

SOME HIGHLIGHTS FROM THE NEW NETWORK INSTITUTE FINANCIAL ANALYSIS

In 2015, NNI created two reports from our new series, ‘Fixing Telecom’ and filed it in 31 separate FCC proceedings. These findings do not just impact special access but every proceeding that is based on the critical infrastructure of the state utilities and the controls by the incumbent phone companies, as these practices and the FCC’s accounting rules are federal in scope. To read the reports: <http://newnetworks.com/fixingtelecom/>

The FCC is about to present the findings of a series of investigation and data collection activities on April 28th 2016. In October, 2015, the FCC found that special access revenues were over \$40 billion dollars in 2013; 60% of which were still based on the aging copper wires, which are not being maintained. In 2013, the FCC quoted the common wisdom, since it had stopped collecting any data in 2007, and claimed it was only \$12-18 billion dollars.

Special Access, Mostly Copper, Revenues Increased 50% since 2007. Verizon NY is a state-based utility and the mostly-copper-based special access revenues increased 50% since 2007. Using actual data from 2007-2014, we projected that nationally, special access was \$23.4 billion in 2013.¹ This means that the copper networks are profitable and growing in revenues.

Special Access Revenues and Lines, Verizon NY and National, 2007-2014

	2007	2010	2013	2014
Verizon NY Special Access	\$ 1,229,611,000	\$ 1,414,376,283	\$ 1,659,458,754	\$ 1,848,840,000.00
Total US Revenues	\$ 17,486,117,000	\$ 20,242,366,192	\$ 23,433,069,163	26,104,439,047.76
Verizon NY Access Lines	46,824,000	53,859,924	63,192,747	70,404,448
National Total Lines	424,004,456	487,716,722	572,228,051	637,532,031

Sources: Verizon NY, FCC, New Networks Institute

“Black Hole Revenues: Special Access in Multiple Financial Buckets. In 2014, we uncovered, when comparing different Verizon NY’s financial reports, an additional \$2.3 billion of revenues in the year 2010, much of which appeared to be special access—and we dubbed it ‘Black Hole’ revenues. We estimated that the total special access revenue was \$45 billion in 2013. However, there were no additional ‘construction’ expenses paid against these black hole revenues.

In all of these proceedings, the FCC left out some basics. The copper-based special access networks are not special. They are actually part of the state-based utility and most often are the exact same copper wires that are used for phone service. However, the accounting has been manipulated to ‘hide’ the number of actual lines in service. A simple example—in New York, Verizon’s special access revenues went up 50% from 2007-2014, and it now makes up almost half of its total revenue. How can the copper networks, then, be ‘unprofitable’? Special access paid a fraction of the actual common costs to offer these services, and so the profits continue to climb.

¹ Note: This chart was first published in May 2014, 17 months before the FCC’s own findings in October 2015.

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Moreover, the fiber optic special access wires are also part of the state utility and put in as “Title II”, common carriage, telecommunications (“TDM”) networks to be able to a) get the utility rights of way and b) have the wireline-local service budgets pick up most of the expenses, charging customers in New York for “massive deployment of fiber optics”, which was not supposed to be the wires to the cell towers, but to wire cities.

Special Access Expenses are Cross-Subsidized by Local Phone Customers. In every category, from network expenses to ‘corporate operations’ expense, ‘Local Service’ paid the majority of expenses. For example, Verizon NY’s Local Service brought in 28% of the revenues in 2014 but paid the majority, 60%, of “corporate operations” expense. ‘Access Fees’, (special access representing 82%), was 45% of the revenues but paid only 30%, while ‘Nonregulated’, (including FiOS TV) paid 10%.²

Demonstrating the FCC’s Big Freeze Verizon New York Revenues, Corporate Operations, Network Costs, 2003-2014

Total Revenues	Local Service	Access
2003	\$2,230,978,000	\$2,230,978,000
% of Revenue	65%	31%
2014	\$1,441,591,799	\$2,357,559,949
	28%	45%
Corporate Operations		
2003	\$1,249,051,000	\$537,299,000
% of Corporate	65%	28%
2014	\$1,572,288,568	\$767,188,356
% of Corporate	60%	29%
Network Costs*		
2003	\$1,735,100,609	\$ 834,121,365
% of Network Costs	62%	30%
2014	\$1,526,422,738	\$787,625,710
% of Network Costs	46%	24%

*Network costs known as “plant” and “Non-specific plant” costs, and include the Capx.

The FCC’s ‘Big Freeze’ Caused this Financial Shell Game. But the kicker is -- the FCC’s own accounting rules, which we dubbed ‘The Big Freeze’, actually froze the allocation of expenses to reflect the year 2000; this allowed the massive cross-subsidies of Verizon’s affiliate companies – and the dumping of most expenses into Local Service. Thus, as we tracked, the majority of Special Access expenses, which can include the wires to the cell towers, or to banks and hospitals, were essentially charged to low income families, small businesses, and everyone else who still had wireline phone or other services that use the state-based wires.

² This info is primarily from Verizon NY. New York is the only state that requires financial reports. As of 2007, all Verizon, AT&T and Centurylink states used this model.

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In 2001, the FCC created a series of rules on how the expenses are allocated—and based it literally on the year 2000; it is still in place today. In 2000, Local Service, (which is just POTS, copper-based phone service) was 65% of revenues and paid 65% of expenses.

The impacts of the Big Freeze are clearly seen in examining the allocation of expenses. In 2003, Corporate Operations expenses matched revenues. Local Service brought in 65% of revenues and paid 65% of the expense, but in 2014, Local Service is paying 60% of the expenses, even though it only brought in 28% of revenue. And in network costs, in 2003, Local service expenses (at 62%) matched revenues (at 65%), but in 2014, while Local service was only 28% of revenue, it paid 46% of this expense. In other words, while the access service share of revenues grew by one-half (from 31% to 45%), its share of corporate expenses was flat and its share of capital expenditure declined by one-third (from 30% to 24%).

By misallocating costs to regulated local service, the local companies falsely claim they are losing money on local service, and try to get it deregulated so they can raise rates, when what they are really doing is earning astronomically high profits on access service.

Verizon Wireless Gets Massive Financial Perks. In 2009 and 2010, Verizon NY’s SEC reports listed payments by AT&T and Sprint for access fees, and billing and collections. The companies were paying 250%-350% more for use of the networks, (based on counting subscribers). Worse, the Verizon “Cellco” payments should have included billions in CapEX, as the wireline networks are have been funding most of the wires to the cell sites, including 4G. While there are caveats, the SEC reports did not claim there was any difference in the services paid by AT&T and Sprint vs Verizon, for the same year.

Verizon Wireless Payments to Verizon NY, Compared to AT&T and Sprint, 2009-2010
(In the Millions)

	2009	2010	2 Year Total
Verizon Wireless	\$78	\$95	\$173
AT&T	\$279	\$237	\$516
Sprint	\$119	\$104	\$223

Sources: Verizon New York, New Networks Institute

The FCC is attempting to answer the question—are prices ‘just and reasonable’, but it can’t possibly calculate this because it did not use the actual financial accounting details we uncovered for Verizon New York and other state utilities.