If the Commission were to include commissions in its calculations of costs attributable to 800 subscriber and access code calls, the FCC must make a determination that such commissions are reasonable (and thus recoverable). The Commission cannot properly allow the inclusion of such commissions, in the payphone compensation amount of non-commissionable calls, if no such determination is made.

2. Line Charges.

Line charges are not appropriately included in the costs that form the basis of payphone compensation for either subscriber 800 calls or for access code calls. Non-PSP carriers already pay the LEC for the use of the payphone line through originating access charges. Moreover, from an incremental standpoint, no additional charges are incurred for 800 subscriber or access code calls because such charges are incurred only when placement of the payphone is justified by the existence of sufficient coin call volume. In fact, Peoples admits this much in its 10-Q quarterly report for the period ended June 30, 1997, filed with the Securities and Exchange Commission. In the "Operating Expenses" section of its 10-Q, Peoples refers to the decrease in telephone charges (which it defines as "local line charges paid to the LECs") and attributes this decrease primarily "to the increase in non-coin revenue related to dial-around compensation earned in 1977 *for which no telephone charges are incurred.*" [Emphasis added.] *See* Peoples 10-Q at p. 10.[26]

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[26] At most, the per-call line charge costs should be equal to the per-message charge on 1MB rates, which is approximately $0.02 to $0.03. *See* Comments of APCC at 13; RBOC Coalition Comments at 16.

3. Field Service/Coin Collection Costs.

It goes without saying that there are no coin collection costs associated with placing coinless calls. With respect to field service costs, according to AT&T, maintenance and repair costs associated with local coin calls at "smart" coin phones are 63% higher than maintenance and repair costs for coinless calls from such phones, and maintenance and repair costs associated with local coin calls at "dumb" coin phones. Warehousing and shipping costs for local coin calls from "dumb" and "smart" phones are 45% higher than for coinless calls, and staffing is 111% higher. *See* AT&T Comments, Robinson Affidavit at 7-9.

4. Billing Costs/Bad Debt Expense.

Peoples states in its comments that its "cost" of collecting "dial-around" compensation, *i.e.*, its bad debt expense, exceeds the costs of coin collection. To make its point, Peoples takes the period from October 8, 1996 through December 31, 1996. The problem with Peoples' attempt to quantify its bad debt expense under the new payphone compensation regime established in the Commission's Order, is that (i) the regime is new, and (ii) the *Payphone Orders* have been in dispute since their release. This time period is therefore not representative because the compensation mechanism and amount were actively being disputed by some carriers who were withholding payment or paying lesser amounts until the issues are finally resolved. *See, e.g.,* Letter from Peter H. Jacoby, General Attorney, AT&T to A. Richard Metzger, FCC, dated August 15, 1997. It is, therefore, likely that the bad debt expense for collection of payphone compensation for 800 subscriber and access code calls will be substantially less than the amount alleged by Peoples in its Comments.

5. Equipment Costs.

There are also significant differences in the equipment costs incurred in completing local coin calls as compared with coinless access code and subscriber 800 calls. As AT&T points out, equipment in the phone needed to rate calls and to determine if the calling party has deposited the correct amount is attributable only to coin calls, not subscriber 800 calls. Comments of AT&T, Robinson Affidavit at 3. In addition, costs attributable to the coin slot, coinbox, and equipment that detects when coins have been deposited should be excluded from the access code/800 subscriber payphone compensation rate. *Id.* Further, when phones are installed, the coin-related functions must be tested, leading to installation costs that are attributable only to coin calls. *Id.* at 4-5. In sum, as AT&T demonstrates, 35 to 47 percent of the costs of a payphone, including installation, are attributable solely to coin-related functions. The remaining costs are shared by both coin and coinless calls. *Id.* at 5. These substantial differences must be accounted for in setting a compensation rate.[27]

C. The Costs Of Payphones Are Inappropriately Allocated Among The Number Of Calls Without Respect To The Differences Between The Types Of Calls.

The cost studies submitted by Peoples, APCC, and the LEC Coalition are faulty because the costs associated with payphones are inappropriately allocate among the number

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[27] peoples includes an estimate for monthly costs for payphone equipment (*i.e.*, depreciation and interest) that is nothing short of incredible. At an amortized rate of $64.33 per month (Comments of Peoples at 10) over 10 years, the total average depreciated cost is an eye-popping $7,719.60. This is four or more time higher than other estimates in the record for total payphone costs, including installation. Assuming *arguendo* that Peoples' other calculations of the cost per call were correct -- as PageNet vehemently asserts it is not -- this overstatement of capital costs would require the exclusion of approximately 20% of the total pre-tax costs.

of calls, rather than being allocated based upon usage (*i.e.* the number of minutes of each call or, alternatively, the average number of minutes for each call type). The data demonstrates that subscriber 800 calls, and paging calls in particular, are shorter induration than most other calls, whether 0+ or access code calls. The differences in call types, particularly with respect to the average duration of the calls, between subscriber 800 calls and access code calls (as well as between 800 subscriber and other call types) are substantial enough such that it is neither economically justified nor fair to allocate costs evenly among payphone calls without regard to the types of calls being placed. Therefore, one of the primary underpinnings of the cost models submitted by these parties must be revised. PageNet's position is supported by the trend with respect to local calling compensation toward charging additional compensation for longer duration local calls (*e.g.* $0.25 for the first three minutes, $0.05 for each additional three minutes). The idea of allocating costs, for purposes of payphone compensation, according to the number of minutes of each call (or the average number of minutes for each call type) is discussed in more detail above.

III. THE RECORD INDICATES THE APPROPRIATENESS OF USING INCREMENTAL COSTS OR, AT MOST, THE COST OF THE MOST EFFICIENT BELLWETHER PROVIDER.

Repeatedly, the payphone providers have argued against the use of an incremental cost methodology for recovery of any 800 subscriber or access code calls, on the theory that all calls should bear a comparable burden in payphone cost recovery. However, they can no longer make such arguments, as their comments in this phase of the proceeding belie all their past efforts at camouflaging the truth regarding the economic justification for installing and maintaining payphones. Peoples' Comments are the most telling. Peoples admits that over

70% of calls from a typical payphone are coin calls (predominantly local calls). Peoples Comments at 6. It also acknowledges that it "will not install payphones in locations which do not generate substantial makers of coin calls." *Id.* The converse, however, is not true. Peoples states that payphones can "rarely, if ever, be justified on the basis of coinless calls alone," and notes that less than five percent of its installed base of 40,000 phones are coinless. *Id.* APCC concurs with this analysis, stating that "very few locations will sustain a coinless phone. Without the coin mechanism, there would be no payphone at all in the overwhelming preponderance of locations."

In short, as Sprint recognizes, payphone providers are already recovering their per-call costs from their existing commissions and coin revenues. These facts clearly support the premise that 800 subscriber payphone origination costs should be based only in incremental costs. Sprint correctly notes that setting rates based on anything other than the incremental costs an efficient provider would incur will result in a substantial windfall for the payphone providers.[28]

These incremental costs would, according to Sprint, "essentially amount to the *de minimis* per-call costs associated with the additional wear and tear on the handset and keypad." Sprint Comments at 4.

An incremental approach such as that proposed by PageNet is consistent with the statutory requirement that the Commission "establish a per-call compensation plan to ensure

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[28] Sprint reports that PSPs are offering to share their Commission-mandated compensation with premises owners, suggesting that payphone providers are more than recovering their costs under the compensation rate set in the *Report and Order*. *Id.* at 5.

that all [PSPs] are fairly compensated for each and every . . . call. . .." 47 U.S.C. § 276. PageNet's approach establishes a per-call compensation plan pursuant to which PSPs are compensated for each call on a measured basis. This mechanism prevents PSPs from receiving windfall profits from above-cost compensation payments, and results in the "fair" compensation envisioned by Congress.

The LEC Coalition has presented to the Commission two analyses which purport to demonstrate that the public will be harmed if they are required to remove any payphones from service as a result of the compensation rate established by the Commission. APCC, too, argues that the public would be harmed by any diminution in the total number of phones. But that assumption is totally unfounded, as it begs the question of whether the phases that are removed were operating efficiently. The public may, in fact, benefit with fewer phones operating more efficiently, or with more phones in higher revenue locations. The payphones that are removed because they are inefficient are not "public policy" payphones; there has been no determination made (and no evidence presented) that suggests that anyone of the potential phones that the payphone providers say wold be targeted for removal are necessary to serve the public welfare.[29]

There is no basis for assuming that the number of LEC payphones installed today bears any relationship to the number that would have been installed in a competitive market. LEC payphone practices have long been based on rate-of-return regulation at the state level -- regulation under which the LECs had every incentive to inflate their capital investments so as

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[29] If, in fact, there are such phones, the payphone providers have the opportunity to have those phones explicitly subsidized, not subsidized as here by exorbitant compensation rates charged to 800 subscriber services by payphone providers.

to increase their overall return. *See In re Policy and Rules Concerning Rates For Dominant Carriers, Report and Order*, 3 FCC Rcd 3195, 3204 (April 17, 1989). According to the FCC, "our own experience with administering a rate-of-return system convinces us that carriers in fact attribute unnecessary costs to their operations." As the Commission recognized, under rate-of-return regulation, profits go up when investment goes up, irrespective of whether an investment is necessary or efficient. Investment, in fact, is especially attractive, since rate payers rather than shareholders paid for this investment.

Thus, the payphones installed by the new competitors, which have not been rate-of-return regulated, could potentially be a more reasonable measure of the level of appropriate investment. However, they, too, have been required to install inefficient plant. For example, it is not unusual to find a bank of three payphones outside a convenience store, originally provided by a LEC under rate-of-return regulation. In order for a subsequent payphone provider to compete for that location, it would likely also have to offer to place three phones in that location, whether or not it was efficient to do so. To do otherwise would suggest to the location owner that the competitive payphone provider was offering inferior service. Thus, the inefficient legacy of the rate-of-return system is perpetuated.[30] Such inefficiently-located phones probably fail to generate the number of calls needed to justify their existence. Concomitantly, such phones understate the average number of calls per phone and tend to drive up potential payphone compensation costs.

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[30] Clearly, there are circumstances where a location owner might agree to fewer installed payphones on its premises but, in those circumstances, the premise owner would want yet another increase in compensation and, therefore, the expense charges from a capital expense to a recurring expense.

Moreover, the LEC Coalition includes in its methodology semi-public phones, which also tends to overstate the "revenue requirement" that payphone compensation must satisfy. The payphone provider requires the location owner to contribute toward partial or full recovery of semi-public payphone costs because they are used predominantly by the location owner, typically in an inside location, to conduct its own business. For example, a small pizza parlor may install a semi-public phone, publish the number, and receive calls placing orders on the phone. Alternatively, another pizza parlor may install the payphone for use by its employees, but not for use of the general public. In either case, the inclusion of semi-public phones understates the average number of calls per phone, thereby overstating the costs per call.

Rather than look at any of these cost models, which would only tend to drive up the "costs" per call without economically defensible justification, the Commission should look at the cost study result of NET-Massachusetts, for an example of an efficient provider. As Sprint and others explain, NET's costs for a payphone local coin call are a maximum of 16.7 cents per call and possibly much lower, if the "Bellwether" test were applied. This cost result should be discounted to take into account perverse incentives associated with NET-Massachusetts' historic rate-of-return regulation, and also to account for the substantial cost differences between local coin and subscriber 800 calls, to arrive at compensation rate.

CONCLUSION

For the foregoing reasons, PageNet respectfully requests that the Commission adopt a calling-party-pays method of compensation. In the alternative, PageNet respectfully requests that the Commission adopt a cost-based approach which apportions, on per-increment rather

than per-call basis, only the additional costs that are incurred through the origination of subscriber 800 calls.

Respectfully submitted,

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September 9, 1997

CERTIFICATE OF SERVICE

I, Patricia J. Goodson, hereby certify that a copy of the foregoing Reply Comments of Paging Network, Inc., was served upon the following individuals by hand delivery this 9th day of September, 1997:

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