Consumer Federation of America

New Networks Institute

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Manipulation of Financial Accounting & Special Access Overcharges

The Federal Communications Commission (FCC) has declared that the absence of competition for Special Access services has resulted in pricing abuse by the dominant local telephone companies who have a virtual monopoly over these services. After fifteen years of obvious abuse, this is a step in right direction.

However, the FCC has decided to address only a small part of the problem (contract terms and conditions that impede competition), while it tries to figure out exactly how bad the pricing abuse is and how future abuse can be controlled in the large part of the market where competition is not likely to be possible and sustainable.

"Banning anticompetitive contract terms may improve the prospects for new entrants, where market conditions will support competition," but that will take time and there are many markets that will remain monopolized." Mark Cooper, CFA's director of Research said. "After seeing the confidential data selectively and partially interpreted and misinterpreted, CFA went in search of detailed "official" data that could shed more light on special access costs and revenues. This is particularly urgent now, since the FCC is about to try to figure out how to regulate rates in situations where there is little competition and no cost data. We think the New Networks Institute (NNI) data is a good place to start.

"The New Networks Institute's estimate of access charges, based on accounting data reported to a state regulator, was very close to the total that the FCC had estimated, and CFA had used in our earlier analysis," Cooper added, "Since their data has a great deal of detail behind it, it provides a platform for getting behind the numbers that has been absent since the FCC stopped collecting data."

"Over the last 6 years, we have uncovered public but unexamined financial data about the state utilities, such as Verizon New York," Bruce Kushnick, founder of NNI. "Our analysis sheds important light on the problems. The manipulation of the accounting for costs, glimpses of which could be seen in the last few years of data the FCC did collect, has continued. (http://newnetworks.com/specialaccessfactsheet/). As a result, the current level of abuse is massive."

"We found that the majority of expenses were diverted to 'Local Service', while the Verizon affiliate companies were able to a) dump expenses into the local service part of the state utility financial accounting, b) not pay market prices that other competitors pay, and c) use this massive financial shell game to claim that the local networks are unprofitable to invent policy justification to 'shut off the copper', 'migrate customers to more expensive services, including data capped wireless, and use this to create obscene profits in special access services.

"As the attached examples from data filed in this proceeding show, the FCC created a large part of the problem fifteen years ago, when it "froze" the productivity factor to reflect the year 2000 (in a space where technology was driving massive improvements in efficiency) and undermined its own ability to size the problem when it gave up data collection and analysis."

"When a wireline phone customer pays for monthly service, low income families, small businesses, or any other customer, should not be paying the expenses to run broadband and data wires, known as special access, to a Verizon cell site," Cooper added. And it shouldn't be supporting massive profits for other special access services, where the majority of expenses somehow end up being used to claim the company needs rate increases. Subsidizing these services with money from captive, local ratepayers is not only unfair, it is illegal under federal and state laws that prohibit such cross subsidies."

"While some have taken a stab at sizing the problem, they were forced to do so by analyzing cost and revenue trends at a very high level of aggregation. We have actual micro level data to make the case much stronger," Kushnick added.

"While the FCC tackles special access, there has been no mention of how it plans to fix the cross-subsidies where low income families, small business have paid the majority of expenses -- which was created by FCC's own 'Big Freeze Accounting'."

"The local phone companies have been shifting costs onto captive local intrastate ratepayers and taking profits in their unregulated and interstate services," Cooper, concluded. "Because the rate of profit on special access services is astronomical, the FCC can arrive at "just and reasonable" rates by both lowering the price of special access and correcting the misallocation of costs to local service.

"We look forward to helping the FCC achieve an effective solution, giving the relief to captive customers that they truly deserve, and creating the conditions for competition where it might be able to flourish."

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CFA's earlier analysis of the "Special Problem of Special Access" can be found at:
http://consumerfed.org/wp-content/uploads/2016/04/4-16-The-Special-Problem-of-Special-Access.pdf

Additional background material from the New Networks Institute can be found at:
http://newnetworks.com/fixingtelecom/

The Consumer Federation of America (CFA) is an association of more than 250 non-profit consumer groups that, since 1968, has sought to advance the consumer interest through research, education, and advocacy

New Networks Institute (NNI), founded in 1992, is now an independent consortium of telecom analysts, auditors and lawyers. It includes David Bergmann, Esq., former Assistant Consumers' Counsel for the Office of the Ohio Consumers' Counsel, the state's residential utility consumer advocate, for almost 30 years and Paul Hartman, former Assistant Chief, Pricing Policy Division (PPD) Wireline Competition Bureau and a leading expert in telephone company financial accounting.