Verizon's State-Based Financial Issues & Tax Losses: The Destruction of America's Telecommunications Utilities

Presented by:
New Networks Institute

Bruce Kushnick, Executive Director

www.newnetworks.com
bruce@newnetworks.com

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Executive Summary

- Verizon's state-based SEC filings showed $5.4 billion of losses for 2009 & 2010 in just 5 states — New York, New Jersey, Pennsylvania, Massachusetts and Rhode Island — resulting in $1.96 billion of income tax benefits.

- Verizon has stopped publishing its state-based SEC filings for 2011. We estimate based on the trends of the previous 2 years that the total losses could be as much as $9.5 billion and with a tax benefit of $3.4 billion dollars.

- Verizon's corporate Annual Report for 2010 shows $9 billion in profits for wireline services.

- Impacts: These state-based losses raise serious questions of tax evasion, cross-subsidization of Verizon Wireless and the other Verizon affiliates and subsidiaries, the destruction of the public switched telephone networks (PSTN), and harm to the economy, including overcharging customers.

In November, 2011, a report titled "Corporate Taxpayers and Corporate Tax Dodgers, 2008-2010"[1] found that Verizon paid no federal income tax in 2008-2010, and yet had profits of $32.5 billion. Moreover, AT&T and Verizon were ranked 2nd and 3rd, respectively, among companies with the largest total federal tax subsidies for 2008-2010, $26.8 billion combined.

This is only part of the story. In just the last two years, 2009-2010, Verizon's state-based SEC filings reported over $5.4 billion of losses in just 5 states — New York, New Jersey, Pennsylvania, Massachusetts and Rhode Island — and an "income tax benefit" of almost $2 billion. (Adding projected 2011 losses could bring the total to $9.5 billion with a tax savings of $3.4 billion) Using these losses, Verizon went back to some of state public service (utility) commissions, such as New York, to raise local phone rates billions of dollars. In some states, like New Jersey, Verizon is also claiming they no longer have to pay property taxes to many municipalities.

Verizon's corporate annual reports show none of these losses for wireline services, even though these state-based companies are some of Verizon's largest states. In 2010, Verizon, in fact, showed $9 billion in profits from wireline networks. (The losses on the corporate level are exceptionally complicated and seem to be related to different, separate accounting maneuvers.[2])

[1] Corporate Taxpayers and Corporate Tax Dodgers, 2008-2010, a joint project of Citizens for Tax Justice & the Institute on Taxation and Economic Policies.

[2] Ibid. "Verizon Communications: In its 2010 report, the company changed its accounting method for pensions, and retroactively restated its pretax profits for 2009 and 2008. The restatement had little effect for 2009. For 2008, our report uses the profits actually reported in the company's 2008 report. Accelerated depreciation and amortization comprised most of the company's tax subsidies. In 2008 and again in 2010, the company divested substantial assets using a technique known as a "reverse Morris trust" transaction, saving an estimated $1.5

These losses are of the state-based phone utility networks, sometimes called the Public Switched Telephone Networks (PSTN). They are being created, it seems, by the manipulation of money and assets through Verizon's affiliates and subsidiaries, from Verizon Wireless or Verizon Enterprise Solutions which provides long distance, or Verizon Online, which offers Internet service. It appears these separate subsidiaries are not paying their fair share back to the state utility for the use of the networks, are dumping expenses into the utility's accounts, while at the same time are shifting assets out of the utility into these separate subsidiaries, which in turn creates massive financial losses on paper. It also seems that Verizon Services, the corporate parent, is dumping billions of dollars in expenses, which could include executive pay and lobbying fees or even foundation donations and legal fees, exacerbating the state-based losses.

NOTE: There have been no audits we can find pertaining to these activities and the state SEC reports do not give enough details to ascertain the total flow of monies. We also note that Verizon has stopped publishing the SEC filings for 2011 (or they are at least not available online). We believe Verizon and AT&T are carrying on similar manipulations in most, if not all of the states in which they are the local incumbents.

The movement of assets also impacts the accounting of 'access lines'. Verizon and those quoting the phone companies claim a dramatic decrease of phone lines in recent years. When these numbers are examined, it becomes clear that the companies are only using a subset of their total lines, known as "switched" access lines. This accounting leaves out whole categories of other active lines, such as 'special access' (e.g. alarm circuits), or business services, such as Centrex, or data and broadband services, such as DSL or FiOS, thus making it appear that there are massive declines in phone lines. In fact, the FCC's most recent data[3] showed that 'switched' access represented only 34% of total lines, with special access and other lines representing the majority of lines and they have been increasing, not decreasing. The 'secret' is that when a service is 'deregulated' or joined in a bundle with another service, it gets redefined as no longer a 'switched' access line and is moved into another subsidiary/affiliate and the revenues goes into another bucket, NOT the public-based-utility networks. We also add that other industry analysts estimate that over 40% of all switched access line losses were due to removing a line when DSL, which travels over the same copper wire as the phone call, made the second or more lines superfluous.

Verizon et al also claim that there is competition from its own and other wireless companies. Relying on data from Center for Disease Control (CDC), which claims that 25% of households are 'wireless-only', one has only to examine the details of their findings to realize it has 2 major flaws. First, the CDC does not count business lines. Second, it does not count the 'wires' in use, such as for cable, broadband or the Internet service. In fact, in a recent

billion in federal and state income taxes. Over a number of years, the company has deferred approximately $2.0 billion in taxes as the lessor in leveraged leasing transactions of commercial aircraft, power generating facilities, real estate, and other assets unrelated to their core business."

[3] The FCC's has stopped requiring or publishing these statistics as of 2007.

study by Strategy Analytics, as reported by Broadband Reports only "6 million U.S. residents now exclusively use wireless as their only in-home broadband service."[4] This represents only 3.9% of US households. Wireless has always been an enhancement and new revenue stream to the phone companies' wireline networks and while there has been cannibalization of wireline by wireless calling, there are few households or businesses that are replacing their cable, broadband and Internet services with "wireless only", much less their data lines, such as lines for ATM machines.

The wireless-only issue is directly related to the tax issues as we will show the wireless networks appear to be a) dumping expenses or getting free advertising or other perks from the wireline utility, b) not paying their fair share back to the utility for network usage as other competitors would (thus lower revenue) and c) may even have the construction budgets that were supposed to be upgrading the state-based networks move to the wireless companies — i.e., local phone customers funding the wireless networks, which in some states violates basic state laws.

But the plot thickens as AT&T stated that in 2010, it was now using a different method of 'inter-segment' accounting where the "Wireless segment, as a purchaser of network, IT and other services from the Wireline segment, experienced a reduction in cash operating expense …with the net result being increased operating margins" i.e.; the company is goosing to make the wireless division more profitable while it makes the 'wireline' division – less profitable. And all of this reshapes the public policy division of that 'worthless' wireline network.

This is all being played out against the FCC's "National Broadband Plan" and the Universal Service Fund proceedings. The FCC, in the name of broadband has decided to back the phone companies' plan that will raise customers' phone rates in multiple different ways. It has created a new "Connect America" Fund, as well as a "Access Recovery Charge", which in and of itself will raise rates $2.00-$3.00 per month for residential customers and $5.00-$6.00 a month for businesses or more as there is no 'cap'. And this doesn't count the multiple taxes, fees and surcharges that are added on top of these fees. Also, the FCC's increases will be on top of other state-based increases that have occurred over the last 5 years.

We note that the FCC has done no audits and has no accurate data on what customers are actually paying for services as they do not collect actual phone bills, nor have they audited any state's local service costs, much less the affiliate transactions. They have not even done audits of the current FCC Line Charge monies and have even stopped requiring most data pertaining to the costs of service.
Moreover, the costs of building and operating broadband and wireless networks and the consumer prices for these services are directly related to what is going on with the wireline

[4] http://www.dslreports.com/shownews/6-Million-Only-Use-Wireless-Broadband-117445

networks. Sooner or later all communications go over a wire, as even wireless networks have wires to connect to the wireless towers.

PART II: America's Communications Infrastructure is at Stake.

This report t is part of a series of inter-locking documents pertaining to America's infrastructure. However, it is important to present a summary of data to answer some basic questions. First, wireless is not a replacement for wireline if America is committed to high speed services. While the companies are shifting assets and construction budgets from wireline to wireless, wireless is too slow, too expensive, and will harm America's economic growth. Today, according to Network World, America is a 3rd rate broadband nation. Companies in Hong Kong offer 300 Mbps bi-directional services for $40.00 and that includes TV. Romania – 100 Mbps each way for $20.00 while South Korea has 100 Mbps in both directions for $20.00 and that includes phone and TV. Those who argue these are smaller countries seem to forget that no American city or state has these speeds and services at those prices. As we will discuss, According to the last FCC Internet Speed Report[5], America had 48,000 customers with over 100 Mbps in 1 direction.

More importantly, America has been and continues to pay through excessive phone rates and tax perks for a fiber optic upgrade of America's PSTN. Starting in the 1990's virtually every state passed 'alternative regulations' that would give the phone companies massive financial incentives to rewire the entire state, residential and business customers or all schools, libraries and hospitals, replacing the old copper wiring for a fiber optic wire, capable of 45 Mbps in both directions. By 2011, America paid over $340 billion dollars and the PSTN was never upgraded.

In fact, AT&T and Verizon have been deploying upgraded services U-Verse and FiOS, but only have about 8 million TV customers and according to their own statements have stopped extending those services.

But the real kicker; Verizon claims to have spent $23 billion dollars for FiOS starting in 2005. Yet, in examining Verizon's FiOS deployments we found no increases to the overall wireline construction budgets. The company spent more money from 2000-2005 than during the FiOS deployment. This means that the companies took whatever monies spent on FiOS (which is not audited by any regulator), and deprived the utility part of the network their normal construction upgrades and maintenance. We believe AT&T has done the same thing, taking the money spent, not new investor funding but from the business as usual monies for capital expenditures.

The implications—that the Public Switched Telephone Networks are being dismantled, that there is no longer anyone upgrading the wires in the states, that the funds are being manipulated to raise rates and at the same time have the 'profitable' businesses be moved out

[5] data from June 2010, published 2011

of the 'utility', while at the same time the construction budgets are being manipulated to pay for a dubious wireless future – not to mention saving billions of dollars on taxes—should make the reader sit up and take notice.

Focusing on the Tax Issues & Impacts:

The tax losses in these states reveal massive current as well as future harms to the economy and the public. More importantly, these losses reveal both a state and federal regulatory failure that has been in effect for over a decade. The Wall Street financial failure and the bailout are clear indications that the regulators failed to analyze and intercede to fix the problems before the crash. This same failure of regulatory oversight has allowed this situation to harm America and customers.

Loss of Tax Revenues: Harms to the State, the Economy and Customers. In just New York State over a 4-year period, 2007-2010, Verizon, New York claimed to have lost $4.25 billion and received an 'income tax benefit' of $1.74 billion. This doesn't include what happened in 2011.

Paying fewer taxes harms the State's ability to properly function, creating local cut-backs, from school closings to less police on the streets.

Use of These Tax Losses to Raise Rates or Not Pay Property Taxes. It is one thing to avoid taxes, but as we will demonstrate, Verizon was able to go to the state and claim that these losses required rate increases, as in New York State. In New Jersey, these losses, which reflect a shift in assets out of the regulatory accounting and into a subsidiary, is now being used to claim that the company no longer has to personal property taxes to dozens of municipalities.

Also, raising rates and charging customers more lessens the monies they have to spend on other items. Especially impacted by this are low income families (or those out of work), or seniors living on a pension and social security. Reducing excess rates would help the economy and spread billions throughout the State by generating more local use of the monies in consumer spending.

As we discuss elsewhere, today Verizon is also overcharging customers on phone bills in a myriad of ways, such as 'ramming',[6] where Verizon puts customers on packages or bundles they do not need, want, order or can even use. We estimate that nationwide, about 80% of small businesses have spurious extra charges, accounting for $10-$15 billion dollars in higher phone rates annually.

Misguided FCC and State Public Policy Initiatives; Close Down the Public Switched Telephone Utilities. Besides raising rates**,** the FCC's Technical Advisory Committee (TAC)

[6] http://www.teletruth.org/ramming.htm

is now calling to actually close down the PSTN, the state-based essential infrastructure utilities and the FCC is having workshops on how to do this transition.[7] Ironically, almost every service, including DSL or AT&T's U-Verse, i.e. almost all of deregulated products are going over the PSTN wiring. Even the upgraded wiring that is now fiber has not only been funded by customers, but was part of the plan to replace the old copper wiring with fiber optic wiring for the utilities since the 1990's.

Harm to Competition through Collusion of Multiple Companies. It appears that Verizon's local phone utilities are playing favorites and putting competitors at a disadvantage in multiple ways. Verizon's affiliates are receiving preferential treatment in their use of the utility networks and services to the detriment of the other competitors that have no choice but to rely on the monopoly telephone provider for the local connections they require completing their own network service offering. This results in the public having less competition, resulting in higher prices and less choice.

More importantly, how are Verizon's other related companies working to pull off these losses and deceive the public? Verizon Wireless is a standalone company and Verizon has a partner, Vodaphone. It is not simply another division of Verizon.

The Dismantling of the Utilities in America. The tax losses indicate that whole areas of the utility networks are being shifted out of the utility and into the affiliates, transferring not only revenues but also assets. This means that networks that have been built with rate-payer funding, including multiple increases allowed with the claims that the companies would be upgrading the utility plant, the State's essential telecommunications infrastructure, are now being shifted for private use with no customer obligations and benefits.

As we will discuss, almost all states granted Verizon significant deregulatory state 'alternative regulations' with the express purpose of upgrading the PSTN with fiber optic wiring that was to go to all households, businesses, schools, libraries and government agencies. Yet it now appears that the utility is being taken apart to the detriment of customers and the economy.

Harvesting Local Phone Customers through Affiliate Collusion. For almost of the last century, local service was supposed to be kept at fair and reasonable prices, but in examining multiple states, it is clear that the companies can now essentially write their own amount and use the losses of the other affiliates to raise rates.

Alongside this, it is now clear that the customer paying 'retail' for services is getting gouged and the only way around this is for the customer to buy 1 or more packages or services from

[7] FCC Workshops on the Public Switched Telephone, Network in Transition, DA 11-1882, Released: November 10, 2011,

an affiliate. – i.e., if you don't buy a bundle with X, Y and Z, you will be forced to pay retail+.

Bundling and the vertical integration of the products via multiple affiliates who benefit from this practice also keeps out competitors as a customer who can only get a cheap price if they bundle is forced to not selecting an ala carte or competitor offering only one service.

Our surveys show that seniors, who may not use a lot of services, or small businesses who just want basic phone lines, are all paying ever increasing amounts with no comparable competitive service – thus, be harvested, meaning to squeeze the customer until the scream uncle and buy additional services or get gouged.

"The Integrity of the Tax System and Public Trust Therein". The Corporate Tax Dodger report states:

> "Ordinary taxpayers have a right to be suspicious and even outraged about a tax code that seems so tilted toward politically well-connected companies. In a tax system that by necessity must rely heavily on the voluntary compliance of tens of millions of honest taxpayers, maintaining public trust is essential — and that trust is endangered by the specter of widespread corporate tax avoidance…While ordinary wage-earners have to report every penny of their earnings, has to undermine public respect for the tax system."

As America watches the OccupyWallStreeters complain about the manipulation of the financial services market by corporate entities, Verizon not paying billions of taxes in just 5 states in just a few years would appear to corroborate these groups' worst fears.

Legality and the Removal of Basic Phone Company Data from Public Examination. The Public simply does not have access to the information needed to analyze Verizon's compliance with applicable laws and regulations. All that can be done is to raise serious questions and request the government to carry out its responsibilities to investigate whether the company is or is not in compliance.

Unfortunately, the government may also no longer have access to the information required to analyze affiliate transactions and make findings, due to the success of lobbying efforts by Verizon and AT&T for the elimination of record keeping, reporting and accountability requirements.

While the FCC claims it is data driven, over the last decade whole sections of the regulations to supply basic information have been erased. For example, the FCC required the phone companies supply basic information about the number and types of phone lines, wiring and basic network information, as well as financial information, among other categories. Known as "ARMIS" data and formerly published in the FCC's "Statistics of Common Carriers", 2006 is the last data available to the public. While the requirements are still on the books, the FCC 'forebeared' on enforcing, much less requiring companies to supply the information.[8]

NOTE: At this time we cannot determine if Verizon has or has not paid the various taxes on their overall IRS tax returns. And there are multiple accounting book types that are used by the phone companies, including regulatory books, SEC books, IRS books and GAAP books.

AT&T does not publish information about their state-based revenues, profits or affiliate transactions, but the data indicates that they are most likely using the same flawed accounting of its subsidiaries as Verizon.

However, we believe that the losses that appear in the SEC filings and the materials we have collected substantiate our claims and requires immediate investigations.

State Report Links:

- **Verizon, New York:**
- **https://investor.verizon.com/income/subsidiaries/ny/pdf/4q10_ny.pdf**
- **Verizon, New Jersey**
- **https://investor.verizon.com/income/subsidiaries/nj/pdf/4q10_nj.pdf**
- **Verizon, Pennsylvania**
- **https://investor.verizon.com/income/subsidiaries/pa/pdf/4q10_pa.pdf**
- **Verizon, New England (MA and RI)**
- **https://investor.verizon.com/income/subsidiaries/ne/pdf/4q10_ne.pdf**

NOTE: During the creation of the report, these links have mysteriously stopped working. Another version of this link was working as of November 2011.

- **Verizon, New York:**
- http://www22.verizon.com/idc/groups/public/documents/adacct/otc_ny_4q_2010.pdf

[8] As of this writing, the FCC has an open docket to at least question whether parts of missing data that has been stripped from public scrutiny should be reestablished. We note that some data was updates from specific topics in 2007.

1) Verizon's State-Based SEC 4th Quarter Reports for 2009-2010 for Just 5 States Reveal $5.4 Billion in Losses with an Income Tax Benefit of $2 Billion.

From 2009-2010, Verizon's state-based SEC 4th quarter reports revealed $5.4 billion in losses with an income tax benefit of $1.96 billion. Verizon, New York had the largest losses with $2.2 billion in just 2010. In the state of New Jersey, Verizon claimed to have lost $786 million in 2009-2010 and received an income tax benefit of $321 million. These losses appear to be common throughout the Verizon territories as in just 2 years, 2009-2010 New England Telephone (Massachusetts & Rhode Island) claimed to have lost $1.2 billion and had a tax benefit of $477 million while Pennsylvania claimed $202 million in losses and a tax benefit of $62 million.

Exhibit 1
Verizon Losses & Tax Benefit in 5 States, 2009-2010
(In the millions)

	Losses		Tax Benefit		2-Year Total	
	2009	**2010**	**2009**	**2010**	**Loss**	**Savings**
New Jersey	-$355	-$431	$161	$160	-$786	$321
New York	-$971	-$2,200	$379	$716	-$3,171	$1,095
New England (MA, RI)	-$345	-$877	$164	$313	-$1,222	$477
Pennsylvania	-$41	-$161	$23	$39	-$202	$62
Total by Year	-$1712	-$3,669	$727	$1,228		
2-Year Total					-$5,381	$1,955

NOTE: Massachusetts and Rhode Island are combined because they are part of "New England Telephone" which was part of the original regional Bell Company, NYNEX.

In fact, over a 4 year period, 2007-2010, Verizon, New York claimed to have lost $4.25 billion and received an 'income tax benefit' of $1.74 billion.

However, as we discussed, Verizon has not put up 2011 SEC state-based filings and we estimate that the company for the 5 states will have lost $9.5 billion from 2009-2011 with a tax benefit of $3.4 billion. This might be conservative as the difference in losses from 2009-2010 average 114%, and the tax benefits jumped 69% in 2010. Our estimates are based on a 20% increase from 2010. The next 2 exhibits highlights the projected losses and benefits, as well has supplies the increases from 2009 to 2010.

Exhibit 2
Verizon Loss before Benefit for Income Taxes, 5 States, 2009-2011
(In the millions)

	2009	2010	Change 2009-2010	2011 Projected	Total 3 Year
New Jersey	$355	$431	21%	$482	$1,268
New York	$971	$2,200	127%	$2,464	$5,635
New England (MA, RI)	$345	$877	154%	$982	$2,204
Pennsylvania	$41	$161	293%	$180	$382
Total by Year	$1,712	$3,669	114%	$4,109	
3-Year Total					$9,490

Exhibit 3
Verizon Tax Benefit, 5 States, 2009-2011
(In the millions)

	2009	2010	Change 2009-2010	2011 Projected	Total 3 Year
New Jersey	$161	$160	-1%	$192.0	$513.0
New York	$379	$716	89%	$859.2	$1,954.2
New England (MA, RI)	$164	$313	91%	$375.6	$852.6
Pennsylvania	$23	$39	70%	$46.8	$108.8
Total by Year	$727	$1,228	69%	$1,473.6	
3-Year Total					$3,428.6

2) Verizon Is Using Financial Losses and the "Loss of Lines" to Raise Rates and Stop Paying Property Taxes, Among Other Perks.

These alleged losses have been used to raise rates in New York and other states and it is clear that these losses have been going on for years. The next quote is from the New York State Department of Public Service (DPS) Order, June 2009, to raise local rates.[9]

[9] CASE 09-C-0327 – Minor Rate Filing of Verizon New York Inc. to Increase the Monthly Charges for Residence Local Exchange Access Lines (1MR and 1FR) by $1.95 per month, State Of New York Department Of Public Service , June 18, 2009

Notice that the Order specifically states that Verizon needs financial relief, meaning rate increases, because of the losses.

> "Verizon's financial condition is 'relevant' when the Commission considers pricing changes because "the state has an interest in a viable company….There seems to be little question that the company is in need of financial relief; Verizon reported an overall intrastate return of a negative 4.89% in 2006 and its reported intrastate return on common equity was a negative 73.6%."
>
> "For 2007, Verizon reported an overall intrastate return of negative 6.24% and a return on common equity of negative 46.0%."

And the Order to raise rates continued:

> "Verizon recently submitted its 2008 Annual Report showing that its earnings continue to be depressed. Specifically for 2008, the company reported a negative overall rate of return of 6.70%, a negative return on common equity of 48.66% and negative intrastate earnings of $396 million."

And there is a match of sorts with the losses discussed by the State DPS and Verizon, New York's 4th quarter losses for 2008. In 2008, Verizon, New York showed a net loss of $350 million and $348 million in 2007. While not an exact match, the $396 million in losses for 2008 quoted by the State would appear to have a direct connection with the SEC filing. (We could not find the original Verizon filing to the State online.)

More importantly, while the state characterizes the increases as "minor" in the Order, since 2004 the price of basic service went up 83% in New York City[10], and some services, like inside wire maintenance, went up 132%. In fact, overall local service, for the exact same service, went up 565% since 1982, and these statistics are based solely on actual phone bills

How can prices continue to increase if, as the State and Verizon claim there's competition? Shouldn't prices be in decline?

In the case of New Jersey, besides the rates increases, Verizon claims that they can stop paying personal property tax to municipalities once the company has lost more than 51% of the lines with 'dialtone and access'.[11] The New Jersey League of Municipality writes:[12]

[10] www.newnetworks.com/VerizonNY2011FIN.htm

[11] New Jersey League of Municipality letter as indicated our September 1 correspondence (http://www.njslom.org/letters/2011-0901-verizon-hopewell.html), Hopewell Borough in Mercer County has appealed Verizon's decision to cease paying the Business Personal Property Tax based upon its interpretation of the applicable statute. Verizon argues that once it unilaterally determines that it no longer supplies dial tone and access to at least 51% of the local telephone exchanges in a municipality, payment of the tax is no longer required. The League continues to be involved in this litigation, arguing against the Verizon assertions.

> "On September 1, Verizon informed an additional 31 municipalities that they would not be paying those entities Business Personal Property Taxes in 2012….As a result, taxpayers in 68 municipalities will now be forced to do without the benefits provided by these revenues."

This matter is currently in court and other legal actions are planned, but the principle, that a 'loss of lines' caused a loss in revenues is at the bottom of Verizon's argument.

How much tax money is at stake in New Jersey? According the League of Municipalities, "In 1997, property taxes were $96 million; in 2007 it was only $44 million."[13] This means that if the loss of lines has been only a mathematical sleight of hand then Verizon could be liable to repay over $500 million, (not counting the statute of limitations and other legal wranglings).

NOTE: At this time this same accounting of lines and taxation could be occurring in other Verizon states. Also, Verizon does not provide a list of all current phone lines that include all 'special access' lines. We will return to this topic later.

3) Construction Budgets Are Down an Average of 21% in 2010 and Depreciation was 100% of Construction.

Are the states increasing their expenditures to fund new construction and thus cause these large losses? According to the 4th quarter reports, construction dropped an average of 21% in 2010 — $600 million less to be exact.

[12] New Jersey League of Municipality letter: September 19, 2011 RE: Verizon Business Personal Property Tax Developments

[13] New Jersey GFOA meeting" Personal Property Tax at Risk, Verizon and two smaller companies are subject to a Business Personal Property Tax which is based upon net book value of depreciated personal property in use for business (N.J.S.A. 54:4-2.45)….Each year Verizon and others send the Division of Taxation their accounting information. They also prepare what is called a Form PT-10 which is to be submitted directly to each municipality. The PT-10 Form contains the original cost of the personal property owned by the company. It reports depreciation. The remainder is the net value which is further depreciated by the Assessment to Sales Ratio. Once this Assessment to Sales Ratio has been measured the resulting value is taxable at the general property tax rate….Beyond the calculation determining net value taxable there is a second factor which is being applied. This is a 51% trigger one might say. If land lines or access lines provided by Verizon falls below 51% of the total number of lines served within the particular community then Verizon claims to no longer be subject to Personal Property Tax. This year, 2009, the 51% trigger occurred within five municipalities representing a net tax loss of approximately $178,000. In 2010 Verizon estimates it will affect 50 additional municipalities and 100 more statewide in the following year.

Exhibit 4
Verizon, Construction Budgets, 5 States, 2009-2010
(In the millions)

	2009	2010	2-year	Drop	Decrease
Massachusetts & Rhode Island	$566	$487	$1,053	$79	16.2%
New Jersey	$837	$608	$1,445	$229	37.7%
New York	$1,315	1216	$2,531	$99	8.1%
Pennsylvania	$744	$551	$1,295	$193	35.0%
Totals	$3,462	$2,862	$6,324	$600	21.0%

But this is only part of the story. According to the same reports, Verizon wrote off, on average, all of the construction budgets — 100%. (In 2010 they wrote off 110%, 10% more than they put into the ground.)

Exhibit 5
Verizon's Depreciation as Compared to Construction in 5 States, 2009-2010
(In the millions)

		2009	2010	2-Year
Massachusetts & Rhode Island	Depreciation	$586	$572	$1,158
	Vs Construction	104%	117%	111%
New Jersey	Depreciation	$643	$650	$1,293
	Vs Construction	77%	107%	92%
New York	Depreciation	$1,242	$1,231	$2,473
	Vs Construction	94%	101%	98%
Pennsylvania	Depreciation	$611	$633	$1,244
	Vs Construction	82%	115%	98%
Totals		89%	110%	100%

4) Verizon's Annual Report Data Doesn't Match the State SEC Filings.

Something seems amiss when Verizon's corporate annual reports for 2008, 2009 and 2010 are compared with the state data. The annual reports show that the wireline revenues after expenses (even after depreciation & amortization) are quite substantial. Wireline business made $9.2 billion in 2010, $9.8 billion in 2009 and $11.3 billion in 2008. Where are the losses? Where is the $5.4 billion in losses from some of the largest states?

Exhibit 6
Verizon Wireline Revenue, Expenses and Income 2008-2010

	2008	2009	2010
Revenue	$44,323	$42,451	$41,227
Expenses	$33,059	$32,640	$31,990
Income	$11,264	$9,811	$9,237
Depreciation	$8,238	$8,174	$8,469
EBITDA	25.4%	23.1%	22.4%

Even after the depreciation is taken into account, the "wireline" business is still profitable.

In the annual reports there are different wireline categories. "Mass Market" services include local service, broadband and the utility revenues. There is also "Global Enterprise", "Global Wholesale" and "Other".

> "Mass Markets — Mass Markets revenue includes local exchange (basic service and end-user access), long distance (including regional toll), broadband services (including high-speed Internet and FiOS Internet) and FiOS TV services for residential and small business subscribers."

The "wireline" information showed that "Global Enterprise", "Global Wholesale" and "Other" lost $3.5 billion in revenues from 2008-2010, while Mass Market increased year after year.

Exhibit 7
Breakout of Verizon Wireline Revenue, 2008-2010
(In the millions)

	2008	2009	2010	Change
Mass Markets	$15,831	$16,115	$16,256	$425
Global Enterprise	$16,601	$15,667	$15,669	($932)
Global Wholesale	$9,832	$9,155	$8,393	($1,439)
Other	$2,059	$1,514	$909	($1,150)
	Drop			($3,521)

This means that the expenses, which most likely tracked with the loss in revenue, would indicate that "Mass Markets" services became more profitable, not less. According the annual reports "Other" dropped $1.15 billion while "Global Wholesale" went from $9.8 billion to $8.4 billion. "Mass Markets" actually increased $425 million from 2008 to 2010.

How can the Mass Markets service revenues be increasing and the wireline services quite profitable, yet the state reports show major losses?

In the Verizon corporate Annual Report for 2010, Verizon is merging all of the products, including FiOS, broadband, etc. Examining the next paragraph from Verizon's Annual Report for 2010, it shows that "switched" access lines — which they are now claiming are the 'old networks', the Public Switched Telephone Networks — are in serious decline. However, they are profitable in this category because of the other services, such as FiOS, broadband, or in the case of businesses, "high-speed circuits".

> ***"2010 Compared to 2009***
>
> The increase in Mass Markets revenue during 2010 compared to 2009 was primarily driven by the expansion of consumer and business FiOS services (Voice, Internet and TV), which are typically sold in bundles, partially offset by the decline of local exchange revenues principally as a result of a decline in switched access lines as of December 31, 2010 compared to December 31, 2009, primarily as a result of competition and technology substitution. The majority of the decrease was sustained in the residential retail market, which experienced a 9.0% access line loss primarily due to substituting traditional landline services with wireless, VoIP, broadband and cable services. Also contributing to the decrease was a decline of nearly 5.0% in small business retail access lines, primarily reflecting economic conditions, competition and a shift to both IP and high-speed circuits."

What does this all mean besides not paying state taxes or raising rates? The state-based companies are not accounting for the total wireline revenues, from services such as FiOS or other deregulated services. Verizon even admits there is a "shift to both IP and high-speed circuits", which means that once the same exact line goes to DSL or some other "high-speed" service, it is now 'different' and therefore not an access line. It also means that the other affiliates are most likely not paying their fair share into the state-based companies.

5) Other Taxes and Surcharges Being Charged to Customers Are Not Part of this Equation.

We need to note that these losses do not include other taxes, fees and surcharges that Verizon is able to 'pass-through' and have customers pay. Here is one example, which adds 3% to services to New York state phone bills.

> **"New York State Gross Revenue Tax Surcharge**
> **"Description:** This surcharge recovers telephone company expenses associated with mandated New York State Transportation and Transmission Corporation Franchise Taxes (Section 184 Tax) and Excise

> Taxes on Telecommunications Services (Section 186E Tax). **This surcharge is not required by the Commission.** (Emphasis added.)

This 'tax surcharge' is also taxed federal and state taxes. In New York that adds an additional 12% to this surcharge. And there are a host of other surcharges, though this varies by state.

6) Affiliate Transaction Data Shows Massive Anomalies and Corporate Expense Dumping. Expenses Were 153% More than Revenues.

First, here is the overall revenue per year for each state-based report to give a sense of 'size' of each company. Verizon, New Jersey averaged about $3.1 billion, while Verizon, NY averaged $7.5 billion, more than double the revenues for New Jersey.

Exhibit 8
Overall Revenue for Verizon State-Based 4th Quarter Reports, 2009-2010

	New	Jersey	New York		New England		Pennsylvania		
	2009	2010	2009	2010	2009	2010	2009	2010	Total
Revenue	$3,137	$3,068	$7,840	$7,221	$2,446	$2,402	$3,258	$3,236	$32,608
Average		$3,103		$7,531		$2,424		$3,247	
Compared to New York		41%				32%		43%	

But it is the details of the affiliate transactions that one has to wonder what hanky-panky is afoot. Stare at the numbers for a short time and you find serious anomalies.

NOTE: SEE APPENDIX 1 FOR A DESCRIPTION OF THESE AFFILIATES.

This next exhibit is taken directly from the Verizon state-based 4th quarter reports.

Specific Issues:

- How can Verizon New Jersey and Pennsylvania have almost 5-10 times less revenue for Internet service than Verizon New York or Massachusetts/RI?
- However, the expenses to Verizon New Jersey and Pennsylvania from Verizon Internet are massive when one examines the fact that New York or Massachusetts/RI do not have any expenses.
- Why does New York not have any long distance revenues?
- This data also has some wireless revenue anomalies. How did the wireless revenues go down in New Jersey and Pennsylvania from 2009 to 2010?
- How did Verizon Wireless pay Verizon, New Jersey $112 million in 2009 while Verizon Wireless only paid Verizon, New York $78 million, even though New York is over double the size of New Jersey.

There also seems to be different accounting rules for the original "Bell Atlantic" states, New Jersey and Pennsylvania, as compared to the original "NYNEX" states, which include New York, Massachusetts and Rhode Island.

Exhibit 9
Verizon, 2009-2010 Affiliate Transactions for 5 States
(In the millions)

	New	Jersey	New York		New England		Pennsylvania		
Operating Revenues:	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**Total**
Verizon Business	$192	181	$ 351	$275	$129	$118	$170	$168	$1,584
Verizon Wireless Inc.	$112	$67	$78	$95	$34	$36	$74	$59	$555
Verizon Services	$48	44	$56	$59	$27	$28	$47	$ 48	$357
Verizon Internet	$ -	$82	$648	$706	$375	$410		$48	$ 2,269
Long Distance	$37	$34			$29	$27	$35	$33	$195
Operating Telephone	$ 4		$ 2		$5		$ 13	$13	$37
Other	$ 1		$1	$ 1	$6	$5	$ 1		$15
Total	$394	$ 430	$1,136	$1,136	$600	$ 624	$340	$ 363	$5,023
Operating Expenses:	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	
Verizon Services	$1,073	$838	$2,036	$ 1,710	$880	$676	$ 972	$ 788	$8,973
Internet Services	$ 251	$148					$ 285	$189	$873
Data Services Inc.	$105	$107	$ 240	$ 249	$106	$114	$ 108	$113	$1,142
Connected Solutions.	$ 78	$35					$ 6	$ 3	$122
Operating Telephone	$ -		$ 835	$637			$ 31	$36	$1,539
Verizon Wireless Inc.	$10	$3	$ 5	$4	$ 4	$1	$1	$ 1	$29
Long distance rec.	$ -								$ -
Verizon Business	$2	$1	$4	$ 4	$3	$ 2	$ 2	$ 2	$ 20
Other	$ -								
Total	$1,519	$1,132	$3,120	$2,604	$ 993	$ 793	$ 1,405	$ 1,129	$12,695

On the flip side, expenses are obviously being dumped. The data for 2008 and 2009 shows a massive increase of “Verizon Services” expenses in 2009. For the 5 states, these fees increased $1.3 billion in a year. And while it went down $700 million in 2010, there is no discussion of why there were these increases or declines.

Exhibit 10
Verizon Services Expenses, 2008-20010 for 5 States
(In the millions)

	2008	2009	2010	3-Year
Verizon Services	$ 3,443	$4,761	$4012	$12,216

Who is Verizon Services?

Verizon Services is the corporate headquarters expenses which includes “corporate finance, external affairs, legal, media relations, employee communications, and corporate advertising”. Translated into English, this most likely means that it dumps everything, from lobbying, monies for the Verizon Foundation, executive pay, travel and a host of other charges that have nothing to do with the cost of actually offering phone service.

Verizon’s state-based SEC reports state:

> “The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, treasury, and rent expenses associated with the rental of facilities and equipment.”

And to confuse this more, this was included in the Verizon, New York 2010 SEC year-end filing. “Verizon Services Group”, “Verizon Services Corp.” and “Verizon Corporate Services Group” (*collectively known as “Verizon Services”) are all listed.

> “The consolidated financial statements include the accounts of Verizon New York Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. We have a 66-2/3% ownership interest in Telesector Resources Group, Inc. (d/b/a Verizon Services Group) and share voting rights equally with the other owner, Verizon New England Inc. (Verizon New England), which is a wholly owned subsidiary of NYNEX. Verizon Services Group operates in conjunction with Verizon Services Corp. and Verizon Corporate Services Group Inc. (collectively known as Verizon Services) to provide various centralized services on behalf of Verizon’s subsidiaries. We use the equity method of accounting for our investment in Verizon Services Group.“

Prior to massive deregulation, virtually none of these expenses would have been allowed to be included in the raising local rates. It is hard to imagine why the New York State commission granted rates increases. We note that the order to raise rates specifically states: "These amounts have not been audited by staff."

NOTE: See Appendix 1 for details of the affiliates.

Expenses without reciprocal revenues have been a pattern over the last decade. The changes over time, increasing expenses and decreasing revenues, can best be seen by this chart for Verizon, New Jersey affiliate transactions, 2001-2010. Expenses are always more than revenues. In 2009 revenues were only 26% of expenses.

Exhibit 11
Verizon, New Jersey Affiliate Revenues and Expenses, 2001-2010

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Revenue	$197	$194	$267	$259	$318	$505	$506	$487	$394	$430
Expenses	$717	$731	$995	$970	$990	$1,038	$1,127	$1,119	$1,519	$1,132
Revenues vs expenses	27%	27%	27%	27%	32%	49%	45%	44%	26%	38%

Who Are the Affiliates?

More importantly, it is hard to even figure out what is going on based on the information supplied to the average customer. The next page has a section of a recent Verizon, New York, small business bill. It has 4 different Verizon companies offering services on one bill and the information doesn't match the names of the affiliates mentioned in the SEC filings. Is "Verizon Online", the same as "Verizon Internet"? Is "Verizon Enterprise Solutions" the same as "Verizon Business"?

Exhibit 12
Verizon Affiliates Listed on a Verizon, New York Small Business Bill, 2011

Service Providers
With Verizon Solutions for Business, Verizon NY provides local service and related features ($45.00/mo.) and other voice services, unless otherwise indicated. Verizon Enterprise Solutions provides long distance services ($13.00/mo.) and other services identified by "VES" in the applicable billed line item. Verizon Online provides Internet services ($47.99/mo.). FiOS is a registered mark of Verizon Trademark Services LLC.

Have the state Commissions audited any of these transactions? We do not believe so and have not found any when we searched.

7) Are the Monies Being Paid by the Affiliates Even Close to What a Competitor Would Pay for the Same Service? Let's Examine Wireless.

Verizon's overall domestic wireless revenues for 2009 were $60 billion and $63 billion for and 2010, based on 89 million customers in 2009 and 94 million in 2010. The total payments to the 5 state-based companies were about $280 million a year. While Verizon is a nationwide carrier, besides connecting the calls, based on revenues it does not seem possible that the few hundred million dollars being shown as revenues to the state-based companies are even close to what a competitor would actually pay for all of the services.

And these monies are for both small and large items. For example, when Verizon sends out an insert with the local phone bill, the printing and mailing of the bill is paid for by the customer, including the postage, etc. The insert many times advertises the wireless service. Did the wireless service pay full freight for the advertising, the mailing, etc?

On the large expenses, there are connection fees that must be paid, such as 'special access' and other fees that a wireless company must pay to get the calls from their cell phone towers or move the traffic to connect to the wireline phone networks. Does Verizon Wireless pay back to Verizon, New Jersey or New York all the monies and fees the other competitors are required to pay?

If the price of phone service is being increased based on the reported losses of the companies, if the companies' affiliates are not paying their fair share back, are customers being overcharged as these increases would not happen had the wireless company paid their full freight?

8) The Wireless Question: Is Verizon Wireless Underpaying Verizon State-Based Companies?

Verizon Wireless seems to be underpaying over $700 million to the Verizon's 5 state-based companies in 2009-2010, based on 2 different analyses.

Analysis 1: Rough Estimate Via Sprint's Testimony

First, let's start with an analysis based on Sprint's testimony[14] to Congress in 2011. Sprint claimed it paid over $2 billion to the local incumbents for "special access" and "billing and collections" (B&C) which is nothing more than network circuits and the connections to local customers that go from the incumbent networks to the cell towers

Sprint:

- Sprint claimed they paid $2 billion for special access and B&C, etc.
- Sprint had 44 million customers
- That comes to about $45.00 per year per customer-line.

Verizon Wireless:

- Verizon had 94 million customers/lines in 2010.
- Special access should cost $4.2 billion.
- New Jersey has 2.8% of the total US population.
- If we assume Verizon, New Jersey has at least 2.8% of all Verizon wireless customers
- Verizon, New Jersey should have 2.7 million customers and should be paying $122 million.
- New York State is 6.4% of the US. Using the same mathematics, Verizon Wireless should be paying $271 million to Verizon, New York.

Sprint has less than ½ of Verizon Wireless customers so they should be paying at least ½ of the money.

- In New York Sprint paid $104 million in 2010, Verizon Wireless paid $95 million.
- In New Jersey, Sprint paid $56, Verizon paid $67.

We will go through this in more detail next analysis, but it is clear that Verizon should have paid more than double what Sprint paid but in NY they paid less and in NJ, while Sprint paid more it could have less than ½ the customers.

[14] Written Testimony of Daniel R. Hesse, Chief Executive Officer, Sprint-Nextel Corporation
Re: Proposed AT&T/T-Mobile Merger, Before The Senate Judiciary Committee, Subcommittee On Antitrust, Competition Policy And Consumer Rights, May 11, 2011

And based on the per customer costs of Sprint, Verizon Wireless is paying at least ½ of what it should be.

- Verizon, New Jersey should be receiving $122 million. --- Verizon Wireless is paying only $67 million
- Verizon, New York should be receiving $271 million ---Verizon Wireless is paying only $95 million.

NOTE: We fully admit that multiple caveats exist to this raw analysis. For example, New Jersey and New York have other phone companies who supply incumbent local wireline services.

Analysis 2: Comparing AT&T to Verizon Wireless Payments.

Another serious indicator of potential underpaying which dovetails into the first analysis is the information supplied by Verizon in each state's SEC filings pertaining to the access and billing and collection fees paid by Sprint/Nextel and AT&T.

> **Verizon New York**
> "Concentrations of credit risk with respect to trade receivables, other than those from AT&T Inc. (AT&T) and Sprint Nextel Corporation (Sprint), are limited due to the large number of customers. We generated revenues from services provided to AT&T and Sprint (primarily network access and billing and collection) of $237 million and $104 million in 2010 and $279 million and $119 million in 2009, respectively."

> **Verizon, New Jersey**
> "Concentrations of credit risk with respect to trade receivables, other than those from AT&T Inc. (AT&T) and Sprint Nextel Corporation (Sprint), are limited due to the large number of customers. We generated revenues from services provided to AT&T and Sprint (primarily network access and billing and collection) of $112 million and $56 million in 2010 and $130 million and $67 million in 2009, respectively."

NOTE: AT&T and Sprint payments could include long distance access fees or other charges; it is impossible to know without more disclosure.

AT&T in 2010 had 95 million customers, which was neck-and-neck with Verizon. Comparing Verizon payments to AT&T's payments, Verizon short-changed the 5 states over an estimated $700 million just on access fees and billing & collections for 2009-2010. Verizon should have more subscribers than AT&T in its states.

We included “Verizon Territory”, adding 10% for this incumbent benefit, but it could be higher. Verizon’s name recognition, combined with multiple advertising for multiple products, gives Verizon wireless an advantage over other wireless competitors. For example, a television advertisement for multiple Verizon services, from FiOS to Wireless with coverage over the whole market gives Verizon a ‘name recognition’ advantage. Also, the coverage of the advertising is ubiquitous so it would most likely cover the other incumbent phone areas.

Here is a summary of the comparisons.

Exhibit 13
Summary: Verizon 5 States Compared to AT&T’s Payments
(In the millions)

	2009	**2010**	**2 year avg.**	**Total**	
Verizon 5 States	$298	$257	$277	$555	
AT&T	$642	$561	$601	$1,203	
Sprint	$303	$260	$281	$563	
Verizon vs AT&T				**$648**	**54% less**
Verizon Territory				**$713**	

The details are even more telling. The numbers for the different states are all over the map, literally.

- Verizon, New Jersey got paid $112 million from the wireless affiliate in 2009 then dropped 40% to $67 million in 2010.
- Verizon, New York received $78 million in 2009 which is less than Verizon, New Jersey even though it is twice as large.
- Verizon’s corporate annual report shows wireless revenues increased 5.6% in 2010.

But the real kicker is comparing Verizon to AT&T and Sprint state by state.

Verizon, New York paid $200 million less than AT&T paid in 2009, and even paid less than Sprint, which is less than half the size of Verizon Wireless.

Exhibit 14
Wireless Revenues to Verizon's State-based Companies as Compared to AT&T and Sprint Access Fees. 2009-2010

	2009	2010	2 Year Total	AT&T	Verizon Underpay
Verizon, NY					
Verizon Wireless	$ 78	$ 95	$ 173	$343	$ 377
AT&T	$279	$ 237	$ 516		
Sprint	$119	$104	$ 223		
Verizon, NJ					
Verizon Wireless	$112	$ 67	$ 179		
AT&T	$136	$ 119	$ 255	$ 76	$ 83
Sprint	$ 67	$ 56	$ 123		
Verizon, PA					
Verizon Wireless	$ 74	$ 59	$ 133		
AT&T	$136	$119	$ 255	$122	$ 134
Sprint	$ 69	$ 61	$130		
Verizon, MA, RI					
Verizon Wireless	$34	$ 36	$ 70		
AT&T	$ 91	$ 86	$177	$107	$ 117
Sprint	$ 48	$ 39	$ 87		
Verizon Territory					$ 713

9) Wireless Transfer of Construction Budgets?

The president of Verizon, New Jersey, Dennis Bone, gave a speech on the future of telecommunications in the state. He is quoted as saying that landlines are now relics and that Verizon is investing in its broadband networks, including wireless. (Note the difference between 'land lines' and 'broadband networks', which he claims are different.)

> "Landlines are also becoming relics, Bone said, noting Verizon has lost 60 percent of its traditional landline business in the past decade. Meanwhile, Verizon is heavily investing in its broadband network, pumping $3.5 billion in New Jersey into the network over the past five years. The future also includes the full roll-out of the 4G wireless network by 2013, offering up to 10 times faster connectivity and less latency than current 3G networks."[15]

[15] Local Talk News, Thursday, 05 May 2011

Why is the Verizon, New Jersey President, who runs the utility, talking about wireless deployments, which is supposed to be a different company that Verizon, New Jersey does not control and is supposed to be working at arms-length with the utility? It is not supposed to be funding the wireless company.

Yet it appears that they are now spending money on their 4G wireless networks. The article states:

> "..deployment of fiber-optic links to wireless providers' cell sites throughout New Jersey as these carriers expand their infrastructure to meet ever-growing demand for wireless broadband and advanced 4G services. In 2010, Verizon deployed fiber optics to connect more than 1,660 of these sites."[16]

Does this mean that Verizon, New Jersey, the utility is now charging local phone customers for construction budgets of the wireless networks?

More importantly, the last section discussed how Verizon Wireless was possibly underpaying Verizon-states over $700 million. Construction expenditures by the state-based companies doing work for the wireless company would appear on the Verizon, New Jersey books as 'revenues'. This could mean that the companies are not only paying less than their fair share for wireless access fees, but for construction budgets as well.

10) Overall Construction Budget Shifts of Wireline to Wireless, More Write Offs.

The shift from wireline expenditures to wireless expenditures is clearly being done on a corporate level impacting all Verizon states. The follow exhibit shows that there has been an 18% deduction to wireline services, while at the same time there an 18% increase to wireless. More importantly, Verizon wrote off 100% of the construction budgets in 2010 overall; 117% in the wireline area for 2010.

[16] Ibid.

Exhibit 15
Verizon Overall Wireline & Wireless Construction and Depreciation
2009-2010

	2009	2010	
Construction			
Wireline	$8,892	$7,269	-18%
Wireless	$7,152	$8,438	18%
Total	$16,044	$15,707	-2%
Depreciation			
Wireline	$8,238	$8,469	3%
Wireless	$7,030	$7,356	5%
	$15,268	15,825	
	95%	101%	
Wireline			
Construction vs Depreciation		117%	

However, these numbers and the other numbers, such as the profit margins of wireless may be all make believe. AT&T's 2010 Annual Report had a disturbing "Management's Discussion", which stated that the wireless divisions' profit margins increased based on what looks like dumping expenses into the wireline division.

> "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations-Continued Dollars in millions except per share amounts
>
> …"Historically, intersegment activity had been reported as revenue in the billing segment and operating expense in the purchasing segment. Upon consolidation, the intersegment revenue and expense were eliminated with the consolidated results reflecting the cash operating and depreciation expense of providing the intersegment service. As part of AT&T's ongoing initiatives to manage its business from an external customer perspective, we no longer report intersegment revenue and report the cash operating and depreciation expense related to intersegment activity in the purchasing segment, which provided services to the external customer. While this change did not impact AT&T's total consolidated results, the impact to each operating segment varied. In particular, the Wireless segment, as a purchaser of network, IT and other services from the Wireline segment, experienced a reduction in cash operating expense partially offset by increased depreciation expense with the net result being increased operating margins."

We do not know if Verizon is or is not doing this but the policy issues are far reaching as it is clear that if Verizon's plan is to plead poverty on wireline, which helps it to get government subsidies. If they are showing how 'strong' wireless is, they can use this argument to claim it is the future, even when it is smoke and mirrors. For example, as we will examine, the FCC's plan to close down the PSTN is based on wireline losing money and wireless having strong profits.

Other Number Crunching: The Data Against Verizon's Line losses and Wireless-Only.

11) "Verizon's "Access Line Accounting" is a Manipulation of the Data of "Total Lines".

The phone companies have continually claimed they are losing lines. Verizon, New Jersey President Dennis Bone said "Verizon has lost 60 percent of its traditional landline business in the past decade."

This idea that the lines are dropping is essentially made-up accounting as the affiliates and the movement of assets, including the lines that these assets support, are now being transferred out of the rate-base and the accounting of all access lines.

Verizon is NOT counting anything but 'switched' access lines, one class of phone service. This definition of 'lines', then, is a subset of the actual lines that are still using the original Public Switched Telephone Network wires. DSL, FIOS, and "special access" lines, which can include anything from alarm circuits to a host of other data applications, are not being included, making the line counts meaningless as they are no longer counting the wire but through a regulatory sleight of hand, they can omit whole classes of services.

This exhibit highlights the total "Bell Company" lines as of 2006, the last available data from the FCC. (The "Bell" companies are the progeny of AT&T's break up and they are now AT&T, Verizon and Centurytel, (formerly Qwest).) While the Bell's "switched" access lines declined, the actual total lines, when "special access" lines are included, continually increased. As of 2006, there were more 'special access' and other lines than there were 'switched' lines.

Exhibit 16
Bell "Switched" Lines Vs Bell "Total Lines", 1984-2006
(In the millions)

	1984	**1990**	**1995**	**2000**	**2005**	**2006**	**From 2000**	**overall**
Bell "Switched" Lines	114	135	158	188	148	140	-25.4%	23%
"Total" and Special Access	118	130	166	245	312	337	37.7%	187%
Difference						197		

Source: FCC using phone company supplied data.

Special access lines are usually data lines that can be everything from an alarm circuit to high speed lines that connect cell towers. They are not special as they can go over the same wiring.

How many lines are part of the PSTN? Well, almost all of them. Even AT&T's U-Verse is still using the old copper wiring and all DSL goes over the old copper wiring. Verizon's FiOS, which is a replacement of the old copper wiring is also part of the PSTN as customers have been funding these upgrades since laws were changed in the 1990's.

12) "Wireless-Only" Accounting Is Also Flawed.

The other claim that is clear from Verizon, New Jersey President Dennis Bone's quote is that wireless services are going to be the future, not wireline. However, again, the accounting of 'wireless' is also in question.

The most quoted materials comes from the Center for Disease Control (CDC) who claims that wireless-only households are now at a whopping 25%. As quoted from the FCC's Technical Advisory Committee[17]:

> "More than 25% of U.S. consumers aged 18 or older have already given up their voice landline for voice wireless-only service."

Unfortunately, when these numbers are examined there are 2 missing components that are relevant and not mentioned by the CDC or the FCC.

- First, the CDC does not count the wire but the service; i.e., voice phone service. So, the household may indeed have a wire coming into the home, which could be for broadband or DSL or Internet or cable. One has only to ask a 20-something to get rid of their cable service or broadband service to understand that even though they may be making wireless calls, they are still NOT wireless-only.
- Second, the CDC doesn't count businesses and there are few, if any all wireless-only large businesses much less small businesses. Main Street USA still has a wire into the business, especially for ATM machines or alarm services.

There is no data available from the CDC or the FCC or any other source to specifically address then how many wireless-only households or businesses there are when the actual wire and other services are taken into account.

We are not suggesting that wireless has not cannibalized the wireline markets for some

[17] FCC Technology Advisory Council, Critical Legacy Transition Working Group (CLT□WG), Status of Recommendations, June 29, 2011

services but as of 2011, the data about the actual impacts of wireless would appear that the wireless has been more of an enhancement, adding hundreds of millions of new lines and billions in revenues than a total replacement of the wireline/cable/broadband/Internet services.

To create new laws based on this flawed data or to claim that the Public Switched Networks should be shut down shows just how the phone company hype has taken control of the policy agenda.

13) Broadband Speeds: Wireline Vs Wireless.

Network World's recent chart on broadband speeds and offerings included these: http://www.networkworld.com/news/2012/020612-global-broadband-255760.html?

- Hong Kong – 300 Mbps in both directions for $40.00 and that includes TV
- Romania – 100 Mbps each way for $20.00
- South Korea – 100 Mbps in both directions for $20.00 and that includes phone and TV

AT&T's U-Verse TV and broadband? Top speed is only 25 Mbps and that's in 1 direction and costs, as of February 2012, $63.00 as a stand alone product.[18]

According to the FCC's most recent data,[19] there are 84 million wired residential broadband service connections in the US. Out of an estimated 120 million homes:

- Only 1.2 million have anything above 25 Mbps — 1%
- Only 48,000 have anything 'at least 100 Mbps' — one-twentieth of 1%.

According to other sources, the average speed in the US is about 5 Mbps in 1 direction.

We note that the FCC report has kept the decade's old definition of broadband which starts at a speed of 200 kbps in 1 direction, (which is 1/5 of a megabit per second). This is being done to boost the number of broadband connections.

But it gets worse. While the hype of 'wireless' for broadband has been spreading, the FCC's Internet speed report claims that there are 84 million wireless broadband connections: However: [20]

[18] http://www.att.com/u-verse/shop/index.jsp?wtSlotClick=1-0061H0-0-1&shopFilterId=500001#fbid=G-GRnS_n3Qv
[19] FCC's internet report on speed http://transition.fcc.gov/Daily_Releases/Daily_Business/2011/db1007/DOC-310261A1.pdf

[20] NOTE: It seems that the wireless connections and wireline connections are tied at around 84 million each at the end of 2010.

- 91% of the population has speeds less than 6mbps.
- 95% of the population has an upstream connections speed of less that 3mbps.

That's it. For wireless to 'take over video and cable', the companies would have to have much higher speeds. And while we hear about much faster speeds, the truth is that 4G has proven to be more marketing hype[21] than standard. Worse, the speeds are for 'new services'; history shows that they will slow down dramatically as the networks have more customers with ever increasing file sizes.

But that's not the only problem. According to multiple sources it takes 100-250 gigabits of downloads to match basic current cable viewing. AT&T's Iphone and Ipad packages have tiered pricing.

Here are 2 current (November 2011) AT&T data plans:[22]

- DataPlus: 200 MB of data for $15 per month. If you go over, you'll get an additional 200 MB automatically for $15.
- DataPro: 2GB of data for $25 per month. If you go over, you'll get an additional 1 GB automatically for only $10.

Compare that to Netflix's data speeds for watching video:

- "Good" —The default setting with good picture quality and lowest data use per hour (about 0.3 GBytes/hour)
- "Better" — Better picture quality and medium data use per hour (about 0.7 GBytes/hour)
- "Best" — Best picture quality and highest date use per hour (generally about 1.0 GBytes/hour or up to 2.3 GBytes/hour when streaming HD content)

Watching 1 HD movie at 2.5 hours cost over $40.00 and uses up all of the time on the "DataPro" plan.

[21] http://www.alternet.org/story/151451/the_smart_phone_con_job%3A_your_so-called_4g_phone_isn%27t_what_it%27s_cracked_up_to_be/
[22] http://www.att.com/shop/wireless/plans/data-plans.jsp?wtSlotClick=1-005DYZ-0-1

PART II: America's Communications Infrastructure is at Stake.

14) The PSTN Was Supposed to be Upgraded. Customers are Paying Extra for the Upgrades.

Our two decades of research on deregulation granted to the phone companies for commitments to upgrade the Public Switched Telephone networks to fiber optic services, found over $340 billion[23] has been collected since the 1990's to pay for massive upgrade projects. Known originally as the "Information Superhighway", state laws were changed to give the companies billions of excess profits to upgrade the PSTN.

Let's use a specific state example. In 1993, Verizon, New Jersey was granted 'alternative regulation', which was an agreement between New Jersey Bell (now called Verizon, New Jersey) and the state to give Verizon massive financial incentives to rewire the entire Public Switched Telephone Networks, replacing the copper wiring with a fiber optic service capable of 45mbps in both directions.

> "D. NJ BELL'S PLAN FOR AN ALTERNATIVE FORM OF REGULATION MAY 21, 1992 — NJ Bell's plan declares that its approval by the Board would provide the foundation for NJ Bell's acceleration of an information age network in Now Jersey and referred to by NJ Bell as 'Opportunity New Jersey' (See the Deloitte Report). Opportunity New Jersey would accelerate the deployment of key network technologies to make available advanced intelligent network, narrowband digital, wideband digital, and broadband digital service capabilities in the public switched network, and thereby accelerate the transformation of NJ Bell's public switched network, which today transports voiceband services (voice, facsimile and low speed data), to a public switched network, which transports video and high speed data services in addition to voiceband services."[24]

The planned speed of broadband in the US in 1992 was 45 mbps in both directions. From the New Jersey state law:

> "Broadband Digital Service — Switching capabilities matched with transmission capabilities supporting data rates up to 45,000,000 bits per second (45mps) and higher, which enables services, for example, that will allow residential and business customers to receive high definition video and to send and receive interactive (i.e., two way) video signals."[25]

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[23] In 2005 we published $200 Billion Broadband Scandal"; however, based on our updating of this data and new state-based analyses, such as New Jersey, Connecticut and Wisconsin, (not to mention our previous detailed state-based models of Pennsylvania and Massachusetts, and our the information supplied in this report, our previous accounting is 'conservative'.

[24] In the Matter of the Application of New Jersey Bell Telephone Company For Approval of its Plan for an Alternate Regulation, Decision Docket Number T092030358, 4/14/03

[25] Ibid.

By 2010, 100% of the state was to be completed based on commitments made to the State. In exchange, Verizon would get tax incentives as well as be permitted to raise rates on a myriad of local services, from local service to calling features, such as Call Waiting and Call Forwarding and keep the excess profits. (Note that these features cost a few pennies to offer and can cost the customer $4.00-$10.00 a month extra.)

This is a timeline of services to be deployed from 1992 through the year 2010 and it is from the original agreement. Based on research, it is supposedly still in effect today. http://www.newnetworks.com/OpportunityNewJerseyFiber.htm

This agreement was continued throughout the last decade, and, in fact, Verizon has been submitting documents to the state every year to show that they have been properly upgrading the state's public switched telephone networks.

This is not just a New Jersey issue as almost every state in the US had similar alternative regulation plans that gave the companies massive financial incentives, most still in place, to do the upgrades of the networks.

For example,

- Verizon, Massachusetts & Rhode Island were to have 330,000 households upgraded by 2000, which was supposed to break ground in 1995.
- Pennsylvania was supposed to have 100% of the state finished by 2015 with 45mbps services (in both directions).

See our report filed with the FCC as an addition to the official FCC broadband report submitted by Columbia University's CITI program[26].

And let us be clear. The money is still being collected and moved out of the utility to fund non-utility broadband deployments. This is another quote from the NY State Department of Public Service that specifically points out that the 'fiber optic' services are being paid for by rate increases. New York State Department of Public Service, June 2009[27]

> "We are always concerned about the impacts on ratepayers of any rate increase, especially in times of economic stress," said Commission Chairman Garry Brown. "Nevertheless, there are certain increases in Verizon's costs that have to be recognized. This is especially important given the magnitude of the company's capital investment program, including its massive deployment of fiber optics in New York. We

[26] "The History, Financial Commitments and Outcomes of Fiber Optic Broadband Deployment in America: 1990-2004 The Wiring of Homes, Businesses, Schools, Libraries, Hospitals and Government Agencies" http://www.newnetworks.com/FCCCITIbroadband.pdf

[27] CASE 09-C-0327 – Minor Rate Filing of Verizon New York Inc. to Increase the Monthly Charges for Residence Local Exchange Access Lines (1MR and 1FR) by $1.95 per month, State Of New York

> encourage Verizon to make appropriate investments in New York, and these minor rate increases will allow those investments to continue."

This broadband issue is at the heart of the tax issue — Was deregulation granted that allowed the movement of assets out of the ratebase, and because of the 'deregulation' let the companies change the rules to intermingle subsidiaries?

15) There is Only 1 Network, the Public Switched Telephone Network.

AT&T has submitted a proposal to the FCC, claiming that AT&T is a poor company losing phone lines and they want to get rid of the old landlines, the utilities, the Public Switched Telephone Networks (PSTN). Gigacom writes: [28]

> "Ma Bell asked the FCC to eliminate regulatory requirements that it support a landline network and to provide a deadline for phasing it out.... The (almost) one in five Americans relying exclusively on a plain old telephone line should prepare to kiss that wall jack goodbye as the major wireline telephone providers back away from that dying (and expensive business."

The reporter adds:

> "However, AT&T in its filing doesn't offer a way to bridge the gap for that 20 percent of Americans relying only on landlines, nor does it address what an all-IP future means for the 33 percent of Americans who have access to broadband but do not subscribe (although those broadband laggards might be paying for a digital voice product from a cable provider)."

As we have discussed before, this is all just a manipulation of the regulatory system. AT&T's current U-Verse travels over the same old copper to the home. This manipulation of the affiliate monies is now clear — they are using ratepayer funding to claim that there are 2 networks and that the PSTN is really a separate network. It is not.

And even the reporter seems to make the same erroneous distinction — claiming 20% of the population relies on land lines. This is patently not true. Almost all of AT&T's products are still over the PSTN, they just have been able to 're-label' the definitions to move assets on paper to claim that there are 2 networks.

Verizon is no better as the majority of their services still use the old copper wiring, such as DSL. Of the upgraded networks, such as FiOS, the networks have been moved out of the

[28] http://gigaom.com/2009/12/30/att-to-fcc-let-my-landlines-go/

rate-base and line accounting, and it seems very clear that the budgets that were supposed to upgrading the utility were used to upgrade a competitive cable product.

Verizon New Jersey's 2001 Infrastructure Report clears up what is the PSTN and what it is not. While the FCC has bought AT&T's hype that the PSTN is only 'voice calling' on basic service called POTs, Verizon's own words shows that the PSTN was ALL services as ALL services were being funded via customers' excess phone charges.

> "By integrating a number of services on a single network, Verizon NJ will continue to make optimum use of our service delivery capabilities. The evolution to the full service ATM based switched broadband network will increase significantly the efficiency of serving New Jersey through automated provisioning and activation processes, increase capacity availability, and result in an even more flexible delivery platform. Verizon NJ's integrated network of switches, transmission facilities and operating systems provides New Jersey's residential and business communities with a technologically advanced telecommunications infrastructure that is ready, willing and able to act as the on-ramp to the Information Highway".[29]

16) Who Owns the Pipes?

It is clear from the affiliate transactions that Verizon has already made claims that they are the sole owners of the "pipe" and that they can show massive losses and drain the asset.

Ed Whitacre, former CEO of AT&T (previously named SBC) in a Business Week interview laid out their position.[30]

> **Business Week: "How concerned are you about Internet upstarts like Google, MSN, Vonage, and others?**
>
> **Whitacre:** "How do you think they're going to get to customers? Through a broadband pipe. Cable companies have them. We have them. Now what they would like to do is use my pipes free, but I ain't going to let them do that because we have spent this capital and we have to have a return on it. So there's going to have to be some mechanism for these people who use these pipes to pay for the portion they're using. Why should they be allowed to use my pipes?
>
> "The Internet can't be free in that sense, because we and the cable

[29] Verizon, New Jersey 2001 Annual Infrastructure Report
[30]At SBC, It's All About "Scale and Scope" November 7, 2005
http://www.businessweek.com/magazine/content/05_45/b3958092.htm

> companies have made an investment and for a Google or Yahoo! or Vonage or anybody to expect to use these pipes [for] free is nuts!"

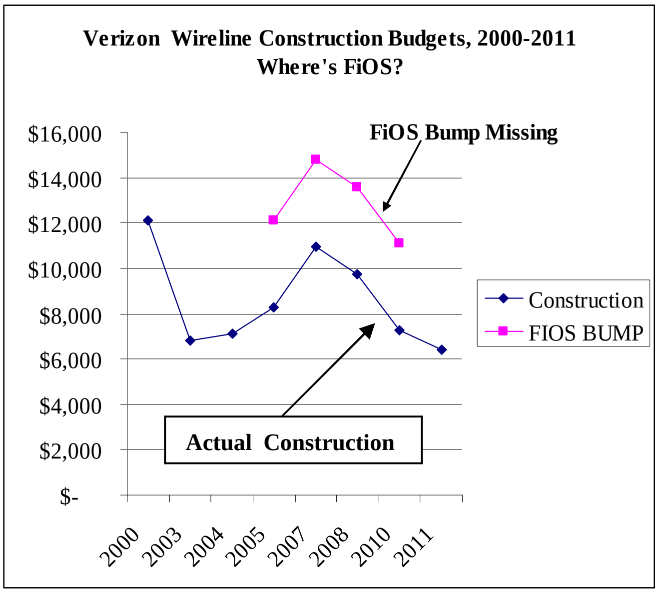
Truth is – It's all about the money flows. The 'broadband pipes being created by the new AT&T are not being funded by investors but coming out of basic rates. And it gets worse when we examine Verizon's FiOS.

17) Who Is Really Funding FiOS & How Much Did Verizon Spend?

Verizon also claims that the company spent $23 billion dollars in rolling out FiOS since 2004**.** According to Tim McCallion, President of Verizon's West Region, (including parts of California) "Since 2004, Verizon has invested over $23 billion to deploy its FiOS network…"[31]

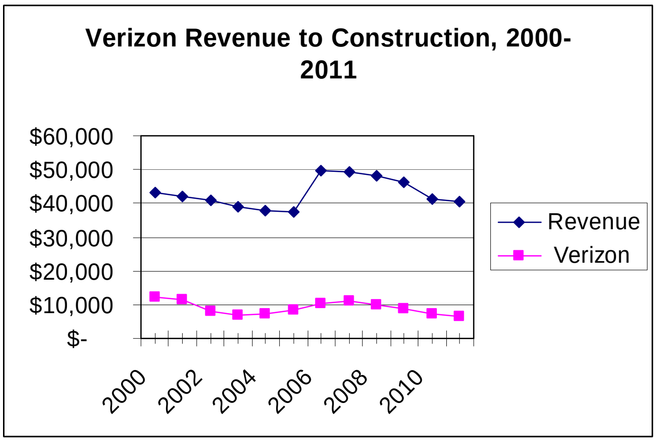
The next chart is Verizon's entire wireline construction budgets for 2000 through 2011, taken directly from the Verizon annual SEC filed reports, as well as the "FiOS Bump", about $3.8 billion dollars per year addition that should have been spent annually over a 6 year period if the company had really been paying out $23 billion dollars for the construction.

The numbers show no bump in construction for FiOS, no major increases in 'capital expenditures' in general. Capital Expenditures are the monies for new network equipment, wiring and construction.



[31] http://www22.verizon.com/about/community/ca/welcome.html

In fact, Verizon, on average, spent more on construction from 2000-2004 then from 2005-2011. The relative size of construction budgets are usually based on comparing the monies spent with the revenues for the year. Historically, construction budgets are 20% to 25% of revenues. I.e.; if the company made $40 billion dollars, the construction budgets should be between $8 billion and $10 billion. And building out a network and spending $23 billion one would expect that they would be spending over 25% a year on construction.
From 2000 to 2004, construction represented 22.2% of wireline revenues, but in 2005-2011 contraction was only 19.7%. Had the companies spent the same construction budgets as a percentage of revenue as the early period, there would have been an additional $7.2 billion dollars. The charge below is a comparison of revenue and construction for Wireline services, 2000-2011.



Here are the actual averages for revenues, construction, depreciation and a comparison of construction to revenues (Const vs Rev) for 2000-2004 and 2005-2011 as well as depreciation vs construction (Deprec vs const)

Exhibit 17
Verizon Averages for Revenue, Construction and Depreciation
2000-2004, 2005-2011

		2000-2004		2005-2011
Revenues		$40,642		$44,636
Construction		$9,108		$8,830
Depreciation		$9,139		$8,790
Const vs Rev		22.2%		19.7%
Deprec vs const		106.5%		102.3%

This next exhibit summarizes what the difference would be if the capital expenditures averaged 22.5% and was applied to the FiOS period of 2005-2011. The company should have spent at least $9.8 billion a year. In toto, there is a difference of about a billion per year or $5.9 billion over 6 years.

Exhibit 18
Had Expenditures been at 2000-2004 Rate average of 22.2% for 2005-2011

Should have spent Annual Construction	$9,820
Actually Spent	$8,830
Difference: Expenditures at 22.5%	$5,941

We note that revenues for Wireline services[32] went up and down, not because of losses of those phone lines we keep hearing they lost, but more from selling off Maine, New Hampshire and Vermont, not to mention adding then dumping many of the former GTE territories, such as selling off GTE Hawaii. It's also from merging with MCI, merging with AllTel, and other items that are part of the Annual Report's wireline numbers. For example, Verizon lost millions of lines and revenue when it closed the competitors' ability to rent the lines or when they blocked Internet Service Providers from offering competitive Internet services over the broadband networks.

Depreciation: Writing Off 132% as Compared to Construction Budgets for 2011.

Depreciation & Amortization are the tax write-offs phone companies can take each year based mostly on the equipment and wires in the networks. It lowers the companies' tax payments and in the old days was kept in check as part of the rate-making process as it is an 'expense'; the more expense, the more the company could charge customers. Historically, under the old Bell system, depreciation was around 65% of construction and that moved to about 80-90% by the 1990's. Today, it's clear that the companies are writing off more than they put into the ground which gives them a massive tax benefit as well. From 2000-2004, Verizon took 106.5% of depreciation as compared to what they spent on construction.

In 2005-2011, Verizon took 102.3% on average; 2011 had 132% depreciation as compared to construction. (We also note that in 2011, the company only spent a total of $6.4 billion on new construction --- a drop of 53% since 2000.)

This acceleration of depreciation brings up questions. If depreciation was kept at 90%, instead of 102.3% during the FiOS period, then the depreciation expense would have dropped $5.91 billion dollars. At 35% federal tax, that would mean an additional tax federal tax payment of $2.1 billion dollars during the FiOS period 2005-2011.

[32] There are some caveats to our analysis. "Wireline Revenues" is a catchall in the annual report for local, long distance, data and broadband services. So, without audits getting the exact amount of just 'revenue' tied to the exact amount of construction on FiOS, local service would require an actual audit.

18) How Many Audits of "Affiliates Transactions" and Expense Dumping Have There Been? There's only One that We Know of.

There's been only one audit that we are aware of that actually examined the dumping of affiliate and other expenses into the rate-base calculation and it was done by the California Public Utility Commission for the years 1997-1999.[33] (There were a host of others done in the early 1990's by NARUC, the National Association of Regulatory Utility Commissioners, but this is the only one we could find since the time of the alternative regulation plan.)

The audit found $1.94 billion in issues.[34]

> "In 1989 the California Public Utilities Commission (Commission or CPUC) adopted an incentive-based regulatory framework for Pacific Bell and Verizon California (at the time GTE California, Inc.). The New Regulatory Framework (NRF) incorporated financial incentives, streamlined regulation and safeguards for customers and shareholders. The Commission established a set of regulatory goals and linked the success of the NRF to its ability to obtain information of sufficient quality and depth to determine whether the goals were met. The Commission adopted a monitoring program intended to provide specific utility data and reports to assess progress in meeting its NRF regulatory goals.
>
> "The audit covered calendar years 1997 through 1999 and included reviews of Pacific Bell's compliance with CPUC accounting requirements, procedures to allocate costs between regulated and non-regulated activities, policies and rules for pricing transactions between Pacific Bell and its affiliated companies and NRF monitoring reports. This audit report focuses on Commission-prescribed regulatory accounting and is not intended to express any opinion on financial statements that Pacific Bell or its parent, SBC Communications, Inc. (SBC), filed with the Securities and Exchange Commission (SEC) or in annual shareholder reports.
>
> **"II. Overview of Audit Findings and Conclusions**
>
> "The audit of financial results identified 67 corrections to Pacific Bell's regulated operating revenues, expenses and rate base. Audit corrections to bring financial results into compliance with CPUC requirements increased the regulated intrastate net operating income that Pacific Bell reported during the audit period by $1.94 billion. This translates into recommended customer refunds under NRF earnings sharing rules of $349 million for

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33 "Regulatory Audit Of Pacific Bell For The Years 1997, 1998 And 1999", Executive Summary [Redacted Copy], California Public Utilities Commission, February 21, 2002

34 http://docs.cpuc.ca.gov/published/REPORT/13420.htm
We do not know the final outcome of these actions.

> the years 1997 and 1998. NRF earnings sharing rules were suspended by the CPUC effective in 1999. Customer refunds for 1999 would have totaled $457 million if the sharing rules had been effective. "

19) Final Punchline: Major Price Increases for Local Service and Ramming

To sum up, the state Commissions granted major rate increases in multiple states, e.g. Verizon, New York, because of the claims that they are losing money and losing phone lines. These losses appear to be caused, not through losing phone business as much as through the manipulation of line accounting as well as the movement of products and services out of the PSTN. These services are also dumping expenses into the local phone network accounting and at the same time not paying their fair back to the utility, which would lower rates.

The utility "basic" phone service has gone up 565%[35] since 1980 in New York City. I.e., if the customer kept the exact same basic local phone service, they'd be paying a great deal more. Almost every part of the service has been deregulated and therefore had massive price increases. However, because of faulty deregulation and the elimination of competition by the FCC, the price of local service has gone up 84% since 2005; inside wire maintenance is up 132%, and directory assistance up is 57%. We note that prices are supposed to be 'fair and reasonable' based on the Telecom Act of 1934 and state laws.

Here are the actual increases based on one Verizon, NY local phone customer 1980-2011. http://www.newnetworks.com/VerizonNY2011FIN.htm

"Ramming": Besides these increases, Verizon has been practicing ramming, where the customer is put on a product or service that they did not need, order, want or can even use. Our surveys and audits of small business customers show that it can cost $500-$1000.00 extra annually for just 2 lines. We estimate that 80% of customers have been rammed with one or more packages, costing customers $10-$15 billion annually nationwide.

To learn more about ramming and our upcoming ebook releases. http://www.teletruth.org/ramming.htm

Appendix 1
Verizon, New Jersey Affiliates, 2010
(Source: Verizon, New Jersey 4th Quarter, for the year 2010)

Verizon Business
Our operating revenues include transactions with Verizon Business associated with the provision of network access services, wholesale interconnection service agreements and from billing and collection services.

Our operating expenses also include transactions with Verizon Business. We recognize costs associated with interconnection agreements and capacity services agreements.

Verizon Internet Services Inc.
Our operating revenues include transactions with Verizon Internet Services Inc. (Verizon Internet Services) associated with the provision of network access and billing and collection services. These revenues are earned from Verizon Internet Services who utilizes our facilities to provide Internet access services to their customers.

ONLY IN NEW JERSEY: Beginning in 2004, we also recognize expenses associated with an arrangement with Verizon Internet Services for the provision of various centralized services associated with providing Internet access services to our customers. A portion of these costs are allocated to us based on our Internet services revenue.

Verizon Wireless Inc.
Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services and from interconnection agreements. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers.

Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services, paging services and for interconnection agreements.

Verizon Services
Our operating revenues and expenses include transactions with Verizon Services (including Verizon Services Corp., Verizon Services Group and Verizon Corporate Services Group Inc.) for the provision of local telephone service and for the rental of facilities and equipment.

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, treasury, and rent expenses associated with the rental of facilities and equipment. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

Verizon Long Distance
Our operating revenues include transactions with Verizon Long Distance who utilizes our facilities to provide long distance services to their customers. We record revenue in connection with the provision of billing and collection services, including programming charges associated with billing system changes.

Verizon Operating Telephone Companies
Our operating revenues include transactions with other Verizon Operating Telephone Companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment. We also earn revenue from fees associated with the termination of their customer's calls on our network.

Verizon Data Services Inc.
Verizon Data Services Inc. provides data processing services, software application development and maintenance, which generally benefits Verizon's operating telephone subsidiaries, including us. We are charged for these affiliated transactions based on proportional cost allocation methodologies.

Verizon Connected Solutions Inc.
Verizon Connected Solutions Inc. provides installation and maintenance services to our customers. We record these services at cost.

Other Affiliates
Other operating revenues include miscellaneous items of income resulting from transactions with other affiliates. These transactions include primarily the provision of local and network access services, and rental of facilities and equipment.

Verizon Network Funding Corp. and Verizon Financial Services LLC
We recognize interest expense and/or interest income in connection with contractual agreements with affiliated companies, Verizon Network Funding Corp. and Verizon Financial Services LLC, for the provision of short-term financing, short-term investing and cash management service.