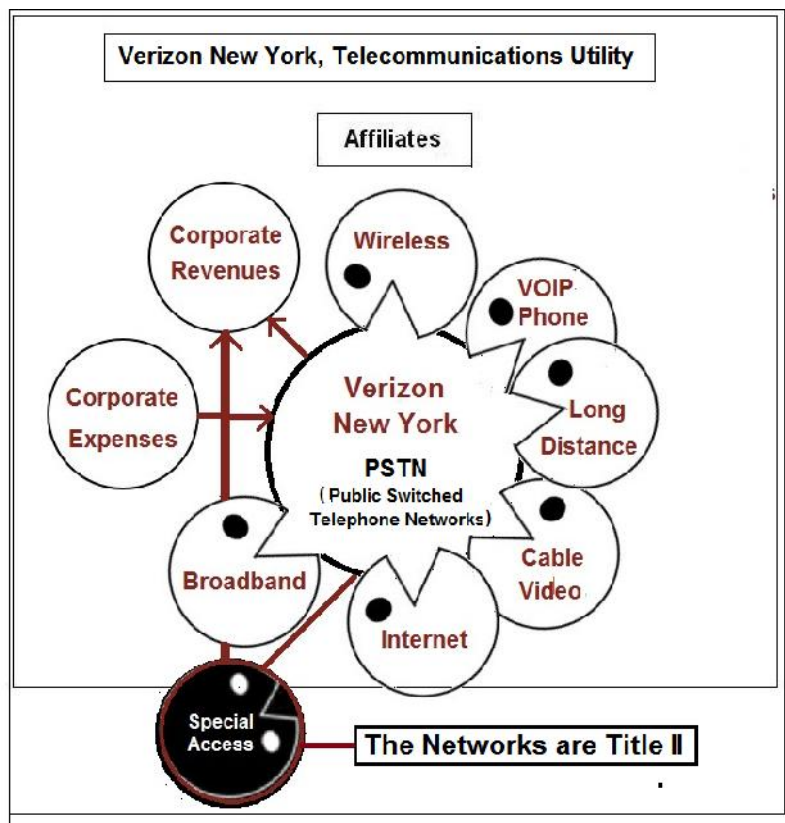


## Verizon New York 2016 Annual Report: Follow the Money: Financial Analysis and Implications



### Part of the “Fixing Telecom” Report Series

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**Verizon New York 2016 Annual Report:  
Follow the Money: Financial Analysis and Implications**

**PRIMARY REFERENCE EXHIBITS**

- **Revenues and Major Expenses, 2016**

**EXHIBIT 1  
Verizon NY Revenues and Major Expenses by Category, 2016  
(Excerpt)**

	<b>Total</b>	<b>Nonregulated</b>	<b>Local Service</b>	<b>Access</b>
<b>Total Operating Revenues</b>	\$5,240,782,258	\$1,552,967,493	\$1,211,751,622	\$2,476,063,143
<b>Major Operating Expenses</b>				
Specific & Non-specific Plant	\$3,256,244,373	\$1,113,045,276	\$1,445,636,286	\$697,562,811
Marketing	\$ 308,034,588	\$ 53,273,050	\$165,799,314	\$88,962,224
Customer Operations	\$ 402,504,360	\$ 28,387,919	\$268,038,623	\$106,077,818
Corporate Operations	\$1,199,635,597	\$ 122,758,995	\$722,877,073	\$353,999,528
<b>Net Operating Revenues</b>	<b>\$(1,079,606,687)</b>	<b>\$183,548,944</b>	<b>\$(2,098,768,683)</b>	<b>\$835,613,052</b>

- **Breakout of the Revenues and Expenses as a Percentage of the Total**

**EXHIBIT 2  
Verizon New York, Percentages of Revenues & Expenses by Category, 2016**

	<b>Nonregulated</b>	<b>Local Service</b>	<b>Access</b>
Total Operating Revenues	30%	23%	47%
<b>Operating Expenses</b>			
Construction/Maintenance(Plant)	34%	44%	21%
Marketing	17%	54%	29%
Customer Operations	7%	67%	26%
Corporate Operations	10%	60%	30%
<b>Average Major Expenses</b>	17%	56%	27%
<b>Net Operating Revenues</b>	17%	-194%	77%

## Backdrop and History

Verizon NY is the state-based telecommunications utility serving the majority of New York State; it is a wholly owned subsidiary of the holding company, Verizon Communications.

Verizon New York is also required to file an annual report with the NY State Public Service Commission (NYPSC) that supplies data that were originally provided in state-based reports filed with the FCC, known as ARMIS. The FCC stopped requiring this information by-state in 2007.

Verizon Wireless, Verizon Online, Verizon Business, etc., are all separate subsidiaries of Verizon Communications and are “affiliates” to Verizon New York. While they maintain separate financial accounting, there are clear cross-subsidies of these other lines of business from the state utility.

This report is part of and must be seen in light of what is happening throughout the US and at the FCC. And the only thing unique about Verizon NY is that it is required to do an annual report by the NYPSC. We do not know of any other state that has publicly available financial information, though some states keep the info and require a FOIA request to obtain it. Unfortunately, while the NYPSC collects the data, it has never acted on what we found. And no other state we know of has audited the financial books. And the FCC has never audited these financial books, even though they are making rules that directly impact customers, cities, etc.

## FCC Actions

The FCC has multiple proceedings underway or recently decided. The FCC’s plan includes:

- **“Shut Off the Copper”** — The FCC has a group of proceedings to remove all obligations or regulations and is planning on giving the incumbent phone companies, including Verizon New York, the right to ‘shut off the copper’ as a federal law, preempting state laws.<sup>1</sup>
- **“Business Data Services” (also known as “Special Access”) Deregulation** — These services use the same wires that are used for phone service. The FCC has ruled that the incumbents can shut off various classes of these services or not have to rent them at reasonable rates to competitors including the wireless companies. (Sprint and Windstream have already filed an appeal).
- **Erasing the Accounting Rules** — The FCC has multiple current proceedings, some already decided, on the cost allocations rules, (which include the Uniform System of Accounting (USOA)). The FCC has also extended a ‘freeze’ on how the expenses are applied that has been in place since 2001. Unfortunately, these rules have become

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<sup>1</sup> [https://www.fcc.gov/ecfs/search/filings?q=copper%20retire&sort=date\\_disseminated,DESC](https://www.fcc.gov/ecfs/search/filings?q=copper%20retire&sort=date_disseminated,DESC)

distorted so that they now place the majority of expenses into the “Local Service” classification, thus cross-subsidizing the other lines of business. And the FCC’s plan is to erase and not fix them, immortalizing the harms.

- **“IP Transition”**— Rarely mentioned anymore, this is actually a plan to shut off the copper and claim that the ‘old’ “Title II”, services should be replaced with new services, even though they use the exact same wires. The other part of the plan is to force customers onto wireless.
- **Net Neutrality, Title II, Privacy** — The FCC has decided to kill off Net Neutrality and curtail privacy, letting a few companies control the wires as they see fit, public be damned.

The IRREGULATORS have filed in some of these current FCC proceedings.<sup>3</sup>

## State-based Challenges

There are now multiple state-based bills that passed to allow the incumbents to ‘shut off the copper’ and remove state-based obligations even to offer services, known as the ‘carrier of last resort’. Some states have already passed legislation to remove basic obligations of the incumbent utility to maintain and offer a wired service.

## State Actions:

- There is a current investigation of Verizon New York’s quality of service and business practices underway.<sup>4</sup>
- The Pennsylvania Public Utility Commission just required Verizon to fix parts of the copper infrastructure in areas where the company has not deployed FiOS, the fiber to the home service.<sup>5</sup>
- The Illinois State legislature voted to remove the obligations of the incumbent telephone companies to offer service or repair the existing service.<sup>6</sup>

## Background<sup>7</sup> (For a complete list see: <http://irregulators.org/verizonny/>)

- In 2012, New Networks Institute published “Verizon’s State-Based Financial Issues & Tax Losses: The Destruction of America’s Telecommunications Utilities” which called for an investigation of Verizon’s financials and the cross-subsidies of its affiliate companies. It was based on the financial SEC-based state annual reports for

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<sup>3</sup> <http://irregulators.org/legalregulatory/>

<sup>4</sup> <http://documents.dps.ny.gov/public/MatterManagement/CaseMaster.aspx?MatterCaseNo=16-C-0122&submit=Search>

<sup>5</sup> <https://www.techdirt.com/articles/20170614/10225537588/verizon-gets-wrist-slap-years-neglecting-broadband-networks-new-jersey-pennsylvania.shtml>

<sup>6</sup> <http://peoriapublicradio.org/post/state-senate-approves-att-abandoning-copper-lines>

<sup>7</sup> <http://irregulators.org/verizonny/>

Verizon New York, Massachusetts, Pennsylvania, New Jersey and Rhode Island. Those reports stopped being published after 2010.

- In 2013, NNI filed comments and wrote a report which was used by Common Cause–NY, Consumer Union, Communications Workers of America and the Fire Island Asc.
- In 2014, with David Bergmann, Esq., Public Utility Law Project, PULP, published “It’s All Interconnected”.

### **Fixing Telecom Series**

- December, 2015, NNI released the first two reports in a new series, “Fixing Telecom”. They are based on mostly public, but un-examined information, the findings impacts all wireline and wireless phone, broadband, Internet and even cable TV/video services in America.
- In 2016, NNI worked with Consumer Federation of America and filed jointly in the FCC’s Business Data Services proceeding.<sup>11</sup>

### **FCC Filings:**

- On May 24th, 2017 the IRREGULATORS filed comments with the FCC and the Federal-State Joint Board on Jurisdictional Separations.<sup>14</sup>
  - Re: Refresh Record Related to Jurisdictional Separations, FCC 17J-1
  - Re: 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
- On May 15th, 2017 the FCC denied our call for audits of the FCC’s accounting rules and granted itself an extension, even though the FCC froze the way expenses were assigned to the different lines of business — but always having ‘local service’ pay the majority of costs.<sup>15</sup>
- 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’ 16 years ago and they have created massive financial cross-subsidies, making local phone customers pay the majority of expenses for all services, from wireless to Broadband Data Services (BDS).

**The IRREGULATORS** — In 2017, a new, independent consortium formed. At the core are 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 consultants.<sup>16</sup>

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<sup>11</sup> <http://newnetworks.com/nnicfacomments/>

<sup>14</sup> <http://irregulators.org/wp-content/uploads/2017/05/irregulatorjointfinal.pdf>

<sup>15</sup> [http://transition.fcc.gov/Daily\\_Releases/Daily\\_Business/2017/db0515/FCC-17-55A1.pdf](http://transition.fcc.gov/Daily_Releases/Daily_Business/2017/db0515/FCC-17-55A1.pdf)

<sup>16</sup> <http://irregulators.org/who-we-are/>

**Executive Summary**  
**Verizon New York 2016 Annual Report:**  
**Follow the Money: Financial Analysis and Implications**

Verizon New York's 2016 Annual Report shows massive financial manipulations, created by a negligent of the state Public Service Commission and the FCC's deformed cost accounting rules.

This report is a summary of the findings from the Verizon New York's 2016 Annual Report, published May 31, 2017.<sup>17</sup>

There are three major areas of revenues on the Verizon NY financial reports:

- **“Local Service”** — covers mostly the regular copper-based phone lines, commonly known as “POTS”, Plain Old Telephone Service, and are ‘intrastate’ services under NY PSC jurisdiction.
- **“Access”** — categorized as ‘interstate’ services and 83% are “Business Data Services” (BDS). Also called “special access” services, these are business lines used for applications such as ATM machines or the wires to cell sites, including services to competitors, (including independent ISPs). These wires use the identical networks for local service and can be copper or fiber.
- **“Nonregulated”** — are items that were previously deregulated or never regulated before and it can be DSL or parts of FiOS, and they, too, are part of and use the state utility wires.

However, there are revenues not on the state utility books. But most disturbing, much 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.

For the year ending December, 31, 2016, Verizon New York had a total of \$5.2 billion in revenues, but also claimed net revenue losses of \$1.1 billion dollars. The financials show that “Local Service” lost, on the books, \$2.1 billion alone.

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<sup>17</sup> <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={EC3B8358-6BE1-4216-A641-4361E04676B3}>



At the same time, using the same network, Access revenues brought in \$2.5 billion dollars. The majority (83%) was from Business Data Services, while the FCC Subscriber Line Charge was 12% of revenues. Access had an EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of 50%.

These facts prove that:

- The state utility wireline networks are not going away but are generating a great deal of revenues.
- Special Access services are ridiculously profitable as compared to Local Service, which had large losses attributed to the service.

But most importantly, when we examine the expenses and how they have been allocated to these services:

- The financial books have been manipulated; Local Service is not causing the expenses but has ended up paying Verizon's other lines of business expenses, which are getting a free ride, paying a fraction of the actual costs.
- Local phone customers have become unwitting defacto investors in the company's other lines of business, from special access and nonregulated services to even the Verizon Wireless expenses.
- Local Service is now paying 56% of all expenses, even though it brought in only 23% of the revenues, thus making it appear very unprofitable.

Moreover, Verizon Communications, the holding company, has dumped the majority of Corporate Operations expenses and the construction expenses into the local state utility. For example, Local Service paid 60% of the Corporate Operations expense and the majority of the construction expenditures, even though Verizon has stated it was no longer upgrading the copper networks. Access services paid only 30% of corporate operations, even though it had almost 1/2 of the total revenues, and it paid 1/2 of what Local Service paid for construction.

### **The FCC's Cost Accounting Rules have Run Amok and the FCC Not Only Refuses to Fix the Problem But Is in the Process of Erasing the Rules.**

The FCC's rules were created in 2001 and they set how the expenses are allocated. The FCC decided that it should 'freeze' the cost allocations to reflect the year 2000. In 2000, Local Service brought in 65% of the revenues and paid 65% of the expenses. And in 2016, Local Service is still paying 56% of the expenses but only bringing in 23% of the revenues.

The FCC, in fact, has started to eliminate parts of the rules and has decided to extend the freeze until 2018, even though it has not examined the impacts and harms the rules have caused – for 16 years.

The FCC and states have also used the unprofitable-ness of Local Service to claim no one is using these networks so they should be ‘shut off’.

## **No Accurate Accounting of Access Lines (“Landlines”)**

In New York alone, Local Service still has 2.2 million POTS, Plain Old Telephone Service users. However, there is no accounting provided of all of the other lines in service. Based on revenues, Special Access and Nonregulated services could have 7-8 million lines not being counted, and most of them still copper. (I.e.; if Local Service was only \$1.2 billion in revenues, out of \$5.2 billion, then the remaining \$4 billion in revenues must have millions of access lines.)

## **Construction Budgets Diverted to Wireless**

Much of the construction budgets have been diverted to pay for the wireless networks – which has meant that the cities were not being properly upgraded and maintained by the utilities.

In 2010-2013 Verizon New York paid for 5,515 cell sites to be built at a cost estimated to be \$2.8 billion – and according to Verizon’s own press statements, this came out of the wireline construction budgets.

In 2016, we estimate that wireless networks generated \$6.5-\$7.5 billion in revenue, but the Verizon NY 2016 Annual Report shows that “Cellco Partners” (Verizon Wireless is a D/B/A), only paid \$69 million to Verizon New York for use of the networks and any construction – which now includes the fiber that was supposed to be used for FiOS, but are now wires to the wireless antennas.

## **The FCC is Out of Control and Both the FCC and States are Negligent in Protecting the Public Interest.**

The situation is out of control as the FCC just deregulated the special access services so that they can a) be shut off at will and b) have rate increases at will, even though they are already obscenely profitable. These are not ‘special’ (and were renamed “Business Data Services”), but use the existing copper and fiber wires of the state utility for everything from ATM machines to those used by competitors to offer wireless services.

The FCC has plans for a federal preemption of the state laws to ‘shut off the copper’ wires at will throughout the US – even if there is no serious substitute to be replaced by wireless – and this includes both regular POTS phone service or special access services that are currently in use.

And the FCC is now erasing the accounting rules without fixing the cross-subsidies that its own rules created.

## **Low Income Families are Defacto Investors, without the Benefits**

Low income families, seniors, rural customers and everyone else got hit with multiple rate increases in New York State since 2006 claiming it was for “massive deployment of fiber optics” and losses; the losses were artificially created and the massive deployment was shifted to wireless. We estimate that in NY State customers paid an additional \$1,500 per line since 2006 as built into rates are these ‘construction’ perks and compensation for losses.

## **What We Expect**

Verizon and AT&T now consider themselves to be wireless-first companies offering entertainment and advertising services and products.

They have let the state utilities network infrastructure deteriorate and have used the utility phone customer as the defacto investor.

At the same time, they are shutting off the retail copper-based networks and force-marching customers on to their wireless services – because they make more money and they can hide the expenses in the state utilities.

The majority of cities in New York State were either ignored or never completed (including New York City), and the plan is – no more wires to the home; just use the fiber to the antenna.

The FCC has been captured, with the current series of proceedings taken directly from AT&T’s original IP Transition filing of 2012. The FCC’s goal is to erase all laws and obligations on the wires and in fact, in the last series of proceedings about ‘shutting off the copper’, neglected to use the word “utility” when discussing access lines or acknowledge that one even exists.

And when one considers that it is the FCC’s own cost accounting rules that have run amok – as we will demonstrate, and are causing major harms to the very public the FCC claims it is helping – especially rural areas and low income families –Verizon’s financial reports clearly exposes a lack of oversight and even a lack of knowledge about the actual financial flows of money.

The rest of this report is a summary of the findings from the Verizon NY 2016 Annual Report and we added some of previous report analyses to strengthen any claims, but the data is based primarily on Verizon NY’s earlier filings.

## Verizon New York 2016 Annual Report: Follow the Money: Financial Analysis and Implications<sup>18</sup>

### SUMMARY of the Findings

- **Verizon NY is the state-based telecommunications utility** serving the majority of New York State; it is a wholly owned subsidiary of the holding company, Verizon Communications.
- **There are three Major Revenue Areas Reported in the Verizon NY Annual Reports:** “Local Service” (intrastate), “Nonregulated” and “Access” (interstate), (which includes Special Access).
- **Major Expenses Include:** “Plant” (maintenance and construction), “Marketing”, “Customer Service Operations” and “Corporate Operations” expense.

This is an excerpt from the 2016 Verizon NY Annual Report presented to the NY Public Service Commission (NYPSC) on May 31, 2017.

**EXHIBIT 1**  
**Verizon NY Revenues and Major Expenses by Category, 2016**  
**(Excerpt)**

	<b>Total</b>	<b>Nonregulated</b>	<b>Local Service</b>	<b>Access</b>
<b>Total Operating Revenues</b>	\$5,240,782,258	\$1,552,967,493	\$1,211,751,622	\$2,476,063,143
<b>Major Operating Expenses</b>				
Specific & Non-specific Plant	\$3,256,244,373	\$1,113,045,276	\$1,445,636,286	\$697,562,811
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Corporate Operations	\$1,199,635,597	\$ 122,758,995	\$722,877,073	\$353,999,528
<b>Net Operating Revenues</b>	<b>\$(1,079,606,687)</b>	<b>\$183,548,944</b>	<b>\$(2,098,768,683)</b>	<b>\$835,613,052</b>

### Basic Definitions:

There are three major areas of revenues on the Verizon NY financial reports:

- **“Local Service”** — covers mostly the regular copper-based phone lines, commonly known as “POTS”, Plain Old Telephone Service, and are ‘intrastate’ services.
- **“Access”** — are categorized as ‘interstate’ services and 83% are “Business Data Services” (BDS). Also called “special access” services, these are business lines used for ATM machines or the wires to cell sites, including services to competitors. These wires use the identical networks for local service and can be copper or fiber.

<sup>18</sup> This report is part of our ongoing series analyzing Verizon NY’s annual reports since 2010. See: <http://irregulators.org/legalregulatory/>

- **“Nonregulated”** — are items that were previously or never regulated before and it can be DSL or parts of FiOS, and they, too, are part of and use the state utility wires.

However, there are revenues not on the state utility books. But most disturbing, much 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.

## Summary of the Findings:

(The section following the summary supplies more detail.)

### Revenues

- In 2016, Verizon NY had \$5.2 billion in revenues from wireline services, with Access services, accounting for 47% of the business. Local Service was only 23% and Nonregulated is now 34% of the revenues.
- NOTE: This does not include the revenues of Verizon Wireless in New York, estimated to be \$6.5-\$7.5+ billion in 2016, or the revenues for Verizon Online or the other Verizon subsidiaries.
- NOTE: This does not include the ‘Black Hole’ revenues, which we estimate that could be over \$2 billion for 2016.

### Losses and the Manipulation of Financial Accounting

- In 2016, Verizon New York claimed Net Operating losses of \$1.1 billion attributed to \$2.1 billion of losses supposedly created by Local Service expenses.
- Local Service is paying the majority of expenses. It is charged 60% of Corporate Operations, (which comes to \$723 million in just New York in just 2016), 54% of the Marketing expenses, 68% of Customer Service, and 44% of the entire construction and maintenance budget (“Plant Specific” and “Nonspecific”).
- At the same time, the Access category is paying only 27% of the expenses, and Nonregulated is paying just 17%. This means that these lines of business pay expenses that are ½ the revenues. Local Service is paying more than double the expenses as compared to the revenue.

### Business Data Services and the FCC Line Charge Are Highly Profitable

- The Verizon NY Access services use the same networks as phone service and much of these services are still based on the copper-based networks.

- Verizon NY 2016 report shows that Access services brought in over \$2.5 billion dollars in revenues, ('Special Access' is 83% of these revenues).
- Access services have a very high profit margin, 50% EBITDA, (Earnings Before Interest, Taxes, Depreciation and Amortization).
- The Access profits are derived in large part because this line of business is paying a fraction of the expenses based on revenues and because the prices of the service are inflated, as can be seen by the monopoly sized EBITDA.
- The FCC Subscriber Line Charge, which is on all regular phone lines, (but is considered 'federal') is also part of the Access services and it represented 12% of the total. It is safe to assume that this service is equally as profitable.
- NOTE: There are other 'Black Hole' areas of special access revenues that have been deregulated, nonregulated or offered via a subsidiary that are not on these financial books but are offered by Verizon.

### **FCC Accounting Rules**

- The FCC's accounting rules have caused much of this overcharging as they are set to reflect the expenses based on the year 2000, 17 years ago. And the FCC 'froze' the allocation of costs so that every year, regardless of the revenues, the expenses would be applied as if it was the year 2000. This has made Local Service look unprofitable on paper and has placed the majority of expenses into Local Service. Local Service was 65% of the revenues in 2000 and paid 65% of the expense; in 2016 it is only 23% but pays 56% of the expenses.

### **Overcharging Local Service**

- If Local Service expenses were based on revenues, (i.e., it brought in 23% of revenues and paid 23% of expenses) then Local Service was overcharged at least \$1.4 billion in 2016, while "Access" was undercharged by \$1.2 billion.
- Local Service is profitable if it was based on 'actual expenses' incurred – i.e., Local Service should not be paying marketing expenses when there is no marketing for POTS, Plain Old Telephone Service.

### **Undercharging Access, then Overbilling**

- Special Access services are under-charged, then overbilled. Special Access is only paying a fraction of the expenses. If Access service expenses were based on revenues, then Special Access, 83% of revenue, is underpaying about a billion dollars.
- The FCC has claimed special access is competitive, but with 50% EBITDA on the regulated revenues (and the other revenues from the nonregulated side much higher), there is no proof of competition based on the profits of this line of business.

### **Verizon Wireless Underpayments**

- Verizon Wireless only paid \$69 million to Verizon New York to use the networks and construction in 2016.
- NOTE: Verizon Wireless is a D/B/A for Cellco Partners.

- Verizon Wireless's estimated revenues for just NY, for just 2016, is \$6.5-\$7.5 billion.
- Verizon Wireless has also been able to divert much of the Verizon New York's construction budgets to fund capital expenditures to build out the fiber optic wires to the cell sites and even new "DAS" sites.
- From 2010-2013, Verizon wireline put in 5,515 cell sites, estimated at \$2.8 billion, for Verizon Wireless with no identifiable payments for the work or as a rental.

### **The Accounting of Access Lines has Been Manipulated.**

- Verizon NY's \$5.2 billion dollars of revenues are for wired telecommunications services in just New York. Unfortunately, the accounting of access lines in New York has only been a small subset of the business.
- The only accounting of lines covers one-sub-category, Local Service access lines, which accounts for only \$1.2 billion of the revenue.
- At the end of 2016, Verizon NY still had 2.2 million copper-based "POTS" local phone lines.
- **MISSING:** The Special Access and Nonregulated categories show no access lines, even though they are the identical wires used for phone service.
- **MISSING: The Majority of Access Lines:** Considering that Local Service is only \$1.2 billion, representing only 23% of revenues, there is an additional \$4 billion in revenue—77%. This could mean that there could be 7-8 million access lines, the majority, that were never counted, but which are increasing.
- **Not Counted: The Majority of Copper Lines:** Moreover, the FCC's last report on Special Access found that the majority of these lines are copper, which means that the majority of copper lines in use, may not have been counted.
- **No Accounting of Actual Physical Lines that Could be 'In Use':** The 2.2 million lines only represents the mostly-copper-based POTS, phone service. While Verizon supplies "households" passed for its FiOS service, the state utility had the entire territory completed by the 1970's—i.e., every home or office served, and there is no accounting of all of the available access lines, whether they are in use at this time, or not. Revenue from most telephone lines served over FiOS fiber plant are booked as unregulated, not part of Local Service revenues.



## Some of the Data

### 1) Break Out of Revenue and Expenses by Category as a Percentage.

This exhibit supplies the percentage of revenues and expenses by category for Verizon NY, 2016. As shown in other reports, 2016 breakouts of expenses are almost identical to previous years because the FCC's rules 'froze' the accounting of expenses to reflect the year 2000.

### The Overall Expenses Being Charged to Verizon New York Are in Question.

The mathematics of this is simple. The majority of all expenses have ended up in Local Service. While Local Service only brought in 23% of the revenues it pays 56% of the expenses, making Local Service unprofitable. The other parts of the business, such as Access or Nonregulated, are getting a free ride.

Why is Local Service paying 60% of Corporate Operations expense?

**EXHIBIT 2**  
**Verizon New York, 2016, Percentages of Revenues & Expenses by Category**

	<b>Nonregulated</b>	<b>Local Service</b>	<b>Access</b>
Total Operating Revenues	30%	23%	47%
<b>Operating Expenses</b>			
Specific & Non-specific Plant	34%	44%	21%
Marketing	17%	54%	29%
Customer Operations	7%	67%	26%
Corporate Operations	10%	60%	30%
<b>Average Major Expenses</b>	17%	56%	27%
<b>Net Operating Revenues</b>	17%	-194%	77%

### 2) Corporate Operations Expense

The total Corporate Operations expense in 2016 appears to be \$2.8 billion, (though this number differs with the accounting presented in the summary).

**EXHIBIT 3**  
**Corporate Operations Expense Charged to Verizon NY, 2016**

Vz Corporate Services Corp	Purchased from Affiliates	\$124,878,159
Vz Corporate Services Group	Purchased from Affiliates	\$177,847,458
Vz Corporate Resources Group	Purchased from Affiliates	\$163,697,848
Vz Services Corp	Purchased from Affiliates	\$ 2,294,979,737
Vz Services Organization Inc	Purchased from Affiliates	\$91,692,828
Subtotal for these companies:		\$ 2,853,096,030



What are Corporate Operations expenses and who is Verizon Services? This is from Verizon New York's 4<sup>th</sup>, 2009 SEC filed Report (which stopped being public in 2010). This same language was also in every Verizon state-based SEC filing.

#### **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.

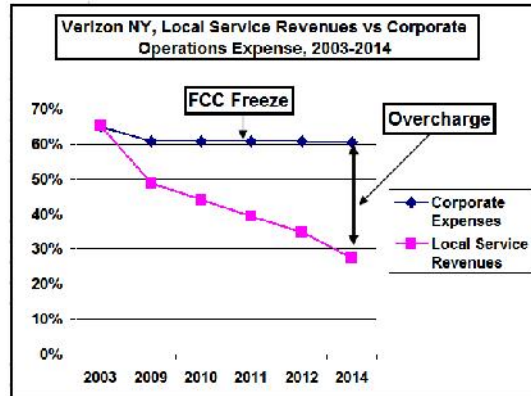
Verizon New York has been continually losing \$1-2 billion dollars on and off for the last 7+ years. And the State has never audited the books to find out how or why. Any company losing a billion annually would stop the hemorrhaging and get rid of paying for a corporate jet fleet or the corporate lawyers or the executive pay. In short, it would have started eliminating or reducing dramatically its major non-essential expenses.

### **3) The FCC Big Freeze Demonstrated Starkly**

And the actual percentage of Corporate Operations expense by year as compared to the revenues, is striking.

The FCC's deformed cost accounting rules created this cross-subsidy scheme. This shows that in 2003, Local Service was 65% of the revenue and it paid about 65% of the expenses. By 2014, Local Service only brought in \$1.4 billion, 28% of the revenues, yet it is still paying 60% of this expense.

**EXHIBIT 4**  
**Verizon NY Revenues vs Corporate Operations Expense, 2003-2014**



And this is the break out by year. Notice that as revenue drops, the Corporate Operations expenses remained the same.

**EXHIBIT 5**  
**Verizon NY Local Service Corporate Operations Expense, 2003-2014**

	Corporate Expenses	Revenues
2003	65.00%	65.3%
2009	60.70%	49.0%
2010	60.80%	44.1%
2011	60.80%	39.4%
2012	60.70%	34.9%
2014	60.40%	27.6%

*Sources: Verizon NY, New Networks Institute*

**EXHIBIT 6**  
**Verizon NY's Local Service Revenue vs Corporate Operations as a %, 2016**

	Corporate Operations	Revenues
<b>2016</b>	<b>60%</b>	<b>23%</b>

Verizon New York is being used for multiple purposes that allow it to act as an expense garbage-pail for all of Verizon's other lines of business.

#### 4) Access and Special Access Services

This is a break out of the revenues for the Access network services on the Verizon NY utility financial books.

- **End User Revenues** — are the FCC Subscriber Line Charge, which is considered a Federal charge, and believe it or not, is not included in the ‘intrastate’ local revenues; it is about 12% of the total.
- **Special Access Revenues** — renamed by the FCC “Business Data Services”, it was over \$2 billion dollars in just 2016 and it represents 83% of this total.

**NOTE:** There is a variance between the total revenues in this excerpt vs the summary of revenues and expenses.

#### EXHIBIT 7 Verizon NY, 2016 Network Access Services Revenues

	2015	2016	Change	% of Total
<b>End User</b>	\$ 268,513,142	\$ 283,518,269	6%	12%
<b>Switched Access</b>	\$ 79,320,774	\$ 88,573,389	12%	4%
<b>Special Access</b>	<b>\$1,987,796,784</b>	<b>\$2,008,589,749</b>	<b>1%</b>	<b>83%</b>
<b>State Access</b>	\$ 33,466,301	\$ 49,430,286	48%	2%
<b>Total Access Revenues</b>	\$2,369,097,001	\$2,430,111,693	3%	

#### 5) Access Service Profits

While Local Service was all losses, somehow, the Access services had a 50% EBITDA when comparing the major expenses and the Access revenues.

#### EXHIBIT 8 Verizon NY, 2016 Network Access Services Revenues Vs Expenses

	Access Regulated
<b>Revenue Access</b>	\$2,476,063,143
<b>Expenses</b>	\$1,229,460,762
<b>EBIDTA</b>	50%

These revenues for Access do not include Nonregulated or the “Black Hole” special access revenues we found in previous annual reports (and are no longer published), but do include the FCC Subscriber Line Charge.

**6) FCC Subscriber Line Charge Increases?**

One of the surprising findings is that the “FCC Subscriber Line Charge” appears to have increased substantially over the last few years. This fee has historically increased to a cap of \$6.50 for residential customers, and higher for businesses. But without more details, it would appear that the average charge was \$10.95 per line a month.

**EXHIBIT 9  
FCC Subscriber Line Charge, Revenues, Lines Annual and Monthly Revenues,  
2015-2016**

	<b>2015</b>	<b>2016</b>
<b>End User</b>	\$ 268,513,142	\$283,518,269
<b>Total Lines</b>	2,429,750	2,157,000
<b>Annual</b>	\$ 110.51	\$131.44
<b>Avg. FCC Line</b>	\$ 9.21	\$10.95

**NOTE:** We assume that an additional charge that was added so it would not look like an increase to the FCC Line Charge, called the “Access Recovery Charge”, has been increased. There could be other reasons for this increase, but this is revenue from an account that would indicate it is part of the original FCC Subscriber Line Charge accounting.

**7) Wireless Questions: How Much Should Verizon Wireless Pay Verizon NY?**

According to the listing in the “Affiliate Transaction” section, Verizon Wireless (Cellco Partnership) paid only \$69 million dollars to Verizon NY for services “Provided to Affiliates”,

**EXHIBIT 10  
Verizon Wireless Payments to Verizon New York, 2016**

Cellco Partnership	Provided to Affiliates	\$ 69,196,616
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Verizon Communications’ 1<sup>st</sup> Quarter, 2017 Report shows that Verizon had 114 million customers nationwide with an average of about \$49.10 a month. We estimate that Verizon’s New York coverage to be about 10% of the market, thus 11.4 million subscribers. Using an average monthly fee (averaged from information in the 1<sup>st</sup> Q report) we estimate that Verizon brought in about \$6.7 billion in annual revenues from New York State subscribers.

**EXHIBIT 11****Estimated Verizon Wireless Cell Customers, Nationwide, New York, and NY Revenues, 2017**

Verizon US cell customers	114,000,000
Verizon New York State subs.	11,400,000
Month (at \$49.10 per month)	\$558,600,000
Annual Revenues	\$ 6,703,200,000

Verizon's Wireless Access fees as well as any capital expenditures for any construction would be included in the payment of \$69 million – which is about only 1% of the Verizon Wireless revenues.

**8) Wireless Issues: Cross-Subsidies**

As we show in other reports, it would appear that Verizon Wireless did not pay for much of the construction of their cell sites; it was done via the construction budgets of Verizon New York. There is no itemized accounting of the construction being done for Verizon Wireless by Verizon New York, but the ‘access fees’ – special access fees to use the networks appears to be a fraction of what Sprint and the other wireless companies pay for using the Verizon New York networks.

The next two sections are taken from these reports. They both relate to Verizon New York.

- “SPECIAL REPORT: Proving Verizon’s Wireline Networks Diverted Capex for Wireless Deployments Instead of Wiring Municipalities, and Charged Local Phone Customers for It.”<sup>19</sup>
- “It’s All Interconnected.”<sup>20</sup>
- “Verizon’s Manipulated Financial Accounting & the FCC’s Big “Freeze””<sup>21</sup>

**We Know the Number of the Sites, the Estimated Costs of a Verizon Cell Site, and Verizon Wireless and Verizon Wired Capex Expenditures.**

Verizon New York, the state wired utility, put in 5,515 cell sites as part of the wireline capital expenditures from 2010-2012. Based on our cell site cost model, this cost an estimated \$2.8 billion, about 80% of the wireline construction budget.

<sup>19</sup> <http://newnetworks.com/wp-content/uploads/DataREPORTSept13finally-1.pdf>

<sup>20</sup> <http://newnetworks.com/wp-content/uploads/PublicNN3.pdf>

<sup>21</sup> <http://newnetworks.com/wp-content/uploads/REPORT2DATADEC16.pdf>

We note that much of this data pertaining to the use of the wireline networks for wireless has not been updated in public statements or documents.

**EXHIBIT 12**

**Verizon Wireless Expenses to Build Cell Sites, and VNY Wireline Capex, 2010-2012**

	2010	2011	2012	3-Year Total
Cell Sites	2,800	1,848	867	5,515
Cell Construction Est.	\$1,439,200,000	\$949,872,000	\$445,638,000	\$2,834,710,000
Verizon NY Capex	\$1,203,000,000	\$1,137,000,000	\$1,141,000,000	\$3,481,000,000
Cell Const. as % of Verizon NY Capex	120%	84%	39%	81%

*Source: Verizon New York, New Networks Institute*

Verizon NY’s press releases from 2010-2012 also establishes that the wireless cell sites are part of the wired infrastructure expenditures. The Verizon 2010 headline reads:

“Verizon Spent More Than \$1.4 Billion in New York’s Landline Telecom Infrastructure in 2010.”

This release clearly establishes that for the year 2010, Verizon spent \$1.4 billion on wireline construction in New York State, and part of the focus was FiOS TV. But there were also 2,800 cell sites being put up as part of the wireline network.

“Deployment of fiber-optic links to wireless providers’ cell sites throughout New York 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 2,800 of these sites.”

AT&T is using the same accounting game. Bill Smith, President, Technology Operations, AT&T, at the Wells Fargo 2016 Convergence & Connectivity Symposium, June 21, 2016, made clear that the wireline side of the business has been funding the wireless build outs.

“I came more from the wire line business and had always a little bit of frustration for me because for many years before I picked up operations in construction and everything for the wireless side of the business, in the wire line world, I was spending a lot of money that was directly supporting the wireless operation, but it showed up as wire line spend. So we’re not that good at allocating those expenditures.”

The New York State Attorney General's Office found that 75% of Verizon NY's capital expenditures for Local Service had been diverted to fund FiOS and the wireless networks.

“Verizon New York's claim of making over a ‘billion dollars’ in 2011 capital investments to its landline network is misleading. In fact, roughly three-quarters of the money was invested in providing transport facilities to serve wireless cell sites and its FiOS offering. Wireless carriers, including Verizon's affiliate Verizon Wireless, directly compete with landline telephone service and the company's FiOS is primarily a video and Internet broadband offering... Therefore, only a fraction of the company's capital program is dedicated to supporting and upgrading its landline telephone service.”

However, in a recent report “SUMMARY REPORT: Verizon Massachusetts & Boston: Investigate the Wireless-Wireline Bait-n-Switch” we found that in Boston MA, while Verizon has told the city it is doing a FiOS, fiber to the home deployment, in reality, it is using the fiber optic wires to do a wireless deployment.<sup>22</sup>

At the Oppenheimer 19th Annual Technology Internet Communications Conference, August 9th, 2016, Timothy Horan, Oppenheimer & Co. Analyst asked Verizon:<sup>23</sup>

“So are you deploying fiber differently now in Boston than you've done for FiOS in the past? Does each small cell need like their own fiber home run to that small cell? Are you going to be deploying a lot more fiber than you have historically?”

David Small, Verizon Communications, Inc. EVP responded:

“Yes, we will. And so, as it relates to FiOS, we've announced a few of the suburb areas, for lack of a better word, for cities, sub cities that we are going to be building into. But beyond that, if you think about the use case for small cells and the coordination elements of the radio access network that need to occur between its corresponding home macro and the small cell, that suggests that, as a general rule, you need home runs from that small cell directly back to that coordinating macro-level cell site. And that's exactly what we are doing.”

It is a shame that this explanation directly contradicts what Verizon has told the city of Boston. And the areas that are supposed to be completed—Dudley Square and Dorchester—are part of the Boston, not suburbs.

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<sup>22</sup> <http://newnetworks.com/verizonmareport/>

<sup>23</sup> <http://www.verizon.com/about/investors/oppenheimer-19th-annual-technology-internet-communicationsconference>



According to multiple sources, the fiber optic wires are being put in via the budgets that were supposed to be for a wireline, FiOS, fiber to the home deployment and not wireless.

## 9) Access Line Accounting Manipulation

Verizon NY has claimed massive access line losses. However, Verizon's accounting is supplying only one class of service — copper-based phone lines that are used mostly for Local Service, voice phone calling, commonly known as "POTS", Plain Old Telephone Service.

Verizon's goal has been to seriously exaggerate the size of the loss of lines as it makes their case that the networks are being abandoned and unprofitable and therefore should be shut off or they should be able to get more rate increases. And while many believe that a 'landline' is just the copper-based service/wire, truth be told, since the 1990's, all wires, including fiber optics, are 'landlines' or what in the industry are called 'access lines'.

USTA Quotes Verizon New York's Access Line Accounting, 2015

"When you look at the numbers in New York, in 2000, the incumbent (Verizon New York) had over 11 million access lines. Today they have 2.9 million access lines."<sup>24</sup>

These numbers are provided by Verizon New York as quoted by the phone industry association and lobby — the United States Telecommunications Association, USTA.

### Most Lines Are Not Counted.

This next exhibit is from the FCC's "*Statistic of Common Carriers*" report for the year 2007. Verizon NY had a total of 46.8 million access lines in just NY State, in 2007. The access lines USTA quotes could fall under the 4.7 million "Main Access Lines" (or it could include some of the other 'switched access' categories), but it is mostly the voice, "switched", copper-based phone lines, which only constitute a fraction of the actual lines in service in the year 2007.

**NOTE:** Terms like "switched", "non-switched" or "special access" are very complicated to understand and there are multiple caveats, too technical to discuss here. But at the bottom of all of this is — there are copper and fiber optic wires and the accounting is manipulated based on how the line is used — but they are all 'access lines'. They all generate revenue for the parent company.

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<sup>24</sup> <http://isoc-ny.org/misc/2015-07-15-mayer-saunders.mp4>



**EXHIBIT 13  
Verizon New York Access Lines, 2006-2007**

	2007	2006
<b>Switched Access Lines in Service:</b>		
Main Access Lines	4,638,451	5,116,406
PHX & Centrex Trunks	460,379	463,709
Centrex Extensions	999,254	963,213
Other Switched Access Lines	1,064,404	1,417,156
<b>Total Switched Access Lines</b>	<b>7,162,588</b>	<b>7,960,486</b>
Central Office Switches Excluding Remote Switches	301	301
Remote Switches	300	299
Central Office Switches	601	600
Basic Rate ISDN Central Channels	62,496	67,019
Primary Rate ISDN Control Channels	14,952	14,442
<b>Access Lines in Service by Customer:</b>		
<b>Business Switched Access Lines:</b>		
Single Line	145,466	151,497
Multiline/Other Than Payphone	2,677,605	2,799,836
Payphone Lines	88,614	99,400
<b>Residential Switched Access Lines:</b>		
Lifeline	263,473	276,013
Non-Lifeline/Primary	3,384,490	4,137,657
Non-Lifeline - Non-Primary	422,640	496,203
<b>Total Switched Access Lines</b>	<b>7,162,588</b>	<b>7,960,486</b>
<b>Special Access Lines (Non-Switched):</b>		
Analog (4kHz or Equiv)	25,765	27,279
Digital (64kbps or Equiv)	39,615,573	35,005,426
<b>Total Access Lines (Switched and Special)</b>	<b>46,803,926</b>	<b>42,993,191</b>
<b>Local Private Lines:</b>	<b>395,018</b>	<b>501,305</b>

*(FCC Statistics of Common Carriers, for the Year Ending December, 31, 2007)*

**FCC’s Special Access investigation**

In 2015, the FCC found that special access was now a \$40 billion market, and started an investigation, which included Verizon.<sup>25</sup> According to the FCC, 60% of this \$40 billion was for ‘mostly’ copper-based services that rely on the existing technology, (TDM). (The FCC raised this to \$45 billion a few months later.)

“TDM-based business data services... are the dedicated (usually copper) circuits that many business and other institutional users continue to rely on for their data and other communications needs... Despite the growth of newer technologies, preliminary analysis of the Commission’s special access data collection shows that revenues from such TDM services continue to make up in the range of sixty percent of the roughly \$40 billion annual special access market.”

In the Verizon New York financial accounting, special access revenues would fall under “Access Fee and Special Access” financial bucket.

However, this brings up a question — how many copper lines are in service? According to this last accounting by the FCC, it would appear that one thing is true — Special Access lines had major gains and Access in 2014 was by far the largest revenue producer.

Moreover, Special Access is just one of many types of access lines in service that are not part of Verizon’s published accounting of “access lines”. Thus, Verizon’s use of just the ‘POTS’ phone line accounting as the only information supplied about lines in service, seriously manipulates this information.

<sup>25</sup> [http://transition.fcc.gov/Daily\\_Releases/Daily\\_Business/2015/db1016/DA-15-1194A1.pdf](http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db1016/DA-15-1194A1.pdf)

In the 2016 Annual Report, Verizon has \$4 billion dollars of revenues from Access services and the Nonregulated business, which includes some of the FiOS revenues and DSL revenues. However, Verizon provides “0” Access lines.

## **10) Rate Increases over the Last Decade Were Created Based on Made Up “Losses” and Non-Existent Fiber Optic Deployments**

Verizon NY had received multiple rate increases for the intrastate losses as well as for a “massive deployment of fiber optics”, which started in 2006. This was Verizon quoting the NYPSC in 2009 for the need of more rate increases.<sup>26</sup>

### **EXHIBIT 14**

#### **Verizon NY’s Detail of a Rate Increase based on “Losses” and Massive Fiber Build Out, 2009**

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%.”<sup>3</sup> For 2007, Verizon reported an overall intrastate return of negative 6.24% and an intrastate return on common equity of negative 46.0%.

And yet, in 2010, Verizon stopped deploying FiOS and moved the construction budgets to build out the fiber optic wires to the cell sites. And as we just detailed, the “losses” quoted are made up and are not based on actual cost-causers for Local Service.

Moreover, all customers paid these increases including low income families, seniors, rural area customers, or anyone who had phone service since 2006.

## **11) Recalculation of Local Service Expenses Based on Revenues.**

If the expenses were tracked to reflect the actual revenues, then Local Service should have paid \$1.2 billion in expenses but instead paid \$2.6 billion – i.e., Local Service was overcharged \$1.4 billion dollars.

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<sup>26</sup>

[https://www3.dps.ny.gov/pscweb/WebFileRoom.nsf/Web/B849A020314983A3852575D900530827/\\$File/pr09054.pdf](https://www3.dps.ny.gov/pscweb/WebFileRoom.nsf/Web/B849A020314983A3852575D900530827/$File/pr09054.pdf)

Using the Verizon NY 2016 financial report, the following exhibits recalculated the financials.

- **“Paid”** is what was actually on the books,
- **“Should have Paid”** takes the percentage of revenues for each category, Local, Access and Nonregulated, and applies it to the expenses.
- **“Overcharged” or “Undercharged”** simply compares the difference; I.e.; Local Service paid \$166 million in Marketing. Based on the fact that Local Service was 23% of the revenues, then it should have paid \$71 million and the overcharge is \$95 million.

**EXHIBIT 15**  
**Verizon NY 2016, Local Service Overcharge**

	<b>Paid</b>	<b>Should Have Paid</b>	<b>Overcharged</b>
<b>Plant Specific</b>	\$1,445,636,286	\$ 748,936,206	\$696,700,080
<b>Marketing</b>	\$ 165,799,314	\$ 70,847,955	\$94,951,359
<b>Customer Operations</b>	\$ 268,038,623	\$ 92,576,003	\$175,462,620
<b>Corporate Operations</b>	\$ 722,877,073	\$275,916,187	\$446,960,886
	\$2,602,351,296	\$1,188,276,351	<b>\$1,414,074,945</b>

Of course there are caveats. For example, Local Service had little, if any actual marketing for copper-based phone service. It should not have paid anything near the \$71 million based on revenues.

**Example:** When was the last time you saw marketing for POTS, regular phone service?

In fact, Local Service is actually profitable once the expenses are based on the actual cost-causers; Local Service did not have major construction or upgrades of the copper networks, thus the overcharging is much larger when the actual expenditures for Local Service are calculated.

## 12) Recalculation of Access Service Expenses Based on Revenues

In examining each category, Special Access and Access services appears to have gotten a free ride. It had revenues of \$2.5 billion but paid \$1.2 billion in expenses. However, Special Access services use the same infrastructure so how is it that Special Access could have major profits while, at the same time, pay a fraction of the expenses?

**EXHIBIT 16  
Verizon NY 2016, Access Undercharged**

	<b>Paid</b>	<b>Should Have Paid</b>	<b>Undercharged</b>
<b>Plant Specific</b>	\$ 697,562,811	1,530,434,855	<b>\$ (832,872,044)</b>
<b>Marketing</b>	\$ 88,962,224	144,776,256	<b>\$(55,814,032)</b>
<b>Customer Operations</b>	\$ 106,077,818	189,177,049	<b>\$(83,099,231)</b>
<b>Corporate Operations</b>	\$ 353,999,528	563,828,730	<b>\$(209,829,202)</b>
	\$1,246,602,381	\$2,428,216,891	<b>\$(1,181,614,510)</b>

The FCC’s rules caused these anomalies and so, in this case, Access should have paid \$2.4 billion in expenses, and was undercharged \$1.2 billion.

**13) Verizon Gamed the Regulatory System in a Myriad of Ways and the FCC and State Commissions Were Negligent in Their Duties to Protect the Public Interest**

This is an excerpt detailing Verizon’s response to a question by CWA pertaining to the revenues and expenses by category—the original version taken from previous New Networks Institute reports in this series.

Based on the response, Verizon believes that these cost allocations are arbitrary, and that the company has not been subject to these rules for over a decade.

**EXHIBIT 17  
Verizon NY’s Answer to a CWA Question in the NYPSC Investigation, 2017**

CWA 3-5	<p>The table on the following page is derived from Verizon New York’s 2014 Annual Report to the New York Public Service Commission. It computes the proportion of Total Revenues and Selected Operating Expenses for the Nonregulated, New York State (aka Local Service) and Other (aka Access) reporting categories. It also computes the Expense-to-Revenue Share ratios for each reporting category.</p> <p>A. Explain, in detail, the reasons for the apparent over-allocation of expenses to Verizon New York’s regulated Local Services reporting segment (labeled as “New York State” in filings) along with apparent under-allocation of expenses to Verizon New York’s Nonregulated and Access reporting segments in virtually every category reflected on the table.</p>
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**Response:**

(A) The table is calculated using allocated amounts reported on Schedule 9, Income Available for Return and Calculation of Rate Base. This schedule and the allocations shown on it are a throwback to a monopoly environment when rates for regulated telecommunications services were set based on book costs and detailed cost studies, rather than on economic and competitive factors. Verizon New York has not been subject to rate of return ratemaking in either the federal or state jurisdiction for well over a decade. For reporting purposes, nonregulated, interstate and intrastate costs are developed using frozen factors developed in accordance with Verizon’s Cost Assignment Forbearance Compliance Plan, approved by the FCC on December 31, 2008. The results thus determined are considered representative of what separated results would look like, without the need to conduct burdensome cost studies for no apparent regulatory purpose. The results for the columns vary due to a variety of factors including product life cycle, technology, obsolescence, as well as the somewhat arbitrary nature of cost allocations in general.

At the same time, the FCC claims that these cost allocation rules are holding up investments. In fact, as mentioned, the FCC has multiple open and recent proceedings to eliminate these accounting rules.

While the FCC's own cost allocation rules are responsible for the cross-subsidies that make Local Service appear to be unprofitable, Verizon uses these rules to create the fiction that Local Service is unprofitable for public policy issues.

But, as the actual financial reports prove, Local Service is profitable and there is a financial shell game in play that needs to be stopped.

See the IRREGULATORS filing

<http://irregulators.org/wp-content/uploads/2017/05/irregulatorjointfinal.pdf>

#### **14) Why the Distorted Accounting Matters.**

The FCC relieved Verizon of its accounting requirements, and continued to freeze separations ratios, based on the premise that those rules don't actually matter any more. They suggest that the separations freeze only applies to rate-of-return carriers, the small mostly-rural carriers who still use rate of return accounting in order to determine the amount of subsidy money they will receive from the federal Universal Service Fund. Verizon, AT&T, Frontier, Windstream and CenturyLink are all classified as Price Cap Carriers, which means that their Special Access prices may not be raised above certain levels – but only in the most rural areas. These prices are not regulated at all in urban markets, where existing or potential competition is supposed to be sufficient.

But of course reality is different. While the supposed losses that Verizon-New York and other state telephone utilities are suffering are not used in traditional ratemaking any more, they are routinely cited as justification for further deregulation. Take, for instance, the industry's desire to shut off the copper and discontinue service to rural areas. Under rate of return regulation, up to the early 1990s, statewide retail prices were set at a level that provided the companies with a specified rate of return on their rate base, the undepreciated value of their capital plant in service. This encouraged investment in all areas, as even an investment in an unprofitable rural area added to the rate base and could be used as a reason to raise urban rates. Such cross-subsidies were built into the system.

When price caps were adopted, the presumption was that the carriers would continue to serve all of their service areas, profitable or not. But they had no incentive to do so, other than regulatory compulsion. They wanted to disinvest in unprofitable rural areas, minimize their expenditures across the board, and maximize the quarterly returns they could make from the plant they had built under rate of return regulation. Investment levels fell rapidly, especially after 2000. And if the carriers' rate base were to be measured today, it might even be near zero or even negative, as depreciation has whittled down the value of the plant. (A rate base can be negative, as future equipment decommissioning costs are factored against it.) Of course it is hard to prescribe much of a return on such nonexistent equity!



Carriers thus use the supposed poverty of their state utilities, like Verizon-New York, as an excuse to ask for further deregulation. While rates are not *directly* set based on rates of return any more, policy decisions are guided by financial claims. And bad numbers make for bad policy.

## 15) This is Happening in Every State: Corporate Operations Expense

This financial shell game is a state-by-state as well as a national and federal issue as it has been happening in every state and it impacts every city.

This next exhibit supplies the “Corporate Operations” expense from the FCC’s 2007 “ARMIS” reports by the state-based telecom utilities, and it is the last available data. In this exhibit we sorted this group to detail the range of Corporation Operation expense added to Local Service expenses.

- Throughout America, on average, in 2007, 70+% of “Corporate Operations” expense had been dumped into Local Service.
- We note that Access paid only 30% of this expense.
- Though it varies by phone company and location, the Verizon California territory (added as part of the GTE merger, which was then sold off to Frontier) dumped a whopping 78% of the Corporate Operations expense into Local Service (intrastate) category, as did AT&T in Illinois.

### EXHIBIT 18

**America's Utility Dumping of Corporate Operations Expense into Local Service, 2007**

	Separations	Local	Access	Special	Local	Access
Verizon-GTE California	\$ 258,859	\$ 203,080	\$ 55,780	\$ 11,261	78%	22%
AT&T-Illinois Bell	\$ 248,908	\$ 193,620	\$ 55,283	\$ 0,847	78%	22%
AT&T-Ohio Bell	\$ 180,067	\$ 136,168	\$ 43,901	\$ 7,572	76%	24%
AT&T-Pacific Bell - California	\$ 743,215	\$ 559,141	\$ 184,074	\$ 40,975	75%	25%
Verizon Florida LLC	\$ 162,890	\$ 122,508	\$ 40,482	\$ 8,393	75%	25%
Centurylink-Qwest-Colorado	\$ 131,609	\$ 97,710	\$ 34,153	\$ 0,049	74%	26%
AT&T-Bell South-Tennessee	\$ 110,541	\$ 81,025	\$ 29,515	\$ 5,167	73%	27%
Verizon-Maryland	\$ 239,740	\$ 173,268	\$ 66,472	\$ 18,848	72%	28%
Verizon Pennsylvania	\$ 422,168	\$ 303,753	\$ 118,415	\$ 30,877	72%	28%
AT&T-Southwestern - Texas	\$ 484,584	\$ 348,590	\$ 135,994	\$ 38,072	72%	28%
Verizon New Jersey	\$ 425,805	\$ 303,828	\$ 121,977	\$ 32,832	71%	29%
Centurylink-Qwest-Oregon	\$ 58,678	\$ 41,835	\$ 16,842	\$ 3,126	71%	29%
AT&T-Southwestern - Kansas	\$ 55,097	\$ 39,030	\$ 16,067	\$ 3,714	71%	29%
Verizon New York Telephone	\$ 1,092,744	\$ 740,543	\$ 352,201	\$ 160,833	68%	32%
Verizon NE - Massachusetts	\$ 328,090	\$ 216,948	\$ 109,142	\$ 48,820	67%	33%
Verizon Washington D.C.	\$ 67,115	\$ 43,884	\$ 23,231	\$ 9,158	65%	35%
Special Access is a Subset of the Total Access				Average	72%	28%
Special vs Total -- % of Special Compared to Total Access.						

FCC ARMIS 2007, New Networks Institute

However, another cross-examination revealed that the differential between the expenses dumped into Local Service and those based on access can be enormous.

## **What Is the Ratio of this Expense to the Revenues?**

In 2007, AT&T's Corporate Operations were about 8-9% of revenues overall while Verizon had it at 11- 20%, I.e., in New York, this one expense was 20% of the size of the revenues.

It has gotten worse over time. In New York, in 2014, Verizon's Corporate Operations expense was \$2.6 billion; however the revenue was \$5.2 billion, so this one expense was literally 50% of revenues. And yet, 60% of these expenses ended up being charged to the Local Service category. In 2014, for example, the Corporate Operations expense was 109% of revenues; i.e., Local Service lost money due to this one expense; an expense that should not have been added to the costs of Local Service. The rate increases mentioned were due to supposed losses and Corporate Operations expense were used in that calculation.

In the 2016 Annual Report we find conflicting data as in one place, Corporate Operations is \$2.9 billion, and yet in the financial summary it is only \$1.2 billion.

## **Conclusion**

The Verizon NY 2016 Annual Report reveals a massive cross-subsidy scheme that has been in play for over a decade. It also reveals that there are massive holes in the FCC's current and proposed plans to erase the accounting rules, shut off the copper, or deregulate special access. Instead, the FCC should be investigating these issues, not attempting to cover them up by erasing the cost accounting rules. This will only immortalize the cross-subsidies.

The current investigation in New York has been underway for over a year, and is being spearheaded by the Communications Workers of America, CWA.

We applaud their efforts but for us this examination of the cross-subsidies and financial hanky panky was first documented in our report in 2012, which was filed with the NY State PSC and ignored, as were the multiple updates to that research.

This new Verizon NY 2016 Annual Report shows that while a settlement in New York may curtail some egregious acts, it is not a cure, especially with the FCC's current plans.

It is time that every state and every city call for and start investigations and use this as a roadmap for change. And it is clear that the FCC must be taken to court over its current and upcoming decisions.