

**Petition Seeking An Order Of The Public Service Commission Commencing A Proceeding To Consider Issues Pertaining To Telecommunication Services**

To: Commissioner Audrey Zibelman, Chair, Commissioner Patricia Acampora, Commissioner Gary Brown, Commissioner Diane Burman, Commissioner Gregory Sayre

PRELIMINARY STATEMENT

This Petition seeks an Order of the Public Service Commission (“Commission”) creating a formal proceeding to consider the methods, technologies, policies and impacts on the public of New York's telecommunications system, with specific reference to Commission decisions regarding deregulation of service<sup>1</sup>. This proceeding should address factual matters upon which policies are based, the broad functionality and impacts of the system and its governing policies, and specific issues enumerated below.

A thorough, transparent and formal proceeding is needed to assess 1) the status and condition of the system, especially with respect to assumptions and findings upon which the Commission has relied in its various reforms of the system over the past two decades, and 2) the consequences of deregulation on consumers, whether they are consistent with the law and policy goals of the Commission and what, if any, course corrections are needed. The Commission should use the results of such an examination of the effects of deregulation on telecommunications services in New York to either reaffirm or change its policies to ensure that New Yorkers enjoy the finest, affordable, universal, reliable and high quality telecommunications system in the nation.

Specific areas of inquiry are set forth below. They are not intended to be exhaustive of issues of concern, but are appropriate for inclusion in a fair-minded look into the deregulated system.

Unlike most states, the decision to deregulate in New York was made administratively by the Commission, with no additional legislative authority.<sup>2</sup> The new system was a radical departure from the

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1 The Commission's policies on deregulation and competition are found in a wide variety of documents and pronouncements. While we acknowledge all these documents, our focus in this Petition is on the primary documents, Opinion 96-13 in Case 94-C-0095, Opinion and Order Adopting Regulatory Framework, adopted and issued on May 22, 1996, otherwise known as and referred to herein as Comp II, and CASE 05-C-0616 – Proceeding on Motion of The Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services. STATEMENT OF POLICY ON FURTHER STEPS TOWARD COMPETITION IN THE INTERMODAL TELECOMMUNICATIONS MARKET AND ORDER ALLOWING RATE FILINGS (Issued and Effective April 11, 2006) otherwise known as and referred to herein as Comp III.

2 Limited legislative authority recently allowed detariffing of “non-basic” telephone services. This eliminated rate filing for “non-basic” services, but did not alter the Commission’s power to review rates, terms and conditions of the detariffed

ways telecommunications services had previously been financed, created, delivered and regulated. It was based on the development of new telecommunication technologies, and a series of assumptions and predictions about them. After almost twenty years it is both possible and necessary that the Commission thoughtfully evaluate the results. It is time to re-examine and consider the assumptions, goals and realities of deregulation and their impacts on the people of the state.

## BACKGROUND

The Public Service Law requires the Commission to use its statutory powers to administer the state's telecommunications system with the goal of achieving universal, affordable, high quality and technologically advanced service.

To that end, about twenty years ago it became the avowed policy of the Commission to encourage competition in the provision of telecommunications services, and to rely on competition rather than regulation to meet its statutory obligations.<sup>3</sup>

The Commission explicitly relied on non-regulatory mechanisms. "...consumer education and market-based initiatives will substitute for regulatory requirements to achieve traditional consumer protection goals."<sup>4</sup>

But the Commission also admitted to its statutory obligation to protect consumers. "It is also the avowed policy of the Commission to protect New York's consumers against increases in cost or inadequate service."<sup>5</sup> "The goal of ensuring the provision of quality telecommunications services at reasonable rates is primary....While other goals in this proceeding may be important, even critical, to various parties, their attainment must not come at the expense of this primary goal."<sup>6</sup>

Competition is not a goal in itself, it is a means of assuring affordable, quality universal service. To the extent those goals are reached, competition will continue to be the primary mechanism for provision of telecommunication services. To the extent they are not reached, the Commission committed to regulating the system as needed. "regulatory protections [should not]be abandoned merely on the promise that the market may eventually provide them."<sup>7</sup>

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services under PSL § 97. PSL § 92-g, effective Jan. 19, 2014. See NY PSC *Detariffing Non-Basic Retail Telecommunications Services*, at <http://www3.dps.ny.gov/W/PSCWeb.nsf/All/49C70372D3F0C00285257C5500586A23?OpenDocument>.

3 "The Commission, by this Opinion, continues to put into place the framework for a robust, dynamic competitive telecommunications market in New York." Comp II at 1.

4 Comp III at 6

5 The Commission is equally committed to "maintaining affordable service for all New Yorkers" and "consumer protection" Comp II at 1

6 Comp II at 3

7 Comp III at 16

Those two goals are explicit and intertwined. “The regulatory framework described herein is intended to facilitate competitive choice and protect captive consumers during the transition to fully competitive markets.”<sup>8</sup> Emphatically and repeatedly the Commission binds itself to do what is in the interest of New York’s consumers. “...all aspects of this framework are intended to protect and benefit consumers”<sup>9</sup>

The system created by the Commission almost twenty years ago was a dramatic departure from the past. It was based on assumptions and predictions of market behavior. Its consequences are widely debated. It has never been subject to a formal inquiry. It is now time for the Commission to evaluate the new system and determine whether it is in fact meeting the predicted goals and conforming to the law and sound policy. There is substantial evidence that in key areas New York's telecommunications system is failing to meet many of these requirements of law and Commission policies. That evidence should be presented to the Commission, tested and evaluated, and where needed, corrective measures should be put into place.

We note that other states have revisited the telecommunications decisions made in the last decades to ensure that the network is meeting the needs of the public. For example, in 2012 California revised its definition of basic telecommunications service to ensure that lower-income customers -- particularly those in less urban areas -- have access to telecommunications services needed in today's economy.<sup>10</sup> Similarly, Colorado and Oregon periodically review the definition of basic telecommunications service and otherwise investigate the reasonableness of telecommunications services provided to consumers throughout their states.<sup>11</sup>

Accordingly, we herein petition the Commission to commence a proceeding to examine our telecommunications systems, and suggest a series of important specific issues for inclusion. We are prepared to supplement this Petition with additional evidence and argument, and to participate in the proceeding itself. As set forth below the need for such a proceeding is clear and unequivocal. The public interest, the law and the Commissions own pronouncements require it.

In addition to the broad inquiry described above the Commission should focus attention on specific areas of concern including but not limited to: (1) Factual And Operational Realities Of The System And Whether They Are Consistent With Commission Assumptions And Predictions; (2) The Inadequacy of Commission-defined Required Basic Services; (3) Changes in Regulatory Practice That Have Diminished Public Awareness and Public Participation and Which Have Led To Deterioration of Service And Increased Cost; (4) Deterioration of The Quality of Service; (5) Deterioration of The Physical Infrastructure; (6) Misallocation of Costs Leading To Excessive Rates; and 7) Systemic Failure Of The Availability Of Competitive Broadband Services

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8 Comp III at 2

9 Comp II at 6

10 *Order Instituting Rulemaking Regarding Revisions to the California High Cost Fund B Program*, D.12-12-038 (Dec. 20, 2012), 2012 Cal. PUC LEXIS 597.

11 See, e.g., *Investigation of Revising the Definition of Basic Local Exchange Telephone Service*, Decision No. C09-1411 (Dec. 21, 2009), 2009 Colo. PUC LEXIS 1460 (conducts review of definition of basic service and other matters every three years); *Re Oregon Telecommunications Assoc.*, Order No. 14,113 (Apr. 7, 2014), 2014 Ore. PUC LEXIS 110 (proceeding concerning the definition of basic local exchange service).

## ISSUES AND CONTENTIONS

### (1) Factual And Operational Realities Of The System And Whether They Are Consistent With Commission Assumptions And Predictions

When the Commission adopted Comp II and Comp III technological change was both obvious and inevitable. Changes in policy were consequently equally inevitable. For better or worse, the Commission adopted policies that were in large part based on predictions and assumptions about the behavior of the marketplace and market participants, the way competition would develop, and the impact of the new system on consumers and providers. These assumptions and predictions were in part guesses, in part ideological, and in part best efforts in a debate about the future that could not be evidence-based. Price, availability, the speed of change, consumer protections, the kinds of choice, every element of the telecommunications system were all remade, based on the Commission's best guesses.

Sufficient time has passed so that these assumptions can be evaluated against the objective conditions of each system. It is a basic principle of administrative law that Commission actions must be based on evidence on the public record. A failure to seek, gather and consider such evidence renders administrative actions illegal, as arbitrary and capricious. The first purpose of our Petition is to create a Commission proceeding in which hard facts and evidence would finally be gathered, and weighed. The assumptions and guesses and predictions would, finally, be tested against the reality experienced by New Yorkers every day. Various interests and participants will finally be able to measure their substantive positions, their concerns for the cost, quality and availability of telecommunications services against the evidence.

We propose the Proceeding examine the following specific issues:

A) How much do providers invest in the legacy systems? In the fiberoptic systems? In wireless systems?

Inadequate financial investment in physical and human infrastructure inexorably leads to physical deterioration and deteriorated service quality, evidence of which is available and growing. For competition to work, consumers need choices of comparable alternative systems. There is evidence that providers intend to starve and abandon the legacy system, and that investment needed to keep them viable has intentionally decreased. The Commission and the public need to know what is actually happening to the financial and investment practices for each system. The Proposed Proceeding should gather and analyze these facts.

B) What are the actual costs and revenues for each system? What rates of return have been earned in the regulated system?

Rate increases and deregulation itself has been premised on assertions that the legacy systems are significant money losers. The public record, which includes PSC documents, FCC document and SEC documents do not sustain those assumptions, and at best present conflicting data on the revenues and costs of providers. For example, in 2010, Verizon New York's SEC-Report had revenues of \$7.2 billion, but the PSC Annual only showed about \$4.98 billion, a difference of \$2.24 billion. Fundamental policies can not be based on such uncertain financial data.

There is also evidence of misallocation of costs and revenues between systems. If the losses asserted by the Commission do not exist, or are substantially smaller than claimed, then the rate structures and other features of the deregulated system are at best unfair, and at worst fraudulent. Many of the Commission's Orders have made assumptions and assertions about such costs and revenues that should be, after twenty years, measured against the actual costs and revenues. The Proposed Proceeding should gather and analyze these facts.

C) What is the current level of service quality in all systems? How is it measured?

Consumers experience these systems by their reliability and provider response to service problems. The Commission's decisions to reduce the public reporting of service quality metrics has left it and the public unable to know if consumers are in fact receiving adequate service compatible with the requirements of the Public Service Law.

D) Does competition exist? How many platforms are available to consumers? Is broadband being deployed?

The Commission's reliance on competition to control prices, quality and availability of services has been based on an assumption that consumers had the choice of three platforms, and that competition would drive system buildout, particularly broadband deployment.<sup>12</sup> There is growing evidence that competition will not do that because "Left to its own devices, the utility would build a network reaching a lower percentage of the population than [policymakers] would desire. For a fixed geographically averaged price, the utility would stop expanding its network when the private marginal cost of doing so began to exceed the private marginal benefit."<sup>13</sup> There is growing evidence that large numbers of consumers do not have such a choice. Commitments to improve the availability of fiberoptic service have been broken. Providers are continuing to attempt to switch customers from legacy systems to wireless systems even though the wireless systems do not provide a full range of telecommunication services. The Commission should assess the sufficiency of competitive alternatives needed to protect consumers. The Proposed Proceeding should gather and analyze these facts.

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12 "... the existence of three platforms, one traditional landline plus wireless and broadband, in any market would indicate that the market is sufficiently competitive to constrain anti-competitive behavior of the market participants." Comp III at 24

13 J. Gregory Sidak and Daniel Spulber, Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States, (2003) at 120.

E) What has happened to rates/cost of service in each system?

Consumers have been asked to pay substantially more for telecommunications service over legacy systems. The public and the Commission need information on rates for all available platforms.

F) What services are technologically available for inclusion in a basic service list? What are public expectations? How are they measured? .

The Commission has not revised its list of required basic services for twenty years, in spite of its promises to do so. It concedes that such revisions should be based on technological availability and consumer expectations. The absence of data, and the inadequate existing basic service list, must both be addressed.

G) What percentage of New Yorkers do not have telephone service?

There is substantial evidence that growing numbers of New Yorkers do not have telephone service. The extent of that deterioration, the role of cost, choice of platforms, the use of lifeline programs and other data must be made available.

Factual uncertainty caused by the absence of reliable data on these and other subject areas is a fundamental problem for the Commission, the public and the Governor and Legislature. It undermines any contention that the Commission's policy are legally sufficient. It leaves lawmakers unable to revise the Public Service Law if the Commission's policies are illegal or insufficient. If the evidence is inconsistent with the Commission's assumptions and guesses, the cost to our economy and our ratepayers is likely to be astronomical. We restate our primary objective in this Petition: The law and the public interest require that the Commission gather, test and debate the actual conditions of the telecommunication system.

## (2) The Inadequacy of Commission-defined Required Basic Services

At the heart of a system of universal, affordable, quality telecommunication services is the definition of what services all consumers should be able to receive. While decades ago it might have been sufficient that the system offer a dial tone and an ability to provide local and long-distance connections, technology and public expectation have evolved. The Commission explicitly recognized the enormous importance of this issue in its earlier rulings, promising to regularly review and update the basic service list. It has not followed through on those commitments, leaving New York consumers with a basic service system that is technologically obsolete, inferior to their expectations and needs and violative of state and federal law. The requested Proceeding should address this shortcoming.

Since 1996, the Commission has repeatedly acknowledged its' responsibility to ensure that the minimum requirements of the network keep up with technology and consumers needs. "As technology and markets change, the list of basic services may require revision to meet evolving customer needs.... We intend that the basic service list be re-examined every three years."<sup>14</sup> and "include the level of customer demand for the service, the public benefit it provides, the extent to which it is required to access other essential services, and the cost of providing it."<sup>15</sup>

The 2006 Comp III Opinion acknowledged the importance of the basic service list, but gave it almost no substantive analysis. In a brief discussion of universal service the Commission firmly rejected requests to update the basic service list. "...while subscription to high speed lines is increasing rapidly, there is no evidence to suggest that a substantial majority of households currently subscribe to that service. The FCC has concluded that the use of the Internet, while valuable, is not 'essential.' [The next paragraph below sets forth the FCC's current position that updating the basic service list is a requirement of law]. The White Paper accordingly concludes that our existing definition of basic service remains appropriate."<sup>16</sup>

The Commission's reliance on outdated FCC language is unjustified. The FCC recently described an adequate basic service list as "required". "The universal service challenge of our time is to ensure that all Americans are served by networks that support high-speed Internet access—in addition to basic voice service—where they live, work, and travel."<sup>17</sup> "Under these circumstances, modernizing USF and ICC from supporting just voice service to supporting voice and broadband, both fixed and mobile, through IP networks is required by statute."<sup>18</sup>

It is inarguable that modern telecommunications systems are capable of providing a much wider range of services than the Commission currently requires. Consumers understand that and expect the telecommunications network to be able to access the Internet and other data services. While all consumers may not decide to purchase those services, and others may require different levels of speed, reliability, and connectivity, New Yorkers want and should have access to a network that can provide reliable connections to data services.

The Commission has recently conducted an inquiry and hearings into the request by Verizon to use VoiceLink as a substitute for hardwire service on Fire Island and across the state. In the course of those events, at public hearings and in comments filed with the Commission the public repeatedly complained of the failure of the proposed VoiceLink service to meet their basic economic and social

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14 Comp II at 9

15 Comp II at 10

16 Comp III at 72. It further explicitly relies on market forces to assure customers have access to data and broadband services. "The markets are generally providing broadband access throughout the state, and we remain convinced that markets are the best tool to achieve full deployment."

17 FCC Order 11-61 October 27, 2011, Paragraph 5, page 6.

18 FCC Order 11-61 October 27, 2011, Paragraph 10, page 8. The FCC goes on to say, "The statute also requires the Commission to update our mechanisms to reflect changes in the telecommunications market. Indeed, Congress explicitly defined universal service as "an evolving level of telecommunications services . . . taking into account advances in telecommunications and information technologies and services."

needs. We refer the Commission to that extensive record. Based on those public comments a list of the services expected and required by the public was formally submitted to the Commission. These services included:

“Medical Alert or Other Monitoring Services  
Relay Services including TDD/TTY for the hearing impaired  
Home Security Systems  
Fax Machines  
DVR Services  
ATM Business Machines  
Credit Card Processing  
Internet Services (Dial up with Modem)  
00, 700, 900, 950, 976, 0, 00, 01, 0 Calls.  
Calling Cards or Dial-Around Calls  
Collect Calls or Third Number Billed Calls  
Ability To Bill Charges on Behalf of Other Carriers  
International Calls from Other Carriers  
Broadband”

The Commission's current basic service list is starkly inferior. The only services listed are:

- “ • Single Party Access Line
- Access to Local/Toll Calling
- Local Usage
- Tone Dialing
- Access To Emergency Services
- Access To Assistance Services
- Access to Telecommunications Relay Services
- Directory Listing
- Privacy Protections”<sup>19</sup>

The current basic service list is technologically outdated, inconsistent with consumer expectations, and a drag on economic and social development across the state. The Commission has promised a regular review and update. Those promises have simply not been kept. State and federal law require that review and update. The requested Proceeding is necessary as a matter of law, Commission promise and sound policy.

### (3) Changes in Regulatory Practice That Have Diminished Public Awareness and Public Participation and Which Have Led To Deterioration of Service And Increased Cost

For decades, Commission decisions were the result of formal tariff proceedings that included significant public participation and public disclosure of key information. That system no longer exists.

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<sup>19</sup> Comp II at 10. See also 16 NYCRR § 602.1(b). “The provision of access to: one party line service, local/toll calling, local usage, tone dialing, emergency services, assistance services, telecommunications relay services, directory listings, privacy protections and non-published service associated with the public switched network.”



Crucial Commission decisions are most often made through informal and private negotiations. Documents and information that had invariably been made public are no longer disclosed. This is not only inconsistent with the regulatory scheme set forth in statute, it has led to practical consequences including deterioration in service and physical infrastructure, and increased cost.

Rather than litigated and public proceedings, most Commission decisions are called "settlement agreements" or "Joint Proposals" of staff and company. Selected interests are often consulted and the Commission usually (not always) approves the Joint Proposals, often rejecting criticisms on the ground that it is a compromise within the range of litigated outcomes.

The Commission has defended its decisions to explicitly abandon formal evidentiary processes. " The process that we have followed has provided adequate notice and opportunity to comment on the issues that we are now addressing and we do not believe evidentiary hearings are necessary."<sup>20</sup> "We disagree with those who argue that additional procedures and a more detailed review of the facts (including a formal evidentiary hearing) are required before any rate increases are granted. We are authorizing rate increases under section 97 of the Public Service Law, which does not require a formal, trial-type evidentiary hearing."<sup>21</sup>

Two profound consequences have emerged. The first is that there is almost no public record of the facts underlying Commission decisions on tariffs, rates, service standards, investment policies and the host of other matters that were subject to public disclosure and scrutiny in traditional tariff proceedings. The public and regulators simply do not know what is happening or why. The consequences are real and disturbing. Specific examples of these consequences are as follows.

The lack of public information or Commission review of essential data occurs even when the existence of anomalous economic conditions raises crucial legal and financial questions. A striking example of this wider breakdown came in the Verizon 2011 Annual Report to the Commission, which reported an intrastate operating loss of approximately \$1.5 billion and a negative 28.08% intrastate rate-of-return. If Verizon's return on equity actually was -28%, it would be entitled to temporary rates, under PSL § 114.<sup>22</sup>, if "duly verified". This is the kind of dramatic economic loss the Commission assumed would occur. Yet the Commission took no steps to ascertain the truth, admitting long after the filing was made that "These figures have not been audited by Department Staff."<sup>23</sup>

These losses gave Verizon a right to temporary rate relief. It never sought such relief, an unusual

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20 Comp III at 64

21 Comp III at 63

22 "Said temporary rates so fixed, determined and prescribed shall be sufficient to provide a return of not less than five per centum upon the original cost, less accrued depreciation, of the physical property of said public utility company used and useful in the public service, and if the duly verified reports of said utility company to the commission do not show the original cost, less accrued depreciation, of said property, the commission may estimate said cost less depreciation and fix, determine and prescribe rates as hereinbefore provided."

23 PSC Order in Case 10-C-0202, issued January 18, 2013 Footnote 23 on page 20

decision given its legal entitlement if the facts were true. The Commission's failure to audit even when Verizon did nothing to recoup these losses was not in the public interest.

In addition, vital information in the possession of the Commission in these informal proceedings is often kept from the public on the grounds that it is "trade secret." For example, Time Warner, which serves more than two million New York telephone customers, recently filed a service quality report with the Commission but its contents are not known to the public.<sup>24</sup> As a consequence customers are deprived of relevant information that is not known in the marketplace, and companies may avoid serious competition in the area of service quality, focusing their competition instead upon expensive advertising of short-lived discounts on ever changing service packages.

A similar lack of clarity on an important factual matter exists over the actual number of New York households that no longer receive telephone service. The FCC's 2013 Universal Service Monitoring Report with data through October 2013 again shows New York slipping in terms of the percentage of households with telephone service. The National average household telephone penetration is 96%, but in New York state only 94.1% of households have phones; 5.9% of New York's 7,230,896 total households equals 426,622 households without phone service. Assuming an average of 2.6 persons per household, we now have 1,109,219 New Yorkers without a phone in their household.

The Commission responded to earlier concerns about the erosion of universal service by taking no action. "With regard to parties' comments concerning the lowered penetration rates for telephone service and Lifeline, we would certainly share these concerns if the magnitude of such a decline could be confirmed and its cause identified."<sup>25</sup> "...we question whether the decline cited actually reflects a change in New Yorkers' access to telephone services, a change in the method by which the data were collected, or some other data anomaly."<sup>26</sup>

The Commission may or may not be well-advised to rely on skepticism about the data. But five years after the original warning signals were shrugged off, Federal data shows that things seem to be getting worse. Absent a formal inquiry and proceeding by the Commission, we are left with an eight year old determination that this disturbing data may be flawed. That is insufficient as a basis for continuing policies that may be causing the decline in telephone availability in New York.

Most recently, Verizon filed its 2013 financial report with the Commission. Schedule 12 shows a decrease in operating expenses of about \$3.8 billion from 2012, and an overall profit of \$1.2 billion up from a previous year loss of \$2.6 billion. In the absence of a formal, litigated proceeding, there is no way to know why or how this change occurred, what it tells about market conditions, price and investment.

In addition to these examples of widespread opacity and public uncertainty, the deterioration of public

24 See Feb. 4, 2014 Time Warner Letter requesting trade secret classification in Case 13-C-0193 - Petition of Time Warner Cable Information Services (New York), LLC for Waivers of Certain Commission Regulations . . . . , available at <http://bit.ly/1jEhQ7H>.

25 Comp III at 76.

26 Comp III at 77.

participation has been the subject of investigation by the Governor's Office. The Moreland Commission on Utility Storm Preparation and Response, created by Governor Cuomo on November 13, 2012 by Executive Order 73<sup>27</sup> recognized the decreased opportunity for public participation in Commission activities, partially because of reduced opportunities and partially because of the decline in institutional public interest funding.

“But a problem arises when the judge –i.e., the PSC hears overwhelmingly from well-funded and professional advocates and economists representing business interests but not from consumer interests....But fairness and due process as there is in judicial proceedings–requires that two sides debate crucial issues.... The Commission believes strongly that the PSC,...requires a robust, permanent, professional consumer advocate office to represent ratepayers.”<sup>28</sup>

These Moreland Commission concerns resulted in an unequivocal recommendation that the interests of consumers needed more than the current system provided.

“Recommendation:

- The State should create a Citizens Utility Board that is independent, controlled by ratepayers, adequately funded and not subject to political interference using one of the models identified herein.”<sup>29</sup>

The Moreland recommendation has validity under any regulatory scheme. But the disuse of formal, litigated proceedings has made such a capability even more important. Less public data, fewer chances for meaningful participation and the factual and legal complexities of deregulation intensify the need for a CUB in New York, and for a return to more traditional, inclusive and information-based Commission proceedings.

The reasons for and consequences of a decline in public awareness of telecommunication policies and practices, and the decline in public participation in Commission decisions are subject to debate. But the decline in information publicly available, the decline in litigated facts and law, the failure to challenge anomalous conditions, and the continued reliance on unexamined assumptions are themselves substantial failures of law and policy. It is now time for the Commission to act. These issues need to be fully and publicly litigated. The Proposed Proceeding should include full and funded public participation. This Petition also seeks Commission support for and action on the Moreland Commission recommendation, including such administrative steps as can be taken under existing law.

#### (4) Deterioration of The Quality of Service

Telecommunications providers tout the reliability of fiber optic networks, and the marketplace is full of claims for the desirability of wireless service. But millions of New Yorkers continue to rely on a

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27 The Moreland Commission Report is found at <http://www.governor.ny.gov/assets/documents/MACfinalreportjune22.pdf> and is cited herein as MAC by page number. While the Commission focused primarily on energy matters its reasoning and recommendations apply to telecommunications issues as well.

28 MAC at 44

29 MAC at 46

network that runs on copper for voice and data services. That copper network is becoming increasingly deteriorated, is not adequately maintained, and the quality of service received by millions of people in the State is getting worse each year.

The evidence of such deterioration is clear, although less comprehensive than in past years. The Commission had for decades relied on a set of service quality metrics that, although self-reported, were able to provide an insight into how consumers experienced the system. The more recent history of Commission requirements for the measurement and improvement of service quality for legacy system customers is discouraging.

The Commission changed the system, repeatedly asserting that competition will drive improved service, and existing standards and metrics were relaxed or eliminated. The Commission explicitly sought to "allow competition to set the level of service quality wherever possible."<sup>30</sup> The evidence shows that competition has not improved service quality. The short summary of events is that Verizon did not meet the initial standards established,<sup>31</sup> the standards were reduced,<sup>32</sup> and the scope of service quality measurement was reduced so that it now covers only a fraction of consumers known as "core" customers.<sup>33</sup>

Service quality has declined significantly. The Commission has repeatedly acknowledged this and penalized providers.<sup>34</sup> "Verizon's service quality with respect to timeliness of repair performance has fallen consistently short of the threshold levels defined in the Commission's service standards."<sup>35</sup>

The Commission most recently addressed the decline in service quality in an Order<sup>36</sup> issued June 12,

30 Case 10-C-0202 - ORDER DIRECTING VERIZON NEW YORK INC. TO FILE A REVISED SERVICE QUALITY IMPROVEMENT PLAN at 2.

31 A report released by the FCC at the end of December 2009 entitled "Quality of Service of Incumbent Local Exchange Carriers," ranked Verizon poorly across all of its territories and that service quality as measured by several indicators began to worsen in 2007, i.e., after the 2006 Comp III order. [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-295377A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-295377A1.pdf)

32 The PSC reduced Verizon's service quality requirements after then current standards were not met. Case 10-C-0202 - *Proceeding on Motion of the Commission to Consider the Adequacy of Verizon New York Inc.'s Service Quality Improvement Plan*. Order Adopting Verizon New York Inc. to File a Revised Service Quality Improvement Plan with Modifications (Issued and Effective June 22, 2010) ("Verizon SQIP Order").

33 "As of December 31, 2012, Verizon served approximately 298,346 core customers, or about 7.7% of Verizon's 3,877,247 total customers. The SQIP defines core customers as Lifeline customers; special needs customers, that is, elderly, blind, or the disabled; and business and residential customers living in areas lacking competitive wireline alternatives to Verizon service." *Order Resolving Petition and Requiring Further Investigation* (Issued and Effective January 18, 2013) See also Case 10-C-0202 – *Proceeding on Motion of the Commission to Consider the Adequacy of Verizon New York Inc.'s Service Quality Improvement Plan* available at <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={6C227099-F923-4583-ABCD-CB005314A34A}> ..

34 Case 10-C-0202, *supra*, ORDER TO SHOW CAUSE, issued and effective February 16, 2012. Although Verizon disagreed with the PSC's findings, it chose to pay the penalty rather than engage in a disputed litigation. See March 6, 2012 letter from Verizon-New York to PSC.

35 Case 10-C-0202 - ORDER ADOPTING VERIZON NEW YORK INC.'S REVISED SERVICE QUALITY IMPROVEMENT PLAN at 2.

36 CASE 13-C-0161 – In the Matter of Quality of Service provided by Local Exchange Companies in New York State .

2104. The Order approved a company remediation plan, addressing what the Commission called “...a pattern of repeated failure, and multiple SIRs across a number of months indicate an egregious level of repetitive poor service quality.”<sup>37</sup> The Order requires Verizon to make “new capital investments” and engage in “Proactive Preventative Maintenance.”<sup>38</sup> As appears above and below, the Commission has previously recognized and this Petition seeks to address intentional and systematic capital underinvestment in legacy systems, and inadequate investment in staff and human resources.

Attorney General Eric Schneiderman has repeatedly sought to call attention to and remedy the deteriorated quality of service. “Even though Verizon has substantially fewer telephone lines to maintain in 2011 than in prior years, the company's network reliability performance has gotten much worse.” “...since mid-2010, the rate of customer complaints to the PSC has increased steadily, and has continued climbing through 2011....”<sup>39</sup>

As is the case in the other specific subject matters discussed in this Petition, the evidence available to the Commission and the public is more than sufficient to require a systematic factual inquiry and a re-examination of the assumptions and policies which have contributed to the decline in service quality.

#### (5) Deterioration of The Physical Infrastructure

The decline in service quality is a consequence of a decline in the physical condition of legacy systems. That decline is also provable, and is also the result of conscious policies and practice of service providers. Attorney General Schneiderman summarized the situation: “Maintaining a reliable telephone network and performing timely repairs to customers' telephones requires both preventive maintenance of the outside plant and an adequate workforce to respond to trouble reports as they are received. Verizon has chosen instead to spend the bulk of its investment and manpower on expanding its wireless business.”<sup>40</sup> The Commission has also concluded that diminished investment in the workforce has played a significant role in the deterioration of service. “[I]t is fair to infer that, had the Company maintained the number of repair personnel at its highest level (i.e., the peak level that was achieved in early September) Verizon would have completed substantially more repair jobs....”<sup>41</sup>

These Commission concerns were again made public in the June 12, 2014 Order in the proceeding concerning service quality. The Commission therein approved a Verizon proposal to substantially increase capital spending by over \$4 million dollars to remediate a pattern of violations that stem from the deterioration of the copper system in specified areas of the state. There is every reason to believe

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37 Ibid footnote 3 at 2

38 Ibid at 4

39 Petition to PSC of Attorney General Eric T. Schneiderman to Modify the Verizon Service Quality Improvement Plan, April 25, 2012 at 9

40 Petition to PSC of Attorney General Eric T. Schneiderman to Modify the Verizon Service Quality Improvement Plan, April 25, 2012 at 24

41 Case 10-C-0202 - Order To Show Cause at 11.

that such additional capital investments are needed elsewhere, as the system continues to deteriorate.

This is no surprise. The Commission has long recognized the linkage between costs and revenues and the long-term deterioration of the legacy systems. “The wireline losses cannot long continue before serious problems will arise in the maintenance and operation of the legacy infrastructure.”<sup>42</sup>

What is different and notable about the deterioration of the physical systems is the candor of providers about their intentions. Verizon Chairman & CEO and former CEO of Verizon Wireless Lowell MacAdams spoke clearly and without equivocation about the Company's policy:

But the vision that I have is we are going into the copper plant areas and every place we have FiOS, we are going to kill the copper. We are going to just take it out of service and we are going to move those services onto FiOS. We have got parallel networks in way too many places now, so that is a pot of gold in my view.

“And then in other areas that are more rural and more sparsely populated, we have got LTE built that will handle all of those services and so we are going to cut the copper off there. We are going to do it over wireless.”<sup>43</sup>

The Commission has often used the need for investment as justification for rate increases. “We are always concerned about the impacts on ratepayers of any rate increase, especially in times of economic stress,” said Commission Chairman Garry Brown. “Nevertheless, there are certain increases in Verizon’s costs that have to be recognized. This is especially important given the magnitude of the company's capital investment program, including its massive deployment of fiber optics in New York. We encourage Verizon to make appropriate investments in New York, and these minor rate increases will allow those investments to continue.”<sup>44</sup>

Nonetheless, the Commission has not engaged in a public inquiry into the level of investment in legacy systems nor the consequences of admitted disinvestment on consumers. The Proposed Proceeding should begin with a requirement that such investment policies and practices be disclosed to the Commission and the public and Commission policies adjusted to ensure that all telecommunication systems benefit from sufficient levels of human and financial investment.

#### (6) Misallocation of Costs Leading To Excessive Rates.

The financial situation faced by legacy system telephone providers is at the heart of almost every

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42 Comp III at 57

43 Verizon at Guggenheim securities symposium, June 21, 2012, [http://www.media-alliance.org/downloads/Verizon\\_Kill\\_Copper.pdf](http://www.media-alliance.org/downloads/Verizon_Kill_Copper.pdf)

44 NYPSC Press Release: CASE 09-C-0327 – *Minor Rate Filing of Verizon New York Inc. to Increase the Monthly Charges for Residence Local Exchange Access Lines (1MR and 1FR) by \$1.95 per month*, State of New York, 6/19/09 <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={3C0D0FC7-606A-4CD3-B360-EA19179D2008}>

Commission decision. Much of the Commission's commitment to deregulation is based on its conclusion that the legacy systems are losing customers and revenue as a result of competition.<sup>45</sup> It is true that over the last twenty years substantial numbers of telephone users have migrated out of legacy systems. The Commission also has concluded that the legacy systems are moneylosers. "... the fact that they are experiencing dramatically lower earnings and in the case of Verizon operating losses. ....the resultant loss of customers and revenues obligates us to lighten our regulatory requirements on those carriers if they are to remain viable telephone service providers in the future."<sup>46</sup> "...the provision of intermodal services are having profoundly negative effects on the incumbents' financial health...."<sup>47</sup> Although the evidence here is much less certain the Commission has treated it as the foundation of its regulatory philosophy.

The result has been massive cost increases for consumers, especially for the garden-variety dial tone service at the bottom of the technological ladder. For example, in New York City customer phone bills, since 2006 the price of residential 'dial tone' service (one line item on the bill) went up 84%, while other services, such as inside wire maintenance, went up 132%.<sup>48</sup>

The truth about the financial condition of telephone providers is complicated and in dispute. There is significant evidence challenging the notion that legacy systems are money losers, and evidence indicating that even if they are, the losses have been inflated by accounting techniques. There is reason to believe that providers are cooking the books. If true, the consumers of the state are being either manipulated or defrauded. There is insufficient evidence from which to draw firm conclusions. There is sufficient evidence to require further inquiry. It is time for a thorough examination of the economic consequences of deregulation.

The Commission has recognized that deregulation of rates is logically connected to actual provider revenues and costs, and "...the need to better align basic rates with underlying costs."<sup>49</sup> If costs and revenues are not accurately reported, and not subject to regulatory challenge, than a fundamental assumption about the ability of competition to protect affordability and universality is no longer sustainable.

There are several cost recovery issues, which are often confusingly intermingled. First, there is the question of recovery of the relevant cost of basic service. Second, there is the issue of competitive losses or stranded revenue requirements. Finally, there is the problem of overall revenue requirement recovery. The critical universal service questions include "are costs of providing wireless service being improperly paid by legacy customers?" and "to what extent must basic service be priced below its cost to maintain universal service?"

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45 From 2009-2013, Verizon New York reported losses of over \$11 billion dollars, with an income tax benefit to Verizon Communications of \$5 billion, and significant tax revenue implications for the state, city and federal governments. Verizon New York has apparently paid no state, city or federal income tax for the last five years or more. See PULP

46 Comp III at 5

47 Comp III at 25

48 PULP at 15

49 Comp III at 40 Comp III contains additional discussion of rate of return and return on equity that are both predicated on accurate and fair cost allocation. See Comp III at 55.

For the purposes of this Petition we present that evidence in simplified form and are willing to supplement as requested. The core need is for Commission review of provider cost allocation practices which have inflated the cost of legacy service and reduced the cost of wireless service. These are often couched in terms of accounting and cost recovery concepts, and have been exacerbated by secrecy and regulatory practices which hide them.

The best evidence of these techniques are the statement of company officials which indicate that wireless costs are being paid by wireline customers. Verizon's Executive Vice President and Chief Financial Officer, Fran Shammo, indicated to investors that Verizon wireline construction budgets are charged for expenses related to wireless service:

“The fact of the matter is Wireline capital — and I won't get the number but it's pretty substantial — is being spent on the Wireline side of the house to support the Wireless growth. So the IP backbone, the data transmission, fiber to the cell, that is all on the Wireline books but it's all being built for the Wireless Company.”<sup>50</sup>

This is confirmed by multiple Verizon press releases pertaining to Verizon New York wireline construction expenditures which outline how serving wireless towers may be deemed to be part of the ‘wired construction’ budgets.<sup>51</sup>

There is also published data showing facial discrepancies between costs and revenues charged by Verizon in internal transactions, and those charged to other providers. The data dates back four years, a consequence of the reduced transparency and reporting of company revenues in recent years.

In 2009 and 2010 Verizon charged its wireless system around \$175 million for services to be paid to its legacy system. In the same two years AT&T was charged approximately \$500 million for services to a system of similar size and Sprint was charge approximately \$220 million for a much smaller system.<sup>52</sup> On a per customer basis, the disparities are equally troubling with Verizon wireless paying Verizon landline about \$14 a customer while the other two carriers paid about \$40 a customer.<sup>53</sup> (See

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50 Thomson Reuters Edited Transcript, Verizon at Goldman Sachs Communacopia Conference, Sept. 20, 2012, [http://www22.verizon.com/investor/DocServlet?doc=goldman\\_vz\\_transcript\\_092012.pdf](http://www22.verizon.com/investor/DocServlet?doc=goldman_vz_transcript_092012.pdf).

51 *It's All Interconnected: Oversight and Action is Required to Protect Verizon New York Telephone Customers and Expand Broadband Services*. Public Utility Law Project of New York, Inc., May 13, 2014, p.80 – 82.. <http://utilityproject.org/wp-content/uploads/2014/05/Its-All-Interconnected-May-14-2014.pdf><http://utilityproject.org/wp-content/uploads/2014/05/Its-All-Interconnected-May-14-2014.pdf>

52 The Company has stated that these numbers are an aggregate of payments for a variety of services. “Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services and from interconnection agreements. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers. Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services and for interconnection agreements.” Verizon, New York, Consolidated Financial Statements As of December 31, 2010 and 2009. p.20

53 Verizon \$13.22 and \$15.29; AT&T \$49.66 and \$37.62; Sprint \$45.77 and \$35.39. See Comments of Common Cause New York, Communications Workers of America Region I, Consumers Union and the Fire Island Association, Filing Number 60, September 16, 2013 in Case 13-C-0197 for specifics and sources. Per line costs were derived by using publicly



Comments of Common Cause New York, Communications Workers of America Region I, Consumers Union and the Fire Island Association, Filing Number 60, September 16, 2013 in Case 13-C-0197 for specifics and methodology)

The Commission's recent experience with other utility holding companies and their questionable affiliate transactions (e.g., Iberdrola and National Grid) supports the need for a close examination of Verizon's affiliate transactions which could be contributing to revenue shortfalls or unreasonable expenses that combine to make the regulated utility entity appear to be losing money, requiring future rate or other relief.

The Commission allowed Verizon rate increases in 2006 and 2008 based, in significant part, upon the assumption that the revenue from the higher rates would lead Verizon to invest in fiber optic lines, presumably for the benefit of wireline customers. Serious questions exist regarding the extent to which funds may instead have been used to build out the network for the benefit of wireless customers. Publicly available reports, while fragmentary, suggest that Verizon may have included construction costs for significant benefit of its wireless affiliate to be included in the costs of the Verizon New York wireline company, thus adding to its costs and tax losses.

#### 7) Systemic Failure Of The Availability Of Competitive Broadband Services

Expected buildouts of competitive broadband services have not occurred. The Commission has explicitly recognized the social and economic necessity of providing all New Yorkers with access to broadband services. "...we agree that broadband is an increasingly valuable tool with a variety of social, political, and economic applications,..."<sup>54</sup> and that the economic future of the state required full broadband access "...the information economy requires widespread access to broadband, wireless, and flexible telecommunications applications that facilitate economic development and investments in jobs from the private sector."<sup>55</sup>

The Commission was equally certain that deregulation and competition would provide this kind of full broadband access across the state. "... we remain convinced that competitive markets are the best tool to ensure appropriate, widespread deployment. The markets are generally providing broadband access throughout the state, and we remain convinced that markets are the best tool to achieve full deployment."<sup>56</sup>

There is substantial evidence and widespread concern that these aspirations and predictions have not yielded the choices of affordable, high quality service that the Commission anticipated and the state

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available numbers for total national customers/subscribers and dividing them by New York's share of national population (6.4 %) and gross revenue to each company (6.8%). Details of these calculations will be provided on request.

54 Comp III at 76.

55 Comp III at 3.

56 Comp III at 76

needs. Outside of the MTA region<sup>57</sup>, the decision by telephone providers to decline to build broadband systems has left millions of New Yorkers with insufficient competition, excessive rates, and inferior service. This problem is especially acute in traditionally underserved areas such as upstate cities, rural communities, communities of color and poor communities.

Local coalitions are emerging across the state demanding competitive broadband systems. Syracuse Mayor Stephanie Miner has demanded fair and effective broadband access in her city. “Ensuring everyone in Syracuse has access to quality, competitive telecom services is key to creating the jobs and economy of a twenty first century city,”<sup>58</sup> Such coalitions are emerging across the state

The Proposed Proceeding should include an examination of the assumptions underlying Commission policies about broadband deployment and the evidence of if and how communities are actually being supplied with broadband service. Commission policies, and underlying legislation, should be adjusted to ensure that this necessary and essential service is available to all New Yorkers.

## CONCLUSION

The successes and failures of the competitive model adopted by the Commission is in need of a full, public and formal review. Specific issues must be examined and addressed. All parties in interest and the public must have an opportunity to participate. The proceedings must be public. A failure to engage in that process now will exacerbate growing problems and endanger the successes of the current system. We respectfully request the Commission to immediately grant this Petition and issuing an Order convening a formal, adversarial and fully litigated Proceeding addressing the issues raised herein.

Respectfully submitted,

(List of signatories below)

July 1, 2014

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<sup>57</sup> This includes New York City which has its own franchise agreement and broadband buildout, and the suburban counties which are generally wired with competitive systems. Communities in Suffolk County however are subject to the same lack of competition as affects upstate, particularly the Town of Brookhaven.

<sup>58</sup> Included in the Syracuse coalition are State Senator Dave Valesky, U.S. Rep. Dan Maffei, County Legislator Linda Ervin, Assemblyman Sam Roberts, Alliance of Communities Transforming Syracuse, Citizen Action, Association of Retired Americans, We Are New York. See [http://www.syr.gov.net/uploadedFiles/City\\_Hall\\_Mayors\\_Office/Content/Press\\_Releases/2014-05-16%20ARCH%20Coalition.pdf](http://www.syr.gov.net/uploadedFiles/City_Hall_Mayors_Office/Content/Press_Releases/2014-05-16%20ARCH%20Coalition.pdf)

AARP New York-Beth Finkel

Citizen Action of New York – Bob Cohen

Coalition For Economic Justice - Anna Falicov

Consumers Union - Chuck Bell

Common Cause/NY – Susan Lerner

Communications Workers of America,  
District 1 – Chris Shelton

Long Island Jobs with Justice - Anita Halasz

Long Island Progressive Coalition - Lisa Tyson

New York State AFL-CIO - Mario Cilento

NY State Wide Senior Action Council - Gail Myers

PUSH Buffalo – Aaron Bartley

Rochester & Genesee Valley Labor Federation,  
AFL-CIO, James Bertolone, President

Rochester Building & Construction Trades  
Council - Terence Moore

NYS Working Families Party -- Bill Lipton

Retired Rochester Police & Area Law Enforcement  
Retirees - Joseph Cimino, President

NY Public Interest Research Group - Russ Haven

#### Municipal Government

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City of Kingston – Shayne Gallo, Mayor

City of Newburgh - Judith Kennedy, Mayor

City of Rochester – Lovely Warren, Mayor

City of Syracuse - Stephanie Miner, Mayor

Erie County Executive - Mark Poloncarz

Suffolk County Executive - Steven Bellone

Suffolk County Legislature - DuWayne Gregory,  
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Town of Babylon - Rich Schaffer, Supervisor

Town of Monroe - Harley Doles, Supervisor

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