economics of Frontier's various state-level operations. The goal was to improve Frontier's ability to evaluate and operate its business and identify and isolate individual state-related costs across its 25-state footprint. The virtual separation analysis does not and will not directly affect future investment decisions or actions in Minnesota.

For the reasons set forth above, there is no basis for the Commission to take any actions in connection with Frontier's virtual separation accounting analysis, which is over and its results have been fully implemented.

Dated: October 29, 2021

Respectfully submitted,

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