

IRREGULATORS vs. FCC

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SCANDAL LINKED TO FCC'S ACCOUNTING RULES COSTS CONSUMERS BILLIONS AND UNDERMINES COMPETITION; ABUSES MUST STOP BEFORE HUNDREDS OF BILLIONS IN 5G COSTS ARE MISALLOCATED TO LOCAL RATEPAYERS

On June 3rd, 2019 the FCC made its first substantive filing in a court case¹ challenging the fundamental accounting rules that determine how telephone companies set rates for local basic telephone services and competitive services that use the local network. The court case alleges that the rules embody a fundamental mistake in how costs are identified and recovered, a mistake so egregious that it is tantamount to accounting fraud and represents one of the largest accounting scandals in American history.

On April 15th, 2019, the IRREGULATORS² filed to appeal an FCC order that rests on a decision that 'froze' the allocation of state telecommunications utility expenses to reflect the year 2000—19 year ago. At the same time, it left the '75%-25% rule' in place that allocates 75% of network expenses to the local jurisdiction and only 25% is allocated to the federal ("interstate") jurisdiction. With a single stroke and the help of what are now AT&T, Verizon and CenturyLink, this decision made it possible for the local telephone companies to manipulate the federal accounting rules to always make the wired public utility networks appear unprofitable, and have the state utility customers fund all of the companies' other services, from the fiber optics for Verizon's FiOS, to the Wireless to Business Data Services. Today, the vast majority of network costs and telephone company revenues come from these services, but the FCC has never updated its allocation rules.

Working with the Consumer Federation of America and others, the IRREGULATORS estimate that this financial shell game is costing America's customers \$50-\$60 billion annually, not to mention the tens of billions per state in harms to economic growth. In fact, almost all communications services, from wireless and internet to broadband are being overcharged through this multi-layered financial shell game.

In December 2018, in spite of decades of evidence that the decision was harming consumers and undermining competition, the FCC decided to continue this "Freeze" on these rules for 6 more years. The IRREGULATORS, who are telecom policy experts, auditors and lawyers, (as well as telephone users), sued to stop the FCC from going forward, arguing that the extent of abuse was about to escalate dramatically because the deployment of 5G technology under these rules would heap hundreds of billions more dollars in misallocated and excessive costs on consumers.

¹ Case No. 19-1085, *THE IRREGULATORS, et al., Petitioners, v. FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA, Respondents*, On Petition for Review of an Order of the Federal Communications Commission, before the United States Court of Appeals for the District of Columbia Circuit.

² In addition to being intensive users of telecommunications services across the U.S. 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. Members of [the group](#) have been working together, in different configurations, since 1999.

The FCC's filing reflects a choice to not challenge the IRREGULATORS' legal right to sue. This is important since it appears to recognize their legal "standing." This means the case will move on to the "merits" phase': presentation of briefs and identification of supporting evidence.

The affidavit of Dr. Mark Cooper, one of the IRREGULATORS, and Director of Research at the Consumer Federation of America, explained the problem and the urgency of correcting it as follows:

"By misallocating costs and recovering them from the wrong people – not the cost causers – the allocation that the FCC seeks to freeze for another six years has created pervasive harm. The FCC has created an immense opportunity to earn excess profits, an opportunity that the communications network owners have exploited aggressively to directly harm consumers with higher bills. The scheme wrecks with and undermines competition, by enabling the dominant firms employ a price squeeze against actual and potential competitors. The most effective first step in dealing with these problems is to cut them off at the source. Without the misallocation and over recovery of costs, the tasks of pursuing the goals of the Communications Act – universal services, just and reasonable rates, increased reliance on competition – will be much easier."

Bruce Kushnick, Executive Director of New Networks Institute and Managing Director of the IRREGULATORS, has led the team to investigate the accounting abuses over the past decade by analyzing the Verizon NY annual reports.³ Verizon NY 2017 Annual Report published, May 2018, combined with the previous financial information and other primary sources, shows that:

- From 2005–2017, local phone customers were overcharged an estimated \$2,700.00 per line due to rate increases using artificial losses and cross-subsidized expenses.
- Verizon Wireless diverted the utility construction budgets to do the fiber to the cell sites. From 2010–2012, Verizon Wireless appears to have underpaid Verizon NY, the state utility, an estimated \$2.8 billion for construction.
- Verizon NY Local Service was charged \$1.8 billion for Corporate Operations expense, 62% of the total, in just 2017, due the freeze. These are the expenses for the corporate jets, lobbyists and lawyers.
- Verizon NY shows losses of over \$2 billion a year for almost a decade, with billions in tax benefits.
- All of these financial machinations have made the wired networks appear unprofitable; created the Digital Divide, and are now being used to dismantle the state utilities and getting rid of basic obligations, even though the losses are artificial.

Dr. Cooper adds:

"The need to act is urgent and a six-year delay will be fatal. Ratepayers will soon be called upon to fund another round of network upgrades to support wireless 5G. The required investment will rival or exceed the amounts dedicated to recent upgrades to digital and fiber plant. The FCC may be content with doubling down on the past misallocations and abuses, but the states are likely to disagree. From a ratepayer perspective a course correction after six years will be much more difficult, if not impossible."

Kushnick also said:

"What we found in NY is most likely happening in every state public utility, where the accounting rules are still in use but are deformed and the FCC should have issued a warning 'Toxic. Do not use.'

"If this financial shell game is fixed it will not only show that 5G is not profitable, as it currently is not paying for the building of most of the wireless infrastructure, but there should be billions in question per state that can be used to deliver on the promises of a fiber optic future for all customers, including rural areas.

³ NY is one of the few states that still requires the utility to report all revenues, expenses, and other important business practices. Also, Verizon NY is required to submit a separate financial report from those of Verizon Communications, Inc, the holding company.