PERSPECTIVES

PHOENIX CENTER FOR ADVANCED LEGAL & ECONOMIC PUBLIC POLICY STUDIES

Below the Belt:

A Review of Free Press and the Internet Association's Investment Claims

George S. Ford*

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One of the central arguments in the Net Neutrality debate is over whether the Federal Communications Commission's ("FCC") controversial 2015 decision to reclassify broadband Internet access as a common carrier "telecommunications" service had a negative effect on network investment in 2016. The evidence is mounting that it did.[1] Recent releases of data from USTelecom and CTIA both reveal very large reductions in capital spending by telecommunications firms in 2016.[2] Even a recent report by Free Press—a zealous proponent of aggressive Internet regulation—backs up FCC Chairman Ajit Pai's claim that investment declined subsequent to reclassification.[3] This anecdotal evidence is supported by recent econometric research demonstrates that the Obama Administration's regulatory "reign of terror" on Broadband Service Providers ("BSPs") has cost the U.S. over one-hundred billion in infrastructure investment since 2010.[4]

Financial data tells a consistent story about investment in 2016—capital spending is down, and way down. Free Press believes the consistency in the data does not carry over to the BSPs' advocacy, however. Comparing statements made by BSPs to the FCC and to Wall Street, Free Press contends that these apparent inconsistencies imply that the companies are lying to the Commission and to the public about the effect of Title II on investment.[5] The Internet Association—a trade group of companies favoring aggressive Internet regulation—recently borrowed from Free Press's report to produce an online video summarizing the Free Press narrative.[6]

Allegations that someone is deliberately misleading the Commission should not be taken lightly. *** [However, b]oth Free Press and the Internet Association omit relevant evidence and selectively edit the BSPs' statements to Wall Street and thus, whether intentional or not, present a highly-distorted view of the qualitative evidence.

Allegations that someone is deliberately misleading the Commission should not be taken lightly.[7] So, in this PERSPECTIVE, I review the shared evidence across Free Press and the Internet Association. Doing so makes it clear that it is Free Press and the Internet Association—and not BSPs—who are not telling the whole story. Both Free Press and the

Internet Association omit relevant evidence and selectively edit the BSPs' statements to Wall Street and thus, whether intentional or not, present a highly-distorted view of the qualitative evidence. In one case, the two entities simply contradict their own policy prescriptions, using as evidence an investment deal struck long after the Trump Administration indicated it would seek to repeal the FCC's *2015 Open Internet Order*.

While Free Press and the Internet Association want the public to believe that AT&T is misleading the public and the Commission on Title II, Free Press and the Internet Association's failure to mention the AT&T/DirecTV merger as the source of the financial change reported by AT&T reveals the true fabulists.

AT&T: Setting the "Record" Straight

The Internet Association's video begins with a statement made by John Stephens, AT&T's Chief Financial Officer, on the company's January-2017 earnings call.[8] On that particular call, Mr. Stephens announced that the company had $39 billion in cash flow from its operations in 2016—an amount, according to Mr. Stephens, that was "a record for us."[9] Mr. Stephens also stated that the company is "investing more in capital than we ever had before…." While Free Press and the Internet Association want the public to believe such statements speak to the insignificance of Title II regulation on capital spending, the statements do not. The sizes of the figures have an obvious explanation: in July of 2015, AT&T completed its $49 billion purchase of DirecTV.[10]

Table 1 includes data on AT&T and DirecTV's revenues, cash flow, capital spending, and property, plant and equipment ("PPE"). In the year prior to the deal (2014), DirecTV's revenues were $33 billion, its cash flow was $6.4 billion, and its capital spending was $2.9 billion.[11] AT&T had revenues of $132.4 billion, cash flow of $31.3 billion, and capital expenditures of $21.2 billion.[12] A combination of these two companies results in an entity with roughly $165 billion in revenues, $38 billion in cash flow out, and $24 billion in capital spending. By adding $6 billion to AT&T's $31 billion in cash flow (a 20% increase), it is no surprise that 2016 was a record for the company. Likewise, DirecTV's $2.9 billion in capital spending is a 14% positive bump to AT&T's capital expenditures, a sizeable increase.

Table 1. AT&T/DirecTV Merger
($ billions)

	2014		2016
	AT&T	DirecTV	AT&T
Revenue	132.4	33.3	163.8
PPE	112.9	6.7	124.9
Cash Flow	31.3	6.4	39.3
Cap. Exp.	21.2	2.9	21.5

PPE: Property, Plant, and Equipment

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In fact, a closer look at the data reveals that AT&T's financial results more plausibly contradict the claims of Free Press and the Internet Association. The AT&T/DirecTV merger was consummated in mid-2015, so let's compare financial data from 2014 and 2016.

In 2014, the ratio of cash flow to revenue for the two companies was 0.1915. Applying this figure to 2016 revenues ($163.8 billion) produces an expected Cash Flow of $37.8 billion, which is not wholly unlike, but lower than, the actual cash flow that year of $39.3 billion. In terms of cash flow, AT&T did a bit better than this naïve expectation.

Turning to capital expenditures, let's look at three ratios of capital spending, all with some conceptual validity: spending to revenue (0.1457); spending to property, plant and equipment (0.2018); and spending to cash flow (0.64).[13] Applying these ratios to the corresponding base for 2016, a naïve estimate of capital spending would lie between $24.1 and $25.2 billion.[14] This range is well above actual capital spending of $21.5 billion. Relative to expectations, since reclassification, AT&T has increased cash flow but reduced investment. The evidence conflicts directly with the Internet Association's narrative.

While Free Press and the Internet Association make a scandal of Mr. Stephens' observation that AT&T was "investing more in capital than we ever had before," the difference between 2016 and 2014 for AT&T alone (ignoring DirecTV's spending in 2014) is only $317 million (about a 1.5% difference). Making an adjustment for inflation between the two years, AT&T's *real capital spending actually fell* by $193 million (= $21.5 – $21.7 billion).[15] Appropriately adding DirecTV's capital spending to AT&T's capital expenditure in 2014 and then making the comparison with the combined company in 2016, the combination's capital spending is down $2.7 billion in nominal and $3.2 billion in real dollars. *AT&T's investment levels are, in fact, down significantly in 2016.* If you think this type of data is probative, then it offers a severe indictment of Net Neutrality regulation.

Free Press and the Internet Association also point to Mr. Stephens' mention of the company's fiber investments.[16] While Mr. Stephens does mention AT&T's fiber rollout, Free Press and the Internet Association fail to mention that no small part of AT&T's fiber investment is the direct result of Chairman Tom Wheeler using the merger review authority of the FCC to *extort* concessions from AT&T during the DirecTV merger proceeding (a common tactic during Obama's regulatory revival).[17] While AT&T had indicated in its merger filing that it could profitably deploy fiber to 2 million households, Chairman Wheeler required, as a condition of the merger's approval, the company to deploy fiber to 12.5 million households.[18] AT&T's fiber rollout says more about the Obama Administration's abuse of power at the FCC than it does about Net Neutrality.[19]

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Comcast

Turning to Comcast, Free Press and the Internet Association point to the following statement made by Comcast's CFO Michael Cavanaugh at during the company's Q4-2016 Earnings Call:

> Through consistent investment and innovation, we offer the best broadband product on the market. We double the capacity of our network every 18 to 24 months. These investments enhance our competitive position, allowing us to

> continue to take advantage of opportunities to grow penetration and market share.[20]

It is unclear why Free Press and the Internet Association view this statement as some sort of "smoking gun." Much of this statement is boilerplate earnings-call banter. Comcast is obviously interested in growing penetration and market share; profit-maximizing firms consider such things important. Comcast also invests billions each year, and likely would do so even under very heavy-handed regulation, especially since it customer base continues to grow. No one has ever claimed that investment would stop in response to the regulatory revival at the FCC under the Obama Administration, but only be less than what it would be under the alternative of less regulation.[21]

Indeed, the correct question is *not* what Comcast is doing, but what it would have done "but for" the regulation (the counterfactual).[22] Without Title II, perhaps Comcast would double its speeds every 12 to 18 months. Econometric evidence employing a counterfactual analysis provides strong support for the attenuation of investment in the telecommunications industry during the Obama years.[23]

In fact, this "but for" issue was addressed in the same earnings call, yet Free Press and the Internet Association left it out of their advocacy. The following is an exchange between analyst Vijay Jayant (Evercore ISI) and Comcast CEO Brian Roberts from that same call:

> Mr. Jayant: … with the prospect of Trump-related tax reform and a deregulated FCC philosophy, [] what would you do differently in terms of investment and return on capital?
>
> Mr. Roberts: … I think regulatory certainty for investors is the same as it is for management. It helps you have the confidence to make long-term plans. And the kind of discussion we've been having this morning, whether it's fiber or other investments in in-home equipment, and what your business opportunities are, the more uncertainty, the less encouraging it is to want to invest. So we're encouraged by the prospect of rules that we believe will encourage that investment, stimulate investment, whether that's tax decreases or revisiting the authority of the government to go to places that they said they weren't going to, but legally they could go to in the Open Internet Order with Title II.
>
> So we're looking forward to working with the new administration and the new regulatory leaders to try to frame something that's good for consumers, and it gives a stable platform that we can invest in … .[24]

Mr. Roberts clearly states the regulatory overhang of Title II raises uncertainty and curbs investment incentives. Why did Free Press and the Internet Association exclude this conversation from their respective works? A plausible explanation is that Mr. Roberts' views don't match so well with the false narrative on Internet regulation and investment offered by Free Press and the Internet Association.

… the correct question is not what Comcast is doing, but what it would have done "but for" the regulation (the counterfactual). *** [T]his "but for" issue was addressed in [Comcast's] earnings call, yet Free Press and the Internet Association appear to have (strategically) left it out of their advocacy.

Verizon

For Verizon, Free Press and the Internet Association offer as evidence the April 2017 announcement that Verizon will purchase $1.05 billion worth of fiber from Corning.[25] The deal spans three years (2018, 2019, and 2020), so it amounts to a $350 million contribution to Verizon's capital spending per year, on average.[26] Verizon buys a lot of fiber, and Verizon's CFO Matt Ellis describes Corning as a company "with whom we have a long relationship."[27] As an initial matter, it is not clear whether this deal with Corning represents an expenditure that is out of the ordinary.

What's surprising about the use of this agreement by Free Press and the Internet Association is that the deal was announced five months after Donald Trump was elected President and three-months after Ajit Pai was selected as FCC Chairman.[28]

To anyone who even casually follows the telecom debate, it should have come as no surprise that the reversal of the FCC's controversial *2015 Open Internet Order* was going to be at the top of the Trump Administration's telecom policy priorities list. On November 22, 2016, just two weeks after the election, USA TODAY reported that Net Neutrality was headed for the "ax under Trump."[29] One month later, Ajit Pai—by then the presumptive nominee for Chairman of the FCC—announced that it was time to "fire up the weed whacker and remove those rules that are holding back investment, innovation, and job creation"—a clear reference to reclassification.[30] Thus, the question of whether the Trump Administration would reverse reclassification was not "if," but "when."[31] To argue that Verizon and Corning—two sophisticated business entities—believed that the heavy-hand of Title II would continue at the time they signed the deal strains credulity.

Indeed, the Verizon/Corning deal is compelling evidence of what may happen after the reclassification decision is reversed. Let's look at the timing. Since the 2015 reclassification decision, analysts have looked to changes in 2016 investment levels. In 2017, the FCC is likely to overturn the reclassification decision. Consequently, analysts will now look for the effects of that decision in the investment numbers from 2018, the same year the Verizon/Corning deal triggers. Verizon's capital spending averages around $17 billion in recent years, so the Corning deal represents about 2% of Verizon's annual capital spending. It appears, therefore, that the argument for the positive effects of returning to a Title I world already has some support.[32] Rather than provide damning evidence that reclassification did not stymie investment, if anything the Verizon/Corning deal is a resounding statement that the industry now believes that the Obama Administration's eight year "reign of terror" on the economic profits of BSPs is rapidly coming to a close and it is time to begin re-investing in their networks.[33]

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Conclusion

While reasonable minds can certainly differ over statutory language and case law interpretation, allegations of perjury are no laughing matter. Both Free Press and the Internet Association have leveled a direct charge that major BSPs have deliberately misled the Commission, saying one thing to the Agency and another to Wall Street.

In this PERSPECTIVE, I show how Free Press and the Internet Association offer the public a highly-distorted view of the BSPs' public response to reclassification. In fact, if anything, the examples used by Free Press and the

Internet Association demonstrate the detrimental effects of Title II regulation, as well as show how low these groups will go to maintain the special interest regulation. Despite the hope of more rigorous analysis of Net Neutrality under the Trump Administration, some parties seeking to influence the Agency (or Congress) remain firmly entrenched in the "economics-free zone" of the prior administration.

NOTES:

* **Dr. George S. Ford** ***is the Chief Economist of the Phoenix Center for Advanced Legal and Economic Public Policy Studies. The views expressed in this Perspective do not represent the views of the Phoenix Center or its staff. Dr. Ford may be contacted at ford@phoenix-center.org.***

1 G.S. Ford, *Reclassification and Investment: An Analysis of Free Press' "It's Working" Report*, PHOENIX CENTER POLICY PERSPECTIVE NO. 17-04 (May 22, 2017) (available at: http://www.phoenix-center.org/perspectives/Perspective17-04Final.pdf).

2 P. Brogan, *Broadband Investment Heads in the Wrong Direction*, USTELECOM BLOG (May 5, 2017) (available at: http://www.ustelecom.org/blog/broadband-investment-heads-wrong-direction). More detail was provided in a telephone conservation with Patrick Brogan (May 19, 2017); *Annual Year-End 2016 Top-Line Survey Results*, CTIA (May 2017) (available at: https://www.ctia.org/docs/default-source/default-document-library/annual-year-end-2016-top-line-survey-results-final.pdf?sfvrsn=2).

3 Ford, *supra* n. 1; S.D. Turner, *It's Working: How the Internet Access and Online Video Markets are Thriving in the Title II Era*, Free Press (May 2017) (hereinafter "*Free Press Report*") (available at: https://www.freepress.net/sites/default/files/resources/internet-access-and-online-video-markets-are-thriving-in-title-II-era.pdf).

4 G.S. Ford, *Net Neutrality, Reclassification and Investment: A Counterfactual Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-02 (April 25, 2017) (available at: http://phoenix-center.org/perspectives/Perspective17-02Final.pdf); G.S. Ford, *Net Neutrality, Reclassification and Investment: A Further Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-03 (May 16, 2017) (available at: http://phoenix-center.org/perspectives/Perspective17-03Final.pdf).

5 *Free Press Report, supra* at 3.

6 Internet Association, *Net Neutrality and Your Internet Service Provider: An Investment Story*, YouTube Video (Posted June 7, 2017) (hereinafter "*Internet Association Video*") (available at: http://www.youtube.com/watch?v=77k2tICj_H0&feature=youtu.be&utm_medium=email&utm_source=morningtech&utm_campaign=nninvestment).

7 Free Press and the Internet Associations accusations of dishonesty are serious. As the Internet Association points out in its video, companies are prohibited by law from making misleading statements to investors. *Internet Association Video, id.* at 1:53; *see also* J. Brodkin, *Title II Hasn't Hurt Network Investment, According to the ISPs Themselves,* ARS TECHNICA (May 16, 2017) (available at: http://arstechnica.com/information-technology/2017/05/title-ii-hasnt-hurt-network-investment-according-to-the-isps-themselves). Thus, taking the allegations of Free Press and the Internet Association to their logical conclusion, if BSPs are telling Wall Street that reclassification did not hurt investment but are simultaneously telling the FCC that it did, then these inconsistencies would be tantamount to a deliberate attempt to perpetuate a fraud against the Commission in violation of the Agency's rules. *See, e.g.,* 47 CFR § 1.17 - Truthful and Accurate Statements to the Commission.

8 Available at: http://seekingalpha.com/article/4039537-ts-t-ceo-randall-stephenson-q4-2016-results-earnings-call-transcript (hereinafter "*AT&T Transcript*").

9 *AT&T Transcript, id*; *Free Press Report, supra* n. 3 at p. 88; *Internet Association Video, supra* n. 6 at 00.26.

10 A. Selyukh, *AT&T, DirecTV Complete Merger to Form Biggest Pay-TV Company*, REUTERS (July 24, 2015) (available at: http://www.reuters.com/article/us-at-t-directv-fcc-idUSKCN0PY26L20150724); R. Yu, *AT&T Buys DirecTV for $48.5 Billion*, USA TODAY (May 18, 2014) (available at: http://www.usatoday.com/story/news/usanow/2014/05/18/att-buys-directv/9247795).

11 DirecTV Annual Report (2015) (available at: http://www.last10k.com).

12 AT&T Annual Report (2015) (available at: http://www.last10k.com).

13 *See, e.g.,* R.S. Chirinko, *Business Fixed Investment Spending: Modeling Strategies, Empirical Results, and Policy Implications*, 31 JOURNAL OF ECONOMIC LITERATURE 1875-1911 (1993); R.E. Hall and D. Jorgenson, *Tax Policy and Investment Behavior*, 57 AMERICAN ECONOMIC REVIEW 392-414 (1967)(available at http://www.stanford.edu/~rehall/Tax-Policy-AER-June-1967.pdf).

NOTES CONTINUED:

14 Ideally, I would use lagged values of the bases, but that's not possible given the data available.

15 Data is adjusted for inflation using the GDP Deflator (with 2016 as the base year).

16 *Free Press Report, supra* n. 3 at pp. 88-9; *Internet Association Video, supra* n. 6 at 00.43.

17 T.R. Beard, G.S. Ford, L.J. Spiwak, and M. Stern, *Eroding the Rule of Law: Regulation as Cooperative Bargaining at the FCC*, PHOENIX CENTER POLICY PAPER NO. 49 (October 2015) (available at: http://www.phoenix-center.org/pcpp/PCPP49Final.pdf); J. Kastrenakes, *FCC Questions AT&T for Halting High-Speed Fiber Deployment Before Net Neutrality Decision*, THE VERGE (November 14, 2014) (available at: http://www.theverge.com/2014/11/14/7222055/att-questioned-by-fcc-for-halting-fiber-rollout); M. Sexton, *AT&T/DirecTV Merger Approved By FCC, Agency Forces Fiber Expansion And More*, TOMSHARDWARE.COM (July 24, 2015); (available at: http://www.tomshardware.com/news/fcc-approves-at-t-directv-merger,29673.html); M. James, *AT&T Gets FCC Approval, Immediately Completes $49-Billion Takeover of DirecTV*, LOS ANGELES TIMES (July 24, 2015) (available at: http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-fcc-approves-atts-takeover-of-directv-20150724-story.html).

18 *In the Matter of Applications of AT&T Inc. and DIRECTV For Consent to Assign or Transfer Control of Licenses and Authorizations,* FCC 15-94, MEMORANDUM OPINION AND ORDER, 30 FCC Rcd 9131 (rel. July 28, 2015) at ¶315.

19 *Eroding the Rule of Law*, *supra* n. 17.

20 Available at: http://seekingalpha.com/article/4040405-comcast-cmcsa-q4-2016-results-earnings-call-transcript (hereinafter "*Comcast Transcript*"); *Free Press Report, supra* n. 3 at pp. 66-7; *Internet Association Video, supra* n. 6 at 00.53.

21 An investment model is provided in G.S. Ford, L.J. Spiwak, and M.L. Stern, *The Broadband Credibility Gap*, 19 COMMLAW CONSPECTUS 75-122 (2010), at pp. 100-4 (available at: http://phoenix-center.org/papers/CommlawConspectusBroadbandCredibilityGap.pdf). The magnitude of the investment effects are provided in Ford, *supra* n. 4.

22 Ford, *id.*

23 *Id*.

24 *Comcast Transcript, supra* n. 20.

25 *Free Press Report, supra* n. 3 at pp. 91-2; *Internet Association Video, supra* n. 6 at 1.36; *see also* A. Athavaley, *Verizon, Corning Agree to $1.05 Billion Fiber Deal*, REUTERS (April 18, 2017) (available at: http://www.reuters.com/article/us-corning-verizon-idUSKBN17K201).

26 Deployment costs of that fiber will add to capital spending.

27 Available at: http://seekingalpha.com/article/4063829-verizon-communications-vz-q1-2017-results-earnings-call-transcript.

28 J. Puzzanghera, *Trump Names New FCC Chairman: Ajit Pai, who Wants to Take a 'Weed Whacker' to Net Neutrality*, LOS ANGELES TIMES (January 23, 2017) (available at: http://www.latimes.com/business/la-fi-pai-fcc-chairman-20170123-story.html).

29 M. Snider, *Net Neutrality, Beloved by Netflix, Looks Headed for the Ax Under Trump*, USA TODAY (November 22, 2016) (available at: https://www.usatoday.com/story/tech/news/2016/11/22/trump-team-appointees-indicate-net-neutrality-reversal/94266912);

30 Remarks of FCC Commissioner Ajit Pai before the Free State Foundation's Tenth Anniversary Gala Luncheon, Washington, D.C. (December 7, 2016) (available at: https://apps.fcc.gov/edocs_public/attachmatch/DOC-342497A1.pdf); *see also* Puzzanghera, *supra* n. 28.

31 That "when" started one month later on May 23, 2017. *See In re Restoring Internet Freedom,* FCC 17-60, NOTICE OF PROPOSED RULEMAKING, __ FCC Rcd __, (rel. May 23, 2017) (available at: https://apps.fcc.gov/edocs_public/attachmatch/FCC-17-60A1.pdf).

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32 Given the highly-politicized nature of telecommunications policy there remains a great deal of uncertainty associated with a potential change in administration every four years. Consequently, it is unclear whether the BSPs will fully respond to more favorable investment policies. Even today, the regulatory overhang of aggressive regulation remains.

33 *See* G.S. Ford, *"Regulatory Revival" and Employment in Telecommunications*, PHOENIX CENTER POLICY PERSPECTIVE NO. 17-05 (June 12, 2017) (available at: http://www.phoenix-center.org/perspectives/Perspective17-05Final.pdf); see also G.S. Ford, *Is the FCC's Regulatory Revival Deterring Infrastructure Investment?* BLOOMBERG BNA (November 13, 2015) (available at: http://www.phoenix-center.org/BloombergBNAInvestmentCounterfactual13Nov2015.pdf).