New Networks Institute

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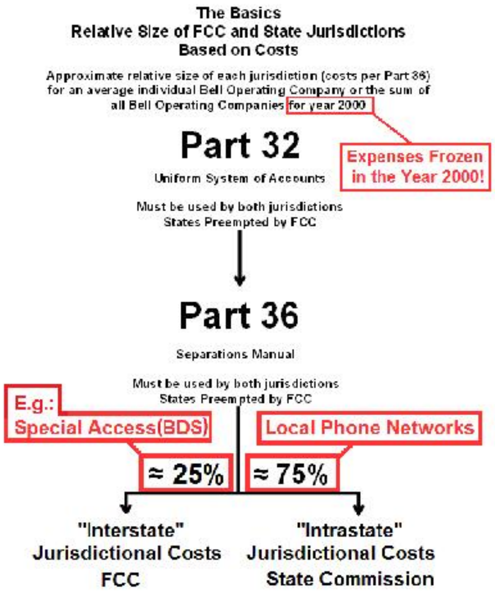
Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Business Data Services in an Internet Protocol Environment, WC Docket No. 16-143; Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25 and RM-10593

New Networks Institute (NNI) today submits two new reports: “The Hartman Memorandum” and “The History & Rules of Setting Phone Rates in America —The FCC’s ‘Big Freeze’ & Cross Subsidies”.

Declaration

The FCC has not examined the massive cross subsidies created by the FCC’s own malformed and distorted cost allocation rules. This includes the fundamental cross subsidy—that 75% of most network costs are paid by the local services (intrastate) while only 25% are paid by ‘interstate’ services, such as special access, recently renamed “Business Data Services”. Worse the FCC has not revisited another set of rules created in 2001 which require the allocation of expenses suited to the year 2000 —16 years ago. These outdated rules have little to do with the connected, digital world of 2016 and their continued application has been inappropriate for years.


The Basics
Relative Size of FCC and State Jurisdictions
Based on Costs
Approximate relative size of each jurisdiction (costs per Part 36)
for an average individual Bell Operating Company or the sum of
all Bell Operating Companies for year 2000
Expenses Frozen
in the Year 2000!
Part 32
Uniform System of Accounts
Must be used by both jurisdictions
States Preempted by FCC
Part 36
Separations Manual
Must be used by both jurisdictions
States Preempted by FCC
E.g.:
Special Access(BDS)
Local Phone Networks
≈ 25%
≈ 75%
"Interstate"
Jurisdictional Costs
FCC
"Intrastate"
Jurisdictional Costs
State Commission

“Special access” are not special services but a fabricated regulatory classification that takes a wire from the state utility and claims it is no longer an ‘intrastate’ service (which are services within the state controlled by the state commission), but are ‘interstate’ services, which are for business data and broadband, and they are controlled by the FCC. – Same exact wire, however.

The FCC claims that it can determine pricing that will be just and reasonable.

The Hartman Memorandum shows that prices for special access services are not just and reasonable because the FCC's own cost allocation rules create massive financial cross subsidies between and among the state-based wired utilities, and the companies' other line of business, such as special access.

We are calling on the FCC to investigate the impacts these rules have had on special access services as well as the cross-subsidies that impact ALL communications services, from local service to competitor access to BDS for wireless.

The Memorandum is accompanied by two other reports:

- **The History & Rules of Setting Phone Rates in America —The FCC’s ‘Big Freeze’ & Cross Subsidies —** which supplies a history of the FCC and state rules discussed herein.
- **Fixing Telecom, Fixing Broadband Data Services** — which supplies a road map on how to use the Memorandum to get cities upgraded and bring in robust competition to lower prices. (Release date: TBA)

Two Items Stand Out:

- **75%-25% Rule —** 75% of most network expenses are paid by the Local Service phone networks (intraLATA) vs any 'interstate' services, such as Special Access, which pays only 25%. This rule was created in 1984 and has not been adjusted or replaced for 32 years.
- **"Cost Allocation Rules” Were Set Based on the Year 2000 —** In 2001, the FCC created a series of rules pertaining to the allocation of expenses to match the year 2000—16 years ago. In 2001, Local Service was about 65% of revenues and it paid 65% of costs. In 2015, Verizon New York's Local Service revenues were 25% but it still paid 61.2% of all corporate operations expense. Access services, which had 47% of revenues only paid 28.6% of the corporate operations expenses.

This Distortion of the Accounting has had Multiple, Direct and Harmful Impacts on All Services — Special access had a 66% “Earnings Before Interest Taxes Depreciation and Amortization”, (EBITDA) -- because it paid only a fraction of expenses while Local Service paid the majority. In fact, all of the 'interstate' broadband networks, including the wires to the cell sites for Verizon Wireless or even FiOS TV, all paid fractions of the expenses and thus have very high profit margins.

Direct Harms to All Wired Services — Unfortunately, special access cannot be examined without looking at all of the other lines of business, from local service to the implications of massive cross subsidies that were designed and helped to create harmful public policies.

At the same time, these expenses made the local phone networks artificially unprofitable, which has been used as an excuse to 'shut off the copper' or force customers onto 'more profitable' wireless services. This has also been an excuse for not building out FiOS broadband to many areas throughout the East Coast.

The FCC's Proposed Rules Do Not Address Cross Subsidies — The proposal does not fix the excessive profit margins nor examine that the FCC's rule making doesn't include the fact that local phone customers have been overcharged, having paid the excess profits. Moreover, the agency has never addressed the fact that these wires are part of the state utility as they are classified as Title II, and that the expenses paid are mostly 'intrastate' where the FCC does not have jurisdiction.

The FCC's Plan Also Includes a Host of Proposed Actions that Will Cause Multiple Harms. **—** For example, the FCC plans do not require the incumbents to share any new build-out of fiber optic special access services with high speeds with competitors, even though the majority of the expenses were paid for by local service under the FCC's own rules, or rate increases agreed to by the state commissions.

Harm to Broadband and Internet Competition — Much of the incumbent's retail business is in Internet access now, including DSL and FiOS, and they are classified as interstate. In fact, anything that carries Internet is interstate. Thus, all of the growth areas, including competitive ones, are in the interstate basket, which is not paying its fair share. This also makes it easier for the ILECs to undercut "broadband" competition.

Harms to Users and Municipalities — As we discuss, Consumer Federation of America found over $75 billion in special access customer overcharging in just the last five years. Moreover, these financial distortions diverted monies to the affiliate companies, such as Verizon Wireless, that should have gone to upgrade and maintain communities' network infrastructure for broadband and internet services.

The Cost Allocation Regulations have been Forebeared But Are Still In Use — There are those who, as a knee-jerk reaction, will say that the rules have been 'forebeared' – i.e., while the rules are still on the books they are no longer required. Unfortunately, the Verizon New York annual reports and matching reports from Massachusetts prove that the rules are still in use. But it also exposes that the price caps did not work

This is Happening in Every State — As we tracked based on the last data from the FCC, every state-based utility company, including AT&T and Centurylink, had been using the exact same cost allocations in 2007. We have found nothing to indicate that this practice stopped.

The Hartman Memorandum walks through the accounting using actual data to show the massive financial overcharging underway.

The Primary Data—Verizon New York has been required to file detailed annual reports through 2015. But we have obtained other financial data from other Verizon states, as well as corporate financial transcripts, state filings, FCC filings, and even press releases covering all Verizon states. We also used FCC ARMIS data through 2007 to show that the same financial rules have been and continue to be applied in all AT&T and CenturyLink states.

NNI is an independent expert consortium and was established in 1992. Over the last decade, NNI has gathered a team of independent experts, auditors and lawyers to work on projects, including "Fixing Telecom".

These reports were created by NNI's experts Paul Hartman, David Bergmann, Esq., and Bruce Kushnick, among others

See:

- **Fixing Telecom Reports, Filings** http://newnetworks.com/fixingtelecomdocs/
- **Joint filings with CFA** http://newnetworks.com/nnicfacomments/
- **New Networks Institute Expert Team:** http://newnetworks.com/nniexperts/

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