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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In The Matter of	)	
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IMPLEMENTATION OF THE PAY TELEPHONE RECLASSIFICATION AND COMPENSATION PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996	)	CC Docket No. 96-128

COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION ON REMAND ISSUES

TELECOMMUNICATIONS RESELLERS ASSOCIATION

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SUMMARY

The Telecommunications Resellers Association ("TRA"), an organization consisting of more than 450 resale carriers and their underlying product and service suppliers, hereby submits the following points with regard to the issues raised by the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Cir.") in its decision remanding the Commission's Report and Order and Order on Reconsideration in the captioned docket:

- The D.C. Circuit's conclusion that the Commission acted arbitrarily and capriciously in including only those interexchange carriers ("IXCs") with annual toll revenues in excess of $100 million in its interim payphone compensation mechanism was predicated on an inaccurate understanding of the interim payphone compensation mechanism.

- In order to avoid generating a "windfall" for the largest carriers and requiring smaller carriers to pay twice for payphone-originated toll free and access code calls, the Commission should limit its interim payphone compensation mechanism to the four major national network operators.

- In exempting all but the largest IXCs from the interim payphone compensation mechanism, the Commission would be acting in a manner rationally consistent with both historical and future payphone compensation mechanisms, long-standing agency precedent and emphatic Congressional directives.

- The Commission should exercise its "forbearance" authority to exempt small IXCs from the interim payphone compensation scheme.

- TRA agrees with the D.C. Circuit that the compensation afforded payphone service providers ("PSPs") by the Commission exceeded fair compensation by a wide margin, producing an unjustified "windfall" for "mini-monopoly" providers.

- TRA submits that per-call payphone compensation should be predicated upon a cost-based pricing methodology based on forward-looking economic costs -- *i.e.,* compensation should be based on total service long-run incremental cost ("TSLRIC").

- Use of local coin rates as a pricing surrogate will grossly inflate payphone use fees for toll free and access code calls.

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In The Matter of **IMPLEMENTATION OF THE PAY TELEPHONE RECLASSIFICATION AND COMPENSATION PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996**	))))))))	**CC Docket No. 96-128**

COMMENTS OF THE
TELECOMMUNICATIONS RESELLERS ASSOCIATION
ON REMAND ISSUES

The Telecommunications Resellers Association ("TRA"),[1] through undersigned counsel and pursuant to Public Notice, DA 97-1673 (released August 5, 1997) (the "Notice"), hereby submits its comments on selected issues raised by the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in its decision remanding the Commission's Report and Order, 11 FCC Rcd. 20541 (1996), and Order on Reconsideration, 11 FCC Rcd. 21233 (1996), in the

[1] A national trade association, TRA represents more than 500 entities engaged in, or providing products and services in support of, telecommunications resale. TRA was created, and carries a continuing mandate, to foster and promote telecommunications resale, to support the telecommunications resale industry and to protect and further the interests of entities engaged in the resale of telecommunications services. While the telecommunications resale industry is comprised of an eclectic mix of established, publicly-traded corporations, emerging, high growth companies and newly created enterprises, the "rank and file" of TRA's resale carrier members are small to mid-sized interexchange carriers serving small business and residential customers.

captioned docket.[2] Specifically, TRA will herein offer recommendations regarding the manner in which TRA believes the interim compensation plan should be restructured and "fair compensation" for payphone-originated toll free and access code calls should be determined.

I.

INTRODUCTION

TRA's primary interest in this proceeding has been, and continues to be, in minimizing, to the maximum extent possible, the adverse impact of the per-call payphone compensation arrangement mandated by the Congress in Section 276 of the Communications Act of 1934 ("Communications Act"), as amended by Section 151 of the Telecommunications Act of 1996 ("Telecommunications Act").[3] To this end, TRA has consistently urged the Commission to be cognizant in structuring the statutory per-call payphone compensation mechanism of the impact of its actions on, and to exercise care to avoid adopting rules and policies that would adversely effect, small resale interexchange carriers ("IXCs") and their primarily small business and residential customers. TRA urged the Commission in particular to be sensitive to the impact of the payphone compensation scheme adopted in this proceeding on the fledgling debit (or prepaid calling) card industry.

While there are a number of elements of the Commission's payphone compensation scheme with which it did not (and does not) agree, TRA endorsed various actions taken by the Commission to mitigate the impact of the per-call payphone compensation mechanism for at least

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[2] Illinois Public Telecommunications Association v. FCC, Case No. 96-1394, slip op. (D.C.Cir. July 1, 1997).

[3] 47 U.S.C. § 257; Pub. L. No. 104-104, 110 Stat. 56, § 151 (1996).

a substantial portion of the small resale IXC community. In particular, TRA strongly supported (i) the Commission's interim compensation mechanism pursuant to which only IXCs with annual toll revenues in excess of $100 million were required to pay (on a monthly, per-payphone basis) compensation to payphone service providers ("PSPs") until late 1997, thereby avoiding not only "rate shock" for small resale IXCs, but also potentially devastating problems for debit card providers with large numbers of issued (or contracted for) cards which do not provide for payphone use fees,[4] and (ii) the Commission's action relieving resale carriers of the obligation to "track" payphone-originated toll free and access code calls and to enter into direct-billing arrangements with the tens (perhaps hundreds) of thousands of PSPs, thereby sparing small carriers the massive investment and huge resource drain that such obligations would entail.[5] TRA, however, did (and continues to) object to the mechanism relied upon by the Commission to set per-call payphone compensation rates, as well as the default level established by the Commission for compensating PSPs, for payphone-originated toll free and access code calls.

The D.C. Circuit agreed with TRA that the Commission's "conclusion that compensation for 800 and access code calls should be set at the deregulated local coin rate . . . [was] unjustified."[6] Unfortunately, the D.C. Circuit also held that the Commission "acted arbitrarily and

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4 Report and Order, 11 FCC Rcd. 20541 at ¶¶ 119 - 126; Order on Reconsideration 11 FCC Rcd. 21233 at ¶¶ 126 - 132. *See* Final Brief of Intervenor Telecommunications Resellers Association in Illinois Public Telecommunications Association v. FCC, Case No. 96-1394, filed April 18, 1997.

5 Report and Order, 11 FCC Rcd. 20541 at ¶¶ 83 - 87; 96 - 101, 110 - 116; Order on Reconsideration 11 FCC Rcd. 21233 at ¶¶ 88 - 92, 99, 111 - 113..

6 Illinois Public Telecommunications Association v. FCC, Case No. 96-1394, slip op. at 16.

capriciously in requiring payments only from large IXCs . . . for the first phase of the interim plan."[7] With respect to the former, the Court found that "the record in this case is replete with evidence that the costs of local coin versus 800 and access code calls are not similar" and concluded that the Commission's conclusion that "the compensation rate for 800 and access code calls should be equal to the deregulated local coin rate . . . coupled with its failure to respond to contrary arguments resting on solid data, epitomize[d] arbitrary and capricious decisionmaking."[8] As to the latter, the Court questioned whether "the administrative burdens are as heavy as the FCC seems to believe them to be," whether "administrative convenience" justified the "huge costs," and whether the interim plan should have been based on "total toll revenues."[9]

TRA agrees with the D.C. Circuit that the Commission should devise a different means of setting per-call compensation rates for payphone-originated toll free and access code calls, jettisoning in so doing its previous reliance upon local coin rates as a meaningful surrogate. TRA, however, strongly disagrees with the Court that excluding small IXCs from the interim compensation plan was not justified. Not only was the Court's decision in this respect predicated upon a misunderstanding of the interim compensation mechanism, but, as TRA will show below, inclusion of any carriers other than the four national network operators would result in a windfall to these four providers. Moreover, as TRA has consistently argued, the Commission, in exempting small interexchange carriers from the interim payphone compensation mechanism, acted in a manner

7 Id. at 17.

8 Id. at 14 - 15.

9 Id. at 17.

rationally consistent with both historical and future payphone compensation mechanisms, long-standing agency precedent and emphatic Congressional directives.

II

ARGUMENT

A. The Interim Payphone Compensation Scheme Should be Limited to the Four Major National Network Operators

1. The Court's Decision was Predicated on an Inaccurate Understanding of the Interim Payphone Compensation Mechanism

In concluding that the Commission acted arbitrarily and capriciously in including only those IXCs with annual toll revenues in excess of $100 million in its interim payphone compensation mechanism, the D.C. Circuit recognized that the Commission was motivated in large measure by a desire to spare small carriers a crushing administrative burden that would produce minuscule individual carrier payments. The Court, however, questioned whether these administrative burdens were "as heavy as the FCC seems to believe them to be."[10] The Court's query was predicated on its erroneous view that "each carrier would merely be required to write a check based on its percentage of annual toll revenues."[11]

The D.C. Circuit was obviously mistaken in its understanding of the mechanics of the interim payphone compensation scheme. If included in the interim payphone compensation mechanism, small carriers would not be required to write a single check; they would be compelled

10 Id.

11 Id.

to issue tens (perhaps hundreds) of thousands of checks.[12] Moreover, prior to making such payments, small carriers would be required to identify the tens (perhaps hundreds) of thousands of PSPs to whom they were required to make payments, establish not only the tens (perhaps hundreds) of thousands of accounts necessary to track these payments, but the verification procedures necessary to ensure accurate and timely payments and to avoid fraud.

In most cases, the administrative costs attendant to such activities would dwarf the actual amounts of the checks. And for most small carriers, the accounts and procedures so established would then be promptly dismantled because once the permanent payphone compensation scheme has been instituted, they will no longer be required to compensate PSPs directly. Under the permanent payphone compensation arrangement, most resale carriers will reimburse their network service providers, generally through payphone surcharges, for compensation paid to PSPs by those network service providers in conjunction with payphone-originated toll free and access code calls carried by the resale carriers.

In short, but for the Commission's well-reasoned balancing of costs and benefits in constructing an interim payphone compensation mechanism, small carriers would have been adversely and materially impacted with precious little, if any, countervailing benefits.

2. Including Resale Carriers IXCs in the Interim Payphone Compensation Mechanism Would Produce a Windfall for the Four Major National Network Operators

As the Commission is undoubtedly aware, the major national network operators have been assessing on their resale carrier customers payphone surcharges generally in the amount of

[12] Report and Order, 11 FCC Rcd. 20541 at ¶ 119.

$0.35 per payphone-originated toll free or access code call, commencing as early as December of last year.[13] Moreover, at least one carrier -- Sprint Communications Company, L.P. ("Sprint") -- has apparently been assessing such surcharges on all payphone-originated pre-paid calling card calls, whether or not such calls are ultimately completed to the called party.[14] In other words, small carriers that resell the services of the major network operators have not only been indirectly contributing to the interim payphone compensation mechanism, but they have been doing so at a rate the D.C. Circuit has held to be excessive and, in some instances, on calls the Commission has categorized as noncompensable to PSPs.[15]

The Commission expressly authorized facilities-based carriers to impose on their resale carrier customers "payphone compensation amounts" attributable to "compensable calls facilitated by its reseller and debit card customers."[16] The major national network providers have availed themselves of this opportunity, passing through to their resale carrier customers charges they believed they would be required to pay to PSPs as a result of payphone-originated toll free and access code calls carried by those resale carrier customers. Any restructuring of the interim compensation mechanism which required resale carriers to make payments directly to PSPs or into a fund to be distributed to PSPs would impose upon such small IXCs an obligation to pay twice for

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13 *See, e.g.,* Sprint Communications Company L.P. Tariff F.C.C. No. 2 at page 665.3.8, Section 7.6.7.

14 *See* International Telecard Association, et. al v. FCC, File No. _______ (filed June 11, 1997).

15 Report and Order, 11 FCC Rcd. 20541 at ¶¶ 63 - 64 ("We conclude that a 'completed call' is a call that is answered by the called party. We have previously found that, where an 800 calling card call is routed through an IXC's platform, it should not be viewed as two distinct calls -- one to the platform and one to the called party.")

16 Order on Reconsideration, 11 FCC Rcd. 21233 at ¶ 75.

originating toll free and access code calls from payphones -- once to their underlying network service providers and once to the PSPs. The result obviously would be a "windfall" for the major national network operators. Indeed, this unfortunate result would occur under the interim compensation mechanism as presently constituted with respect to the many resale carriers that are included among the roughly two dozen IXCs with annual toll revenues in excess of $100 million.

Complicating this issue, it is not uncommon for contracts between resale carriers and their underlying network service providers to provide contract termination rights in the event of unilateral rate increases, but to allow for the pass-through of charges either occasioned by regulatory actions or imposed by third parties. Thus, imposition of payphone surcharges often did not give rise to contract termination rights by resale carriers when first imposed because they appeared to be flow-throughs of additional charges levied on the underlying network service providers. If resale carriers are required to make direct payments to PSPs or to contribute to a fund to be distributed to PSPs, the purported payphone surcharges become naked rate increases which will trigger widespread contract termination rights; indeed, absent the issuance of refunds or credits to resale carriers by their underlying network service providers, a significant reduction in the interim compensation mechanism will trigger like contract termination rights.

TRA submits that the solution to these problems is twofold. First, the revised interim compensation mechanism should be limited to the four major national network operators -- AT&T Corp. ("AT&T"), MCI Telecommunications Corp. ("MCI"), Sprint and WorldCom, Inc. ("WorldCom"). To TRA's knowledge, each of these four carriers has established a payphone surcharge which they are imposing on their resale carrier customers, including many of the carriers currently required to contribute to the interim compensation mechanism. Accordingly, extending interim compensation obligations to small IXCs, or even maintaining current obligations for carriers other than the four national network operators, would impose double payment obligations on most and provide a windfall for a few. Second, to the extent they have collected from resale carriers payphone surcharges in amounts the Commission ultimately determines were in excess of "fair compensation" for PSPs, the Commission should direct AT&T, MCI, Sprint and WorldCom to refund or credit such excess amounts to their resale carrier customers.[17]

TRA does agree, however, with the Court's assessment that a sufficient nexus does not exist between total toll revenues and the number of payphone-originated toll free and access code calls to justify use of this allocative standard within the interim payphone compensation mechanism. TRA submits that a more appropriate standard would be a carrier's relative percentage of toll free traffic, or, if available, a carrier's relative percentage of payphone traffic. While the allocative standard becomes less important if the interim compensation mechanism is limited to the four major national network operators, if the universe of contributors is any greater, the standard becomes critical. For example, a carrier which provides service on a "dial-around" basis is not likely to generate much payphone-originated traffic, even though its overall toll revenues might be large.[18]

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[17] In a letter to the Commission, AT&T, for example, has advised the Commission that it will make "interim payments to the PSPs pending the order on remand . . . at the imputed rate of $.12 per call times 75% of the number of calls for which AT&T owed compensation under the Payphone Orders during the period before tracking is available, and AT&T will make payments at a rate of $.12 per call thereafter -- with each amount subject to retroactive true-up (up or down) after the final order on remand." Letter to A. Richard Metzger, Deputy Chief, Common Carrier Bureau, Federal Communications Commission, from Peter H. Jacoby, General Attorney, AT&T, dated August 15, 1997. Left unstated in AT&T's letter is the amount of the payphone surcharges it will impose on its resale carrier customers during this period.

[18] *See, e.g.,* "Petition of Telco Communications Group, Inc. for Waiver of Section 64.1301 of the Commission's Rules," filed in CC Docket No. 96-128 on March 24, 1997.

Such a carrier would be assessed a disproportionately large percentage of the PSP compensation obligation if total toll revenues were the allocative standard.

3. Excluding All but the Largest IXCs from the Interim Payphone Compensation Mechanism Would be Consistent with Agency Precedent and Congressional Directives

In exempting all but the largest IXCs from the interim payphone compensation mechanism, the Commission would be acting in a manner rationally consistent with both historical and future payphone compensation mechanisms, long-standing agency precedent and emphatic Congressional directives. The interim compensation mechanism proposed by TRA mirrors in key respects the pre-existing independent payphone provider ("IPP") compensation arrangement and would be thematically consistent with the per-call compensation mechanism that will follow. Exclusion of all but the largest IXCs from the interim payphone compensation mechanism would further be consistent with size-based distinctions among carriers commonly drawn by the Commission to further public policy objectives. And the associated exemption afforded small IXCs from the interim payphone compensation plan would be consistent with Congressional directives to increase opportunities for small businesses in the telecommunications industry.

"Interim solutions may need to consider the past expectations of parties and the unfairness of abruptly shifting policies."[19] In structuring its interim payphone compensation mechanism, the FCC thus should be faithful to past practice and cognizant of the importance of maintaining consistency going forward. The interim payphone compensation mechanism proposed by TRA above would mirror the preexisting IPP compensation arrangement in its recognition of the need to avoid unduly burdening small IXCs.

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[19] MCI Telecommunications Corp. v. FCC, 750 F.2d 135, 141 (D.C.Cir. 1984).

Prior to enactment of Section 276, IPPs were compensated for interstate payphone-originated access code calls through flat-rate per-phone payments made directly by IXCs. Only those IXCs with annual toll revenues in excess of $100 million were subjected to this compensation obligation, with payments set in accordance with each IXC's relative share of the aggregate toll revenues of all contributing IXCs. The Commission justified its reliance upon this limited universe of payers in terms that apply with equal force here:

> [L]imiting compensation obligations to IXCs providing operator services who earn $100 million or more in annual toll revenues (there are currently fourteen such carriers) will substantially ease administrative burdens of billing and collection. Moreover, IXCs earning less than $100 million in toll revenues per year collectively account for less than five percent of long-distance carrier toll revenues. Individually, they account for a much smaller percentage.[20]

The interim payment compensation mechanism proposed by TRA would also be thematically consistent with the per-call payphone compensation arrangement which will follow. Thus, the FCC in structuring its per-call compensation mechanism exercised care to ameliorate to a substantial degree the burden imposed on resale carriers, relieving them of call-tracking and direct payment obligations, although authorizing their underlying network service providers to pass-through per-call payments made to IPPs on their behalf.[21]

The Commission periodically draws distinctions among carriers when necessary to achieve public policy objectives. In so doing, the Commission is particularly sensitive to the impact of its actions on young industries and small businesses. Thus, for example, the Commission, in implementing its existing access charge regime, exempted both enhanced service providers ("ESPs")

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[20] Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd. 3251, ¶ 51 (1992).

[21] Report and Order, 11 FCC Rcd. 20541 at ¶¶ 86, 101

and certain resale carriers from payment of interstate switched access charges. In terms highly pertinent here, the Commission declared that "[o]ne of [its] primary concerns in fashioning a transition plan [was] the customer impact or market displacement that any proposed remedy might cause."[22] Chief among these "transitional considerations," the Commission identified avoidance of "rate shock" and its resultant adverse impacts upon a fledgling industry populated by many small providers.[23] The Commission's assessment was upheld on appeal in the face of claims that "the Commission impermissibly discriminated against OCCs and resellers in favor of the closely related enhanced service providers and some sharers."[24]

Other examples of the Commission's recognition of the need to differentiate between large and small providers abound. Thus, in securing funding for the "Universal Service Fund," as well as such associated programs as "Lifeline Assistance" and "Link Up America," the Commission historically assessed contributory obligations only on the few dozen IXCs that serve 0.05 percent or more of the presubscribed lines nationwide.[25] Indeed, the Commission actually modified its

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22 MTS and WATS Market Structure, 97 FCC2d 834, ¶ 84 (1984).

23 Id.

24 National Ass'n of Regulatory Utility Comm'rs v. FCC, 737 F.2d 1095, 1136 (D.C.Cir. 1984), *cert denied*, 469 U.S. 1227 (1985). Also noteworthy in light of the consistency between the preexisting IPP compensation arrangement and the interim compensation mechanism, the Court remarked that the exemption afforded ESPs and certain resellers "merely extend[ed] to the enhanced service providers and some sharers the benefits of a graduated transition which was previously granted to those carriers subject to ENFIA tariffs." Id. at 1137.

25 47 C.F.R. §§ 69.116, 69.117.

original formula to "avoid unreasonably harsh effects on small, concentrated IXCs."[26] Similarly, the Commission did not initially impose on long distance resellers the regulatory fees it imposed on facilities-based IXCs[27] and still does not assess wireless resellers the fees it imposes on facilities-based wireless providers.[28]

Nor are the distinctions drawn by the Commission between large and small providers limited to monetary payments. The Commission imposes a variety of additional regulatory obligations on carriers, particularly local exchange carriers ("LECs"), that generate annual revenues in excess of $100 million. The Commission, for example, divides LECs into "tiers" and "classes" of operating companies based on revenue and other thresholds, and imposes on "Tier 1" and "Class A" carriers increased accounting, reporting and cost support requirements.[29] Moreover, the Commission subjects Tier 1/Class A LECs to additional accounting/non-accounting safeguards and expanded interconnection requirements, among other regulatory obligations.[30] Similarly, the Commission requires reports of IXCs generating in excess of $100 million that it does not require of small IXCs.[31]

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[26] "Preparation for Addressing Universal Service Issues: A Review of Current Interstate Support Mechanisms," Universal Service Task Force, Common Carrier Bureau, Federal Communications Commission, pp. 38, 51 (Feb. 23, 1996); Amendment of Part 69 of the Commission's Rules Relating to the Assessment of Charges for the Universal Service Fund and Lifeline Assistance, 4 FCC Rcd. 6134 (1989).

[27] Assessment and Collection of Regulatory Fees for Fiscal Year 1994, 9 FCC Rcd. 5333, ¶ 95, fn. 36 (1994).

[28] Assessment and Collection of Regulatory Fees for Fiscal Year 1997 (Notice of Proposed Rulemaking), MD Docket No. 96-186, FCC 97-49, Appx. H, ¶ 14 (March 5, 1997).

[29] *See, e.g.,* 47 C.F.R. §§ 32.11, 32.9000, 36.112, 43.21, 43.22, 43.43, 61.39.

[30] *See, e.g.,* 47 C.F.R. §§ 64.702, 64.1401.

[31] *See, e.g.,* 47 C.F.R. § 43.21

In short, the Commission, in distinguishing among IXCs by size in structuring its interim compensation mechanism, acted in a manner consistent with other elements of its broad regulatory regime. The interim payphone compensation mechanism proposed by TRA would also further Congressional mandates to enhance opportunities for small businesses in the telecommunications industry. In the Telecommunications Act, the Congress directed the FCC to redouble its efforts to avoid unduly burdening small businesses involved in the telecommunications industry. Thus, in Section 257 of the Communications Act, Congress directed the Commission to "identify[] and eliminat[e] . . . market entry barriers for entrepreneurs and other small businesses in the provision and ownership of telecommunications services and information services."[32] Pursuant to this Congressional mandate, the Commission has already undertaken a number of initiatives designed to "increase opportunities for entry and expansion by small business in telecommunications markets," including the conduct of an "omnibus Section 257 proceeding . . . [to] further the objective of Section 251 to reduce market entry barriers for small businesses."[33].

4. **The Commission May Forbear From Applying Section 276(b)(1)(A) To Smaller IXCs in Structuring its Interim <u>Payphone Compensation Mechanism</u>**

Under Section 401 of the 1996 Act, the Commission "<u>shall forbear</u> from applying . . . any provision of [the 1996] Act . . . to a class of telecommunications carriers or telecommunications services . . . if the Commission determines that:

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by,

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[32] 47 U.S.C. § 257.

[33] <u>Section 257 Proceeding to Identify and Eliminate Market Entry Barriers for Small Businesses</u> (Notice of Inquiry), 11 FCC Rcd. 6280, ¶¶ 2, 7 (1997).

> for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> "(2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> "(3) forbearance from applying such provision or regulation is consistent with the public interest."[34]

Moreover, Section 10(c) further requires the Commission, in reaching the above-described determination, to "consider whether forbearance from enforcing the provision or regulation will promote competitive market conditions."[35] And Section 10(d) in no way limits the Commission's ability to forbear from applying Section 276(b)(1)(A).[36]

Forbearing from imposing interim payphone compensation obligations on small IXCs is certainly consistent with the public interest. Forbearance would avoid the devastating impact that immediate assessment of per-call payphone compensation requirements would have on small IXCs, particularly those engaged in providing prepaid calling card services. In so doing, it would further the strong Congressional desire to promote greater involvement by small business in the telecommunications industry. Forbearance would also help maintain the competitive population of the interstate, interexchange market, thereby preserving for small business in particular the availability of alternative sources of supply. As the Commission has acknowledged, small IXCs "are able to serve narrower niche markets that may not be easily or profitably served by larger

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[34] 47 U.S.C. §160(a) (emphasis added).

[35] 47 U.S.C. §160(b).

[36] 47 U.S.C. §160(d).

corporations." Small business consumers of telecommunications constitute just such a "niche market."[37]

The only countervailing interest here is that of the largest IXCs and the Commission has previously found that the public interest balance must be struck in this instance in favor of the small IXC community. In adopting the pre-existing IPP compensation scheme, the Commission recognized that limiting responsibility for competitive payphone compensation to only the larger IXCs had little adverse impact on these carriers and avoided substantial damage to smaller IXCs.[38] As the Commission explained:

> We note that there are approximately 455 IXCs currently purchasing switched access, a great many of which provide operator services. To extend compensation obligations to all of these carriers would have significantly increased the administrative costs of a compensation mechanism. By contrast, limiting compensation obligations to IXCs providing operator services who earn $100 million or more in annual toll revenues (there are currently fourteen such carriers) will substantially ease the administrative burden of billing and collection. Moreover, IXCs earning less than $100 million in toll revenues per year collectively account for less than five percent of long-distance carrier toll revenues. Individually, they account for a much smaller percentage. Therefore, the payment obligations of these carriers, had they been included, would have been quite low in any case.[39]

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[37] Section 257 Proceeding to Identify and Eliminate Market Entry Barriers for Small Businesses (Notice of Inquiry), GN Docket No. 96-113 at ¶ 6.

[38] Policy and Rules Concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd. 3251 at ¶ 51.

[39] Id. (footnotes omitted).

B. The Commission Should Reassess Its Methodology for Setting Per-Call Payphone Compensation Rates

It is beyond dispute that Section 276 of the Communications Act requires that PSPs be "fairly compensated" for use of their facilities to complete toll free and access code, as well as all other interstate and intrastate, calls. While TRA recognizes that the Commission has limited flexibility in implementing this statutory mandate and certainly does not begrudge PSPs fair compensation for use of their facilities, it nonetheless agrees with the D.C. Circuit that the compensation afforded PSPs by the Commission exceeded fair compensation by a wide margin, producing an unjustified "windfall" for "mini-monopoly" providers. Accordingly, TRA urges the Commission to revisit not only the default payphone compensation levels, but the Commission's reliance upon "local coin rates, subject to an offset for expenses unique to those calls" as the basis for compensating PSPs for payphone-originated toll free and access code calls.[40]

1. Market-Driven Pricing is Inappropriate in a Mini-Monopoly Environment

In the Report and Order, the Commission acknowledged that "there are certain locations where, because of the size of the location or the caller's lack of time to identify potential substitute payphones, no 'off-premises' payphone serves as an adequate substitute for an 'on-premises' payphone."[41] TRA submits that for transient callers, this is unfortunately more often the rule than the exception. Contrary to the Commission's stated belief, most payphones will not "face a sufficient level of competition from payphones at nearby locations to ensure that prices are at a

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40 Notice, DA 97-1673 at 2.

41 Report and Order, 11 FCC Rcd. 20541 at ¶ 15.

competitive level."[42] And even where alternatives are reasonably proximate, TRA suggests that it is not realistic to assume that a consumer, having located a payphone in an airport, or in a parking garage, or in a restaurant or on the street, will elect not to use that phone and seek out another because the first phone requires a deposit of 35¢, or 50¢ or even a $1.00.

The real competition in the payphone market is for access to prime locations. As the Commission has recognized, location providers can often "contract exclusively with one PSP to establish that PSP as the monopoly provider of payphone service."[43] This competition drives upward commissions payable to location providers, not downward rates charged to payphone users. Indeed, this competition not only encourages PSPs to charge higher, not lower, rates, but effectively demands, as well as enables them, to assess supra-competitive charges. And the irony is that the long-run beneficiary of this price inflation will not be the PSP, but the location provider.

Hence, pegging toll free and access code payphone use fees to market-based local coin rates will all but ensure that such use fees will be inflated, and perhaps grossly inflated. Any amounts lost to consumer antipathy to making excessive coin deposits can be recovered through toll free and access code calls which many consumers will pay in the form of higher overall rates and of which most consumers will be wholly unaware.

TRA, accordingly, concurs with AT&T and others that per-call payphone compensation should be predicated upon a cost-based pricing methodology based on forward-looking economic costs -- *i.e.,* compensation should be based on total service long-run incremental cost ("TSLRIC"). As the Commission recognized in pricing interconnection and to local exchange

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42 Id.

43 Id.

networks and access to unbundled local exchange network elements, "economists generally agree that prices based on forward-looking long-run incremental costs (LRIC) give appropriate signals to producers and consumers and ensure efficient entry and utilization of the telecommunications infrastructure."[44] Certainly, it is not inappropriate to include, as the Commission did in its Local Competition Order, in such TSLRIC-based pricing a "reasonable return on investment (*i.e.*, profit), plus a reasonable share of the forward-looking joint and common costs."[45] It is, however, no more appropriate with respect to payphones than it was with regard to unbundled network elements to predicate prices on embedded, or worse yet opportunity, costs. As to the former, the Commission acknowledged that "an 'embedded-cost'-based pricing methodology would be pro-competitor . . . rather than pro-competition" and as to the latter, the Commission correctly concluded that opportunity cost-based pricing would never "drive prices toward competitive levels."[46]

If TSLRIC-based pricing fairly compensates incumbent local exchange carriers ("ILECs") for interconnection to, or for use on an unbundled basis of, their networks and appropriately balances the interests of incumbents, competitors and consumers in the monopoly local exchange market, TRA is hard pressed to understand why TSLRIC-based pricing would not fairly compensate PSPs and appropriately balance competing interests in the mini-monopoly payphone market.

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44 Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶¶ 672 - 703 (1996), *motion for stay denied,* 11 FCC Rcd. 11754, *recon.* 11 FCC Rcd. 13042 (1996), *further recon.* 11 FCC Rcd. 19734 (1996), *further recon.* FCC 97-295 (released Aug. 18, 1997), *vacated in part sub nom.* Iowa Utilities Board v. FCC (and consolidated cases), Case No. 96-3321, *et al.*, (8th Cir. July 18, 1997).

45 Id. at ¶ 673.

46 Id. at ¶¶ 704 - 11.

2. Local Coin Rates are Not an Appropriate Surrogate for Per-Call Payphone Compensation

As the D.C. Circuit noted, the record in this proceeding "is replete with evidence that the costs of local coin calls versus 800 and access code calls are *not* similar."[47] Indeed, the record clearly shows that use of local coin rates as a pricing surrogate will grossly inflate payphone use fees for toll free and access code calls.

Several points are now clear. First, revenues currently generated by local coin calls and "0+" commissions already produce between two to three times the annual costs of providing a payphone. Second, local coin rates are not appropriate surrogates for the Commission per-call compensation mechanism because they are designed to recover costs simply not incurred in originating toll free and access code calls. Thus, the local coin rate must compensate the PSP not only for use of its telephone equipment, but for transporting the call through the local calling area to the end office terminating the call. In sharp contrast, it is the IXC that bears the cost of transporting a payphone-originated toll free or access code call from the payphone location to its ultimate destination, including the costs of local transport and long distance transmission. In other words, in paying a toll free or access code payphone usage fee, an IXC is paying only for use of the telephone, not for call completion. Third, the costs associated with providing coin service differ markedly from the costs associated with providing coinless service. Thus, the local coin rate must recover the substantial labor-intensive costs associated with coin collection and counting, as well as other unique costs associated with coin rating and coin fraud. In short, local coin rate-based payphone usage fees for originating toll free or access code calls are neither cost-based nor fair;

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47 Illinois Public Telecommunications Association v. FCC, Case No. 96-1394, slip op. at 14.

indeed, they would produce a substantial windfall for PSPs. Even the American Public Communications Council ("APCC") conceded that "the local coin rate should be higher than the rate for a non-sent paid call because of the usage and coin collection costs typically associated with local coin calling."[48]

As an arguably local coin-based rate, the interim 35¢ default payphone usage fee suffers from the deficiencies identified above and more. The 35¢ default payphone use fee reflects "the local coin rate in four of the five states that have deregulated their local calling rates."[49] Not only is this a strikingly small sample, but the states involved -- *i.e.,* Iowa, Nebraska, North Dakota and Wyoming -- are hardly representative of the demographics of the country as a whole. Indeed, it is quite likely that payphone concentration in these rural states is lower than the national average and that as a result local coin rates are inflated.

In short, the 35¢ default payphone use fee is inflated and this inflation will likely grow as toll free and access code payphone use fees float with market-driven local coin rates. TRA, accordingly, urges the Commission to prescribe a fixed fee which reflects the costs associated with providing non-sent paid, rather than local coin, calls. Absent such a cost-based fixed fee, IXCs will be denied the opportunity to make informed judgments regarding acceptance of calls from individual payphones because they will have no way of knowing what fees they will be incurring in so doing.

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48 Comments of APCC filed July 1, 1996 at p. 16, n. 15.

49 Report and Order, 11 FCC Rcd. 20541 at ¶ 72.

III.

CONCLUSION

By reason of the foregoing, the Telecommunications Resellers Association urges the Commission to adopt rules and policies in this docket consistent with the above comments.

Respectfully submitted,

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