IRREGULATORS

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Comprehensive Review of the Part 32 Uniform System of Accounts	)	WC Docket No. 14-130
	)	
Jurisdictional Separations and Referral to the Federal-State Joint Board	)	CC Docket No. 80-286

COMMENTS by the IRREGULATORS

On April 17th, 2017, the IRREGULATORS filed comments with the FCC calling for the Agency to do audits and investigations of the FCC's "Big Freeze". The FCC's accounting rules were 'frozen' so that the expenses are allocated to different services based on the year 2000, 17 years ago. This 'freeze' has created massive financial cross-subsidies, making local phone customers pay the majority of expenses for all services, from the capital expenditures for the wireless companies, to Broadband Data Services (BDS). Auditing the impacts of the 'freeze' is important because it documents that the FCC has been negligent and is creating new public policies without accurate financial data.

With those comments we submitted a series of reports written by experts, forensic auditors and lawyers. This included "The Hartman Memorandum", which was written with the assistance of a former FCC Assistant Chief of the Pricing Policy Division (PPD) who was also a member of the Federal-State Joint Board and a specialist in the cost allocation rules.

The Reports were ignored, and the comments made by the FCC about the work lacked sense as the FCC never dealt with any of the specific findings outlined in the reports or comments.[1] Instead, the FCC decided to continue the freeze for an additional 18 months. This appears to be nothing but a cover-up to remove all of the accounting rules without any analysis, audits or investigations. However, it will immortalize the financial cross-subsidies that benefit the incumbent phone companies, especially AT&T, Verizon and CenturyLink.

We recognize that the Commission has chosen to deregulate the so-called Price Cap Carriers such that to the limited extent that they are subject to rate regulation, it is via a price cap mechanism, not the traditional Uniform System of Accounts. Hence only the Rate of Return Carriers are directly subject to the separations mechanism for the computation of their interstate rates. However, even in the case of the Price Cap Carriers, Separations is a joint federal-state matter, and the freeze imposed by the Commission directly impacted state rates and, even more importantly, policies. Fictitious accounting leads to bad decision-making.

[1] See FCC 17-55 (May 15, 2017), ¶ 12.

Hence the costs of more accurate separations are not an undue burden. Rate of Return Carriers already are required to provide detailed regulatory accounting in order to determine their appropriate rate and subsidization levels. Price Cap Carriers, especially the Bells (including their successors-in-interest) are large companies with ample accounting resources. Thus, the issues we raise are not moot, even when dealing with the largest carriers.

The Federal-State Joint Board has asked:

- Re: Federal-State Joint Board on Jurisdictional Separations Seeks to Refresh Record on Issues Related to Jurisdictional Separations, FCC 17J-1
- Re: Federal-State Joint Board on Separations Seeks Comment on Referral for Recommendations of Rule Changes to Part 36 as a Result of Commission Revisions to Part 32 Accounting Rules, FCC 17J-2

To protect the Public Interest, the Joint Board must act – and stop the FCC's plans from erasing the accounting rules, but instead implement a fix that stops the massive cross-subsidies that have been put into place and benefit the companies and their affiliates over the Public Interest.

The Freeze and the FCC's accounting rules have distorted every aspect of telecom. From the proceeding to 'shut off the copper', where the FCC has neglected to mention that the wires are part of the state utility or that the networks are 'unprofitable' through a manipulation of the accounting of expenses, to the Business Data Services (special access) proceeding, where the FCC never acknowledges, again, that the wires are part of the state utility or that the services are paying a fraction of common costs because of the FCC's freeze of the cost allocation rules. There has been no serious oversight for 16 years and the FCC has created a financial shell game that has gone hidden from view, but is making severely flawed and harmful public policies.

And there are other 'freezes' that are even more disturbing, such as the 75-25% rule: The Hartman Memorandum details how the FCC has never examined or fixed the 75-25% rule—which assigns 75% of much of the network expenses to "intrastate", and this has been a rule since the dawn of the Digital Age.

In toto, all of these financial machinations make the local networks appear unprofitable, when they are not. They have made local phone customers defacto investors in the companies' interstate and nonregulated businesses, which was not supposed to occur. And worse, through manipulations of the access line accounting, though the FCC wants to 'shut off the copper', it can't tell America exactly how many total copper wires are used for services that are not being counted—everything from DSL and VOIP services to special access ATM and alarm services, or even the wires used by AT&T for its copper-to-the-home service, U-verse.

We are also concerned by recent comments of Chairman Pai during an interview with Re/Code, May 5th 2017, where he specifically singles out Part 32. He had asked his staff

"When was the last time you looked at these (Part 32) reports?" They replied, "Pretty much, never". The Joint Board must examine whether the FCC failed to properly review and analyze all of the implications of eliminating the Uniform System of Accounting (USOA) before the Agency's action on February 23, 2017.

As if in some rush, now, the FCC wants to simply erase the rules as if they were a serious burden, and to keep the cross-subsidies in place, which will have no financial audit trail to follow. Considering that the companies have to prepare annual taxes and that with billions of dollars in revenues per state and expenses that are itemized, the only burden has been on communications customers and the economic growth of America.

We refresh this record, again, with "Fixing Telecom", a report series done as an independent voice, without corporate or political financing, because sometimes the Public should come first.

- Report 5: The Hartman Memorandum[2]
- Report 6: The History & Rules of Setting Phone Rates in America —The FCC's 'Big Freeze' & Cross Subsidies[3]
- Report 1: Executive Summary: Verizon's Manipulated Financial Accounting & the FCC's Big "Freeze"[4]
- Report 2: Full Data Report[5]
- Report 3: SPECIAL REPORT: How Municipalities and the States can Fund Fiber Optic Wireline and Wireless Broadband Networks.[6]
- REPORT 4: Data Report Proving Verizon's Wireline Networks Diverted Capex for Wireless Deployments Instead of Wiring Municipalities, and Charged Local Phone Customers for It.[7]

FILINGS:

- Letter to the FCC for an Investigation of Cross Subsidies as detailed in the Hartman Memorandum.[8]
- FCC Filings: Cover Letter. On December 16th, 2015, we filed the first reports in 31 separate FCC proceedings[9]
- FCC List of FCC Proceedings in which reports were filed[10]
- Joint Filings with Consumer Federation of America in the Special Access, (Business Data Services) proceeding[11]

[2] http://newnetworks.com/hartmanmemorandum/
[3] http://newnetworks.com/hartmanhistory/
[4] http://newnetworks.com/report1executivesummary/
[5] http://newnetworks.com/report2data/
[6] http://newnetworks.com/muniwireless/
[7] http://newnetworks.com/report2datawirelinewireless/
[8] http://newnetworks.com/fccletterhartman/
[9] http://newnetworks.com/fcccoverletter/
[10] http://newnetworks.com/listfccfilings/
[11] http://newnetworks.com/nnicfacomments/

Discussion Section: We have added a separate section to summarize and discuss the impacts of the Big Freeze, the mal-formed cost allocation rules, and why investigations and audits are an imperative, as compared to the FCC's current plans to cover up and immortalize the financial shell game in place today.

With Respect,

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May 24th, 2017

IRREGULATOR Team

In April 2017, a new group called the "IRREGULATORS" was formed. The core of the IRREGULATORS is an independent consortium of retired and semi - retired telecom experts, analysts, policy wonks, forensic auditors, and lawyers who are former senior staffers from the FCC, state advocate and Attorneys General Office experts and lawyers, as well as former telco staff and consultants. Members of the group have been working together, in different configurations, since 1999.

Some of the documents and comments were submitted by New Networks Institute. Established in 1992, NNI has been a consortium of independent communications -focused experts, analysts, auditors and lawyers over the last 5 years.

Discussion

- **Removing Accounting Rules without Investigation**

Chairman Pai's agenda as told by an interview with Re/Code, May 5th, 2017, is to use a weed-whacker to remove the accounting rules.[12]

> **"Re/Code:** "In the early days, you had said that you wanted to take a weed-whacker to remove the rules that are holding back investment. What did you mean by that?
>
> "What I had in mind were some of the regulations that we've had on the books for a while that stand in the way of investment in networks. **Our Part 32 accounting rules — exceedingly boring, I recognize — but just the fact that companies have to maintain two different sets of books, literally one for their business and one for the FCC's purposes, and the FCC hadn't relied on any of that paperwork in years. I asked our staff, "When was the last time you looked at these reports?" They said, "Pretty much never."** We wanted to relieve some of those. Those are the kinds of regulations I had in mind because I want every dollar that a company has to be spent on building out networks, not on paperwork or regulatory requirements that aren't relevant in 2017, whatever relevance they might've had back in 1934 or 1996 or 2015 or whatever." (Emphasis added.)

The FCC has just eliminated the Part 32 rules claiming that they are not relevant, that it is a burden to compile for the companies and that getting rid of these regulations will save money to add to the network investments. Elsewhere, the FCC's press release of February 23, 2017 claims that the Part 32 rules are a burden. [13] "Reducing the cost and burden of these FCC rules will allow carriers to allocate scarce resources toward expanding modern networks that bring economic opportunity, job creation and civic engagement to all Americans." And the FCC states that "This can be costly, requiring additional training for accountants, a second set of customized software, and two sets of audits."

Before we go through the actual accounting, we note that the "scarce resources", the job creation and the burden of keeping financial books is contradicted by Verizon, which filed on March 7th, 2017 to request an extension for submitting the Verizon NY Annual Report for 2016 to the New York Public Service Commission (NYPSC), that was originally due on

[12] https://www.recode.net/2017/5/5/15560150/transcript-fcc-chairman-ajit-pai-net-neutrality-merger-recode-decode
[13] https://apps.fcc.gov/edocs_public/attachmatch/DOC-343610A1.txt

March 31, 2017,[14] Verizon writes that there are only three individuals (with support from some other personnel) that do this work as well as a great deal of other work in NY and other states.

> "Verizon's regulatory reporting team is comprised of three individuals who, together with their manager and a system administrator, have responsibility for preparing, reviewing, and filing over 300 reports annually, in New York and in other states. Well over half of those reports are due at the beginning of the year — between January 1 and April 15. None of the financial data that provides the basis for the reports is available until January 21 at the earliest. Thus, over half of the group's annual workload is compressed into less than a quarter of the year."

Verizon has about 161,000 employees, so this burden requires some 'burden of proof'. The idea that the companies do not keep track of all of these financial details, especially when they have requirements to pay state and federal taxes, is simply ludicrous. As we will see, Verizon NY had revenues of over $5 billion in 2014 – and getting all of the documentation for tax purposes alone would require the majority of the data collection needed to fulfill the cost accounting rules in place.

Moreover, the accounting rules, including Part 32, do not stand in the way of investments. The combined rules actually have been gamed by the companies, thanks to the FCC's freeze, turning local phone customers into defacto investors. The removal of the rules would then immortalize the cross-subsidies that have formed over the last 16 years of neglect.

- **The FCC's Cost Accounting Rules Created Phone Customer Harms**

Before we go into how the harms were created over this period, here is a snapshot of just how out of control the accounting rules have become.

This is an excerpt taken directly from the Verizon NY Annual Report for 2014 that was submitted to the NY Public Service Commission. It shows the dramatic harms that have been created by the FCC's mal-formed cost accounting rules (that are federal in scope).[15]

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[14] http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={6E27D36C-78A9-4EDD-A340-4388987912F6}

[15] These reports are based on the Part 32, the Uniform System of Accounting, and Part 36, which allocates the expenses to the different lines of business. There is also Part 64 which allocates the expenses for 'nonregulated' services. The information in this report was previously required to be submitted by the FCC until 2007 known as ARMIS data that the FCC discontinued.

Verizon NY Annual Report 2014

	A	B	C	D	E
	Item	Total	Nonregulated	Local Service (Intrastate)	Access (Interstate)
	Operating Revenues				
1	Total Operating Revenues	$ 5,230,477,636	$ 1,431,325,888	$ 1,441,591,799	$ 2,357,559,949
2	***Percent of Revenue***		**27%**	**28%**	**45%**
3					
4	**Operating Expenses**				
5	Plant Specific	$ 2,535,841,259	$ 891,518,508	$ 1,090,578,464	$ 553,744,287
6	Plant Non-specific	$ 763,914,646	$ 94,188,950	$ 435,844,274	$ 233,881,422
7	Marketing	$ 342,016,769	$ 76,972,507	$ 179,995,472	$ 85,048,790
8	Customer Operations Services	$ 405,002,246	$ 30,895,045	$ 275,329,437	$ 98,777,763
9	Access	$ 98,098,706	$ -	$ 47,074,037	$ 51,024,668
10	Corporate Operations	$ 2,604,155,474	$ 264,678,550	$ 1,572,288,568	$ 767,188,356
11	Subtotal	$ 6,749,029,100	$ 1,358,253,560	$ 3,601,110,252	$ 1,789,665,287
12	Depreciation & Amortization	$ 1,061,243,296	$ 63,754,349	$ 655,763,997	$ 341,724,951
13	Total Operating Expenses	$ 7,810,272,396	$ 1,422,007,909	$ 4,256,874,249	$ 2,131,390,238
14	***Percent of Expenses***		**18%**	**55%**	**27%**
15	Net Operating Revenues	$ (2,579,794,760)	$ 9,317,979	$ (2,815,282,450)	$ 226,169,711
16					
17	Operating Taxes				
18	Total Operating Taxes	$ (821,119,363)	$ 12,328,712	$ (865,401,573)	$ 31,953,498
19	Net Operating Income*	$ (1,717,684,403)	$ (3,027,385)	$ (1,923,842,326)	$ 209,185,308

The state utility has three primary financial buckets:

- **"Local Service"** — (sometimes referred to as "State" or "Intrastate") — This is mostly regular "POTS", Plain Old Telephone Service phone service.
- "**Network & Special Access"** (sometimes referred to as "Federal" or "Interstate" or just "Access") — These are the fees paid by companies and competitors to use the networks.
- "**Nonregulated"** — can be formerly regulated telecommunications services that are deregulated but related to local service, or other services that were never regulated. This can include DSL or FiOS revenues.

There are revenues not on the state utility books. However, most of the expenses are included in the state utility financial budgets.

- "**Black Hole" Revenues** — the fourth category, are additional revenues we uncovered that appeared in one set of financial books, Verizon NY's SEC-filed annual reports, but are left out of the state-based Verizon NY annual reports filed with the NY Public Service Commission.
- **"Verizon Subsidiaries"** — Verizon's other divisions/companies include Verizon Online, which handles the Internet service and equipment, Verizon Business, Verizon Wireless and Verizon Long Distance, for example.

NOTE: Other reports in the report series address the revenues, 'Black Hole', and subsidiaries in detail.[16]

Revenue: Line 1 and 2 show that:

- Verizon NY, the state utility, had $5.2 billion dollars of revenues in 2014 with Nonregulated service accounting for 27%, Local Service (intrastate) being 28% and Interstate (which includes the FCC Subscriber Line Charge and Business Data Services, including the mostly copper-based DS1 and DS3 services) representing 45%, about $2.4 billion dollars.

Note:

- These are all the 'wired', Title II, common carriage networks, that include broadband.
- These revenues do not include the IP services nor the wireless services or the online ISP services, which are in separate subsidiaries.

Expenses:

- The expenses as created by Part 36, have allowed massive financial cross-subsidies of the companies other lines of business.

- **Overall, 55% of all expenses ended up in the 'Intrastate' part of the business and the 'Interstate' and 'Nonregulated' services do not pay their fair share of the expenses.**

Verizon New York Revenues and Expenses by Category, 2014

			Local Service	Access
Item	**Total**	**Nonregulated**	**(Intrastate)**	**(Interstate)**
Total Operating Revenues	$ 5,230,477,636	$1,431,325,888	$ 1,441,591,799	$ 2,357,559,949
Percent of Revenue		**27%**	**28%**	**45%**
Total Operating Expenses	$ 7,810,272,396	$1,422,007,909	$ 4,256,874,249	$ 2,131,390,238
Percent of Expenses		**18%**	**55%**	**27%**
Net Operating Revenues	$(2,579,794,760)	$ 9,317,979	$(2,815,282,450)	$ 226,169,711

- While Local Service brought in 28% of the revenues, it paid 55% of the expenses.
- At the same time, Access services were $2.4 billion in revenues but paid only 27% of the total expenses.
- Nonregulated had about the same revenues as Local Service but it paid only 18% of the expenses.

[16] Report 1: Executive Summary: Verizon's Manipulated Financial Accounting & the FCC's Big "Freeze", Report 2: Full Data Report

And, Verizon NY lost $2.6 billion in just 2014 on paper, with Local Service claiming a whopping $2.8 billion in supposed losses. Access services and Nonregulated were profitable, even though they are using the same utility networks.

- **In every category, Local Service (Intrastate) paid the bulk of the expenses, even though the expenses are not generated by Local Service and more importantly, the other lines of business are being cross-subsidized.**

[5]

Nonregulated services and the 'Interstate' services are not paying their full common costs yet are the 'cost causer' of much of these expenses – violating multiple Telecom Act regulations as well as violating multiple state laws.

Verizon NY, 2014, Expenses Paid by Category as a Percentage of the Total
(Rounding Used)

Item	Nonregulated	Local Service (Intrastate)	Access (Interstate)
Construction & Maintenance	**24%**	**50%**	**26%**
Marketing	23%	53%	25%
Customer Operations Services	8%	68%	24%
Corporate Operations	10%	60%	29%

- "Local Service" is paying the majority of all expenses, which is ridiculous. Why is Local Service paying 50% of the construction and maintenance when Verizon has specifically stated that it is not upgrading or maintaining the copper wires?
- How can POTS, Plain Old Telephone Service, be paying 53% of the Marketing expense? When was the last time you saw an ad for a copper-based phone line?
- The kicker is: Local Service is paying the majority, 60%, of Corporate Operations.

In contrast:

- **Nonregulated** services, including some of the revenues from the FiOS services, had the same revenues as Local Service but it is paying 1/6th of the Corporate Operations expense and ½ of the Marketing expenses that Local Service is paying; it is also paying ½ of the construction expenses.

- **Access (Interstate**), of which 80% are BDS services, had the majority of revenues, but it is paying ½ of what Local Service is paying for CapEx.

To sum up, Local Service was about one-quarter of the revenues but paid the majority of the expenses.

- **Verizon New York Local Service has had multiple rate increases – 84%, starting in 2006, to pay for "massive deployment of fiber optics" and losses.**

In New York, Verizon was granted three rate increases back to back; the 3rd occurred in June 2009. Verizon filed a 2-page letter, with attachments for the increase — that's it.[17] In the discussion, Verizon characterizes the FiOS build out as "an advanced voice/video/data network". And most important, Verizon does not mention it is losing money but quotes the NYPSC that addresses Verizon's financials.

Excerpt from Verizon's request for a rate increase:[18]

> This price increase will generate needed additional short-term revenues for Verizon, as the company faces the dual financial pressures created by competitive access line losses and the costs of building out an advanced voice/video/data network in the State. As the Commission has noted, Verizon's financial condition is "relevant" when the Commission considers pricing changes because "the state has an interest in a viable company. This is especially important given the magnitude of the company's capital investment program, including its massive deployment of fiber." "There seems to be little question that the company is in need of financial relief; Verizon [New York] 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%."[3] For 2007, Verizon reported an overall intrastate return of negative 6.24% and an intrastate return on common equity of negative 46.0%.

The State's analysis is scary because it, too, has ignored the actual cost causers of making Local Service unprofitable and granted increases, where the actual expenses had nothing to do with Local Service provisioning. In fact, this shows that local phone customers had rate increases to pay for fiber optic broadband.

And there is a caveat to how this played out. In 2005, the NYPSC granted Verizon these rate increases for FTTP, fiber to the premises, as Verizon claimed that the networks were Title II, common carrier services that were nothing more than an upgrade of the existing state utility.

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[17] http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={8AD98EB0-80A2-420C-9CFD-ED6E011E9CBB}
[18] Ibid.

On June 15, 2005, the New York Public Service Commission ("NY PSC") "declared that Verizon NY's FTTP upgrade is authorized under its existing state telephone rights because the upgrade furthers the deployment of telecommunications and broadband services, and is consistent with state and federal law and in the public interest." The NY PSC determined that, unlike a company seeking to build an unfranchised cable television system, Verizon NY already has the necessary authority to use the rights-of-way to provide telecommunications service over its existing network. *See* Declaratory Ruling on Verizon Communication, Inc.'s Built-Out of its Fiber to the Premises Network, NY Public Service Commission, Case 05-M-0520/05-M-0247, June 15, 2005 at 4.

As more fully described in Exhibit 1, Verizon NY maintains that it is constructing its FTTP network pursuant to its authority as a common carrier under Title II of the Communications Act of 1934, as amended, and Section 27 of the New York Transportation Corporations Law. For this reason and others, certain terms and conditions may differ between the incumbent cable provider's franchise and Verizon NY's franchise.

This happened in at least every Verizon state. And this directly contradicts the FCC's statements elsewhere that getting rid of Title II increases investment when these networks are all Title II.

- **Verizon New York: Local Service Was Overcharged $1.7 Billion in Just 2014**

Verizon NY's expenses do not track with the actual cost-causing activities or even track to the revenues.

If Local Service was paying expenses based on the revenues it brought in, then Local Service was overcharged $1.7 billion – in just New York, in just 2014. Conversely, Access (BDS) services underpaid by $1.3 billion in expenses while Nonregulated was undercharged $438 million.

Verizon New York: if Expenses Were Based on Revenues, 2014

		Local Service	Access
Should Be Paying	**Nonregulated**	**(Intrastate)**	**(Interstate)**
Networks	$ 890,934,094	$ 923,931,653	$ 1,484,890,157
Marketing	$ 92,344,528	$ 95,764,695	$ 153,907,546
Customer Operations	$ 109,350,606	$ 113,400,629	$ 182,251,011
Corporate Operations	$ 703,121,978	$ 729,163,533	$ 1,171,869,963
		Local Service	**Access**
Over And Undercharged	**Nonregulated**	**(Intrastate)**	**(Interstate)**
Networks	$ 94,773,363	$ 602,491,084	$ (697,264,447)
Marketing	$ (15,372,020)	$ 84,230,777	$ (68,858,757)
Customer Operations	$ (78,455,561)	$ 161,928,808	$ (83,473,247)
Corporate Operations	$(438,443,428)	$ 843,125,035	$ (404,681,607)
Overcharged and Under	$(437,497,646)	$ 1,691,775,705	$ (1,254,278,058)

But, this analysis leaves out a critical point – Local Service should not be paying most of the Marketing or for the ‘massive deployment of fiber optics’.

- **The FCC’s Freeze Caused this Massive Cross-Subsidy Scheme.**

Why is Local Service paying 60% of the Corporate Operations expense? In 2014, Local Service paid $1.6 billion of this expense, but it only brought in $1.4 billion – causing Local Service to look unprofitable.

For just Corporate Operations, Verizon New York’s Local Service was overcharged $843 million dollars in just 2014, based on revenues. At the same time, Special Access services underpaid by $405 million dollars.—Why?

The FCC simply wants to dismantle this entire accounting and has punted to fix these problems. Yet, the FCC’s own accounting rules are responsible for this shell game and dismantling or erasing the rules will simply result in a permanent freeze on the cross-subsidies.

- **How the Financial Shell Game has been Played.**

Let’s examine one aspect of the losses — dumping the majority of “Corporate Operations” expenses into “Local Service”. This is an excerpt that appeared in the Verizon New York SEC financial report, as well as the other Verizon state financial reports, for the year 2010.

And, it is important to remember that Verizon New York was able to get multiple rate increases for basic residential phone service over the last decade based on ‘massive deployment of fiber optics’ and ‘losses’; Corporate Operations expenses are included in the calculation of ‘losses’.

Verizon Services, as told by the Verizon NY SEC 4th Quarter Filing, 2010

Verizon Services

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.

(Almost identical language appeared in every Verizon state-based SEC report for the year 2010, from Massachusetts down through Virginia; it was even in the SEC-filed reports for the former GTE territories — California, Texas and Florida, (which were sold off)).

There are also FCC rules and definitions of what constitutes the ‘corporate operations’ expense that are more extensive and show that almost any expense can end up in this expense line item. For example, the following list shows that the monies are going to ‘maintain relationships' with the public et al., and that can include public relations, or dealing with new or existing legislation. (And notice that there are other financial buckets of money at play here that also show up on state utility books.)

Corporate Operations Expense as defined by the FCC Rules[19]

> "(d) Maintaining relations with government, regulators, other companies and the general public. This includes:
> (1) Reviewing existing or pending legislation (see also Account 7300, Nonoperating income and expense, for lobbying expenses);
> (2) Preparing and presenting information for regulatory purposes, including tariff and service cost filings, obtaining radio licenses and construction permits;
> (3) Performing public relations and non-product-related corporate image advertising activities;

Corporate Operations expense could include the lawyers and lobbyists who defend the company's position to defeat Net Neutrality or the privacy laws or to push through harmful deregulation on the state level. Thus, customers are paying Verizon to defeat initiatives that can harm them or cost them more money.

- **Corporate Operations: Verizon Services**

"Verizon Services" is an umbrella for the corporate-expense fund that ends up in the accounting of the state utility.

This exhibit is a partial collection of affiliate companies that were included in a list of the 'affiliate transactions' where Verizon New York "purchased (services) from affiliates". Unfortunately, there are no descriptions of these companies in the financial books or any coherent description anywhere else online, so some of these may, in fact, not be part of the corporation operations expense.

Verizon NY Purchased Services from Selected Verizon Affiliate Companies, 2014

Vz=Verizon		Amount Paid
Vz Corporate Services Corp	Purchased from Affiliates	$ 468,671,411
Vz Corporate Services Group	Purchased from Affiliates	$ 148,001,498
Vz Corporate Resources Group	Purchased from Affiliates	$ 168,971,552
Vz Select Services Inc	Purchased from Affiliates	$ 1,382,945
Vz Services Corp	Purchased from Affiliates	$1,488,388,751
Vz Services Operations Inc	Purchased from Affiliates	$ 9,908,329
Vz Services Organization Inc	Purchased from Affiliates	$ 107,994,523

[19] In the Annual Report it is referred to as Corporate Operations Expense, on the FCC rules it is under General and Administrative -- http://www.hallikainen.org/FCC/FccRules/2014/32/6720/index.php

- **How Does It All Play Out in Verizon New York's Accounting?**

Verizon NY Revenues and Corporate Operations Expense, 2003-2014

2003	Total	Nonregulated	Local Service	Access
Total Revenues	$ 7,148,203,639	$ 219,748,000	$ 4,666,839,000	$ 2,230,978,000
% of Revenues		3%	65%	31%
Corporate	$ 1,921,045,187	$ 131,435,000	$ 1,249,051,000	$ 537,299,000
% of Corporate		7%	65%	28%
2010	**Total**	**Nonregulated**	**Local Service**	**Access**
Total Revenues	$4,982,344,773	$657,117,766	$2,198,098,276	$2,127,128,731
% of Revenues		13%	44%	43%
Corporate	$996,443,439	$101,275,522	$605,665,165	$289,502,751
% of Corporate		10%	61%	29%
2014	**Total**	**Nonregulated**	**Local Service**	**Access**
Total Revenues	$5,230,477,636	$1,431,325,888	$1,441,591,799	$2,357,559,949
% of Revenues		27%	27.6%	45%
Corporate	$2,604,155,474	$264,678,550	$1,572,288,568	$767,188,356
% of Corporate		10%	60%	29%

Sources: Verizon New York, New Networks Institute

In 2003, Local Service represented 65% of the revenues and it paid 65% of Corporate Operations. By 2014, Local Service represented 27.6% of Verizon New York's revenues but paid 60% of corporate expenses — $1.57 billion.

When examining the minutia of this category one is struck by what has been dumped into the state utility books. This excerpt from the 2014 Verizon New York Annual Report includes executive pay, legal, regulatory and a host of other large categories, such as "Other General & Administrative". Local Service was charged 60% of this expense.

Verizon NY Corporate Operations Expenses, 2014

VERIZON NY CORPORATE EXPENSES, 2014			This Year Total (e)
		Corporate Operations Expense	
		Executive and Planning	
80	6711	Executive	24,834,054
81	6712	Planning	1,450,839
82	6710	Executive and Planning	26,284,893
		General & Administrative	
83	6721	Accounting & Finance	40,799,397
84	6722	External Relations	6,960,031
85	6723	Human Resources	35,726,684
86	6724	Information Management	206,345,037
87	6725	Legal	21,582,152
88	6726	Procurement	4,836,026
89	6727	Research and Development	(1,353)
90	6728	Other General & Administrative	2,261,622,605
91	6720	General & Administrative	2,577,870,580
92	6790	Provision for Uncollectible Notes Receivable	0
93		Total Corporate Operations Expenses	2,604,155,474

Sources; Verizon NY Annual Report, 2014, New Networks Institute

- **The Stark Pattern of the "Freeze"**

To show the stark pattern of freezing the expenses for each year, regardless of the change in revenues, this next exhibit details the year 2003 and then for 6 years, from 2009 through 2014. The pattern remains almost identical, plus or minus a few percentage points. In 2003, Nonregulated paid 8.6% of this expense, Local Service paid 69% and Access was 22%, and each following year kept this ratio pretty much intact.

Customer Operations Service Expenses by Financial Buckets, 2003-2014

	Expense by Bucket	Nonregulated	Local Service	Access
2003	**Customer Operations Services**	8.6%	69.4%	22.0%
2009	**Customer Operations Services**	7.3%	69.3%	23.4%
2010	**Customer Operations Services**	8.6%	68.6%	22.7%
2011	**Customer Operations Services**	8.3%	70.9%	20.8%
2012	**Customer Operations Services**	8.3%	70.3%	21.4%
2013	**Customer Operations Services**	7.6%	68.8%	23.6%
2014	**Customer Operations Services**	7.6%	68.0%	24.4%

Sources; Verizon NY Annual Reports, New Networks Institute

And all major expense categories we examined had the same mathematical patterning, where Local Service paid most of the expenses and the other financial buckets paid considerably less. This is "Marketing".

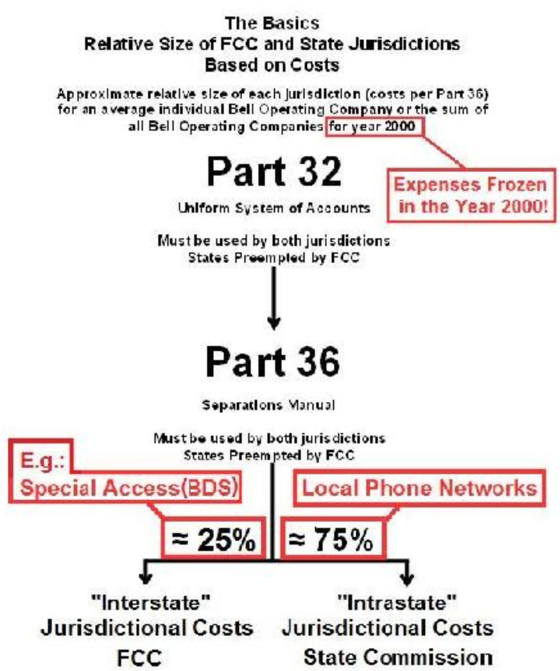
Marketing Expenses by Year by Local, Access & Nonregulated Buckets, 2003-2014

		Nonregulated	Local	Access
2003	**Marketing**	5.8%	68.2%	26.0%
2009	**Marketing**	25.4%	53.4%	21.2%
2010	**Marketing**	22.7%	56.2%	21.0%
2011	**Marketing**	24.7%	53.9%	21.4%
2012	**Marketing**	26.0%	53.7%	20.3%
2013	**Marketing**	23.0%	53.9%	23.1%
2014	**Marketing**	22.5%	52.6%	24.9%

Sources; Verizon NY Annual Reports, New Networks Institute

- **The Hartman Memorandum**

This Memorandum supplies a very detailed analysis of the Part 32 and Part 36 rules and how they have been corrupted over the last 15 years. It is accompanied by a separate report **"The History & Rules of Setting Phone Rates in America**".[20]



- **75-25% Rule**

One of the most disturbing things covered by the Hartman Memorandum is the fact that the FCC never examined or fixed the 75-25% rule—which assigns 75% of much of the network expenses to "intrastate", and this has been a rule since the dawn of the Digital Age.

[20] http://newnetworks.com/hartmanhistory/

Comments filed by SureWest Communications filed on April 18, 2011 detailed the rule's origins.[21]

> "Subscriber Plant Factor Reform: Sections 36.154(a) through (c) of the Commission's rules set forth procedures for allocating loop costs between the state and interstate jurisdictions. Prior to 1982, loop costs were allocated using a traffic sensitive interstate allocation factor known as the subscriber plant factor ("SPF").[22] By the early 1980's, increases in relative interstate usage caused carriers' interstate subscriber plant factors to escalate rapidly, reaching the maximum interstate cost allocation of 85 percent for some carriers. **As a result, the Commission, in consultation with the Federal-State Joint Board,[23] instituted a flat-rate 25 percent interstate allocation factor to be phased in during an eight-year transition period, 1986 to 1993.[24]** Concurrent with the institution of the new SPF transition period, the Commission established the universal service fund allowing ILECs with high local loop costs to allocate an additional portion of those costs to the interstate jurisdiction.[25] The universal service fund was phased in during the same eight-year transition period as the new subscriber plant factor. In order to ensure that a carrier's interstate cost allocation would not drop precipitously during the transition, the rules specified that the combined interstate factor determined by considering the interstate subscriber plant factor and the universal service amount, would decrease by no more than five percent in any

[21] *In the Matter of Connect America Fund,* WC Docket No. 10-90; *A National Broadband Plan for Our Future,* GN Docket No. 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135; *High Cost Universal Service Support*, WC Docket 05-337; *Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92; *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45; *Lifeline and Link Up* , WC Docket No. 03-109.

[22] See, 47 C.F.R. Part 67 (1980). The subscriber plant factors were determined by weighting toll minutes of use by factors greater than 1.0, weighting local minutes of use by 1.0, and determining the relative state and interstate proportions. Regardless of the relative proportions determined in this way, the rules limited the interstate subscriber plant factors to a maximum of 85 percent.

[23] See, 47 U.S.C. § 410; *Amendment of Part 67*, Notice of Proposed Rulemaking and Order Establishing a Joint Board, 78 FCC 2d 837 (1980).

[24] See, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, 89 FCC 2d 1 (1982) (adopting Joint Board's recommendation to freeze the subscriber plant factor at 1981 levels); Decision and Order, 96 FCC 2d 781 (1984) (adopting Joint Board's recommendation to establish a fixed 25 percent interstate allocation factor); *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order*, 50 Fed. Reg. 939 (1985) (revising the transition period to eight years with a limit of five percentage points reduction per year).

[25] See, 47 C.F.R. Part 36, Subpart F.

> one year.[26] Carriers with a very high subscriber plant factor were directed to extend their transition periods, subject to the five limitation, until the 25 percent interstate allocation was reached."[27] (Emphasis added)

This is the Table of Contents from the Hartman Memorandum.

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Conclusion: We believe that the FCC had an obligation to read the reports that were submitted as part of our filings and that the FCC did not address even the basic findings that are part of **The Hartman Memorandum.** Moreover, based on Chairman Pai's interview with Re/Code, the Joint Board must investigate whether the FCC has adequately examined the record before it dismantles the cost accounting rules.

Finally, the massive cross-subsidies created by the FCC's failure to examine the record for 16 years is seriously problematic and needs a complete and thorough review, as well as an investigation into the impacts on customers and the economic growth of America.

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[26] See, *Amendment of Section 36.154 of the Commission's Rules*, Memorandum Opinion and Order, 6 FCC Rcd 1873, 1874 (1991).

[27] Id.