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William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Mr. Caton:

Please find enclosed for filing the original and fifteen copies of the Comments of the Coalition of Six Regional Bell Operating Companies. I also include an electronic version of the Comments, as requested by the Commission.

Please stamp and return the extra copy of the Comments to the messenger.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

COMMENTS OF THE RBOC PAYPHONE COALITION

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EXECUTIVE SUMMARY

Section 276 itself provides the overarching principles that should guide the Commission's inquiry. Section 276 directs the Commission both "to promote competition among payphone service providers" and to "promote the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). These goals are congruent. Competition among payphone providers will both promote the widespread deployment of payphone services and ensure efficient, affordable service for the benefit of the general public.

To enable such competition to flourish, the Commission should deregulate the payphone industry to the extent possible, and establish market parity among all payphone service providers ("PSPs"), so that they can compete freely on the basis of price, quality, convenience, and service. A PSP should have neither artificial advantages nor disadvantages as a result of any affiliation with a LEC. All PSPs should meet on a level playing field where competition, rather than regulatory fiat, rules the day

As an initial matter, then, the Commission must reclassify LEC payphone assets from regulated to unregulated operations and treat payphones as unregulated CPE. The Commission must discontinue the intrastate and interstate carrier access charge payphone service elements and payments. It must otherwise ensure that LEC PSPs do not subsidize their payphone services directly or indirectly from their telephone exchange service and exchange access operations. And it must ensure that LECs do not prefer or discriminate in favor of their own payphone services. At the same time, the Commission must put RBOC-affiliated PSPs on an equal footing with other PSPs in their ability to negotiate with long distance carriers and with location providers.

All of these mandates are relatively straightforward, and the Commission's <u>Computer III</u> and CPE orders are well-established precedents for implementing them. Even after implementing these mandates, however, the Commission will not be able to leave the provision of payphone service completely to market forces, as it has with CPE and enhanced services. Some transitional regulation will be required. This is true for at least four reasons.

First, the Telephone Operator Consumer Services Improvement Act ("TOCSIA"). 47 U.S.C. § 226, prevents PSPs from blocking access code and 800 access calls. As a result, PSPs are in no position to negotiate for compensation on those calls. To ameliorate this problem (and others), Congress has now required the Commission to ensure that PSPs are "fairly compensated for each and every completed intrastate and interstate call using their payphone." 47 U.S.C. § 276(b)(1)(A). The Commission therefore will have to intervene to establish a per-call compensation system for access code and subscriber 800 calls.

Second, non-RBOC PSPs have long been able to negotiate with operator service providers ("OSPs") for compensation on operator service (0+, and revenue-generating 0- and 00-) and 1+ calls from their payphones. They can thus offer location providers "one-stop shopping," a single source package deal that combines compensation on local and long-distance calls. Because the Modification of Final Judgment barred RBOC PSPs from selecting the presubscribed OSP on their payphones, RBOC PSPs currently do not receive per-call compensation for interLATA calls originated on their phones. Many OSPs already have entered into long-term contracts with location providers on these phones. While these contracts are in force -- some of which have terms of 10 years or more -- RBOCs will not be able to obtain compensation by negotiating with the OSP and offering the location owner a different package. Yet the statutory mandate that PSPs be "fairly compensated for each and every completed intrastate and interstate call using their payphone" surely extends to 0+, 1+, and revenue-generating 0- and 00- calls from RBOC payphones.

Third, in some areas local regulations require that local coin calls be offered at artificially depressed prices. For example, at least 7 states still have 10 cent rates, such as Massachusetts and, in specified locations, Minnesota. These below-cost rates do not provide full and fair compensation.

Fourth, there are numerous "public interest payphones, which are provided in the interest of public health, safety, and welfare, in locations where there would otherwise not be a payphone." Congress has directed the Commission to determine whether there should continue to be public interest payphones and, if so, how they are to be "supported fairly and equitably."

These four problems complicate the transition to a purely market-based payphone environment. But in dealing with these problems, the Commission must keep in mind the ultimate goal -- a fully competitive payphone industry Consequently, the Commission must ensure that its solutions to these particular problems aid rather than block the overall transition to pure competition. Regulation should be a temporary ladder to be pulled up once the new plane of competition is reached by all, not an endless staircase in an Escher drawing.

This viewpoint should profoundly influence how the Commission approaches each of the problems listed above. For example, the Commission should not engage in a rate-base, rate-of-return proceeding to determine the appropriate amount of per-call compensation. Instead, the Commission should start by looking to areas where the market is allowed to work, such as in negotiations between non-RBOC PSPs and OSPs The amount that OSPs are willing to pay PSPs for originating presubscribed calls is a rational, market-based proxy for what IXCs should pay PSPs for access code and 800 subscriber calls -- and a perfect proxy for the amount OSPs would pay RBOC PSPs for operator service and presubscribed calls under competitive conditions.

Moreover, the Commission should not calculate a per call compensation rate and impose it as a non-negotiable, across-the-board requirement That would present a fixed, regulatory solution incompatible with the transition to competition. Instead, the Commission should establish a "default" price that governs situations where the parties cannot arrive at a negotiated price. This will permit industry participants to arrive at mutually-beneficial agreements where the market permits negotiations. And where the market does not permit negotiations -- such as with access code and subscriber 800 calls or where location providers are locked into long-term contracts with OSPs -- it will ensure fair compensation where compensation otherwise would be lacking.

Similarly, local coin call prices can be set by competitive forces rather than by regulatory fiat, either at the state or the federal level. But for regulatory constraints, the payphone marketplace is structured to operate competitively -- it has few, if any, barriers to entry, it has many experienced market players (none of whom can charge excessive prices and expect to survive), and it is rapidly deconcentrating so as to leave the LEC PSPs with ever-decreasing market shares. Some states have already deregulated the local coin rate in recognition of the competitive nature of the payphone market. In those states that have not deregulated the local coin rate, however, the Commission will have to ensure that PSPs receive fair compensation for local calls until the market is completely deregulated.

To ensure that public interest payphones are "supported fairly and equitably" within a market-based environment, the Commission should require entities that want public interest payphones to bear the costs of installing and maintaining those phones, in the same way that they bear the cost of installing street lamps and hiring local police. They can do so through competitive bidding among PSPs. (In California, however, the current scheme should be grandfathered).

All of these proposals would ensure fair compensation while making the transition to full, market-based pricing. In the final analysis, however, the most important question will not be how compensation is provided during the transition period but how much compensation is provided. As competitive enterprises, payphone operators cannot and will not retain or install phones that do not cover their full costs. If subsidies are removed and compensation is set too low -- for example, if compensation is based on "average" costs and/or call volumes that, by definition, are insufficient to compensate for the costs of payphones with above-average costs or below-average volumes -- then the number of payphones will plummet and the public interest will suffer. This is directly contrary to the Commission's mandate to promote "widespread deployment." Because its decision will have to be made in the face of uncertainty, the Commission must bear in mind the adverse consequences of inadequate industry compensation for the millions of U.S. payphone users.

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Provisions of the	)	
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COMMENTS OF THE
RBOC PAYPHONE COALITION

The new pro-competitive regulatory framework that the Commission promulgates under Section 276 of the Telecommunications Act of 1996 will shape the payphone industry for years to come, determining both the vigor with which competition will occur and the number of payphones available for public use. Six of the seven Regional Bell Operating Companies ("RBOCs") -- the Bell Atlantic telephone companies, BellSouth Corporation, NYNEX Corporation, Pacific Telesis Group, Southwestern Bell Telephone Company, and U S WEST, Inc. -- have formed a coalition for the purpose of addressing legislative and regulatory issues affecting the payphone industry. They offer here their collective views of how the Commission best can implement Section 276. To the greatest degree possible, these comments address issues in the same order as the NPRM.

DISCUSSION

I. THE COMMISSION'S PER-CALL COMPENSATION PLAN SHOULD PROVIDE COMPREHENSIVE AND FAIR MARKET-BASED COMPENSATION

A. The Commission Must Ensure that PSPs are "Fairly Compensated for Each and Every Completed Intrastate and Interstate Call Using Their Payphone[s]." [NPRM ¶¶ 15-20]

In its NPRM, the Commission recognizes that it has an obligation to ensure that PSPs[1] are fully and fairly compensated for "each and every completed intrastate and interstate call using their payphone[s]." § 276(b)(1)(A) (emphasis added). As a result, the Commission must ensure that there is fair compensation for all calls that use a payphone -- including local coin,[2] directory assistance, operator services (0+ and revenue-generating 0- and 00-),[3] 1+ toll, access code,[4] and 800 access calls. See NPRM ¶¶ 16-22. The Coalition thus agrees with the Commission's tentative conclusion.

The Coalition also agrees with the Commission that international, as well as local and toll, calls should be covered. Id. ¶ 18. While the language of the statute leaves no room for interpretation with respect to interstate and intrastate calls, nothing in the statute precludes

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[1]As used in these comments, the term "PSP" refers to all payphone providers, including independent payphone providers, those affiliated with an RBOC or other LEC, and those affiliated with an interexchange carrier, "IXC."

[2]By "coin" calls, the Coalition means to include all sent-paid calls. Most of these in fact use coins, although the term includes calls made using a pre-paid cash card.

[3]0- calls (pressing the 0 key once) generally go to the LEC operator. 00- calls (pressing the 0 key twice) are generally routed to the OSP.

[4]The Coalition uses the term "access code" calls to include all calls routed to a long-distance carrier by means other than direct dialing through the presubscribed interexchange carrier. It uses the term "subscriber 800" calls to mean calls placed to subscribers of 800, 888, or comparable services (e.g., 1-800-FLOWERS), but not to carriers that use 800 numbers as "access codes" (e.g., 1-800-CALL ATT).

application of the fair compensation requirement to international calls. See id. Indeed, excluding international calls might well prove unworkable. Some toll-free 800 numbers are located abroad (particularly in Canada), and it is impossible for the PSP to tell whether a subscriber 800 call is international or not. Moreover, as the Commission points out, the cost of maintaining the set and providing access for consumers to complete calls is the same whether the call is international or not, and the value of the call -- the benefit to the interexchange carrier -- is highest for international calls. Surely it would be an odd system that required interexchange carriers to compensate for all calls except the most profitable ones.

The Coalition also strongly agrees with the Commission that any rate set by a free and open market is, by definition, the "fair" rate. NPRM ¶ 16. Under the free market system, no participant will provide its service if the rates are less than "fairly" compensatory, and no participant will accept those services where the charge is too high to be "fair." Id. ¶ 16 & n.54. Moreover, because the market yields not merely fair but efficient pricing, it best benefits the general public. Accordingly, the Coalition agrees that the Commission needs to "prescribe compensation only when payphone providers are not already 'fairly compensated.'" Id.

The Coalition also agrees with the Commission, however, that there is not yet a way for the market to set fair compensation for many types of calls. The most obvious of these, as the Commission notes, are "access code calls, subscriber 800 and other toll-free number calls, and debit card calls." NPRM ¶ 17. TOCSIA requires PSPs to permit access code calls, including 800 access calls, to any IXC.[5] Because of this, IXCs have no incentive to negotiate or to pay any compensation to PSPs for these calls, as the IXCs are guaranteed to receive these calls even if they refuse to pay. Yet the PSP provides the IXC a valuable service, as the IXC would not

[5]Because PSPs have no way of differentiating between 800 numbers that are access codes and subscriber 800 numbers, the practical effect of TOCSIA is to unblock all such calls.

receive the traffic if the PSP blocked the calls or the payphone did not exist. Consequently, the Coalition agrees with the Commission that intervention to ensure "fair" compensation for these calls is required. Id.

The Coalition believes that Commission intervention is also needed with respect to 1+ toll and OSP (0+ and revenue-generating 0- and 00-) calls made on RBOC payphones. Non-RBOC PSPs have been able to negotiate commissions freely with IXCs that want payphones presubscribed to them. The amount OSPs are willing to pay (and non-RBOC PSPs are able to charge) is thus determined by market forces. RBOC PSPs, by contrast, have been barred from selecting the IXC on their own payphones and therefore have been unable to negotiate for these commissions. The RBOCs currently receive no compensation at all on these calls and are unlikely to do so for some time absent Commission intervention.[6]

Once RBOC-affiliated PSPs can negotiate with OSPs, they too will be able to negotiate per-call compensation for operator service calls. Numerous OSPs, however, have strategically prevented this from happening for years to come. In order to lock-in compensation-free calling from RBOC payphones, they have induced location providers to enter into long-term contracts, some of which are for 10 years or more. The Act "grandfathers" these contracts where the OSPs entered into them before the effective date of the Act. See p. 45, infra. Until those contracts expire, RBOC PSPs have no opportunity to offer location providers a different package of services, or to negotiate with OSPs for commissions. RBOC PSPs now face a requirement that they operate with stand-alone responsibility for costs, just like independent PSPs. As a result, the Commission must require OSPs to pay RBOC PSPs compensation on all presubscribed (1+,

[6]NPRM ¶ 16 (recognizing that only "PPOs and non-BOC LECs receive compensation" for 0+ and 0- calls as a result of negotiations); id. ¶ 8 (recognizing that, while non-BOC LECs and PPOs "may receive a portion of the commissions from IXCs on interLATA operator-service calls using the presubscribed carrier, the BOCs do not receive any revenue directly from these calls").

0+, and revenue-generating 0- and 00-) calls made on RBOC payphones. To do otherwise would preserve for many years a system under which RBOC PSPs receive nothing for these calls, a situation wholly irreconcilable with Congress's mandate that all PSPs be compensated for every call completed using their phones.

Finally, two other call types warrant mention. First, the Coalition believes that PSPs should be allowed to recover the cost of providing local directory assistance from their payphones. See NPRM ¶ 19.[7] Currently, PSPs in many states are charged a per call rate by the LEC for directory assistance calls placed from their payphones. At a minimum, the PSP should be able to recover the amount it is charged by the LEC. Additionally, the PSP should be permitted to charge an additional amount to achieve "fair compensation," though particular PSPs may choose to forego "fair compensation" for business or other reasons.

Second, in the Coalition's view, the plain language of the statute includes incoming calls among those for which fair compensation is required: the statute requires compensation for calls completed "using" the payphone, not for calls "originated" on it.[8] Current technology, however, may not always allow for collection of payment on these calls. Nonetheless, as technology and

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[7]The same principles applied to local directory assistance should also apply to long distance directory assistance provided by carriers. If, for example, a carrier uses a 1-800 platform to provide directory assistance, per call compensation would apply.

[8]Moreover, because many states prohibit the blocking of incoming calls, barring compensation on incoming calls might create a gap in compensation. IXCs, for example, could avoid paying compensation by using call-back services, which turn compensable payphone originating calls into non-compensable payphone terminating calls. Similar services are used for rate arbitrage on international calls already. See, e.g., Order on Reconsideration, VIA USA, Ltd. Telegroup, Inc., Applications for Authority Under Section 214 of the Communications Act of 1934, as Amended, to Operate as International Resale Carriers, 10 FCC Rcd 9540, 9542, ¶ 5 (1995).

the market advance, the Commission may have to revisit this issue to ensure fair compensation on payphone terminating traffic as well.

B. The Party Responsible for Paying Per-Call Compensation Should Be the Party That Obtains the Primary Economic Benefit from the Call. [NPRM ¶¶ 24-28]

The Commission has tentatively concluded that. "for non-coin payphone calls, either a 'carrier-pays' system or a 'set use fee' system where the end user pays would satisfy the requirements of the 1996 Act." NPRM ¶ 28. The Commission believes, however, "that the carrier-pays mechanism is preferable because it would result in less transaction costs because the IXC could aggregate its payments to payphone providers." Id. The Coalition agrees that a carrier-pays system is appropriate, but urges the Commission to "grandfather" existing state set use compensation schemes.

In the Coalition's view, the party that obtains the primary economic benefit from the call should be responsible for compensating the PSP In general, that party is the carrier that prices, bills for, and receives revenues from the call. Under this system, compensation for a 0+ or 1+ toll call from a payphone would be paid by the toll service provider that prices the call and bills for it; compensation for a call placed from a payphone by way of a carrier access code would be paid by the toll service provider; compensation for a local coin call would be paid by the cash customer (at the local call rate); compensation for a non-cash local call would be paid by the operator service provider that prices the call and bills for it; and compensation for calls to subscriber 800 services would be paid by the service provider. This is consistent with the "carrier-pays" approach endorsed by the Commission in the NPRM.

At the same time. the Coalition does not agree with the Commission's suggestion (NPRM ¶ 28) that the use of "set use fees" by certain states -- under which the carrier bills the end user and remits payments to the PSP -- creates a materially greater administrative burden than a carrier-pays rule. The only difference between a set use fee and a carrier-pays rule is that, under the former, the fee shows up as a line-item on the carrier's bill to the customer. Under carrier-pays, the charge is simply subsumed within the general rate. Set use fees currently are used in five states, including Florida and California. Accordingly, the Coalition sees no reason why these established compensation plans should not be grandfathered so that parties in those states can use them in coordination with the rules the Commission devises here.

C. Tracking and Administration. [NPRM ¶¶ 29-34]

The Coalition agrees with the Commission that the technology for effective call tracking exists and is employed today. NPRM ¶ 29. The Coalition also agrees that the party that obtains the primary economic benefit of each call should have the responsibility for tracking calls. See id. ¶ 31. There is no need, however, for the Commission to develop a standardized technology for tracking. Compare id. ¶ 32. So long as every tracking system provides sufficient detail to allow an audit of the data, there is no reason to bar individual industry participants from developing individualized solutions.

The Coalition agrees with the Commission's suggestion that all carriers be required to initiate an annual independent verification of their per-call tracking functions, and that they be required to make that verification available for FCC inspection. Id. ¶ 31. The Coalition further believes that all carriers should be required to make their verification available for inspection by PSPs. That will relieve the FCC of some of the burden of inspection and place it on the party most interested in ensuring the accuracy of the carriers' data.

The Coalition also agrees with the Commission's proposed dispute resolution system. NPRM ¶ 34. Currently, no such system exists, and disputes can languish indefinitely. The Commission, however, could improve the system by providing penalties for willful failure to pay, in the absence of a legitimate dispute. And even where the failure to pay is the result of negligence or oversight, the debtor should be required to pay the statutory rate of interest on what is in effect an involuntary loan.

Nonetheless, two things are missing from the Commission's tracking proposals. First, the Commission does not establish a time-line for the development of tracking mechanisms. Although the technology for tracking exists and many carriers have it in place, not all of them do. Those that do should be required to begin paying per-call compensation as soon as payphone subsidies to LECs are ended. See pp. 31-32, infra. Those that do not have tracking systems should be required to develop them within 12 months of the effective date of the regulations, and should be required to pay compensation at interim rates -- based on average calling volumes at the per-call compensation rate -- until they do.

Second, the Commission's order should specify that nothing prohibits LECs and PSPs from developing their own tracking mechanisms. If a LEC or PSP develops a technology that permits it to perform this function more efficiently, the LEC or PSP should be permitted (but not required) to offer that technology to carriers.[9] With the addition of these two proposals, the Coalition believes that the Commission's proposed approach to tracking is correct.

D. The Amount of Per-Call Compensation on Toll Calls. [NPRM ¶¶ 35-40]

In setting the amount of per-call compensation on toll calls, the Commission must keep one basic principle in mind -- the Commission's own observation that the market price is not merely the efficient (and therefore socially desirable) price, but the "fair" price as well. NPRM ¶ 16 & n.54. Consequently, where possible, the Commission should allow the market to set compensation levels.

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[9]With respect to some of these systems, surrogates may be needed where the system does not capture every call (e.g., calls placed through regenerated dialtone).

Where the market is not yet permitted to work fully and freely, the Commission still must look to the market for guidance. In the Coalition's view, actual market experience with similar services, rather than an abstract and inherently arbitrary measure of costs, provides the best starting point for setting prices. Accordingly, the Coalition proposes that the Commission rely on market proxies for setting per call compensation

1. The Commission Should Use Market Proxies to Establish Default Compensation Levels for All Toll Calls, Including Access Code, Subscriber 800, Operator Service, and 1+ Calls.

The Coalition strongly agrees with the Commission's tentative conclusion that the market can best determine the rate at which payphone providers are "fairly compensated" for calls made using their payphones. There can be no question that prices set by the market will best benefit the general public. And precisely such market-based prices have been established for certain calls. For example, there is already a market for some operator service (0+) toll calls. Non-RBOC PSPs negotiate freely with OSPs. Because the amount OSPs are willing to pay (and non-RBOC PSPs are able to charge) for presubscribed calls is determined by market forces, the result is fair: Neither party would enter into the transaction if it were "unfair" from their perspective. See Strategic Policy Research, Economic Report on FCC Resolution of Payphone Regulatory Issues 33-34 (attached to the separate comments of BellSouth Corp.) (hereinafter "SPR Report"). NPRM ¶ 16 & n.54.

This freely negotiated rate provides an appropriate market-based proxy for the rate applicable to all similarly-situated calls. In the Second Report and Order, the Commission acknowledged that an appropriate market-based measure for compensation is the value of receiving these calls.[10] Surely there is no better measure of "value" than the amount the OSPs are willing to pay to receive similar calls in a free and open market place. See SPR Rep. at 33-34.[11] In fact, the Commission has relied on precisely such a measure. As the Commission explained in the Second Report and Order, it is a "reasonable approach" to base compensation on "AT&T's 0+ commissions." 7 FCC Rcd at 3257 Based on the data available in 1992, the Commission estimated that the average AT&T commission was approximately $0.40. Ibid.

To update the Commission's data, the Coalition commissioned Arthur Andersen to examine commissions paid on operator services traffic for independent PSPs similar to the RBOC PSPs. See Arthur Andersen L.L.P., Calculation of Per-Call Compensation and Review of Accounting and Regulatory Treatment for Payphone Asset Reclassification, 1-11 (attached) (hereinafter "Andersen Report"). The resulting study, not surprisingly, has produced a range of results. Independent PSPs comparable in size to the RBOC PSPs generally receive a commission of about 36 percent. Since the average call price reported by these independent PSPs is about $2.50, the average commission for these large PSPs is $0.90 per call. Andersen Report at 2-3.

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[10] Second Report and Order, Policies and Rules Concerning Operator Services and Pay Telephone Compensation, 7 FCC Rcd 3251, 3256, ¶ 35 (1995) ("A second reasonable approach would be to base PPO compensation on some measure of the value to OSPs of receiving access code calls").

[11] It makes sense to look at non-RBOC PSPs rather than RBOC PSPs, as RBOC PSPs are currently forbidden from negotiating directly with IXCs. To base compensation on rates negotiated by RBOC PSPs would thus require the Commission to look to the amount that OSPs pay to location providers on RBOC payphones and somehow factor in the payphone element of the Carrier Common Line Charge ("CCLC") associated with the non-access line cost recovery as well. Clearly, the more direct method is to look at negotiations between non-RBOC PSPs and OSPs.

This estimate, however, is on the high side. If one uses AT&T payments as the measure, some call types (very short distance, night-time calls) produce average commissions of closer to \$0.50. And for AT&T's non-local traffic, commissions range from a low of \$.54 (for the average 300-mile night/weekend call) to a high of about \$1.27 (for a daytime, operator-dialed 3,000-mile call). On the whole, AT&T's commissions seem to cluster around the \$.60 range for customer direct-dialed calling card calls, and just above \$1.00 for operator-dialed calls. Id. at Exh. A. If one uses the same methodology and traffic patterns used by the Commission in 1992, the average commission paid by AT&T last year was \$.81 Id. at 4-5.

In addition to examining commissions payable to the largest PSPs and paid by AT&T, Arthur Andersen examined the reported non-coin income of the three largest independent PSPs and the number of non-coin calls they reported. Based on these figures, Arthur Andersen estimated that the average amount of compensation paid on each non-coin call is \$.84. Id. at 5-6. This figure, it should be noted, is actually a somewhat conservative estimate of the price the market would generate. It includes in average compensation not only calls for which a negotiated commission is paid, but also access code calls for which a below market rate of \$.25 per call, or \$6.00 per month, has been set by regulation. Id. at 6-7.

Based on these figures, it is clear that the \$.40 per call figure the Commission relied on in 1992 is by now well out of date. Accordingly, the Commission must update its estimates, bringing them in line with the price that markets, if permitted to function effectively, would generate.[12]

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[12]In 1992, the Commission also used tariffed operator transfer service charges to establish a low-end value for the service the PSP provides. The Coalition believes that the operator transfer service charge is too low for two reasons. First, it was established taking into consideration many regulatory and rate base considerations. Second, the interexchange carrier pays for transfer service whether or not the call is completed. Consequently, if the rate is to be

The Coalition does not suggest, however, that one of these amounts should be set as a mandatory rate. The Commission should take care to preserve as much of the market as functions. For this reason, the Commission should set a transitional default rate, which prevails in the absence of a negotiated agreement, but from which the parties by agreement may depart.[13] By using a default system, the Commission can permit the market to adjust prices downward if the rate inadvertently is set too high: Because most IXCs can identify the specific payphone a call comes from and reject the call (even if it is an access code or subscriber 800 call), the IXCs can refuse to accept calls from PSPs who charge too much. In contrast, PSPs generally will not be able to negotiate a higher rate, because they have no leverage -- no ability to block calls -- if negotiations fall through. They at most can insist on receiving the default rate. The use of a default rate rather than a mandatory rate thus helps regulation mimic the market: IXCs will

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translated into a price for per call compensation on completed calls, it must be adjusted upward, and even then it must be recognized that the market would likely produce a higher rate. (The market certainly would not produce a lower rate; if interexchange carriers believed that current tariffed prices were too high, they could refuse to accept these calls now -- something they do not do.)

It appears that, since 1992, 0- transfer service rates may have gone up a bit, but not substantially. They range from about $.22 to $.46. The National Exchange Carrier Association, for example, charges about $.46 (Tariff F.C.C. No. 5, 4th Rev. Page 17-13 (Jan. 30, 1995)); Illinois Consolidated Telephone Company and GTE charge $.35 (Tariff F.C.C. No. 2, 9th Rev. Page 164 (Apr. 1, 1996)); GTE Tel. Oper. Cos. Tariff FCC No. 1, 9th Rev. Page 248.1 (June 17, 1992); Bell Atlantic (depending on the jurisdiction) charges about $.28; Southwestern Bell (depending on the jurisdiction) charges between $.28 and $.35; Ameritech charges $.22; and NYNEX charges $.24. Arthur Andersen estimates the average rate is $.34, and the rate per completed call ranges from $.42 to $.49 (based on estimated call completion rates of between 69 and 81 percent). See Andersen Report at 7.

[13]After two years, the Commission should reexamine the designated default rate using the same methodology to determine whether any change is in order. The Commission should also, at that time, determine whether a transition to complete market-based pricing is possible for all calls or, at least, for significant categories of calls.

attempt to negotiate rates downward, and will be limited in their ability to do so only by their own estimate of the value (and hence the cost of rejecting) the calls.

2. The Commission Should Not Set Per Call Compensation on Toll Calls at Some Measure of "Cost"

The Commission has proposed that PSPs be compensated based on the "cost" of "originating" dial-around calls. See NPRM ¶ 39. In the Coalition's view, relying on the "cost" of originating calls is economically unsound and from a public policy perspective unwise. It would distort market signals and cause the number of payphones to plummet dramatically, in direct contravention of an express congressional command.

First, looking at the "cost" per call looks at the wrong end of the economic elephant. The PSPs provide payphones, not individual calls. Their output decisions therefore are based not on the cost of carrying individual calls but rather on the expected revenue from deploying an additional payphone. It is for this reason that any proposal to set rates at the "marginal" cost per call is wholly untenable. If prices for all calls were priced at some measure of incremental cost, the total cost of providing the payphone -- all joint, common and overhead costs -- would never be recovered. No rational business will install payphones unless it can recover the total costs of its investment.

Undoubtedly, some carriers will argue that joint, common, and fixed costs can be shifted to other call types. In the Coalition's view, such cost-shifting would be uneconomic, unwise, and contrary to the statute. It would be uneconomic because it would artificially shift demand among call types based on arbitrary regulatory fiat rather than a rational market allocation of costs. It is unwise because the most obvious call type for bearing this cost would be the local call, which is precisely the call that is most sensitive to absolute (rather than percentage) changes in price.

It would be contrary to the statute because the statute calls for fair compensation on each and every call, not for some calls to be overpriced in order to subsidize others.

Second, even setting aside the problems inherent in incremental costing, any cost-based approach would have to rely on some sort of geographic averaging of call costs and, perhaps, calling volumes as well. See NPRM ¶ 38 (suggesting use of "generic" or "industry-wide" costs). But these components of the calculation vary among providers, locations, and phones. SPR Report at 26-27. A compensation rate based on average costs and average volumes would lead those payphones with high call volumes (and high revenues) or low costs to flourish. But any phones with less than average calling volumes (which, by definition, will be somewhere around half of existing payphones) and/or above average costs (again, about half) would be at risk of removal because they cannot recover total costs. See id. at 27. This decline in payphone numbers would not only be contrary to congressional command -- including an express injunction that "widespread" payphone availability be promoted -- but detrimental to social welfare.

Third, as the Commission has already recognized in rejecting a cost-based approach in 1992, cost-based compensation poses obvious administrative difficulties related to compiling and analyzing PSP cost data, and it requires the Commission to make considerable assumptions about joint and common costs. Second Report and Order, 7 FCC Rcd at 3255-56, ¶ 32. Indeed, it would be particularly difficult to rationalize the wide divergence of existing cost structures -- for RBOC PSPs, independent PSPs, and carriers such as AT&T -- into a single, cost-based rate. Moreover, as cost structures change with technology over time, the Commission would have to adjust its methodology and its results continuously, effectively turning what is supposed to be a competitive, market-based industry into a highly regulated, cost-based one. See ibid.[14]

Fourth, gathering the cost data for independent PSPs may prove especially difficult, as the Commission has concluded before. Ibid. But the Commission cannot simply rely on RBOC cost data as a basis for setting compensation for the independent PSPs. The costs of RBOC PSPs have been skewed by regulatory considerations and the technology the RBOCs have employed; as a result, they are not a fair surrogate for the costs of independent PSPs. If the Commission wants to set per call compensation based on costs, then each company will have to have its own per call rate based on its own costs.

Fifth, and finally, some cost models assume that per call compensation will be the same on all calls (local and toll). Yet, as we explain below, there are good reasons for pricing per call compensation for local calls differently from toll calls. See pp. 16-17, infra. Using a cost-based approach thus creates a kind of see-saw effect: As the local rate goes down, the rate for toll calls must go up, and vice versa. To avoid this see-saw effect, the Commission should dispense with the cost basis altogether. It should base price on a realistic approximation of the amount that would be paid in an open and free market.[15]

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[14]Moreover, basing per-call compensation on a cost per-call model would require the Commission to predict a specific level of demand. But a higher price will depress demand (i.e., the number of calls), requiring a still higher rate to satisfy revenue requirements. Accurately calibrating the equilibrium point in a period of change of this magnitude will prove not merely difficult, but impossible.

[15]Nonetheless, the Coalition recognizes that the Commission specifically requested cost data in its NPRM. Accordingly, the Coalition has asked Arthur Andersen to calculate the costs a PSP incurs in providing payphone service on the most appropriate basis possible. Arthur Andersen has included the following elements in its calculations: (1) the direct costs of providing payphone service; (2) the "joint costs" shared by a particular group of services that are incurred even if any one service in the group is discontinued; (3) the "common costs" that are necessary to operate the firm as a whole and which are not incremental to any individual service or to any specific

3. Local Coin Rates Are Not a Good Surrogate for Per-Call Compensation on Toll Calls.

The Commission has requested comment on whether existing "state-established rates for local coin calls . . . would be a reasonable surrogate" for per call compensation on toll calls. NPRM ¶ 38. The answer is emphatically "no."

Local coin rates have been held artificially low in many, if not most, jurisdictions. Regulators have sought to preserve the social welfare aspects of local payphone service regardless of market-based or cost considerations, making up shortfalls from telephone exchange and exchange access operations. Such subsidies are now expressly forbidden by the new Act. 47 U.S.C. § 276(b)(1)(B).[16] Since current local rates are not even based on cost considerations, much less market factors, they are not a good surrogate for fair compensation.

Nor would the market price (rather than the regulated price) for local calls be a good surrogate, as the market would price local calls and toll calls independently. This is true because the effect of price changes on local calling and long-distance calling volumes are radically

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group of services, but are incurred so long as the firm is operating at all; and (4) a reasonable rate of return. See Andersen Report at 9. Also, Arthur Andersen assumed that the RBOC PSPs would be subject to non-structural safeguards pursuant to Computer III, see pp. 33-40, infra. Costs could vary if separate subsidiaries are required.

Based on these factors, Arthur Andersen has estimated that, given current local call rates, the payphone cost of toll calls, on a per call basis, ranges from a low of \$.22 to a high of \$.73. Andersen Report at 11. The principal reason for the wide range is the disparity in local calling rates. If an average cost per call for all calls, including both local and toll calls, is used, the cost ranges from \$.25 to \$.32 for each call. Id. at 10

[16]Local regulators have also had to take coin configuration into account in setting local rates so as not to inconvenience consumers or increase the rate at which coin boxes must be emptied. For example, rates that require the use of a nickel are disfavored because they increase the costs of collection; they fill payphone coin boxes too quickly, either forcing the PSP to empty the boxes more often, or preventing consumers from placing additional local calls until emptying takes place. Such concerns do not come into play in setting the per call compensation rate on toll calls.