Fixing Telecommunications
Report 1: Verizon's Manipulated Financial Accounting & the FCC's Big "Freeze"

This is the first report in a new series, "Fixing Telecommunications". It is based on mostly public, but unexamined, information that exposes one of the largest financial accounting scandals in American history. It impacts all wireline and wireless phone, broadband, Internet and even cable TV/video services, and it continues today with impunity.

Verizon, AT&T, CenturyLink, and other large telephone companies have been able to manipulate their financial accounting to make the local phone networks and service look unprofitable and have used this 'fact' in many public policy and regulatory decisions that benefited the incumbent telecommunications utilities.

In NY State, Verizon used this excuse to raise rates multiple times, stopped deploying and upgrading the fiber optic-based wired networks fiber and even stopped maintaining the copper networks with the plan to shut off the copper and force customers onto wireless. This has left most cities with deployment gaps or no upgrades at all.

Worse, it also impacts the price for wireless services, as almost all mobile data, video or calls end up riding over a wire, known as 'special access'. These services are mostly controlled by Verizon, and in their own territories, AT&T and Centurylink (they do not compete among themselves for this business in any significant way).

Adding insult to injury, the losses were caused by the other Verizon lines of business dumping expenses into the state utility. Much of Verizon Wireless's fiber wires to the cell towers were paid for by local phone customer rate increases.

Finally, this impacts every aspect of the FCC's Internet Order, commonly known as Net Neutrality, which is now in court. The massive cross-subsidies between and among Verizon NY and Verizon's other subsidies have allowed the company to control the networks and services over them, including blocking competition —which caused Net Neutrality concerns in the first place.

The FCC's Big Freeze—15 Years of Regulatory Neglect

While there are multiple questionable acts, at the core, the fact is that the losses were created, in part, by the FCC, which sets the rules about the incumbent phone companies' accounting. Simply put:

- In 2001, the FCC "froze" the calculations of expenses that are used in every state, based on the year 2000 — and this freeze will continue until the year 2017.[1] It assigns the majority of all expenses to the local phone service category.
- **EXAMPLE**: In 2003, Verizon NY's Local Service brought in 65% of revenues and paid 65% of the "Corporate Operation" expenses. In 2014, Local Service generated

[1] The FCC's most recent order on this: http://apps.fcc.gov/ecfs/document/view?id=7521314401.

only 27.6% of revenues, about $1.4 billion, but it paid the majority of the "Corporate Operation" expense, over 60%, which came to $1.6 billion—making it unprofitable.

- This happened with every major expense area: Verizon NY's Local Service category paid 57% of all expenses, from network costs to advertising and marketing.
- **NOTE:** Local Service is mostly the copper-based, POTS, Plain Old Telephone Service and add-on features. There should be no 'advertising costs' or even major network costs for local service.
- **Kicking it down the road.** For the last 15 years there have been no audits and no examination by either state commissions or the FCC. This phrase, more or less, has appeared since 2001in FCC materials — "**until comprehensive reform could be achieved".**

Manipulation of the Counting of Access Lines

Verizon NY claims that there are only 2.7 million access lines in NY State. However, this is a subset of the total number of actual copper and fiber optic lines in service, especially business broadband and data lines known as special access. In 2007, the FCC's last accounting showed that basic phone lines represented only 17% of total Lines. We estimate that there could be over 65 million total access lines (and equivalent lines) in service in NY in 2015.

There are Many Impacts on Customers and Cities

Claiming that the wired networks are 'unprofitable', Verizon New York has been able to manipulate public policy and regulatory decisions in their favor.

- **Multiple Rate Increases**: Verizon local phone rates went up 84%, costing customers about $996.00 a line extra from 2006-2015; add-ons added $300-$600 per service.
- **No Upgrades**: Verizon stopped building out the fiber optic networks and left 900+ NY cities undone or incomplete, including New York City.
- **Pay No Income Tax**: Verizon NY did not pay state or federal income taxes for over a decade.
- Verizon NY Local Service was charged 60% of the corporate operations expenses, paying $1.6 billion — 109% of the total revenues of Local Service.
- **Massive Cross-Subsidies**: Verizon NY local phone customers paid the majority of the construction expenses, much of which funded other lines of business, such as wireless.
- **How much money are we talking about? Billions per year, per state**: In New York, Verizon's Local Service was over-expensed by $2.1 billion for 2014 alone. On a national basis, this over-expensing would be around $24 billion annually. This doesn't account for rate increases paid or otherwise inflated pricing or the other economic harms incurred.

At the FCC, this now puts every proceeding where Verizon or AT&T claimed that local service was unprofitable into question. From shutting off the copper networks, the "IP transition and migration", the building out of cities with fiber optics, the costs of all wired services, including local service, to the costs of special access services used by businesses, not to mention the costs and speed of wireless services (which rely on the wires) — are affected by these findings.

This is but one of a series of questionable state and federal acts that need to be corrected which will be examined in the series, 'Fixing Telecommunications'.

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