

**From:** Bruce Kushnick  
**To:** [CA Broadband Council](#)  
**Subject:** comment California Broadband Council by New Networks Institute and the Irregularators  
**Date:** Friday, November 20, 2020 1:08:59 AM  
**Attachments:** IRRLOGOsmall.png  
IRREGULATORSCAcouncilfin.pdf  
californiabroadband.pdf

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## **IRREGULATORS**

Bruce Kushnick, Managing Director, IRREGULATORS

Executive Director, New Networks Institute



November 20<sup>th</sup>, 2020

RE: California Broadband Council is seeking public comments on Governor Newsom's California Executive Order N-73-20 which requires the development of a California State Broadband Action Plan.

New Networks Institute (NNI) and the Irregularators submit our written comments via email. Our comments have 2 primary parts;--- ATTACHED

- Comments filed originally with the California Public Utility Commission in proceeding Rulemaking 20-09-001, filed 10/25/20 and Order Instituting Rulemaking Regarding Broadband and Infrastructure Deployment and to Support Service Providers in the State of California. (Starts page 6.)
- We included a Summary, some graphs, and a Timeline of Broadband and Deregulation from 1989-November 2020, as well as the Irregularator bios.

These comments are presented by New Networks Institute, a market research and consulting firm, and the Irregularators, an independent consortium of senior telecom experts, analysts, lawyer sand forensic auditors. (See page 4.)

- Separately attached: "The History of Fiber Optic Broadband In California", covering 1993-2004. Originally published as a chapter in "\$200 Billion Broadband Scandal & Free the Net", the 2<sup>nd</sup> book in a trilogy published in 2015 .
- We included this chapter because in discussions with both CPUC staff and most experts, etc. there is a serious lack of understanding about how the Digital Divide was actually created and what is required to fix it, much less the factual history of fiber optic broadband and deregulation in California.

## SUMMARY

In order to solve the Digital Divide by upgrading all of California to broadband capable of 100mbps download speed at affordable prices, as proposed by Governor Newsom, the State must address certain fundamental issues.

While we applaud comments from others, our reply lays out a critical new path that focuses on halting billions of dollars in cross-subsidies from AT&T's state based public telecommunications utility, AT&T California, and the AT&T subsidiaries. This overcharging should be immediately redirected to fund the deployment of very high speed fiber optic services to all citizens of California at affordable rates.

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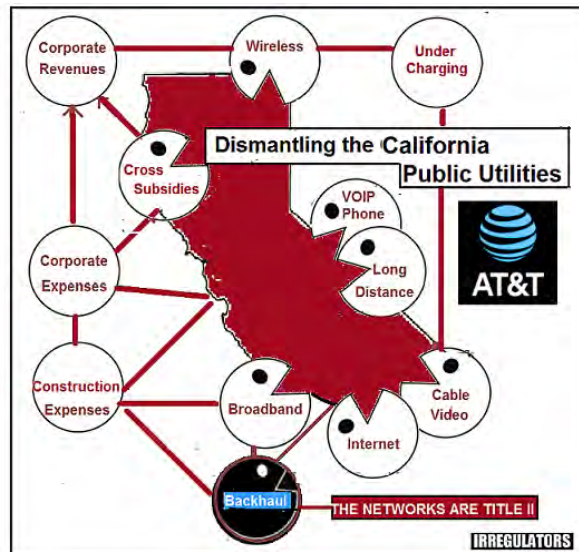
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By the end of 2000, Pacific Bell (AT&T California) claimed it would have 5.5 million households wired with fiber optics and spend \$16 billion dollars. This is an excerpt from the Pacific Telesis 1994 Fact Book, detailing the deployment schedule. It was never built.

*Consumer Broadband Deployment Schedule*

Geography for 7-year deployment	Regional Areas where Pacific Bell will initially break ground	Cities within regional areas slated for initial deployment in the 1994-1996 time frame	Areas slated for deployment by 2000
San Francisco Bay Area	Silicon Valley and San Jose	Campbell, Cupertino, Los Altos, Los Altos Hills, Milpitas, Mountain View, San Jose, Santa Clara, Saratoga, Sunnyvale	Peninsula, San Francisco, East Bay, Contra Costa
Los Angeles	San Fernando Valley/West LA	Parts of Los Angeles (Canoga Park, Reseda, Sherman Oaks), Calabasas, Hidden Hills, Inglewood	Most of greater Los Angeles area
San Diego	San Diego	Central San Diego, (and other parts of San Diego, including La Jolla, Linda Vista, Pacific Beach and Rancho Bernardo), Del Mar, Poway	Central and eastern San Diego areas
Orange County	Anaheim	Anaheim, Buena Park, Cypress, Garden Grove, Orange, Stanton, Villa Park	Orange County and western Riverside County

As explained, herein, this next graphic represents what happened the last 2 decades. AT&T has been dismantling the public state telecom utility by using manipulated FCC accounting formulas. Based on other states, we believe AT&T cross-subsidized the other lines of business, making the state utility a ‘cash machine’. Instead of upgrading the networks to fiber optics, it was able to take the construction budgets and shift them to the other lines of business including wireless, while adding other corporate expenses. There have been no audits or investigations of the flows of money in California for at least 15 years.



**Pacific Bell, AT&T California Timeline**

1989	Incentive Deregulation --- companies got to make extra money to fund tech roll out of ISDN – splitting the extra profits over a certain amount
	ISDN rollout was a flop. – 53,000 ISDN lines by 1995
	Schools were supposed to be upgraded to data and video
1993	Pac Bell Audit by NARUC, incomplete, reveals \$1 billion in overcharging; shows cross-subsidies of all of the wireless and other lines of business
1993	Pac Bell Announces \$16 billion on 5.5. million fiber lines by 2000.
	Cities cut deals to be upgraded to fiber up and down the coast including San Diego, San Jose and Sacramento
1995	Granted an additional billion dollars in productivity gains
1995	Takes \$3.6 billion dollar tax deduction – FASB 71
1996-1997	SBC merger – SBC stops any building, takes deductions for what was built, but spent less than \$1 billion vs \$16 billion as told to the public.
1997	Profits go through roof
1997	Construction timeline shows no extra capital expenditures in CA
1998	Bait and Switch—rolls our DSL over the existing copper wires
1999	SBC merger with Ameritech; supposed to spend \$6 billion on fiber
2001	Audit of 1996, 1997, 1998 reveals \$1.94 billion in questionable expenses in the incentive split deal, shows major cross-subsidies of corporate expenses, dumping of expenses into the state utility
2004	SBC announces Lightspeed – which was fiber to the home according to FCC filings. This was renamed U-Verse
2005	SBC merges with AT&T, renames itself AT&T
2006	AT&T merger with Bellsouth
2006	SBC pulls bait and switch and rolls out U-Verse, copper is used
2006	More deregulation DIVCA is signed to with statewide franchise –
2007	100% of AT&T 21 state territories were supposed to have been upgraded to some broadband at 200kbps –this would mean there should be no unserved areas in California for broadband at DSL speeds (the only service that could have fulfilled this obligation at the time.)
2013	AT&T announces GigaPower; taken to task over lack of actual deployments. wireless; bait and switch – is using the fiber optic wires for wireless in most parts
2015	DirectTV merger: AT&T admits that “15 million customer locations, mostly in rural areas where AT&T does not provide high-speed broadband service today.”
201X	Government subsidies for slow wireless in rural areas
200X	Wireless bait and switch substitution
200X	FCC \$400 million connect America fund
200X	California high cost fund B—an additional \$146 per line for rural areas
200X	Administration fee
200X	Cost Recovery Fee added
200X	Continuous rate increases granted, no audits, no inspection of actual costs.
2020	AT&T announces the closing of DSL
Nov.2020	CPUC requests info about all services and an analysis of how many customers will be impacted.

**BIOS: THE IRREGULATORS (PARTIAL LIST)**

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

The **IRREGULATORS** is an independent consortium of senior telecom experts, analysts, forensic auditors, and lawyers, some of whom are former senior staffers from the FCC, state advocate and Attorneys General Office as well as former telco consultants. The group has filed at the FCC and state commissions, and took the seminal legal challenge, **IRREGULATORS v FCC**, which freed the states from using the FCC's accounting rules.

- **Bruce Kushnick, Managing Director**, has been a telecom analyst for 39 years, and started as an industry expert working for IDC/Link, (a subsidiary of International Data Corp). In 1992, Kushnick helped to invent and deploy the first independent 3-digit phone service, “511” with Cox Newspapers. In 1992, Kushnick also started New Networks Institute and was telecom director for the nationwide "Prime Time to End Hunger" campaign. In 2002, Kushnick was one of the founders of Teletruth, and worked with Congressmen Nadler’s office on "The Broadband Bill of Rights”. Kushnick is the author of an infamous trilogy of books about the fiber optic broadband broken promises and telecom; the most recent is “The Book of Broken Promises: \$400 Billion Broadband Scandal & Free the Net”, released May 2015.
- **Paul M. Hartman** is a former FCC Asst Chief of the Pricing Policy Division (PPD), part of the Wireline Competition Bureau, as well as worked in the Office of Inspector General as part of the Universal Service High Cost Oversight by the commission. Paul was also on the FCC’s Jurisdictional Separations Federal-State Joint Board. Paul is one of the leading experts pertaining to the FCC's accounting rules and has been involved in regulatory cost studies since working for the Bell System in 1973.
- **Scott McCollough, Esq.** McCollough is an attorney who focuses on communications law and regulation, representing the consumers and small business competitors. Past activities include 10 years as an Assistant Texas Attorney General and Contract Consumer Advocate (representing residential and small business consumers) Scott was lead counsel for **IRREGULATORS vs FCC** and is part of the Robert F Kennedy Jr. team, challenging the FCC. Scott was on the EFF Austin Texas Board of Advisors.
- **Chuck Sherwood** is a former member of the Alliance for Community Media’s Public Policy Working Group, and the Policy and Legal Committee of the National Association of Telecommunications Officers and Advisors, and has worked for community access and internet deployments for over 40 years.
- **Tom Allibone** is the President of LTC Consulting, and former Director of Teletruth’s Auditing Division. Tom worked for New Jersey Bell and AT&T as a systems consultant and National Account Manager, starting in 1970. Tom led Teletruth’s auditing capabilities which has resulted in the settlement of 4 class action suits against Verizon, New Jersey, as well as telecom auditing resulting in

over \$30 million in refunds. Tom was a member of the FCC Consumer Advisory Committee.

- **Kenneth Levy, Esq.** joined the FCC in the late 1970s, and held several supervisory positions including Deputy Chief, Operations of the Common Carrier Bureau and Chief of the Tariff Division during the period leading up to divestiture and through the aftermath. He left the FCC to become General Counsel of the National Exchange Carrier Association, Inc., the organization charged with administering the FCC's interstate access charge plan and universal service fund. He now consults on legal and regulatory telecommunications cases in the public interest.

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA

*Order Instituting Rulemaking Regarding  
Broadband Infrastructure Deployment and  
to Support Service Providers in the State  
of California*

Rulemaking 20-09-001  
(Filed 10/25/20)

REPLY COMMENTS OF THE IRREGULATORS & NEW NETWORKS INSTITUTE

Bruce Kushnick  
Managing Director,  
IRREGULATORS  
Executive Director New  
Networks Institute

[REDACTED]

October 25<sup>th</sup>, 2020



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OF THE STATE OF CALIFORNIA

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REPLY COMMENTS OF THE IRREGULATORS & NEW NETWORKS INSTITUTE

Introduction

In accordance with Rule 6.2 of the California Public Utilities Commission (“Commission”) Rules of Practice and Procedure (“Rules”), the IRREGULATORS & New Networks Institute submits reply comments to the Order Instituting Rulemaking 20-09-001 (“Rulemaking”).

In order to solve the Digital Divide by upgrading all of California to broadband capable of 100mbps download speed at affordable prices, as [proposed by Governor Newsom](#), the State must address certain fundamental issues.

While we applaud comments from EFF and others, our reply lays out a critical a new path that focuses on halting billions of dollars in cross-subsidies from AT&T’s state based public telecommunications utility, AT&T California, and the AT&T subsidiaries. This overcharging should be immediately redirected to fund the deployment of very high speed fiber optic services to all citizens of California at affordable rates.

The [IRREGULATORS](#) is an independent consortium of senior telecommunications experts, analysts, forensic auditors, consultants, and lawyers, including former officials at

federal and state agencies, including the FCC, state attorney general and consumer advocate offices, who advocate for consumer interests by exposing the unlawful acts of large telecommunications companies.

New Networks Institute was established in 1992 as telecommunications market research and consulting firm.

**The Issues that Need to be Investigated and Actions Taken**

**First**, we believe there is massive cross-subsidizing leading to overcharging of the wired networks by AT&T, costing consumers \$1.7-2.4 billion annually and that this money can be redirected to fund fiber optic broadband to all, not at 100 Mbps speed for downloads but 1Gbps in both directions, as well lower dramatically lower rates on all communications.

At the core, AT&T has used the wired utilities as a cash machine to fund and/or subsidize its other lines of business, and also to convince the state to adopt public policies that are favorable to its business.

<b>Estimated Partial Overcharging AT&amp;T California Local Service, 2019; 5 Year</b>				
<b>UTILITY</b>	<b>STATE</b>	<b>2019 LOW</b>	<b>2019 MEDIUM</b>	<b>5-YEAR (2015-2019)</b>
AT&T	California	\$ 2,437,728,664	\$ 1,675,938,457	\$ 10,284,167,803

**IRREGULATORS**

Over the last decade the IRREGULATORS has found massive overcharging in New York by Verizon, which is based on the [Verizon New York 2019 Annual Report](#) and previous years' financial information. We strongly suspect that AT&T is doing the same in California.

The former Bell companies, Verizon NY and AT&T California, continue to use deformed FCC accounting rules, (known as “USOA” or “ARMIS”) to allocate an excessive percentage of company costs to local wired service, based on 20 year old formulas that produce greatly distorted results. In California, as in New York, we suspect that the formulas dump corporate operations expenses on local service, resulting in that service appearing to be unprofitable, while cross-subsidizing U-Verse and AT&T’s wireless service.

What is needed is a full audit of financial annual reports of AT&T and the other carriers for cross-subsidies with the wireless and other affiliates, such as U-Verse, as well as the adoption of a cost allocation approach that reasonably tracks the way costs are incurred by the various services.

**Second**, California needs to not just investigate but to take action to halt these cross-subsidies and use the new- found funding to fix the Digital Divide once and for all. There should be enough to upgrade all areas of the AT&T territory with fiber optics.

The California PUC has not investigated AT&T’s cross-subsidization of services, even when the Office of Ratepayer Advocates (ORA) raised the matter. The Commission claimed that the FCC’s accounting, known as ARMIS data, did not include data to determine if there were violations. In the [2013 Annual DIVCA Report](#):

“The Phase I decision implementing DIVCA adopted FCC ARMIS data for purposes of monitoring. However, the Communications Division staff has determined that ARMIS data does not include data that would be necessary to determine whether or not cross subsidy is occurring. Therefore, the only recourse available to enforce the prohibition of cross subsidy violations would be to conduct a cost study proceeding.

“A pending Proposed Decision still subject to Commission adoption rejects ORA’s request that the Commission commence an investigation into whether DIVCA’s cross subsidy provision has been violated.”

And the Commission even claimed that it would be too “onerous” to do an audit, and worse, there has not been an audit done for decades, because of the New Regulatory Framework.

“To make this determination significant analysis is required. Revenues for residential basic service, video service and other services that use the shared network to provide video service would need to be compared to their respective costs. The Commission would need to audit those costs to ensure they have been accurately assigned to each service. Such an audit **would be onerous** as it would require the Commission to perform a cost of service analysis, which has not been performed in decades, since the Commission adopted its New Regulatory Framework and established price caps to replace cost of service regulation.”

The original deregulation plan New Regulatory Framework was created in 1989 based on a commitment to bring broadband services to California, and other deregulations were applied later as Pacific Bell, now AT&T California, claimed it would be giving California a fiber optic future. The updated Uniform Regulatory Framework, decided in August 2006, erased more regulations, as if that would bring the new broadband future to the State. But, the State still requires “FCC accounting rules” based annual reports.

As we will discuss, the Verizon New York financial reports, which are public, show that there are billions of dollars in cross-subsidies—that were created through using the “FCC accounting rules”, which are federal but have become corrupted over the last 15 years.

But, at the core—the deregulations that occurred over the last 3 decades, known as “price caps”, were a failure, and it cost the state hundreds of billions in economic growth, and at least 20+ billion.

**Third**, the Governor needs to assess why AT&T was not held accountable for renegeing on its obligation to deploy fiber optic services throughout California, starting in the 1990’s, for which it was granted multiple deregulatory concessions, such as “price caps” that were based on claims that California would be a fiber optic state.

For documentation about this history of fiber optic broadband in California:

<http://irregulators.org/caattfiberastory/>

This is from the Pacific Bell Video Dialtone filings at the FCC, where Pacific Bell claimed it was going to deploy fiber to the home and curb services as part of a federal plan. At the same time, this announcement was in the Pacific Telesis 1993 Annual Report.

By the year 2000, California should have had 5 million homes connected with fiber optics for video and data service, and spend \$16 billion to do it.

The California First plan, announced by Pacific Bell November 11, 1993, is a \$16 billion investment plan to allow both telephony and video services to be provided over an integrated network. By the end of 1996, we expect more than 1.5 million homes to be hooked up to the network, with more than 5 million homes connected by the end of the decade. The integrated network will be capable of transporting voice, broadcast video, and interactive services, including video and data services. December 21, 1993

Re: *RM-8380 / Joint Petition for Rulemaking to Establish Rules for Subscriber Access to Cable Home Wiring for the Delivery of Competing and Complementary Video Services*

And this is not just a history lesson; “price cap” regulations and other deregulatory favors were granted based on statements and assumed commitments, yet virtually none of this was provided, and there was no serious tracking of whether granting deregulation worked; the answer was, the company got billions, took over \$3.6 billion in tax deductions and there was nothing to show for it.

Here’s the actual timeline from [Pacific Telesis 1994 Fact Book](#).

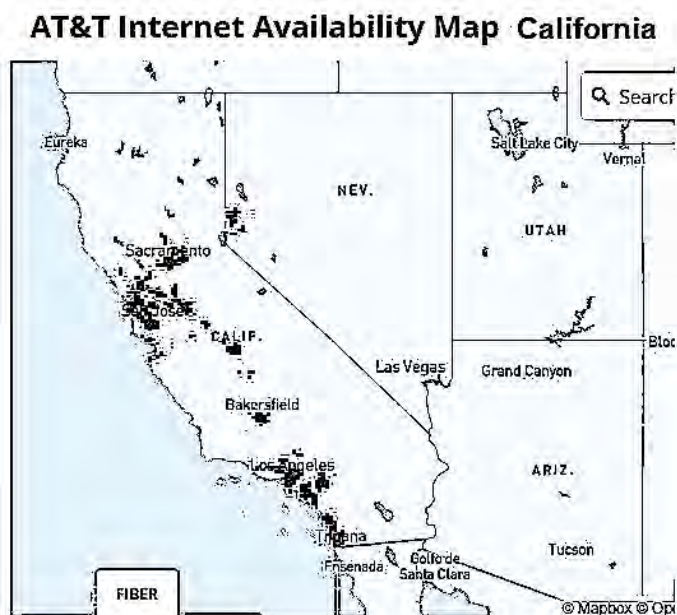
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Read the Full STORY: [The History of Fiber Optic Broadband in California](#), 1993-2005.

This was the first wave of commitments to have California upgraded to fiber.

But is the current deployment of fiber that is problematic. The map of AT&T fiber optic Internet availability by [Broadbandnow](#) shows an empty landscape of fiber optic services in California.



### **U-Verse was a Bait and Switch.**

AT&T also stated that U-Verse was based on using the existing telecommunications wires, meaning the legacy copper wires to complete the service. The ‘fiber’ was to a location within the town that can be ½ mile from the customers’ homes. Ironically, AT&T told the public and the FCC that this was going to be a fiber optic connection.

AT&T, (formerly SBC) 2004 Annual Report

“Project Lightspeed In June 2004, we announced key advances in developing a network capable of delivering a new generation of integrated IP video, super-high-speed broadband and VoIP services to our residential and small-business customers, referred to as Project Lightspeed... **“We anticipate that we will deploy approximately 38,800 miles of fiber, reaching approximately 18 million households by year-end 2007, and expect to spend approximately \$4 billion over the next three years in**

**deployment costs** and \$1 billion in customer-activation capital expenditures spread over 2006 and 2007.” (Emphasis added)

In fact, SBC told the FCC it was rolling out fiber to the home. According to former FCC Chairman Michael Powell’s statement as to why he closed the networks to direct competition, he pointed to AT&T’s commitment for fiber. [Powell claimed his reason](#) for closing the networks (“removing unbundling obligations”) was based on ‘commitments’ for 100 Mbps, fiber-optic based services by SBC (now AT&T) in October 2004.

**Fourth, Find the Dark Fiber and Let The Cities Light It Up.**

One of the most disturbing issues in California is, where did all of the fiber optic wires go?

This information is from the FCC’s last published report, the “Statistics of Common Communications Carriers”, which stop collecting basic financial business information from the state utilities in 2007.

AT&T California, (Pacific Bell) had 81% of their fiber optic network NOT LIT and NOT IN USE. Thus, as of December 2007, there were 2.9 million miles of fiber optic wires in California; 2.4 million miles were NOT TURNED ON.

**AT&T California Fiber Miles, December 2007**

**Source: FCC**

	<b>Miles of Fiber</b>	<b>%</b>
<b>Lit</b>	571,835	19.4%
<b>Dark</b>	2,382,140	80.6%
<b>Total</b>	2,953,975	

NOTE: This chart was originally calibrated in kilometers, and converted to miles.



**We is all of the dark fiber? What happened since 2007?**

We are requesting that a full accounting of ALL copper and fiber optic wires, regardless of the classification, be supplied to the public and this would include the Backhaul and business data services, Special Access, U-verse, DSL, as well as basic copper phone service.

We are requesting that every wire be related to the capital budget that was used to build the networks—As we found in New York, while the wires to the cell sites are placed into the wired network budgets, and AT&T stated that most of the wireless was funded via the wireline networks.

**Fifth**, the state needs to go back and fix the data collection and analysis, where AT&T and the other providers are not even mentioned in the Annual Report to the Governor.

Moreover, AT&T is now treated more like “Voldemort”, the Harry Potter nemesis that is referred to as, “You know who” or “He who must not be named.” AT&T is the state’s largest public telecommunications utility and yet it is a fact that is never discussed, it appears, nor even mentioned and singled out in the Governor’s plan. The company has been able to have the state reports, like DIVCA annual reports, not mention or examine or deliver specific information about AT&T, but only aggregated data. And yet the State is attempting figure out why it has a massive Digital Divide problem and whole areas of the state were never upgraded.

How crazy does it get?

The Digital Infrastructure and Video Competition Act, December, 2019 (DIVCA) Report is supposed to

“DIVCA contains dual State policy goals: the promotion of video competition and the deployment of more and better broadband services.”

But it has been crafted to omit basic information by company—and AT&T covers 80% of the state; it is not some random small concern but has been in control of the majority of California major infrastructure, including as Pacific Bell.

The information has to be presented in aggregate form:

“Pub. Util. Code § 914.3 directs the CPUC to submit to the Governor and the Legislature a report that includes, based on year-end data, on an aggregate basis, the information submitted by SVF holders pursuant to subdivision (b) of § 5960.”

And it is atrocious. Here is a chart that shows that there are 14.5 million households being offered video – with no breakout, but only 12.7 million households in the video area.

**Video Service Offered by Non-Telephone Corporations**

	Number of Households in Video Service Areas	Number of Households Offered Video
<b>Households</b>	12,712,846	14,543,667

Meanwhile it is based on a methodology to examine ‘census tracts’, which says if there is one customer, count the entire census tract, and the census numbers are from 2007.

It is clear that these reports do not reflect the actual marketplace and aggregating the information is hides what each company has an has not deployed, and where.

And these types of holes in the regulatory fabric, where the state advocate's office can not bring in evidence of wrongdoing in the application proceeding makes sure that the same bad dynamics that brought California to this place, will just keep repeating.

### **Sixth; Investigate the “Unserved Areas” and Payments to AT&T**

Investigate the unserved areas – how much money did AT&T get to upgrade areas of its own state utility?

The AT&T BellSouth merger was supposed to have 100% of their territories upgraded to handle the FCC's minimum broadband speed level, which was only 200Kbps, and completed by the year 2007.

We cut out the actual text from the [AT&T-BellSouth merger agreement](#)

#### **Promoting Accessibility of Broadband Service**

1. By December 31, 2007, AT&T/BellSouth will offer broadband Internet access service (i.e., Internet access service at speeds in excess of 200 kbps in at least one direction) to 100 percent of the residential living units in the AT&T/BellSouth in-region territory.<sup>2</sup> To meet this commitment, AT&T/BellSouth will offer broadband Internet access services to at least 85 percent of such living units using wireline technologies (the “Wireline Buildout Area”). AT&T/BellSouth will make available broadband Internet access service to the remaining living units using alternative technologies and operating arrangements, including but not limited to satellite and Wi-Max fixed wireless technologies. AT&T/BellSouth further commits that at least 30 percent of the incremental deployment after the Merger Closing Date necessary to achieve the Wireline Buildout Area commitment will be to rural areas or low income living units.<sup>3</sup>

This should have meant that there was no one who couldn't get broadband in the AT&T California territories. We note that at the time, to deliver (200kbps?) would require at least DSL, as there was no other product that was available from AT&T.

AT&T not only received other state-based grants to cover unserved areas since that time, as well as federal funding via the CAF funding.

But, (a) we know of no study done by the state to corroborate that the unserved areas were served via this merger deal, (b) multiple stories and filings show that AT&T had not completed this obligation in (checking?) during 2015.

The State and FCC should have audited this merger condition to see if it had been accomplished, but there are other overlapping issues.

In Mississippi, Commissioner Presley filed with the FCC to investigate that AT &T received \$283 million over the last 5 years from the CAF fund, but failed to complete the roll out.

This impacts not only the CAF funding, but the USF funding, the high cost funds, and other monies given to AT&T including California Advanced Services Fund, etc.

**Seventh, the companies have been mainly serving the wealthy areas, and this is a social injustice and caused the Digital Divide**

A [Haas Institute](#) study had a number of disturbing findings about California.

“Rural California is left behind by AT&T. In 14 largely rural counties, virtually no household has access to AT&T broadband at the FCC’s 25/3 Mbps speed and one-third or more households are underserved without access to AT&T broadband at 6/1.5 Mbps.”

“Many urban and suburban Californians are stuck in AT&T’s slow lane. AT&T’s slow speeds are not limited to rural areas. In Los Angeles county, for example, approximately 443,000 households (20.4 percent) in AT&T’s wireline footprint lack access to AT&T broadband at 6/1 Mbps and approximately 1.1 million households (51.5 percent) lack access to AT&T broadband at 25/3 Mbps.”

A [California Public Utilities Commission report](#) states,

“AT&T’s investments in fiber upgrades have tended to favor higher-income communities, such that wire centers that serve areas with the lowest household incomes are also characterized by the poorest service quality.”

**Eighth**, the price for local services is no longer just and reasonable.

- The price of the basic AT&T California state utility phone service went up 143% from 2004-2016.
- The price of every ancillary service went up, from Call Waiting, which went up 240%, to unlisted numbers, which went up 525% (a fact that was also uncovered by the [LA Times](#) in 2016.)

**AT&T Local Service Calling Features and Services, 2004 -2016**

	2004	2008	2016	Increase	Annual
<b>Local Service</b>	\$10.69	\$10.94	<b>\$26.00</b>	143%	\$183.72
<b>Call Waiting</b>	\$3.23	\$6.00	<b>\$10.99</b>	240%	\$ 93.12
<b>Caller ID</b>	\$6.17	\$9.99	<b>\$9.99</b>	62%	\$ 45.84
<b>Inside Wire (Wirepro)</b>	\$2.99	\$6.00	<b>\$8.00</b>	168%	\$ 60.12
<b>Unlisted Numbers</b>	\$0.28	\$1.25	\$1.75	525%	\$ 17.64

*Updated: IRREGULATORS, using AT&T pricing guide, 2017*

In fact, the CA Public Utility Commission [recently stated](#) that competition lowers prices.

“Our decision was based on the economic theory that increased competition would drive rates close to cost, thus a competitive market could act in place of traditional rate regulation.”

And the State has an obligation to make sure rates are just and reasonable.

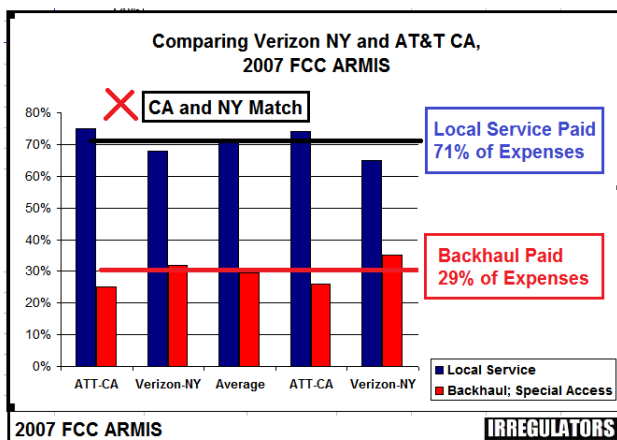
“We undertake this investigation mindful of our obligation, pursuant to Public Utilities Code § 451, to ensure just and reasonable rates, terms and conditions of service. Accordingly, we request data and comment on these issues as an exercise in good government, and in light of our promise to monitor and inform ourselves about the State’s telecommunications infrastructure. This data-driven approach does not reflect an intent to regulate where the Commission lacks regulatory authority.”

But Local Service pricing is one of multiple issues. AT&T et al controls the wires to the cell sites, and, with Verizon control the pricing of wireless service as well as the data usage a customer receives.

Moreover, because there is no competition from AT&T for high speed broadband, the cable companies have been able to not only charge what they want but add multiple fees that should never be added to the customers bills, especially on the Triple play services.

**Ninth,** Price caps did not work and AT&T appears to be cross-subsidizing the other lines of business and overcharging customers in different ways, just like New York.

We think the numbers will show massive overcharging. These are the expenses as shown in the FCC’s ARMIS Report of 2007 for Verizon New York and AT&T California.



The FCC’s accounting rules allocate expenses to different lines of business, which in 2007 the 2 main lines were:

- “Local Service”, which is revenues for the copper based phone service.
- “Backhaul” (sometimes called Special Access or Business Data Services) which are the guts of the networks, and are data lines.
- These copper or fiber lines go to ATM machines and are the lines that go to the cell sites; they are also used by competitors.

The FCC’s accounting rules, just like a basic company, divides up the expenses into categories, such as marketing or equipment or staff.

And this chart shows 2 different expense items, ‘Corporate Operations’ and network construction expenses charged to AT&T California and Verizon New York, using the FCC’s 2007 data, the last available information published by the FCC.

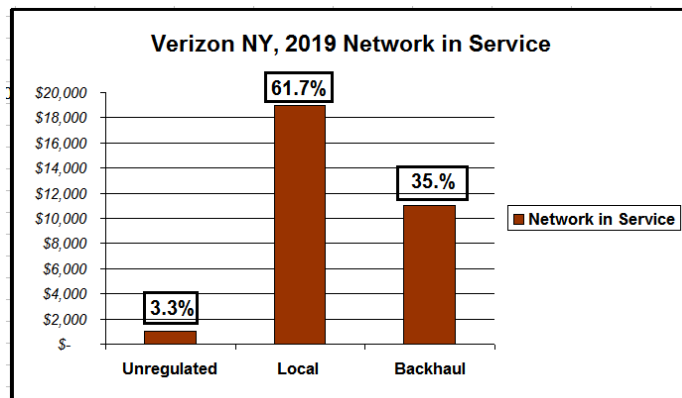
- **Corporate Operations** is a garbage pail for executive pay, lawyers, pr and even the corporate jet, not to mention the lobbyists, etc
- **Construction and Maintenance** are the monies spend to maintain and upgrade the networks.

Local Service in AT&T California and in Verizon New York averaged paying 71% of the total Corporate operations expenses and 71% of the construction budgets.  
 Backhaul only paid 29% of the total expenses.

And both states’ used the same, exact formulas as the percentage assigned to each line of business is virtually identical. Which, of course, is problematic ---but it got worse.

**Fast Forward to 2019: Local Service Overcharging in New York**

This chart shows that the “network in service”, i.e., the entire state-based wired telecommunications utility infrastructure for the last few decades was. And divided into the different lines of business, somehow, the mostly copper networks have been charged just to Local Service. Here, the Local Service paid 62% on average for the last 2 decades, with the total network being \$31 billion (not counting the write offs). “Nonregulated” which represents FiOS video and VOIP, only paid about \$1 billion, or 3%.



This shows that Verizon’s fiber optic deployment and most of the backhaul, and even Verizon wireless lines, got a free ride on the backs of local phone customers. There are plenty of caveats.



This means that local phone customers have been the defacto ‘investors’ in the networks, and that the overwhelming majority was cross-subsidizing other lines of business, as the basic copper wires weren’t upgraded or even maintained and repaired.

SEE: [Solve the Digital Divide by Halting Billions in Cross-Subsidies](#): Verizon NY 2019 Annual Report

Did AT&T California do the same accounting, which is based on the FCC’s accounting formulas?

**The Financial Reporting for California and New York Should Match, based on FCC Accounting ARMIS Rules.**

AT&T California’s financial annual reports are not public and we do not believe that California adjusted the formulas for the FCC accounting rules. In 2006, the state said:

“We instead, therefore, base our requirements on Generally Accepted Accounting Principles (GAAP) accounting standards and FCC accounting rules, and consequently streamline our audit practices.”

These are the reports that AT&T et al. are required to give the State; And they based on the FCC’s accounting rules.

1. [FCC ARMIS Reports \(due March 31\)](#) – applicable to Uniform Regulatory Framework (URF) Incumbent Local Exchange Carriers (ILEC)
  - a. FCC Report 43-01, the Annual Summary Report
  - b. FCC Report 43-02, the USOA Report
  - c. FCC Report 43-03, the Joint Cost Report
  - d. FCC Report 43-07, the Infrastructure Report

e. FCC Report 43-08, the Operating Data Report

**Therefore, the State should immediately start audits to find out whether the accounting has been manipulated just like Verizon New York as it could be 1.7-2.4 billion being overcharged annually-- and this is the low number.**

**And it should halt all cross-subsidies as they are not legal in California under multiple laws.**

### **Conclusion**

Prices are now out of control and the recently announced plan by AT&T to eliminate DSL service is further evidence of their failure to provide the service they have promised year after year and are they are being aided and abetted by the FCC to substitute a sham 5G service that will use the fiber in the ground, both lit and unlit, to provide a service that will never meet the broadband needs now openly visible due to the Pandemic.

This service must be a connectivity service that is ubiquitous, asynchronous and high-speed to enable all Californians with the ability to work from home, school from home and receive telehealth services from home.

And once the subsidies and monies are realigned, the State now has a new path to fix these long standing abuses. Government subsidies can halt, prices should immediately be lowered and revitalizing the state with fiber optic broadband, not some wireless kludge that is not profitable when AT&T had to pay for using the networks customers-funded.

We stand ready to work with California to make this plan work.

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## Chapter 24      How Pac Bell and SBC Stole California's Digital Future.

In 1993, Pacific Bell laid out a massive Information Superhighway plan titled "California First". The company stated that they would be spending a whopping \$16 billion to rewire the state with fiber optic technologies, replacing the old, in use, copper wiring. By the year 2000, the company would have 5 million homes rewired, 1.5 million by the end of 1996! According to Pacific Telesis's 1993 Annual Report:<sup>349</sup>

*"In November 1993, Pacific Bell announced a capital investment plan totaling \$16 billion over the next seven years to upgrade core network infrastructure and to begin building California's 'Communications Superhighway'. This will be an integrated telecommunications, information and entertainment network providing advanced voice, data and video services. Using a combination of fiber optics and coaxial cable, Pacific Bell expects to provide broadband services to more than 1.5 million homes by the end of 1996, 5 million homes by the end of the decade."*

And what would be offered? — Tele-medicine, tele-learning, and "unlimited programming choices", to name a few services.<sup>350</sup>

- "telemedicine, linking medical specialists across time zones for review of x-rays and medical procedures;
- learning and education programs that connect universities and school districts, whether for information access, or teacher-student and class-to-class interaction;
- unlimited programming choices at flexible times for TV watchers and unprecedented public access for TV producers; and
- multi-media, virtual-reality computer games; and voice-activated home shopping from an infinite variety of vendors."

This wonderland would not just include regular cable or online services, but would also give customers between 70 cable channels and 150 to 300 digital channels, according to Pac Bell's

video dialtone application to the FCC for permission to deploy this fiber-upgraded system. According to the FCC: <sup>351</sup>

“The Commission found that Pacific Bell's proposed platform, consisting of 70 analog channels and between 150 and 300 digital channels, would offer sufficient capacity to serve multiple programmers.”

The speeds of these services would be incredibly fast, according to the Pacific Telesis 1994 Fact Book.<sup>352</sup> Fiber optics is a glass wire and has the capacity to deliver speeds about 100 times faster than current DSL, which still travels over the original copper wiring.

### **Exhibit 53**

#### **Pac Bell's Consumer Broadband Hybrid Fiber/Coaxial Direction**

(\* The speeds are not quite the equivalent to Mbps)

750-50 MHz Forward Direction (to the customer)

5-40 MHz Reverse Direction (from the customer)

*Source: the Pacific Telesis 1994 Fact Book*

But the main reason the FCC agreed to allow Pac Bell to build this new network was because Pac Bell would be bringing in competition in both cable (video) services, as well as new interactive digital services. <sup>353</sup>

“The Commission found that Pacific's proposals will produce new investment in an advanced telecommunications infrastructure, bring additional competition in the distribution of video services, and give consumers in those areas additional choices in video programming and interactive digital services.”

And who was going to pay for this fiber optic wonderland? According to Pac Bell, the expenses would fall to customers. <sup>354</sup>

“Pacific Bell officials say the whole project will cost about \$1,000 per household. While most of the cost will be covered by telephone rates, Pacific Bell officials were adamant that phone bills would not be increased. “

Pac Bell reiterated this numerous times. In another article, Pac Bell said the fiber upgrades would benefit customers so, of course, it would be paid for by ratepayers.<sup>355</sup>

"Pacific Bell officials say most of the new network would be paid for by ratepayers because the upgrade would benefit phone customers by improving quality and reducing maintenance costs.”

There were, of course, numerous people who questioned the plan. Some complained that the Bell was creating a schism between the communities that would and would not be wired — the first signs of today’s Digital Divide.

"While hailed by many state and local officials, Pacific Bell's plan has come under fire from Sen. Steve Peace, D-Chula Vista, because South Bay communities were not included in the phone company's initial upgrade program.<sup>356</sup>

“Peace said his 720,000 constituents, who live south of Interstate 8, primarily in the South Bay, will be economically and educationally disadvantaged by the telephone company's initial deployment of the superhighway in more affluent communities to the north.<sup>357</sup>

“You're going to have two societies out there — one that's plugged in and one that's not plugged in', Peace said. 'Pacific Bell has carved out where the wealth is in the county, and it's going to give those communities a head start. The gap is going to get wider and we'll never catch up.’”

However, though there were doubters, Pac Bell decided to go forward, and in 1994, they would start replacing the older copper wiring with the newer fabled fiber optics — as one writer put it, “The Copper Age is over in California”.<sup>358</sup>

*“The Copper Age is over in California.* Hundreds of Pacific Bell technicians have begun yanking thousands of miles of twisted-pair copper telephone wire and replacing it with broadband fiber and coax. Lasers and light — that's the future for this Baby Bell's 10 million telephone customers, who will be among the first in the nation to ride on the information highway.”

Also, it was clear from Pac Bell that this was not a test or trial, but full deployment.<sup>359</sup>

“And there's one crucial difference between what is happening in the Golden State and interactive efforts elsewhere: In California, they're playing with real bullets.

“While other RBOCs and cable companies continue to test market their broadband networks with subscribers, *Pacific Bell has launched into full-scale deployment.*“

As we discuss in other sections, virtually every phone company had plans to roll out fiber optics in the states they controlled. From Bell Atlantic's 8.75 million households by 2000, or Ameritech's 6 million households by 2000, All of America was going to be rewired. As we now know, this was mostly fiber to the press release.

### **Construction Begins.**

In May of 1994, four areas were included in the initial phases of construction:<sup>360</sup>

- The San Francisco Bay Area in Northern California
- The Los Angeles area
- Orange and Riverside counties
- The San Diego area

In a Los Angeles Times article, titled “Interactive TV Will Come to Valley in '94”, specific neighborhoods were detailed:<sup>361</sup>

“Areas of Canoga Park, Reseda, Sherman Oaks, Northridge, Van Nuys, Calabasas and Hidden Hills have been targeted for Pacific Bell's Los Angeles roll-out of a high-speed fiber optic network that will bring customers everything from phone and cable television services to movies-on-demand, video catalogue shopping and video research libraries.”

Even the starting point, the Reseda area, was outlined by Pac Bell.<sup>362</sup>

“The initial Valley beachhead will be part of the Reseda area, where 45,000 households will be wired with fiber optic cable next year. By 1996, when all the targeted Valley areas are connected, 250,000 homes in the Valley will be capable of receiving the new phone and video services.”

The next page is an actual copy of the deployment plan as stated in the Pacific Telesis “Fact Book”, from 1993. It outlines in no uncertain terms, the various parts of California that should be rewired — and when.

**Exhibit 54**  
**Pacific Telesis' Consumer Broadband Deployment Schedule for California,**  
**1996-2000.**

*Consumer Broadband  
 Deployment Schedule*

Consumer Broadband

<i>Geography for 7-year deployment</i>	<i>Regional Areas where Pacific Bell will initially break ground</i>	<i>Cities within regional areas slated for initial deployment in the 1994-1996 time frame</i>	<i>Areas slated for deployment by 2000</i>
San Francisco Bay Area	Silicon Valley and San Jose	Campbell, Cupertino, Los Altos, Los Altos Hills, Milpitas, Mountain View, San Jose, Santa Clara, Saratoga, Sunnyvale	Peninsula, San Francisco, East Bay, Contra Costa
Los Angeles	San Fernando Valley/West LA	Parts of Los Angeles (Canoga Park, Reseda, Sherman Oaks), Calabasas, Hidden Hills, Inglewood	Most of greater Los Angeles area
San Diego	San Diego	Central San Diego, (and other parts of San Diego, including La Jolla, Linda Vista, Pacific Beach and Rancho Bernardo), Del Mar, Poway	Central and eastern San Diego areas
Orange County	Anaheim	Anaheim, Buena Park, Cypress, Garden Grove, Orange, Stanton, Villa Park	Orange County and western Riverside County



**Other Promises: The Wiring of Schools**

Alongside these promised networks, Pac Bell made other claims that insured that even California's schools and libraries would be entering the future.<sup>363</sup>

"Pacific Bell will spend \$100 million during the next three years to hook up more than 7,400 schools, community colleges and libraries to computer and video networks, the company announced yesterday.

"By the year 2000, phone company officials predicted, *every classroom will be wired to handle voice, data and video telecommunications.*"

In fact, Pac Bell would:<sup>364</sup>

"install four digital lines, called ISDN, free in every public school, community college and public library in its service areas by end of 1996. Costs of installation and one year's usage would be waived.

"Wire two rooms at each school and library for computers and video-conferencing and donate \$5 million in seed money for wiring all classrooms."

Pac Bell said that they would be the ones footing the bill.<sup>365</sup>

"Pacific Bell President Phil Quigley said telephone rates will not be affected by the company's program because the money is coming from the corporation's regular capital-spending budget.

"in the same breath Pac Bell stated that it would 'ask the Public Utilities Commission to set special rates for educational access'."

But the phone company didn't have to worry. The Public Service Commission slapped everyone with the bill.<sup>366</sup>

“The PUC is developing a \$150 million-per-year grant program for schools, libraries and nonprofit groups to develop telecommunications programs, train personnel and buy equipment.”

### **Video Dialtone Promises**

As in every other state, the phone company also filed with the FCC to offer "video dialtone" services. By 1993, Pac Bell California filed for four locations with 1.3 million households in the initial wave of construction.

**Exhibit 55**  
**Requested Video Dialtone Applications by Pacific Telesis for California,**  
**Filed 1993**

Date	Telco	Location	Homes	Proposal
12/20/93	Pacific Bell	Orange Co.	210,000	permanent
12/20/93	Pacific Bell	So. San Francisco	490,000	permanent
12/20/93	Pacific Bell	Los Angeles	360,000	permanent
12/20/93	Pacific Bell	San Diego	250,000	permanent
			1,310,000	

### **Did Promises of the Highway Effect California Customer Phone Rates?**

As early as 1988, Pac Bell pushed hard to change state laws that would give them more money to build this wonderous wonderland, as well as roll out ISDN. Based on the Bell's continual assault in the press about how California needed this wonderland, laws were changed to give the Bells more money. The old "rate of return" (which capped the Bells profits, since they were still a monopoly) was replaced with a newer form known as "alternative regulations". Also, known as "price caps", the law capped the price of some services for a while, but not the profits. And considering that the costs to offer telephone service continually dropped, price caps just supplied more profits — i.e., extra billions of pennies, nickels, dimes, and quarters on customers' phonebills.<sup>367</sup> In short, Pac Bell received an additional \$600 million.<sup>368</sup>

"John Gueldner, Pacific Bell's vice president of regulatory affairs, said yesterday's decision on rates 'gives Pacific Bell the funding we need to continue building the information superhighway'.

"'With that \$600 million, we'll be able to accelerate our investment in improving telecommunications in California', said Gueldner."

Another form of monies came in the numerous concessions that the Bell was able to get from the very anxious California cities and counties that wanted their fiber optic networks — ASAP. As the San Jose Deputy City Manager put it: <sup>369</sup>

"'We want to get the on-ramps and off-ramps (to the systems) built as soon as possible... We want it to be clear, from (city) staff to the city council, that San Jose is aggressively pursuing (the high-tech development)', said Greg Larson, deputy city manager."

Though each city and county had a long list of enticements, the major incentives offered were: (Note: It is not in the scope of this report to identify all of the agreements and their terms.)

- loosened regulations and fast-track permitting
- various fee waivers for prospective developers
- waivers for its enterprise zones
- waiver of candidate fees, charges for use of public right-of-ways

We will return to the topic of the financial impacts of these decisions later.

## **A Dark Secret: The Technology Didn't Work as Advertised.**

Unfortunately there was a very dark secret — the system couldn't be built. As discussed in other sections, the technology wasn't available — not for the price that the companies had outlaid for each home, and there were even questions if it could be built for any sum. According to a report titled "The Information Superhighway: Get a Grip", by New Networks Institute, 1994: <sup>370</sup>

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“Numerous speeches given at a conference titled 'Interactive Marketing', May 1994,<sup>371</sup> discussed the technological and manufacturing hurdles required to bring to the residential subscriber full-motion, interactive video services. The consensus was simple:

- The boxes required computer chips that were not yet being mass manufactured.
- The initial boxes would cost \$2,000–\$5,000 per unit, since they are, in reality, high-speed computers and not production models.
- The mass market manufacturing price would most likely wholesale for \$1,200–\$1,500 per unit.

“In fact, in most of the interactive TV trials during 1994-1995, the price per set-top box was between \$4,000-\$5,000. The Time Warner trials in Orlando, originally scheduled for spring 1994 (and shut down in 1997) were delayed a year because even the prototypes were not fully operational and the boxes reportedly cost \$5,000. In another trial by Viacom and AT&T in Castro Valley, that was also canceled, the cost was \$4,000 per box. This \$4000-\$5000 box didn't take into account the network upgrades, or the digital switches and servers, which were believed to cost an additional \$1,000 to \$1,200 per subscriber.”

And there were obvious signs that there were problems with the Info highway. For example, Bell Atlantic halted its video service plans in April of 1995.

“Bell Atlantic Halts Plan for Video Services”, *The New York Times*, April 26, 1995<sup>372</sup>

“Bell Atlantic Corporation called an abrupt halt to its scramble into television yesterday. Saying it wanted to rethink its strategy for upgrading its telephone network, the company asked the Federal Communications Commission to suspend its application to offer video services to as many as three million telephone customers....”

Meanwhile, an article in *The New York Times*, December 18, 1995, stated that:

"Bell Atlantic revealed that it cost \$17,000 per household to build and deliver a Full-Service network." (in Toms River, New Jersey)<sup>373</sup>

The odds that Pac Bell was aware of this at the time this law was passed was high, since Bell Atlantic and US West (two other Bell companies) both started to close down some of their info highway plans months before, citing technical difficulties.

As we discuss elsewhere, statements made by both Verizon and SBC about their new fiber optic plans, including Verizon's FIOS and SBC's Lightspeed, also indicate that it wasn't until 2004 that they were once again discussing their new fiber optic deployments, both claiming that the plans to have fiber-to-the-home was a 'first', with no mention that these identical plans were first announced in 1993!

### **Construction Expenditures for the Network Came from the Regulated Budget.**

More to the point, an examination of Pacific Bell's construction expenditures for the years in question clearly show that there weren't any major increases in network spending. The company spent more money on the telephone network in the mid-1980's.

#### **Exhibit 56**

#### **Pacific Telesis Construction & Capital Expenditures, 1984-1996**

*(In the billions)*

1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
\$2.1	\$2.3	\$2.2	\$2.2	\$1.6	\$1.9	\$2.1	\$1.7	\$1.8	\$1.9	\$1.7	\$2.1	\$1.8

*Source: Pacific Telesis Annual Reports, 1984-1996.*

From these statistics it is clear that Pac Bell's network upgrades for fiber most likely came directly from their normal annual spending, and most likely replaced the upgrades to the copper wiring plant — the same plant that handles DSL.

Also, simple math would dictate that if the company was spending \$16 billion starting in 1994 for a total of seven years, then the 1994, 1995, and 1996 expenditures would have to be at least \$2.3 billion a year above the normal average amount.

### **The SBC-Pacific Bell Merger: The Hatchet Comes Down on California's Plans.**

While Pac Bell at least gave the appearance that it cared, although didn't fulfill any of these obligations, SBC simply pulled the plug on all of these plans.<sup>374</sup>

"Pacific and Southwestern Video Curtailment/Purchase Commitments — SBC also announced in 1997 that it was scaling back its limited direct investment in video services in the areas also served by Pacific Bell Telephone Company (PacBell) and Southwestern Bell Telephone Company (SWBell). As a result of this curtailment, SBC halted construction on the Advanced Communications Network (ACN) in California. As part of an agreement with the ACN vendor, SBC paid the liabilities of the ACN trust that owned and financed ACN construction, incurred costs to shut down all construction previously conducted under the trust and received certain consideration from the vendor. In the second quarter of 1997, SBC recognized net expense of \$553 (\$346 net of tax) associated with these activities. During the third quarter of 1997, SBC recorded the corresponding short-term debt of \$610 previously incurred by the ACN trust on its balance sheet.

"Additionally, SBC curtailed certain other video-related activities including discontinuing its broadband network video trials in Richardson, Texas, and San Jose, California, substantially scaling back its involvement in the TELE-TV joint venture and withdrawing its operations in territory served by SWBell from the Americast venture. During 1999, SBC negotiated a settlement with its Americast partners related to the withdrawal. The settlement did not have a material impact on SBC's financial condition or results of operations. The collective impact of these decisions and actions by SBC resulted in a charge of \$145 (\$92 net of tax) in the second quarter of 1997."

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To demonstrate the total irony of this move, SBC released a press release about Philip Quigley, Pac Bell's president, at the time of SBC-Pac Bell merger. It demonstrates how the hype continued, regardless of the reality. Even though Pacific Telesis stopped all of its major highway plans and never spent the money, the press release (April 1, 1997) stated that Quigley led Pac Tel's \$16 billion broadband Info Bahn project.<sup>375</sup>

*"During Quigley's tenure, Quigley led PacTel's comprehensive \$16 billion network redesign program, which involved construction of a broadband information superhighway."*

However, as the previous quotes demonstrate, not only did SBC do a wholesale cleanout of the advanced network plans, but, more importantly, Pac Bell never spent the \$16 billion — not even a fraction of it. However, it seems they did write-off whatever was put into the ground. It also seems that customers never benefited from the network, or the write-offs. However, customers did pay for these fabled networks. In fact, some parts of California were wired — but never connected — a true highway to nowhere.

### **Show me the Money**

If the networks weren't finished, where's all the money? In other sections of the book we outline our belief — overcharging comes to approximately \$2000.00 per household. Without audits it is hard to tell exactly how much money was overcharged in the Pac Bell territories, but it is most likely close to the other phone companies.

### **Changes in State Laws**

Pac Bell stated that the additional \$600 million would be spent on the new networks. As Pac Bell stated the money was on an increasing scale from \$100 million in 1996 to \$300 million in 1998, accrued from changes in state laws.<sup>376</sup>

*"Pacific Bell said the PUC's productivity formula would have required refunds of \$100 million in 1996, \$200 million in 1997 and \$300 million in 1998 — money that it needs to be competitive in the new marketplace."*

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However, Toward Utility Rate Normalization (TURN) said the refunds were higher and that over \$1 billion was at stake.<sup>377</sup>

“The commission just handed Pacific Bell a billion-dollar Christmas gift’, said Regina Costa, a telecommunications analyst for TURN.”

This extra billion dollars is only a small part of the overcharging picture. The “Regulatory Audit of Pacific Bell for 1997, 1998, and 1999 by the California Public Utilities Commission”,<sup>378</sup> just examined the “regulated intrastate revenues”, found that the company made mistakes of \$1.94 billion dollars and that in 1999, the amount of monies that should have been collected, had the law not been changed in 1999, would have been an additional \$457 million.

“The audit of financial results identified 67 corrections to Pacific Bell’s regulated operating revenues, expenses and rate base. Audit corrections to bring financial results into compliance with CPUC requirements increased the regulated intrastate net operating income that Pacific Bell reported during the audit period by \$1.94 billion. This translates into recommended customer refunds under NRF earnings sharing rules of \$349 million for the years 1997 and 1998. NRF earnings sharing rules were suspended by the CPUC effective in 1999. Customer refunds for 1999 would have totaled \$457 million if the sharing rules had been effective. Following are additional key findings and conclusions from the audit.”

And these were simply corrections needed. They do not reflect how much money the phone company made from the changes in state law.

## **Did Customers Illegally Fund ADSL in California?**

As we just discussed, what was promised to Californians was a fiber optic wire, not simply using the old copper wiring.

The difference is of course speed and services. The fiber optic future was of 45 Mbps and hundreds of channels. DSL is about 45-100 times slower. ADSL, which is “Asymmetric” DSL, is only fast in one direction.



However, the Audit of Pac Bell for the years 1997-1999 found that Pac Bell had \$196 million dollars in expenses to develop ADSL and much, it not all of it, was charged to phone customers, which is known as “cross-subsidization”.

According to the Audit.<sup>379</sup>

“ADSL was introduced in 1998 but was not widely available until after the audit period. During the three year audit period Pacific Bell incurred net expenses of \$196 million to develop ADSL service and placed substantial ADSL plant investment into rate base.... At the end of 1999, at about the time the service was ready to be widely marketed, Pacific Bell transferred ADSL to SBC Advanced Solutions, Inc.. As a result, regulated customers paid a substantial amount for ADSL’s development, but never received the benefit of significant ADSL revenue.”

We need to point out that there have been many fights, legal actions, etc.. over DSL in California, as well as on the Federal level. For example, the FCC ruled that DSL is an Interstate Information service and doesn’t have to be to competitive Internet Providers. If customers funded these networks, then shouldn’t they have remained open to competition? We will come back to this issue in Volume II.

## **Cross-Subsidization of Other Expenses**

A customer is only supposed to be charged for local service when paying a local service bill. However, it seems that every phone company, including Pac Bell, has been able to move expenses to the phone company’s regulated’ side, thus raising the cost of local phone service for ‘ratepayers..

The Pac Bell audit found a host of these improperly added expenses, which can add hundreds of millions of dollars or expenses, such as with ADSL. Here are some examples. In this case, SBC charge Pac Bell customer for their political and legislative lobbying costs.

“We found other cross subsidies flowing from Pacific Bell’s customers to SBC shareholders. Examples included parent company political and legislative

influence costs and secondary cost allocations of parent company “management fees” charged to Pacific Bell’s customer (above-the-line) accounts.”

SBC extortion charges? SBC charged more money to California in the form of building the SBC Corporation.

“Pacific Bell’s operating expenses increased because of a substantial increase in corporate charges. Pacific Bell’s corporate charges increased from less than \$120 million in 1996, the year before the merger, to nearly \$300 million in 1999. *Most of the increase was due to new and higher cost levels billed by SBC’s Texas-based corporate organization, which was added to the California-based PTG organization that existed prior to the merger.* Pacific Bell’s corporate charges continued to climb in 2000. This occurred in part because cost allocations from Management Services Inc., SBC’s Texas-based parent organization, were layered on top of costs being charged by PTG’s parent organization prior to the merger”

And there are loads of areas that are impacted. Here are 9 different items totaling \$463 million. To sum up a few — the company incorrectly charged \$38 million for local number portability, (the ability to take you phone number when you go to a competitive service), \$49 million for local competition costs, \$35 million for not adding the merger savings, etc. However, the author’s personal favorite was \$41 million for the “Shut down of an Advanced Communication Network that was never placed into service,” — the fabled fiber optic deployment.

“We identified and calculated nine audit corrections to operating expenses. These include 1) removing \$138 million in local number portability (LNP) costs from intrastate operating expenses that the FCC explicitly ruled should be assigned directly to the interstate jurisdiction; 2) removing \$49 million in local competition implementation costs that should have been deferred and amortized over the period of CPUC-authorized surcharge recovery that began in 2001; 3) reducing operating expense by \$35 million to reflect the allocation of merger savings between ratepayers and shareholders ordered in the CPUC decision that approved the merger of SBC and Pacific Telesis; 4) removing \$41 million in cost associated with the shut down of an Advanced Communications Network that was never

placed into service; 5) reducing operating expenses by \$44 million to correct Pacific Bell's accounting for a December 1999 software buy-out agreement; 6) removing \$103 million of unsupported and unauditible litigation and regulatory accruals from operating expense; 7) reducing incentive compensation accruals by \$29 million to reflect the actual payout levels for the 1997, 1998 and 1999 performance years; 8) reducing 1997 and 1998 operating expense by \$42 million to remove the cost of settlements paid to contract billing customers for an increase in uncollectible amounts attributable to 1996 operations; and 9) increasing operating expense by \$19 million to correct the classification of traffic bound for internet service providers for separations purposes. In total these nine corrections reduce audit period intrastate regulated operating expense by \$463 million."

#### **An Additional \$3.6 Billion in Tax Deductions Is Tied to Changes in State Law.**

In 1995, the company took a massive one-time deduction of \$3.6 billion using the excuse that they were replacing the older copper wiring with the fiber optics, which, of course, did not happen. We discuss this deduction in our construction and depreciation analysis of the Bell companies, as every other Bell also took a similar deduction tied to the changes in state regulations for their broadband announcements.

(NOTE: In 1999, New Networks Institute filed a \$3.6 billion Complaint against Pac Bell with the IRS, contending that the copper wiring was still in use and had not been removed. This saved the company over a billion dollars in Federal taxes.)

Without a full audit of the monies directly related to the changes in state law that were made for their fiber optic promises, it is impossible to tell the full extent of the costs to customers and the economy.

#### **Other Business Indicators**

Because of the mergers with SBC, the various write-offs, etc., it is impossible to go into complete detail about how the fiber optic promises played out in each state. But a few things are clear — in 1992, the company's overall return on equity, a standard business measure, was then 16.1% and went to 46% in 1996, an increase of 186%. And one of the reasons for this increase

was the massive staff cuts. There were 57,000 staffers in 1992. By 1996 there were only 48,300 — a drop of 8,670, or 15%.

**Exhibit 57**  
**Pacific Telesis Return on Equity, Staff, 1992-1996**

	1992	1994	1996	
Return on equity	16.1%	22.0%	46.0%	186%
Staff	57,023	51,590	48,330	-15%

Clearly, changes in regulation that allowed for massive staff cuts, and a lack of large increases to construction, as previously discussed, all added up to major increases in the companies' profits.

**Coda: So Much for California's Digital Future.**

There were some customers that did notice. The San Diego Tribune wrote what amounts to an obituary for the fabled highway.<sup>380</sup>

"San Diegans continue to shake their heads in disbelief over the sudden cancellation of a project that promised to bring meaningful competition to the local cable market — and much more.

"It was a little disappointing to hear about all these marvelous things that they were going to provide us with, and then, with no communication with us, they just came through and started yanking (the new boxes) out again.' said Gordon Buck, a Clairemont resident. 'I'm just puzzled by it,' said Lou Quayle, another Clairemont resident. 'They had an army up here for almost three years.'"

More to the point, there's a network to nowhere sitting in various California neighborhoods.<sup>381</sup>

"Late last year, the company quietly sent word out in the industry that it is willing to sell its cable operation in San Jose as well as its unfinished networks in San

Diego, Los Angeles and Orange County – a total of 2,733 miles of fiber optic and coaxial cabling.

“Since that announcement in June, Pac Bell has disconnected cable customers in San Jose and has spent months tromping through San Diego neighborhoods to disable household boxes and reconnect customers to the old copper phone network.”

In fact, the fabulous Information Superhighway is now nothing more than another version of POTS — plain old telephone network.<sup>382</sup>

“Pac Bell's video network here, begun in May 1994, had included more than 73,000 homes in Pacific Beach, Mission Beach, Clairemont, Mira Mesa and Scripps Ranch when it was canceled last year.

“Although the network never carried video service, about 3,500 local customers in the beach areas had been receiving phone service over the high-tech network. To date, all but 946 phone customers here have been reconnected to copper wires.”

*The San Diego Tribune* encapsulated the failed deployments in 1998 with a timeline titled “A plan that failed,” highlighted on the next page.

**Exhibit 58****San Diego Tribunes' Year by Year: A Plan that Failed****(Summary of the Pac Bell Deployment of the Information Superhighway.)**

- November 1993 — Pacific Bell unveils plans to spend \$16 billion over seven years to upgrade its California network to handle interactive services like home shopping and compete against cable companies with video channels and movies-on-demand.
- May 1994 — PacBell begins network construction in Pacific Beach and Mira Mesa in San Diego. Construction also begins in San Jose and in Orange and Los Angeles counties.
- October 1994 — City of San Diego considers proposal to require that Pacific Bell pay franchise fees and abide by other requirements imposed on cable companies if it gets into the video business.
- October 1994 — Pacific Telesis, Bell Atlantic Corp. and Nynex Corp. form TELE-TV, a joint venture to provide the companies with video programming, entertainment and information to sell to residents.
- January 1995 — PacBell and city of San Diego sign "landmark" agreement, with PacBell pledging to give the city 5 percent of gross revenues from voice, video and data services sold over new network. City agrees not to regulate PacBell as a cable company.
- April 1995 — PacBell buys Cross Country Wireless Inc. and announces plans to offer "wireless cable" service to 5 million-customer service area covering San Diego, Riverside, Los Angeles and Orange counties.
- September 1995 — PacBell slows network construction to save \$1 billion in capital costs over five years for statewide project, but accelerates network construction in San Francisco.
- January 1996 — PacBell halts fiber/coaxial network construction in Los Angeles County. Network projects continue in San Diego, San Jose and Orange County (briefly).
- April 1996 — SBC Communications of Texas signs deal to buy Pacific Telesis.
- May 1996 — Network construction halted in Orange County.
- June 1996 — San Jose City Council awards PacBell a cable franchise, giving the company official standing as cable operator.
- September 1996 — PacBell begins selling video service in San Jose over its new network.
- April 1997 — SBC's purchase of Pacific Telesis becomes final.
- April 1997 — TELE-TV, jointly owned by Bell Atlantic Corp., Nynex Corp. and Pacific Telesis Group, cuts staff in half and abandons all joint video projects in favor of individual company efforts.
- May 1997 — PacBell launches 'wireless cable' service in Los Angeles and Orange counties.
- June 1997 — SBC abandons almost all attempts to compete with cable, announcing immediate ends to Pac Bell's video network project as well as a smaller test in Texas. The decision halts construction in San Diego and pulls the plug on 8,000 PacBell cable customers in San Jose. SBC writes off \$500 million investment in both ventures.
- November 1997 — PacBell sends out requests for bids on various components of the partially built video network.