$200 Billion Broadband Scandal

(The sequel to the "Unauthorized Bio of the Baby Bells")

Introduction and Summary

You're owed money. We estimate that you are owed over $2000.00 per household for a fiber optic broadband network service you have yet to receive and for other overcharging from your local Bell phone company — SBC, Verizon, BellSouth and US West. It is impossible to tell the exact amount in your state without audits.

This is the true tale of one of the largest scandals in US history.

NOTE: See: *"Who are the Bell Companies?"* in the Appendix for the history of the mergers of the companies, and how AT&T and MCI fit into all of this.

We will attempt to show how America entrusted the phone companies with our fiber optic Digital Future and we were taken to the cleaners. It not only cost you and everyone you know a significant sum of money, but it has also harmed our entire economy. It is the reason America is not first in broadband in the world but 12th or 16th, depending on which International agency's data you believe.

We estimate that the failed fiber optic deployments has cost America over $206 billion in higher phone rates, tax breaks and other financial perks to the phone companies, and it has cost the American economy an estimated $500 billion annually in loss of new growth — so far a total of about $5 trillion.

It is a tale of deceit, fraudulent data and gaming the regulatory system using fake consumer groups, biased research firms and campaign-financed politicians to control everything from the FCC, to Congress, to the state legislatures and commissions to vote for phone-company-financed laws that are not in the public interest.

And it's time to take actions now, because it will get worse before it gets better. This expose is not simply some tale of history that you may not know about. This tale impacts the next decade of telecommunications and broadband, not to mention the entire economy. It impacts every aspect of the digital spectrum, from broadband, to peer-to-peer filing sharing, to

VOIP or Internet services, to municipalities rewiring their cities with Wi-fi services, to the actual costs of service and the choices you will have in the future.

You, the Jury

So, think of yourself as someone on a jury, and let us present the case. This story is being presented in two volumes: the first is dedicated to the story of fiber optic broadband in America, or the lack thereof.

The case is simple:

- Do you have a 45 Megabit-per-second (Mbps), bi-directional (download and uploading are the same speed), fiber optic service offering 534 video channels for about $50 bucks a month today? (We will explain all of these terms in future sections.)
- We argue that you, your family and friends, not to mention your company, school, library, and everyone you know, paid for this fiber optic service through higher phone rates, not to mention other perks your phone company received for promising to roll out these fiber-based services. In essence, you have been paying a hidden broadband tax — about $2000.00 per household, to fund these other networks. NOTE: Every state had different laws and different commitments.
- Speed is the issue: If you're using DSL or cable modems, your speed is about 50 times slower than what was promised in 1992. Dialing-up the Internet is 1000 times slower.
- DSL is not a substitute. DSL goes over the old copper wiring to the home or office, and should have been replaced by glass-based fiber optic wiring.
- "Fiber to the home", the direct connect to the home or office, is the Holy Grail of broadband. It is sometimes called "The Last Mile", "Last 100 Feet", "FTTH" (Fiber optics-to-the-home), "FTTP" (Fiber-to the-Premises), "FTTC" (Fiber-to-the-Curb) — This fiber optic wiring is NOT somewhere in the ether of the network, but directly to your home or office.

Overcome the "Forget-Me-Not" Drug: Collective Amnesia Like some Harry Potter potion, the story you are about to hear is rarely discussed, improperly remembered, or removed completely from government agencies' reports, including the FCC's (Federal Communications Commission) broadband report.[7] Most, if not all "average citizens" do not remember that they paid for the missing networks through higher phone rates. **Collective Amnesia** or simply the phone companies' and the government agencies' failure to make this essential fact clear is something for you to discern as you read this tale.

The Background

Starting in the early 1990's, driven by the Clinton-Gore Administration's desire to create a very high-speed network throughout America, the Bell phone companies claimed that instead of the government taking the lead role, the Bell companies would step up to the plate to rewire America's homes and offices, schools and libraries with a fiber optic broadband network. It would replace the aging, 100-year old copper-based network, with a glass-based fiber optic wire that could handle America's broadband needs.

From 1993 through 1996, there were announcements and plans that would make anyone think that we were in the midst of a fiber optic revolution. In order to make the country believe that these networks were real, the phone companies spent almost a billion dollars on two groups, TeleTV and Americast. Americast, (the group formed by SBC, BellSouth, GTE, Ameritech and Disney to promote fiber optic/broadband content), was promising 68 million fiber optic homes in 28 states. And in virtually every state, the companies hyped the proposed plan with additional millions of dollars in lobbying, advertisements, research reports and campaign financing.

What was promised? By 2000, according to the Bell companies' annual reports, press releases and state filings, about 50 million households should as been rewired**.** California's Pacific Telesis (Pac Bell) promised to have 5.5 million households wired with fiber optic services, Ameritech, (which covered 5 states including Illinois, Indiana and Michigan, Ohio and Wisconsin) promised 6 million homes by 2000, Bell Atlantic claimed 8.75 million homes, and NYNEX said 1.5-2 million by 1996. (Ameritech, Pac Bell, Bell Atlantic and NYNEX were four of the original Bell companies.)

Alongside the annual reports, the Bell companies also filed with the FCC to offer "video dialtone" services over fiber optic wire. Over 9,787,400 households in 43 cities were supposed to be upgraded between 1995 and 1997.

None of this was DSL. DSL goes over the old existing copper wiring and could not deliver "broadband", as defined by the Bell companies. "Broadband" was defined as 45 Mbps in both directions, capable of high-quality video services. On average, these plans called for the ability to handle at least 534 video channels. In fact, the Bells' current DSL service was considered "inferior" in 1993 because it travels over the old copper networks at a fraction of the speed.

And the amount of money to be spent was staggering. Bell Atlantic's 1993 Annual Report announced they were the "leaders" of the Info Bahn, and that they would be spending $11 billion by 2000. Not to be outdone, Pacific Telesis' President Philip Quigley boldly announced that they were going to spend a whopping $16 billion dollars. And if a 1994 article on Ameritech’s expenditures is to be believed, the company would be adding $4.4 billion for video services, for a whopping total of $29 billion over the next 15 years.

By 2005, if the Bell companies (including Verizon/GTE) had actually delivered on their broadband promises, approximately 86 million households would have had fiber optic based services. These state commitments also would have rewired schools and libraries, hospitals and government offices. And in most states, the plan called for ALL customers to be rewired equally, whether they were in rural or urban areas, rich or poor. Universal Broadband was to be accomplished state-by-state because customers were, in essence, defacto-investors funding these network upgrades.

How Do We Fund this Network? Duh… Customers Will Pay for It.

The local phone companies are regulated by the state public utility commissions. They are utilities, and offer essential services – phone and data services. The utilities were regulated by controlling the companies’ profits, known as "rate of return". Remember, in the 1990’s, there was no competition of any consequence, and so the phone companies had a guaranteed income. It’s still guaranteed in that if their profits fail to please, they ask for a price increase.

The plan was to simply get all 50 states to remove this old "rate of return" regulation with “deregulation”, meaning the removal of regulation. In this case, it was also called “price caps”, or “alternative regulations”, or “incentive regulations”, all of which would give the phone companies more money to pay for these upgrades.

Some states also required the laws of the state be modified and so state legislatures in many states had to kick-start this process and create new statutes. Many of these statutes were written by the phone companies and given to key legislators to sponsor.

From the customer side, in essence, these plans allowed the phone companies to either raise the price of specific services, or allowed the companies to not have to give back money for very profitable services. For example, “Calling Features”, such as “Call Waiting” or “Call Forwarding”, can cost $3-$5 a month, yet cost less than ***ONE CENT*** to offer. Pennies, nickels, dimes and quarters do add up.

They could also cut staff, take large tax write-offs for the aging equipment, and get a host of other perks.

At the same time the phone companies were lobbying hard to rewrite the Communications Act of 1934 and eventually got the passage of the Telecom Act of 1996. The new law was based on the premise that the local phone networks would be opened up for competition. Of importance to the local phone companies was a trade-off — if they opened their networks sufficiently, they would be allowed into the long distance markets, something that they had wanted to do since 1984, the year of their birth. When AT&T was split up, AT&T got the long distance service while the Bells were the local providers. (A long distance call is an "inter-state" call which crosses state lines, such as a call from New Jersey to California.)

And so, armed with an array of heaving lobbying, biased research, campaign financing, and a large advertising budget to convince customers that they were the next Digital Coming, starting in 1993 through 1996 they were able to get the majority of states to change their laws in favor of giving the phone companies a great deal more money.

Splat. Well, more like the sound of a hatchet falling, would be the way to explain what happened next. A primary finding of this tale is that the mergers of SBC (Southwestern Bell), Ameritech, Pacific Telesis, and SNET, and the mergers of Verizon, Bell Atlantic, NYNEX, and GTE killed deployment of fiber optic broadband in 26+ states, starting in early 1997. (See “Who are the Bell Companies” for more details of which states were involved.)

There were two different versions of this story. Pacific Telesis, Ameritech, SNET, and GTE had all rolled out some fiber networks, though not what was promised. Ameritech had rolled out regular cable services over its fiber optic wiring in 5 states, SNET was offering cable in its regions, and various communities in California had been wired by Pac Bell. None of them matched the descriptions as told by the annual reports and press releases, but it was something. In every case, when their time to merge came, their fiber optic plans were shuttered.

The second version of this story is the Bell Atlantic-NYNEX story. In this case, in all 13 states, it looks like the public and the state commissions had been conned, since there is no evidence that any massive fiber-based undertaking in any one of the states occurred. So what if Pennsylvania, New Jersey, Massachusetts, Rhode Island and other states had state fiber optic deregulatory plans that had passed in 1993-1995. NYNEX, in Massachusetts, had told the public and regulators it would have 330,000 lines installed by 1995, while the entire state of New Jersey was to be upgraded with fiber to the home by 2010. Pennsylvania's commitments were to have 50% wired in rural, urban and suburban areas wired by 2004. Nothing was put in, though these companies argue that the fiber wiring somewhere in the phone networks' ether is what was promised. Poppycock. — That wiring is at best a highway with no on-and-off ramps.

We also need to point out that these two mergers not only shuttered 26 states' fiber optic deployments, not counting the GTE territories which is spread throughout the US, but the companies also lied about the need to become larger to compete with each other. SBC promised to be competing vigorously for local wireline competition in 30 cities outside of their territories by 2002, while Verizon promised 21 cities, both directly competing with each other. None of that materialized with any competitive force, and it is clear that both companies used competition as an excuse, knowing full well that the regulators weren't going to enforce their statements, or break up the mergers.

Is this a Fraud Case? A Case of Collusion? A Case of Misleading Commercial Speech?

Now, there are those who will make the case that since the regulators were complacent in much of the changes in the state laws and the phone-bill-booty that would come, they don't really "owe" customers money, but it was a "cost" of bad regulation with no oversight. Others will say that the mergers changed the situation or that state laws were changed because of the Telecom Act.

Our belief is that these companies made agreements with the public because state laws were changed in virtually every case based on the announced plans. In many states, such as New Jersey or Pennsylvania, there were committed time schedules laid out.

The real kicker? The networks couldn't be built then, much less now. That's right, the fiber optic info-highway, 534 channel, 45Mbps services, could not be built when these statements were made and these state agreements signed.

How do we know this? Well, Verizon, of course, is one source. Verizon's May 19, 2004 press release states emphatically, that Verizon was only now, in 2004, doing fiber optic 'field trials'.

> "Although the use of fiber optic technology is common throughout the telecom industry, Verizon is the first company to begin using it to directly connect homes and businesses to the network on a widespread scale… FTTP is moving from field trials and the lab to the real world."

The fact that Verizon's FIOS project as of October 2005 still can't deliver video services, now called IPTV, should make everyone consider this a case of fraud, and not simply market forces that caused Verizon to offer fiber-based services, only a decade late.

We contend that the state alternative regulation plans, which deregulated the companies, should never have been allowed to stand. Our analysis of overcharging, then, is how much money, write-offs, and other perks were accrued from the changes in law.

The phone companies were a utility and the contractors didn't fulfill their obligations. The companies, as a utility, had to have their networks open to competitors as part of the law, since the funders were the customers. In this case, the contractor pointed to the old copper networks and said — *"Viola, We're done. That's why we just charged you a few billion."'*

More to the point, the laws would never have changed just for DSL. DSL travels over the old copper wiring and could have been deployed without any new, serious upgrades in 1993. It did not require the industry to be "deregulated", and it could not handle high-quality video, which was the definition of broadband in 1993.

And then there's collusion. If one company in one state had done this terrible thing — charged customers for a fiber optic wire and services that weren't delivered, that would be bad enough. But as we will show, as early as 1994, some states realized it couldn't be built, not for the prices that they had quoted, and yet, other states still made claims it could be built in 1995. And since none of it was ever built by 9 different companies (SNET, GTE, plus the original 7 Bells), amounting to the majority of states, it's now obvious that this information was surpressed, covered up, and using TELE-TV and Americast as the "beard", this ruse was carried out on a massive scale. Some companies must have known it couldn't be built, but never said a word, especially about giving back the money and perks, not to mention the breaking up of the mergers.

Follow the Money

We've prepared a 20-year analysis of data using the Bells' own annual reports — Revenues, Profits, Staff, Construction and Depreciation (write-offs) are just some of the specific analyses. We also compared them to other standard business information, including the Business Week's Scoreboard for "Utilities" and "Industry", as well as Census data.

While each state has different laws, nationwide, we estimate that the Bell companies overcharged over $205 billion from 1992-2004 for these networks, including various financial perks — and that figure is growing. On average, we estimate that it was over $2000 per household. We'll go through our exact calculations later.

Essentially, what happened was that because of the state and Federal deregulations, primarily written for the companies' fiber optic service promises, local service became the Bells' private cash machine. By dumb luck, the timing for deregulation couldn't have been better. There was a massive increase in telephone services being purchased, fueled by the Internet's growth, starting in 1995. Many of the services were now deregulated, and the Bells' local services were the cash-engine. But this financial booty compounded by the other corporate perks of deregulation, including massive staff cuts, massive tax write-offs and depreciation of the networks, as well as cuts in construction, gave the phone companies even more money.

We do not argue that the companies should be entitled to a fair and reasonable return and that some cuts were "productivity gains", that could be argued were needed for shareholder comfort. We argue that the company made false statements that changed the laws, and that those laws should never have been allowed to stand based on what the company delivered, and the monies refunded or given to others, such as the municipalities, to do the work.

The Money

First and foremost, by any indicator, the Bell companies have been highly profitable. Revenues increased 128% between 1984 and 2004, and while this may not sound like a lot of growth, based on Census data, the number of households increased only 28%. And overall, the companies' revenues went from $72 billion, (the money the company received in sales, sale of asset, etc.) to $165 billion in 2004 as compared to household growth.

But the real cash came from the massive cuts in major expenses: staff and new construction.

- **Massive staff cuts since 1984**. In 2004, there were 30% less employees than in 1984; about 200,000 people were dropped. When you compare this to the revenues, there's been a 65% drop in the staff to do the work.
- **Construction budgets have also been slashed**. In 1984, the Bell companies spent $18 billion on new construction, approximately 24% of revenues. In 2004, the companies spent $17 billion, approximately 14.3% of revenues. — a 60% drop as compared to the revenues.
- **Writing-off more than they are putting into the ground** is now the tradition. In 1984, depreciation write-offs were $11.7 billion, new construction was $18 billion and the ratio of write-offs to construction was 65%. By 2004, depreciation was $22.6 billion, construction was $16.7 billion and so the companies wrote off 133% more than they put into the network. We will explain how these write-offs save billions on taxes.
- **Prices should have been slashed.** What should seem obvious to anyone is that if your two major expenses have been cut, prices should have followed, especially if these companies were under rate of return. By removing the safeguards, every indicator shows massive increases, not in the consumer's favor. The network is way cheaper to offer services, but because of deregulation, the prices are all inflated and customers received little, if any benefit.

If anyone thinks that local or long distance prices have been in the decline over the last four years, they haven't done their homework and read our research on phone bill charges in America.[8] Studies in California, New York and New Jersey revealed that prices have massively increased. In New York City, it comes to about 400%[9] since 1984, and that's based on actual phone bills and not FCC data, which is seriously flawed.

Briefly, local service for most of the US was a bundled service of unlimited local phone calling, unlimited directory assistance, the wire in the home, and a phone, all for $8-$10 a month. In 2005, everything is up and ala carte, and new monthly bogus charges, such as the FCC Line Charge, now capped at $6.50, but going up, have been added. The argument has been that long distance prices declined and there was a trade off. Baloney. Then you have local and long distance packages. About 15%-25% are now paying more than buying ala carte. The entire thing has been rigged to simply charge customers more, and Teletruth has more than ample proof of this.

The Fiber Optic Booty

The specific fiber optic deregulatory years in question, 1994-2000, show the real changes. It is actually easy to track the monies accrued from the failed fiber optic deployments because most state laws were changed starting in the early 1990's and the changes were dramatic.

- **Profits went through the roof**. In raw business indicators, before the advent of the deregulatory plans the Bells' return on equity, a standard business measure of profits, was about 12-14% from 1984-1992, which was somewhat high but not outrageous for a utility. By the mid-1990's this had increased to 29.1%, and was 126% above other Utilities. If the return on equity went through the roof, the 'profit' margins of the Bells were 158% higher from 1995-2000 than the Business Week Scoreboard "Utilities" or other "Industries".
- **Overcharging.** If you simply track the Business Week Scoreboard statistics for profits and return on equity, it is clear that the difference, "overcharging", grew from a $0.5 billion in 1991 to over $16 billion a year in 2000. This, plus the excessive tax write-offs, brings our estimate to $205 billion garnered by the fiber optic deregulation through 2004.
- **Inflated Pricing Continues**. Prices for all services continue to be inflated and overcharging continues today on every wholesale and retail service, as well as the Universal Service Fund. This also increases all taxes and surcharges, etc.
- **Cross Subsidization: The Largest Bait and Switch in History** Because of deregulation, the phone companies' other products, including long distance, wireless, and DSL have all gotten a free ride at your expense. It is clear that customers have funded the roll out of long distance and DSL through higher phone rates. Under the previous rate of return, the charges for local service were ONLY for local service, and not for funding other services. Now, the line is clearly blurred. One has only to look at all of the advertisements to know that the phone companies' original local service advertising budgets are now being used for every other product. Under rate of return, these monies would have been refunded to customers in the form of lower phone rates.

All this overcharging is only part of this tale. This does not take into account an additional estimated $80 billion dollars in missing equipment that was added to the cost of phone services — about $600 per household.

Those “Poor Bells”. Give Me a Break.

The Bells keep insisting that they have been hit really hard in the last 4 years because of competition. Every company had problems because of the economic crash, but the phone companies were still outperforming virtually all of the basic indicators. For example, from 2000 to 2004, the phone companies profit margins were 155% more than Business Weeks’ “Industry” and “Utilities”.

Caveats to Volume One

So, let us present to you the story of fiber optic broadband services that were never delivered and how it cost you $2,000 and counting. We’ve divided up this story into two volumes. I would like to point out a few important points:

- Volume I only deals with fiber optic service deployments as promised by the phone companies, starting in the early 1990’s.
- The FCC’s “Advanced network reports” do not include any of the thousands of documents we present in this expose. Teletruth filed a “Data Quality Act” complaint over this. (FOOT)
- This is not a history lesson. We believe that the failed fiber optic deployments still have a financial impact on current telecom rates, and on proposed legislation, both state and federal.
- While we are proposing a “Broadband True-Up” to get refunds from the misdeeds of the phone companies. We do not expect refunds at this time, since they require audits, which no regulator seems willing to undertake.
- Formatting: Because we are using these materials as parts of various filings, please forgive duplicative information. Also, all quotes with “bold” have been added for highlight.