

New Networks Institute

December 16th, 2015

VIA ECFS

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

Re: *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 and 97-21; *Special Access for Price Cap Local Exchange Carriers*, WC Docket. No. 05-25; *AT&T Corporation Petition/or Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates/or Interstate Special Access Services*, RM-10593; *Connect America Fund*, WC Docket No. 10-90; *AT&T Petition to Launch a Proceeding Concerning the TDM-to-IP Transition*, GN Docket No. 12-353, *Technology Transitions*, GN Docket No. 13-5; *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 15-191; *Policies and Rules Governing the Retirement of Copper Loops by Incumbent Local Exchange Carriers*, RM-11358.

And Re:

- *Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, WC Dkt. No. 15-247
- *Protecting and Promoting the Open Internet*, GN Docket No. 14-28
- *City of Wilson, North Carolina Petition for Preemption of North Carolina General Statute Sections 160A-340 et seq.*, WC Docket No. 14-115
- *The Electric Power Board of Chattanooga, Tennessee Petition for Preemption of a Portion of Tennessee Code Annotated Section 7-52-601*, WC Docket No 14-116
- *Petition of Granite Telecommunications, LLC for Declaratory Ruling Regarding the Separation, Combination, and Commingling of Section 271 Unbundled Network Elements*, WC Docket No. 15-114
- *Lifeline and Link Up Reform and Modernization*, WC Docket No. 11-42
- *Telecommunications Carriers Eligible for Universal Service Support*, WC Docket No. 09-197
- *Amendments to Part 4 of the Commission's Rules Concerning Disruptions to Communications*, PS Docket No. 15-80 and ET Docket No. 04-35
- *Implementation of Section 224 of the Act, WC Docket No. 07-245 and National Broadband Plan for Our Future*, GN Docket No. 09-51

New Networks Institute

And Re:

- *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements*, CC Docket Nos. 95-20, 98-10
- *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission’s Rules*, CC Docket No. 00-175
- *Notice of Inquiry Concerning a Review of the Equal Access and Nondiscrimination Petition of BellSouth Telecommunications, Inc. for Forbearance Under 47 U.S.C. § 160 from Enforcement of Certain of the Commission’s Cost Assignment Rules*, WC Docket No. 05-342
- *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s Cost Assignment Rules*, WC Docket No. 07-21
- *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s ARMIS Reporting Requirements*, WC Docket No. 07-139
- *Petition of Qwest Corporation for Forbearance from Enforcement of the Commission’s ARMIS and 492A Reporting Requirements Under 47 U.S.C. § 160(c); Petition of the Embarq Local Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of ARMIS Reporting Requirements; and Petition of Frontier and Citizens ILECs for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s ARMIS Reporting Requirements*, WC Docket No. 07-204
- *Petition of Verizon for Forbearance, 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s Recordkeeping and Reporting Requirements*, WC Docket No. 07-273
- *Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering*, WC Docket No. 08-190
- *Petition of United States Telecom Association for Waiver from Application of the Equal Access Scripting Requirement*, WC Docket No. 08-225
- *Petition of Cincinnati Bell Telephone Company LLC for Waiver from Application of the Equal Access Scripting Requirement*, WC Docket No. 09-206
- *Review of Wireline Competition Bureau Data Practices*, WC Docket No. 10-132
- *Petition of USTelecom for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain Legacy Telecommunications Regulations*, WC Docket No. 12-61

Dear Ms. Dortch:

New Networks Institute (“NNI”)¹ hereby submits, for inclusion in each of the above-captioned dockets, the attached documents:

¹ NNI, established in 1992, is now a consortium of independent communications-focused experts, analysts, auditors and lawyers. For more information and a brief bio of the signatories, see: <http://newnetworks.com/nniexperts/>.

Report 1: Verizon’s Manipulated Financial Accounting & the FCC’s “Big Freeze”

Report 2: Data Report on Verizon New York’s Financial Accounting

The reports detail Verizon New York’s ongoing cross-subsidization² of its lesser-regulated subsidiaries’ use of its wireline, mostly POTS, Plain Old Telephone Service, copper-based network, (sometimes referred to as the “PSTN”, “Public Switched Telephone Networks”). The reports show how this abuse of Verizon’s (ILEC)³ telephone customers was abetted by the FCC’s freeze of jurisdictional separations factors, beginning in 2001, where the FCC ‘froze’ the calculations of expenses, from network costs to corporate operations and advertising, to be based on the year 2000.⁴

This Freeze has allowed Verizon and others to create a manipulated, financial fiction—that the local service communications networks are unprofitable. In fact, our findings reveal that Verizon’s affiliate transactions a) charge local service a disproportionate amount of every expense; b) do not allocate a fair share of common costs to the subsidiaries, affiliates and their other lines of business; c) many of the affiliates’ products and services are not paying tariff or market-based prices to Verizon New York, thus artificially and improperly lowering regulated

² There is much confusion in, and over-use of, the term “subsidy” in telecommunications discussions, even by the FCC. See Faulhaber, G., “Cross Subsidization: Pricing in Public Enterprises,” *American Economic Review*, Vol. 65, No. 5 (Dec. 1975), at 966-977; see also 2002 update, <http://assets.wharton.upenn.edu/~faulhabe/cross%20subsidy%20analysis.pdf>. “Cross-subsidy,” as used here, includes the unfair allocation of network (joint and common) costs, as alleged for Verizon in a 2014 NNI paper, “It’s All Interconnected” (<http://newnetworks.com/wp-content/uploads/PublicNN3.pdf>).

³ ILEC, Incumbent local exchange company, is the term used to connote the state-based utility phone companies, who control the critical, wired communications infrastructure.

⁴ **NOTE:** We focus on Verizon New York because New York State has maintained a requirement that the incumbent telecommunications utilities, in this case Verizon New York, supply an extensive financial annual report based on the Uniform System of Accounts (USOA). This financial accounting information is identical to the data that had been collected by the FCC as part of the “**Automated Reporting Management Information System (ARMIS)**” data, provided in the FCC’s *Statistics of Common Carriers* (“SOCC”). Unfortunately, the FCC stopped requiring the phone companies to supply this information to the public in 2007.

revenues; with the result that d) these affiliate transactions lead to local service (and the ratepayers) ‘funding’ these non-core lines of business with the result that Verizon New York improperly and inaccurately “reports” massive financial losses in New York State.

These and other regulatory and accounting manipulations allowed Verizon New York to claim that all fiber optic deployments are being done as part of the “Title II”, common carrier, incumbent utility operations; and that the fiber deployment is an enhancement to the existing, telecommunications service network. Verizon’s FiOS services use Title II, common carriage, fiber optic wires, as do the services used by wireless carriers that go to the cell towers. But neither FiOS nor Verizon Wireless operations actually pay Verizon New York prices equal to those paid by unaffiliated carriers and providers for the same services. The affiliates get a discount funded by basic service ratepayers that is not available to competitors. These massive affiliate transaction-based cross-subsidies between regulated and lesser-regulated activities unfairly burden Verizon New York ratepayers and competitively harm those who seek to compete with FiOS and Verizon Wireless.

These machinations also demonstrate that Verizon has been able to ‘vertically integrate’ its products and services at the expense of all other competitors. And this is at the expense of all customers, because Verizon has inflated all prices to end users and competitors, but most of all local phone service. In New York, Verizon was able to get multiple rate increases for basic service – 84% – starting in 2006, based on the claim of artificial “losses” that were not actually or fairly attributable to actual expenses or investment incurred in offering the mostly copper-based basic service to ratepayers.

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Verizon is not the only incumbent local exchange company (“ILEC”) that has distorted its positions for its and its affiliates’ financial advantage; the last FCC data (2007) reveals that this is a nationwide problem, impacting every major incumbent (especially AT&T, Verizon, and CenturyLink) in every state.

The bottom line to our multi-year investigation, encapsulated in these first two reports (and the rest of the series that will be published in the near future) is that Verizon, AT&T and CenturyLink have been able to manipulate their accounting of revenues and expenses in ways that make their local service networks look unprofitable when that is simply not true.

This situation must be properly investigated and rectified. Any FCC or state proceeding that has relied on the phone companies’ claims that networks were unprofitable must now be reconsidered and opened for investigation. These reports are being filed in several open FCC proceedings, but each state commission should also take note and appropriate action.

This report is relevant to these dockets. For example:

- *AT&T Petition to Launch a Proceeding Concerning the TDM-to-IP Transition*, GN Docket No. 12-353
- *Technology Transitions*, GN Docket No. 13-5
- *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 15-191

The “transition” and “migration” have been based on the assumption that local service and the phone networks are “unprofitable” and therefore customers should be forced onto wireless or lesser-regulated IP-based networks in certain areas. The telephone companies would then be allowed to then “discontinue” legacy services and then “shut off the copper”.

However, current copper-based POTS service has been the source of massive subsidies for ILEC-owned wireless, broadband and video services.

- *Special Access for Price Cap Local Exchange Carriers*, WC Dkt. No. 05-25
- *AT&T Corporation Petition/or Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates/or Interstate Special Access Services*, RM-10593

The proper calculation of costs is crucial to the proper pricing of dedicated special access services used by businesses, competitors (and, although they are not now paying for it, the ILECs' affiliates).

Current profits to the ILEC have been rigged: The affiliates pay a fraction of the special access costs attributable to network (plant) and expenses that they use. At the same time, however, competitors appear to be paying several multiples of what Verizon New York's affiliates are paying for the same services. And, as noted, basic local phone customers pay a disproportionate amount of the expenses, including network costs that are properly attributable to, and should be recovered from, Verizon New York's affiliates.

- *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 and 97-21;
- *Connect America Fund*, WC Docket No. 10-90

Whether and where federal (and in some places state) universal service funding is truly needed to ensure that basic service is reasonably comparable to that enjoyed in urban areas, and that all areas have access to broadband service, depend crucially on the actual costs of those networks as currently used – not on costs based on outdated “frozen” allocations from 2000.

- *Policies and Rules Governing the Retirement of Copper Loops by Incumbent Local Exchange Carriers*, RM-11358

A copper loop that has exaggerated costs – especially since it has likely been neglected – is a logical target for retirement. And again, the Freeze has allowed these copper networks to appear to be unprofitable. Based on this, the affiliate companies and other lines of business have been able to claim that they are not profitable and then networks should not be upgraded or even maintained.

- *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286

The distortions caused by the fourteen-year freeze on separations should not be allowed to continue in the current network transition.

Erasing Basic Data Collection

- *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirement*, CC Docket Nos. 95-20, 98-10
- *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission’s Rules*, CC Docket No. 00-175
- *Notice of Inquiry Concerning a Review of the Equal Access and Nondiscrimination Petition of BellSouth Telecommunications, Inc. for Forbearance Under 47 U.S.C. § 160 from Enforcement of Certain of the Commission’s Cost Assignment Rules*, WC Docket No. 05-342
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- *Petition of Qwest Corporation for Forbearance from Enforcement of the Commission’s ARMIS and 492A Reporting Requirements Under 47 U.S.C. § 160(c); Petition of the Embarq Local Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of ARMIS Reporting Requirements; and Petition of Frontier and Citizens ILECs for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s ARMIS Reporting Requirements*, WC Docket No. 07-204
- *Petition of Verizon for Forbearance, 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission’s Recordkeeping and Reporting Requirements* WC Docket No. 07-273

- *Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering*, WC Docket No. 08-190
- *Petition of United States Telecom Association for Waiver from Application of the Equal Access Scripting Requirement*, WC Docket No. 08-225
- *Petition of Cincinnati Bell Telephone Company LLC for Waiver from Application of the Equal Access Scripting Requirement*, WC Docket No. 09-206
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The FCC's decision to forebear from using most accounting and reporting requirements for the incumbent utility phone companies and from requiring basic data reporting for ARMIS and the SOCC reports, on various topics, including separate accounting for affiliates, helped to create this accounting financial shell game.

According to the FCC⁵

“In 2008, the Commission issued a number of conditional forbearance orders that reduced both the number of ARMIS reports and, in those cases where forbearance did not extend to all data items within a report, the amount of ARMIS data that carriers filed. Among these, the Commission granted certain large carriers conditional forbearance from the obligation to file FCC ARMIS Report 43-01. In 2013, the Commission extended forbearance from the FCC ARMIS Report 43-01 reporting requirement to all price cap carriers with the same conditions as those imposed on the larger carriers.”

Take the manipulation of Access Line accounting. The FCC, today, cannot tell America how many copper lines are in service, much less how many special access lines there are. The FCC has found that Special Access is now a \$40 billion dollar market with 60% still mostly based on copper and TDM.

⁵ <https://www.fcc.gov/general/armis-data-descriptions-1>

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Moreover, Verizon and other ILECs claim massive access line losses. The accounting of lines, however, does not include the actual wires in service, even if they are still part of the PSTN, or are copper based. The erasing of basic data collection has aided in the freeze and allowed these machinations to occur over the last decade. The lack of objective information prejudices every discussion, from ‘shutting off the copper’, or the IP transition, to the costs of all services to competitors.

Bad data or no data has led to bad public policy decisions—including the continuation of the FCC’s Big Freeze.

NNI will likely submit the report in other dockets. And the remaining reports in this series will also be filed, as appropriate, when complete.

Respectfully submitted,

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Fixing Telecommunications documents can be found at:
<http://newnetworks.com/fixingtelecom/>

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