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IRREGULATORS v. The FCC: Exposing and Legal Challenge of One the Largest Accounting Scandals in American History.

19 Years of Negligence—The FCC ‘Froze’ the Accounting Rules to the Year 2000; Made the US Infrastructure Look ‘Unprofitable’, Creating the Digital Divide.

Extend the Freeze to 2024? Hundreds of Billions of Dollars in Overcharging Were Already Collected; Hundreds of Billions More and Widening the Digital Divide Will happen Over the Next 6 Years.

The FCC Decision, The Appeal, Reports and Filings:

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On April 15, 2019, the IRREGULATORS filed with the court to stop an FCC decision that tries to bury one of the largest accounting scandals in American history. It is directly tied to AT&T, Verizon and CenturyLink’s state-based utilities. Unbelievably, the FCC (with the help of AT&T, Verizon and Centurylink) ‘froze’ the cost accounting rules that are supposed to divide up the expenses of the different lines of business that use the state-based telecommunications infrastructure, the state-based utilities, to reflect usage in the year 2000 –19 years ago.

By 2006, these frozen FCC rules had put the majority of all expenses into local service and it made almost all of the state-based “intrastate”, wired telecommunications networks in America appear to be unprofitable. At the same time, all of the other subsidiaries and lines of business, including affiliated wireless services that are classified as “interstate”, or an “information service”, that use the exact same networks, got a free or discounted ride.

Unknown to most, there are still state utilities, like Verizon NY or MA or AT&T California and they are not just the copper wires but almost all of the wires within the state; copper and optical fiber. This scheme diverted billions of dollars of construction budgets per-state to pay for the Verizon’s FiOS fiber to the home video service, or AT&T’s U-Verse, as well as the wires used for the wireless networks, even the special access wires (also known as “backhaul” or “business data services”). And all of this made the state utility appear to lose billions of dollars.

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In December 2018, to add to this harm, [the FCC extended this ‘Freeze’](#) for an additional 6 years – through 2024.

Kenneth Levy states:

“We are appealing the order extending the separations freeze for six years because the FCC ignored the data we filed showing that the outdated freeze wrongfully diverts substantial company costs to local telephone customers resulting in excessive rates and overcharges. Moreover, the FCC has based public policy decisions, such as the discontinuance of local wireline service, on the false notion that local service is unprofitable, including in rural areas.”

As early as 2006, the National Association of State Utility Consumer Advocates (NASUCA), exposed these financial manipulations in [documents it filed](#) with the FCC.

“Consumers are paying billions due to misallocated telecom costs... ‘seismic changes’ in the type of services provided over local telephone lines have resulted in consumers overpaying billions of dollars in their local telephone rates.”

Mark Cooper, Director of Research of the Consumer Federation of America, (and an IRREGULATOR Adjunct) explains that if this is not fixed, the telecom companies will continue to overcharge consumers hundreds of billions of dollars over the next 6 years.

"Our analysis shows the fundamentally flawed FCC order that this court case challenges has a huge, negative effect on consumers and the communications sector."

"By misallocating costs and recovering them from the wrong people – not the cost causers – the allocation that the FCC seeks to freeze for more than half a decade, wreaks havoc, supporting hundreds of billions of dollars of cost misallocation and over-recovery."

Why this Case is Critical: We Found a Structural Flaw in Every FCC Proceeding, from Net Neutrality to “Shut Off the Copper”.

Bruce Kushnick, Managing Director of the IRREGULATORS, states:

“Since 2015, New Networks Institute and the IRREGULATORS detailed, in multiple expert reports and filings, the hundreds of billions of dollars of harm from this FCC-authorized massive cross-subsidy scheme—and the FCC ignored all our comments.

"Many FCC orders are structurally flawed because the Agency’s analysis did not include this important state-based data, despite our having filed it in each of those related proceedings.

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“This means that the ‘investment’ information, the data about the profitability and losses of the wired networks and even accounting of the access lines in service have all been manipulated to fit the AT&T, Verizon and Centurylink corporate objectives.

“Net Neutrality, shutting off the copper, 5G, or the USTelecom interconnection challenge and every current FCC proceeding can be reopened and revisited once the actual financial data is presented and cross-subsidies are exposed,” added Kushnick.

And then we have Zombie Rules. In state-after-state we found that while the FCC, AT&T et al. claim that these rules have been erased, or ‘forborne’, they are still alive and wreaking havoc – just like the walking dead.

Fred Goldstein notes:

“The FCC says that these separations rules only apply to a narrow class of small rural carriers. But they are wrong when they suggest that this process is as good as dead. These zombie rules are also used by the states for a variety of purposes. They lead to distorted accounting and that leads to bad policy.”

The ‘Freeze’ Manipulated Hundreds of Billions of Dollars as well as Public Policies.

- **Created the Digital Divide.** The companies routinely allowed the infrastructure in the rural areas of their state utilities to deteriorate claiming they were ‘unprofitable’; even many inner cities weren’t upgraded, especially in low income areas. But this was just part of this artificial financial shell game in almost every state, as AT&T, Verizon and Centurylink had laws changed and received billions per state in rate increases and financial perks to fund broadband deployments starting in the 1990’s.
- **Customers were Overcharged Billions of Dollars for Wireless.** This is not chump change. With this cross-subsidy scheme, local phone customers in most states were illegally charged billions to pay for the build outs of fiber optic networks that are used for wireless. Wireless service has also been paying a fraction of the market prices and expenses that it should be paying for using the utility networks.
- **5G Is Not Profitable Once These Cross-Subsidies Are Removed.** A wireless service that requires a fiber optic wire every block or two is never going to be deployed in rural areas, especially when it has to pay for the fiber infrastructure. It is doubtful that 5G would be financially viable even in more densely populated areas if the wireless companies were to pay the true cost of deployment and upkeep.
- **Tax Benefits from Artificial Losses.** With local wired networks paying the majority of expenses (even though the services did not actually incur these costs), the companies have been able to show enormous losses and enjoy tax relief.
- **Shut Off the Copper; Dismantle the State Utilities.** Making the local service networks appear unprofitable is now used as part of the claim that the companies should be allowed to ‘shut off the copper’ and force-march customers onto wireless

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(because it makes them more money). And to help AT&T et al., the FCC's current plan is to dismantle the utilities, handing them over to the wireless company as private property for private use.

- **Major Manipulation of the Access Line Accounting.** While America has been told that there is a massive drop in landlines, the FCC, AT&T et al. have been involved in a shell game, reclassifying the exact same copper lines that are part of the state utility as an 'interstate' or 'information' service, which are then removed from the access line accounting. Verizon NY had 1.9 million access lines listed in 2017. However, these are just "POTS", "Plain Old Telephone Service" lines which brought in \$1 billion in revenues. Verizon NY had \$5 billion in revenues; thus \$4 billion in revenues had zero lines listed.

Tom Allibone explains how the FREEZE is stripping away customer protections.

"The FREEZE has been used as an excuse to weaken and remove customer protections and push through major rate increases, claiming losses that appear to be artificial or have nothing to do with the actual costs of offering service. The continued deregulation has also been moving customers to customer service agreements with one sided "contracts of adhesion", where there is no longer due process; the customer is always wrong, and your day in court is now arbitration only. With claims that there is competition, how can prices continue to rise? The FREEZE has also manipulated the accounting."

Hard-Core, Irrefutable Evidence

- The Verizon NY 2017 Annual Report was published in June 2018—and supplies the full financials of the state-based telecommunications utility.
- In July 2018 there was a settlement of Verizon NY with the NY Public Service Commission terminating an investigation that started in 2015. Estimated at \$300-\$500 million, and based in part on our work, Verizon NY is required to upgrade 32,000 lines to fiber optics and maintain the existing copper networks.
- New York is the only state we know that requires a full annual report.
- Meanwhile, the FCC stopped publishing basic financial data in 2007.
- These financial reports and the settlement directly contradicts every FCC analysis; it shows the massive financial cross-subsidies caused by the accounting rules, which are still in use.
- It is also clear that every state we examined never removed these federal rules.

Mark Cooper expects the court to hold the FCC accountable for its shenanigans.

"The court case will turn on the flaws in the reasoning, process and justification for the specific rule, but it is important to recognize that the basic problem is the flawed flow of resources from consumer to communications giants. The most effective first step in dealing with these problems is to cut them off at the source. Without the misallocation and over

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recovery of costs, the tasks of pursuing the goals of the Communications Act – universal service, just and reasonable rates, increased reliance on competition – will be much easier.”

Chuck Sherwood believes the IRREGULATORS’ actions will help municipalities.

"Municipalities and Counties as Local Franchising Authorities (LFA's) have had to fight with state regulatory agencies and legislatures along with the FCC and Congress, since the passage of the Telecom Act of 1996, to enforce their "fiduciary authority" to manage their Public Rights of Way and collect the fees owed by the Cable and Telecom Providers for their use. The legal action is an attempt to provide the LFAs with the data necessary to reregulate the Providers who have used the Congress, the FCC and state legislatures to support the Providers power grab to establish themselves as unregulated Monopolies."

The IRREGULATORS’ Conclusion

The public has been harmed by the FCC’s wrongfully allowing the FREEZE to remain in effect for 19 years without any serious auditing or investigation, and cavalierly extending it for 6 more years without any serious analysis of the data showing its distortions and harmful effects. We spent years documenting this travesty (at our own expense), just to have our filings ignored or dismissed.

We leave you with this quote from a 2017 [interview by Re/Code with Ajit Pai](#), who claimed that his staff “pretty much never” examined the rules being removed:

‘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?

‘Pai: “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.” (Emphasis added.)

The IRREGULATORS is an independent consortium of senior telecom experts, analysts, forensic auditors, and lawyers who are former staffers from the FCC, state advocate and Attorneys General Office, as well as telecom auditors and consultants.

We [created a full library](#), which was filed in this and the previous versions of Docket 80-286 since 2015, including 18 reports and filings, as well as back up documentation.