

You Make the Call

High Speed Broadband for All Or Tax Loopholes for Verizon?

Communications Workers of America and
the International Brotherhood of Electrical Workers

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SUMMARY

- Maine, New Hampshire and Vermont rank at or near the bottom in terms of broadband availability in the United States.
- Verizon wants to sell most of its operations in the three-state region to tiny FairPoint. Most regulatory experts have said that FairPoint will not have the financial resources or operational capacity to improve service quality or appreciably expand access to high speed Internet.
- FairPoint currently offers DSL Internet access that is slower *and* more expensive than Verizon's.
- FairPoint plans to limit its broadband investment to DSL technology instead of fiber optic cable to the home, which is much faster and more dependable.
- Verizon chose FairPoint as a buyer because it can take advantage of a tax loophole to avoid paying \$600 million in taxes.
- Taxpayers are in effect subsidizing Verizon with \$600 million to abandon its operations in northern New England and, in the process, avoid meeting the commitments it previously made to regulators and customers to attain minimum service quality standards and expand broadband availability.
- If Verizon's \$600 million tax savings were placed in a special Broadband Infrastructure Fund it would be enough money to provide access to fiber to the home to 84 percent of the residential consumers in the three-state Verizon service area *OR* to provide access to nearly 100 percent of those who do not presently have DSL and to provide access to fiber to the home to 75 percent of the residential consumers in the three-state Verizon service area.

Northern New England Has Been Shut Out of the Information Super-Highway

According to the Fiber to the Home Council, in fifteen years 80 percent of US homes will have fiber optic con-

nections to the Internet.¹ Fiber to the home (FTTH) currently can reach lightening fast speeds of 100 megabits per second both in terms of download and upload speeds. This is much faster than DSL which generally provides speeds of only 1.5 to 3 megabits per second.

¹ Portland Phoenix, *Internet Disconnect: Getting on-line in Maine can be painfully slow. And the planned Verizon-FairPoint merger won't help*, by Jeff Inglis. August 22, 2007.

People with FTTH could download an entire movie in just two minutes, but it can take two hours or more with a typical DSL connection.

Speed defines what is possible on the Internet. It determines whether we will have the 21st century networks we need to expand jobs and our economy. Speed is critical to support innovations in telemedicine, education, and public safety that could dramatically improve our lives and communities. Most U.S. Internet connections today are not fast enough to permit interactive home-based medical monitoring, multi-media distance learning, or to send and receive data to run a home-based business.

Unfortunately, too many Maine, New Hampshire and Vermont households and businesses do not even have access to 20th century Internet. These three states rank at or near the bottom in terms of broadband availability in the United States.

In Verizon's combined service area in Maine, New Hampshire and Vermont, only 64 percent of residential households have access to DSL broadband. An estimated 373,000 residential customers – or 36 percent of the total — cannot subscribe to DSL broadband in these states because Verizon does not offer it to them.²

The Northern New England states also suffer from a speed gap. Maine ranks 35th and Vermont ranks 21st in the nation in terms of download Internet speeds.³

Just two years ago, Verizon's customers in Maine, New Hampshire and Vermont had reason to believe that they would obtain access to the best technology available: fiber to the home. In 2005, Verizon began to invest in fiber to the home (its FiOS service) in Southern New Hampshire. In a little more than a year, approximately 100,000 households had access to fiber — almost 25 percent

of Verizon's residential customers in New Hampshire. As a result, New Hampshire ranked 8th in the U.S. in terms of average download speeds.⁴ Verizon had plans to do much more. However, in 2006 Verizon abruptly stopped investing in FiOS in the three-state region and soon afterwards put its access lines up for sale.

The Proposed Sale of Verizon's Operations to Tiny FairPoint Could Relegate Northern New England to the Information Dirt Road

After 100 years of service by Verizon and its predecessor Bell companies, the company wants to abandon its Maine, New Hampshire and Vermont operations. In January 2007, Verizon announced an agreement to sell its lines in the three-state Northern New England (NNE) region to FairPoint, a small company that is just one-sixth the size of the assets it proposes to purchase. FairPoint, with a high debt load already, will have to add \$1.7 billion in debt and issue \$1 billion in new stock to make the deal work.

In terms of broadband, FairPoint currently offers maximum DSL Internet access at speeds of just 1.5 megabits per second in the subsidiaries it owns in Maine and Vermont. This is one-half the speed of Verizon's 3 megabits per second DSL offering.

FairPoint's plans for broadband are not very promising. The Chairman of the Maine PUC even called

Percentage of Residential End-User Premises with Access to High Speed Services

State	Percent Broadband Availability*	Rank
New Hampshire	61 percent	Last
Vermont	64 percent	Next to Last
Maine	67 percent	4th from Bottom
US Average	79 percent	

* DSL Availability where Incumbent Local Exchange Carriers offer Telephone Services.

Source: Federal Communications Commission, High Speed Services for Internet Access: Status as of December 31, 2006, released October 2007, Table 14.

² Access line data is from the Federal Communications Commission, *ARMIS Report 43-08, Table III: Access Lines in Service by Customer for 2006*. Data on access to high-speed services is from the Federal Communications Commission, *High-Speed Services for Internet Access: Status as of December 30, 2006*.

³ Communications Workers of America, *Speed Matters: A Report on Internet Speeds in All 50 States, July 2007*. The median download speeds for Maine and Vermont were 1.534 and 2.005 megabits per second respectively.

⁴ *Ibid.* The median download speed in New Hampshire was 2.7 megabits per second.

FairPoint's broadband build-out plans "anemic." FairPoint has no plans to build state-of-the-art fiber to the home to existing customers. FairPoint also does not plan to expand Verizon's current fiber offering beyond the 100,000 households in New Hampshire that already have access because of Verizon's past investment. Instead, FairPoint will rely on DSL technology that is much slower than fiber to the home. DSL has finite limitations in the speed and amount of information that can be transmitted due to the quality and thickness of the copper wire and the distance from the central office. Fiber to the home does not have these limitations and requires less maintenance.

Unfortunately, FairPoint does not have the financial resources, operational capacity or experience to operate Verizon's Maine, New Hampshire and Vermont properties successfully. Rather than invest in its operations to improve service quality or expand broadband availability, FairPoint intends to divert hundreds of millions of dollars out of the region by paying one of the industry's highest dividends, with a yield that currently is nearly twice that of Verizon.⁵

■ FairPoint's finances will be shaky. Already heavily debt laden, FairPoint is adding \$1.7 billion in debt and does not even plan to obtain a minimum investment grade bond rating.

■ FairPoint will invest \$50-\$60 million

a year less than Verizon actually invested in annual capital expenditures from 2002 through 2006.

■ FairPoint is "cannibalizing" itself by paying out more in dividends than it earns. FairPoint's own investment advisor, Deutsche Bank, projected that through 2015, FairPoint would pay out \$1.1 billion in dividends while earning just \$290 million in profits — a ratio of \$4 in dividends for every \$1 in profits. FairPoint has decided to divert this money out of the region rather than invest in high-speed broadband or improved service.

■ FairPoint's shareholder value will become negative by 2013.

■ FairPoint has no experience managing a 600 percent increase in access lines, a 333 percent increase in workforce and a 283 percent increase in debt.

As a result of such concerns the Maine Public Advocate, the New Hampshire Consumer Advocate, the staffs of the New Hampshire and Maine Public Utilities Commissions, and the Vermont Department of Public Service have all recommended that the regulatory commissions in their states deny the transaction as proposed.

Ultimately, FairPoint's strategy will, in a phrase used by The New York Times, leave "millions of people in the Internet's slow lane, just as high-speed access is becoming more of a necessity than a luxury."⁶

Taxpayers Are Providing a \$600 million "Subsidy" For Verizon to Abandon its Maine, New Hampshire and Vermont Operations

Verizon chose FairPoint as the buyer of its northern New England lines because FairPoint would qualify Verizon for an arcane tax loophole allowing it to avoid paying \$600 million in taxes.⁷ This loophole is called a Reverse Morris Trust. Ivan Seidenberg, Verizon's Chief Executive Officer, is pleased about it.

*"The Morris Trust works, so we feel good about that. We've sold lines in the past and paid a lot of taxes on them, you know? So I think the financial wizard has figured out a better way to do that, and I am pleased with that."*⁸

Taxpayers have provided Verizon with a \$600 million subsidy to abandon 1.5 million customers and, in the process, avoid meeting the commitments it previously made to regulators and customers in these states to meet minimum service quality standards and expand broadband availability. This is a classic example of how bad tax policy can distort the functioning of an important market. In this case, Verizon chose to avoid taxes rather than open up the bidding to companies like Embarq, CenturyTel or Citizens that have the resources and experience needed to

⁵ The sources for the following points are identified in the briefs filed by the Communications Workers of America and the International Brotherhood of Electrical Workers in the Maine, New Hampshire and Vermont proceedings which are available on the websites of the regulatory commissions.

⁶ NY Times, Rural I, by Ken Belson. September 28, 2006

⁷ Verizon can qualify for the tax loophole because FairPoint is smaller than Verizon's northern New England properties and Verizon's shareholders will own more than 50 percent of FairPoint if the transaction is approved. If Verizon sold its properties to another corporation for \$2.7 billion (the same total value of the FairPoint transaction) without tax loopholes it would owe more than \$600 million in taxes since Verizon's \$1.8 billion gain from the sale (the \$2.7 billion stated value of the transaction minus the \$900 million value of the assets to be sold) would be taxed at the corporate tax rate of 35%. However, Verizon avoided these taxes because of the Reverse Morris Trust tax loophole.

⁸ Merrill Lynch Communications Forum, February 28, 2007.

operate the properties successfully over the long term.

Verizon will sell its NNE operations for \$2.7 billion, make \$800 million in profits and avoid paying \$600 million in taxes due to an arcane tax loophole. Federal tax policy is “subsidizing” Verizon to walk away from a badly neglected telephone network as well as abandon its commitment to provide high speed Internet.

Create a Broadband Infrastructure Fund – Invest the \$600 million “Subsidy” To Better Serve the Public Interest

If the regulatory commissions of the three states and the Federal Communications Commission approve the sale, then Verizon should not be rewarded for abandoning its lines and its previous broadband commitments by allowing it to

pocket this tax subsidy. The taxpayers of the U.S. — and especially those in Maine, New Hampshire and Vermont — should not subsidize a transaction that harms the public interest, distorts markets and stimulates a company to abandon its operations to a small, undercapitalized and unprepared firm.

Instead, the \$600 million in tax savings should be placed in a Broadband Infrastructure Fund that would be dedicated to expand high-speed broadband to all the residents in the three states.⁹ The Fund would be overseen by regulatory bodies, but the money would be used by telecommunications providers to expand broadband build out in each state with a special focus on un-served and under-served areas. The \$600 million would be enough to achieve either of the following results:¹⁰

■ Build out fiber to the home to provide access to 84 percent or 857,000

of northern New England’s residential consumers served by Verizon.¹¹

■ Build out DSL to provide access to nearly 100 percent and build out fiber to provide access to 75 percent of northern New England’s residential consumers served by Verizon.¹²

The regulatory commissions in Maine, New Hampshire and Vermont as well as the Federal Communications Commission have a unique opportunity. They should not allow Verizon to game the system, abandon its previous commitments to 1.5 million customers and avoid paying \$600 million in taxes. Instead, this money should be allocated to expand high speed broadband throughout the region. This investment would place northern New England at the forefront of the United States in terms of broadband deployment and speed. It would add significant benefits in terms of jobs, economic development, as well as the health and safety of its residents.

⁹ The CWA and the IBEW recommended to the Federal Communications Commission that a \$600 million Broadband Infrastructure Fund be created as a condition for any approval of the sale. Go to the CWA/IBEW filed ex parte communications for November 9, 2007 at http://fjallfoss.fcc.gov/cgi-bin/websql/prod/ecfs/comsrch_v2.hts.

¹⁰ The following percentage figures are estimates calculated from data supplied by the following sources. The projected cost of FiOS was itemized by Verizon in its Verizon Communications Inc., Briefing Session, September 27, 2006. The number of access lines in 2006 was provided by the FCC in its ARMIS data base. The number of access lines with access to high speed services was provided by the FCC in its “High-Speed Services for Internet Access: Status as of December 31, 2006, released October 2007.

¹¹ Verizon projected that it would cost on average \$700 in FiOS capital expenditures to pass a home by 2010. Thus, more than 857,000 homes out of a total of 1.035 million residential lines could be passed at a cost of \$600 million. Of course, the actual amount of capital expenditures required to provide access could vary from Verizon’s stated average costs which, in turn, would affect the number of homes passed.

¹² FairPoint, in testimony delivered to the Utilities Commissions in Maine, New Hampshire and Vermont, stated that it costs, on average, \$150 to pass a home with DSL. Thus, it would cost an estimated \$56 million to provide DSL access to the 373,000 homes that do not currently have such access in Verizon’s NNE service area. The balance of the \$600 million could then be used to provide access to fiber to the home to 777,000 homes. Of course, the actual amount of capital expenditures required to provide access could vary from Verizon’s stated average costs which, in turn, would affect the number of homes passed.



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Or go to www.stop-the-sale.org or www.no-deal.org