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KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.
1301 K STREET, N.W.
SUITE 1000 WEST
WASHINGTON, D.C. 20005-3317

(202) 326-7900

FACSIMILE
(202) 326-7999

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
JEFFREY A. LAMKEN
AUSTIN C. SCHLICK

April 7, 1997

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Federal Communications Commission
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William F. Caton, Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

In re Matter of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, **CC Docket No. 96-128**

Dear Mr. Caton:

Enclosed for filing in this docket are the original and one copy of a letter to Mary Beth Richards and Kathy Franco regarding the above-captioned matter. I sent this letter to Ms. Richards and Ms. Franco today on behalf of the RBOC Payphone Coalition. I would ask that you include the letter in the record of this proceeding in compliance with 47 C.F.R. § 1.1206(a)(2).

If you have any questions concerning this matter, please contact me at (202) 326-7902. Thank you for your consideration.

Yours sincerely,

Michael Kellogg

Michael K. Kellogg

cc: Mary Beth Richards
Kathy Franco

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Mary Beth Richards
Deputy Bureau Chief
Common Carrier Bureau
Federal Communications Comm'n
1919 M Street, N.W., Room 500
Washington, D.C. 20554

Kathy Franco
Legal Counsel to Bureau Chief
Common Carrier Bureau
Federal Communications Comm'n
1919 M Street, N.W., Room 500
Washington, D.C. 20554

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

Dear Mary Beth and Kathy:

On behalf of the RBOC Payphone Coalition, I write in regard to the March 20, 1997 ex parte letter submitted by MCI, the March 28, 1997, ex parte letter submitted by AT&T, and the Commission's Order of last Friday, April 4, 1997 ("April 4 Order") in the above-captioned proceeding. MCI's and AT&T's letters both express concern that RBOCs have not filed rate revisions to eliminate intrastate payphone subsidies, and the Commission accordingly has clarified that intrastate payphone subsidy removal is a pre-requisite to RBOC eligibility for per-call compensation.

In the Coalition's view, MCI's and AT&T's complaints are unfounded and are being registered with the Commission prematurely. The payphone orders are clear: The removal of intrastate payphone cost recovery is a matter for the States in the first instance. Order on Reconsideration ¶ 131. The RBOCs are actively working with the States to identify and eliminate any intrastate payphone subsidies. To the extent AT&T and MCI wish the States to handle this matter differently than they are, they should so advise the state commissions before complaining to the FCC. If AT&T and MCI still believe there is a subsidy in a particular state *after* exhausting state remedies, then they should file a complaint with the Commission as indicated in the Bureau's April 4 Order (at 15 n.93).

Nevertheless, the Coalition does believe it appropriate to keep the Commission advised on how its orders and Congress's commands currently are being implemented in the States. Accordingly, the Coalition offers the following general description of how intrastate payphone subsidies are being identified and eliminated, the status of that process in each State, and a brief response to some of the arguments raised by AT&T and MCI regarding the magnitude of subsidies identified.

A. Cost/Subsidy Removal. Coalition members are removing intrastate payphone cost recovery elements and subsidies through a two-step process. First, they look to see whether any payphone cost recovery rate elements exist as part of non-payphone services rates. If so, such payphone cost recovery rate elements are eliminated. It turns out that very few States explicit payphone cost recovery rate elements in non-payphone services rates.

Second, Coalition members look to historical intrastate costs and intrastate payphone revenues to ensure that, even if payphone cost recovery rate elements have not been built into non-payphone services rates *explicitly*, payphone costs have not been recovered *implicitly* from non-payphone services rates. Specifically, each Coalition member looks at intrastate payphone costs and compares them to intrastate payphone revenues. If costs exceed revenues, the Coalition member treats the difference as if it were a subsidy and takes appropriate action to eliminate it. In North Carolina, for instance, BellSouth eliminated the historical intrastate payphone subsidy of $2.4 million by adjusting the flat rate hunting charge so as to reduce revenue by $2.4 million.

As you can see from the attached chart, this process has shown that there was an intrastate subsidy in some States but not others. This is to be expected, as each State has different regulatory treatment, different rates for payphone service, and different payphone costs.[1]

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[1]It is for this reason that AT&T's reliance on the elimination of $900,000 in subsidies in Alaska is misplaced. The amount of subsidies in Alaska depends not only on the number of

B. Subsidy Amounts. It is the Coalition's understanding that, based on an estimate of interstate subsidies, some interexchange carriers have estimated that intrastate subsidies may be as high as $750 million. But these arguments are fatally flawed. They assume that, because 75 percent of all costs are allocated to the intrastate jurisdiction and 25 percent to the interstate jurisdiction, then 25 percent of all subsidies will appear in the interstate and 75 percent in the intrastate. This assumption is simply wrong, because revenues do not follow the 75 percent/25 percent formula.

Coalition members do allocate approximately 25 percent of their payphone costs to the federal side. But every dime in federal payphone cost recovery comes through a subsidy -- the CCL charge -- because there is no interstate payphone rate through which those costs otherwise could be recovered. Thus, there are interstate payphone costs, but no direct interstate payphone revenues. Consequently, 100 percent of interstate payphone costs are recovered by means of a subsidy.

In contrast, all or almost all of intrastate payphone costs can be recovered directly through intrastate payphone revenues. This is true because, while about 75 percent of payphone costs are allocated to the intrastate jurisdiction, 100 percent of direct payphone revenues come from the intrastate jurisdiction. Since all or almost all intrastate payphone costs can be recovered through intrastate payphone revenues, intrastate payphone subsidies are typically small or non-existent.

Indeed, there is only one situation where the 25 percent/75 percent formula used by the interexchange carriers would be accurate: If Coalition members recovered all of their intrastate payphone costs through a subsidy, as they did with all of their interstate costs. But there is no State in which payphone service is free, and thus no State in which 100 percent of intrastate costs are recovered through intrastate subsidies.

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payphones, but on the amount of payphone cost recovery allowed in the past, as well as the cost of providing payphone service in that unusually harsh environment. Alaska is a high-cost state and it has had artificially low coin rates. In any event, in many States, Coalition members have eliminated subsidies many times the size of the subsidy identified by Alaskan LECs.

It is also the Coalition's understanding that the interexchange carriers are arguing that "subsidy removal" requires RBOCs not only to eliminate historic subsidies, but also to reduce their intrastate rates by an amount equal to expected income from per call compensation. See AT&T March 28 ex parte at 3. MCI argued this position before the Florida PSC, which properly rejected it. The purpose of the Act, as was made clear in the payphone orders, was to remove payphone subsidies, not to offset the higher costs of the IXCs who are required, for the first time, to pay per-call compensation to RBOCs on dial-around calls. This was the very conclusion reached by the Florida PSC, which deemed MCI's argument "unpersuasive" since "[t]he objective is to eliminate any LEC payphone subsidy, not offset the IXCs' higher costs for dial-around compensation." Order, Petition by MCI Telecommunications Corporation for an order requiring BellSouth Telecommunications, Inc. to remove its deregulated payphone investment and associated expenses from its intrastate operations and reduce the Carrier Common Line rate element of its intrastate switched access charges by approximately $36.5 million, Florida P.S.C. Docket No. 970173-TP at 5 (March 31, 1997) ("Florida Order").

Finally, the Coalition believes that some carriers are arguing to the Commission that, where subsidies are detected, any rate reductions must come out of access rates, and cannot come out of some other rate. But the argument is being raised in the wrong forum, as the question of how subsidies are eliminated is a question for the state commissions, which have sole responsibility for setting intrastate rates. Moreover, the argument lacks merit. Where payphone cost rate elements are explicitly recovered in a particular non-payphone rate, cost recovery should be eliminated from that rate. Where payphone costs were implicitly recovered from other, unidentified services -- where there is no explicit payphone cost recovery rate element built into non-payphone rates, but payphones revenues still were not covering payphone costs -- the subsidy could be in any rate or all rates. For this reason, the Florida PSC rejected MCI's argument that access charges, rather than rates for other services, had to be reduced:

> Unlike the interstate case where a portion of the payphone investment and expense is specifically recovered through the CCL, any intrastate payphone subsidy could be recovered anywhere. Since intrastate rates are not based on allocated costs, there is no way of determining which rate elements are contributing to any payphone subsidy.

Florida Order at 5. In such a situation, the States must have the discretion to identify which rates will be adjusted to eliminate the subsidy. The States not only are more familiar with local conditions, but have sole authority to regulate rates for the affected intrastate services.

I hope you find this update helpful and informative. If I can offer any further information or be of assistance, please feel free to call.

Sincerely yours,

Michael Kellogg

Michael K. Kellogg

cc: Dan Abeyta
Thomas Boasberg
Craig Brown
Michelle Carey
Michael Carowitz
James Casserly
James Coltharp
Rose M. Crellin
Dan Gonzalez
Christopher Heimann
Radhika Karmarkar
Regina Keeney
Linda Kinney
Carol Mattey
A. Richard Metzger
John B. Muleta
Judy Nitsche
Brent Olson
Michael Pryor
James Schlichting
Blaise Scinto
Anne Stevens
Richard Welch
Christopher Wright

BELL ATLANTIC				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
Delaware	None	None	None	None
Maryland	None	None	AT&T (Letter filed 03/28)	None
New Jersey	None	None	None	None
Pennsylvania	None	None	None	None
Virginia	None	None	MCI (Letter filed 02/10)	None
West Virginia	None	None	None	None
Washington, D.C.	None	None	None	None

BELLSOUTH				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
Alabama	None	None	AT&T (3/25); Gulf States Pub. Comm. Council (3/25)	Cost Study Filed
Florida	None	$6,500,000	MCI (2/7); Fla. Pub. Comm. Council (3/6 & 10)	$6,500,000 rate reduction (4/15)
Georgia	None	None	Ga. Pub. Comm. Ass'n (3/12); Consumer's Util. Counsel (3/20)	Cost Study Filed
Kentucky	None	$1,700,000	MCI (3/20)	$1,700,000 rate reduction (tariff pending)
Louisiana	None	$2,600,000	MCI (3/19)	$2,600,000 rate reduction (to be acted on 4/16, retroactive to 4/1)
Mississippi	None	$1, 400,000	None	$1,400,000 rate reduction (3/20)
North Carolina	None	$2,400,000	MCI (3/27); N.C. Payphone Ass'n (3/20)	$2,400,000 rate reduction (4/1)
South Carolina	None	$2,500,000	S.C. Pub. Comm. Ass'n (2/27); Consumer Adv. (3/6)	$2,500,000 rate reduction (pending)
Tennessee	None	$800,000	TN Payphone Ass'n (3/14)	$800,000 rate reduction (pending)

NYNEX				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
Connecticut	None	None	None	None
Maine	None	None	None	None
Massachusetts	None	$11,300,000	MCI (3/28) New Eng. Publ. Payphone Council (3/26) Att'y Gen'l (3/14) Nat'l Cons. Law Center (3/28)	$32,100,000 Price Cap Adjustment (retroactive to 4/1)
New Hampshire	None	$2,400,000	MCI (3/31) Office of Cons. Adv. (automatic) Union Tel. (3/6) New Eng. Publ. Payphone Council (3/17) N.H. Legal Assistance (3/12)	$4,200,000 Rate Adjustment (expected 4/14)
New York	None	None	None	None (3/31 Order)
Rhode Island	None	None	None	None (Letter filed and accepted 2/19)
Vermont	None	$1,800,000	Dep't Pub. Srv. (3/12) MCI (4/7)	$1,900,000 Extended Area Service Expansions (Pending)

PACIFIC/NEVADA BELL				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
California	None	None	None	None
Nevada	None	None	None	Cost study Filed; Open Proceeding.

SOUTHWESTERN BELL				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
Arkansas	None	**	None	**
Kansas	None	None	AT&T (3/6); Kansas Payphone Ass'n (2/7)	Open Proceeding
Missouri	None	$600,000	MCI (2/21); Midwest Ind. Coin Payphone Ass'n (3/24)	Open Proceeding
Oklahoma	None	None	AT&T, MCI, various PSPs (not on subsidy issue)	Open Proceeding
Texas	None	None	MCI (1/24), AT&T (2/21), Texas Payphone Ass'n (3/14)	Open Proceeding
** Under investigation; filing addressing subsidy issue will be made prior to April 15.				

U S WEST				
STATE	**EXPLICIT RATE ELEMENTS**	**HISTORIC REVENUE SHORTFALL**	**INTERVENORS (Date)**	**ADJUSTMENT (Effective Date)**
Arizona	None	None	None	None
Colorado	None	None	None	None
Idaho	None	None	None	None
Iowa	None	None	None	None
Minnesota	None	None	None	None
Montana	None	None	None	None
Nebraska	None	None	None	None
North Dakota	None	None	None	None
New Mexico	None	None	MCI (3/21) AT&T (3/17)	Open Proceeding
Oregon	Yes**	None	None	No Adjustment to Rates; $636,526 Revenue Requirement Adjustment**
South Dakota	Yes**	None	None	No Adjustment to Rates; $209,948 Revenue Requirement Adjustment**
Utah	None	None	None	None
Washington	Yes**	None	None	No Adjustment to Rates; $2,081,169 Revenue Requirement Adjustment**
Wyoming	None	None	None	None

**No adjustment to rates required because current intrastate CCL charge is below the current and adjusted revenue requirement.