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October 1, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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Mr. William F. Caton
Acting 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 are two copies of the Further Report of Arthur Andersen on Avoided Costs for Coin and Coinless Payphones, and Amended Critique of AT&T's Cost Model. The RBOC/GTE/SNET Coalition is submitting this report to you for inclusion 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.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg

Enclosures

cc: John Muleta
Michael Carowitz
Rose Crellin
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Further Report of Arthur Andersen on Avoided Costs for Coin and Coinless Payphones, and Amended Critique of AT&T's Cost Model

Carl R. Geppert

October 1, 1997

Further Report of Arthur Andersen on Avoided Costs For Coin and Coinless Payphones, and Amended Critique of AT&T's Cost Model

Arthur Andersen submits this Further Report to address information gathered since the RBOC/GTE/SNET Payphone Coalition ("the Coalition") submitted our September 9, 1997 Report in connection with its Reply Comments in this payphone compensation remand proceeding. In particular, we address herein whether and to what extent the costs of providing coin rather than coinless payphones influences an avoided-cost analysis for per-call compensation purposes.

A. Coin Mechanism Costs Are Not Avoided

As an initial matter, we must point out that alleged differences in the cost of coinless and coin sets are not relevant for purpose of an avoided cost methodology. First, as discussed in our September 9, 1997 report, only 6% of the Coalition's payphones -- Coalition payphones account for 70% of all payphones -- are coinless.[1] But for coin calls, the majority of payphones would become unprofitable and cease to exist,[2] and replacing Coalition payphones with coinless sets would ensure prompt unprofitability as well. Consequently, coin handling mechanisms and the cost to collect these coins should be treated as "necessary", not avoided, in the provision of access code and subscriber 800 calls.

Second, carrying access code and subscriber 800 calls using coin sets actually reduces the cost of coinless calls because of the increase in total call counts. Where a coin mechanism is used, call volumes increase dramatically, allowing joint and common costs to be spread over a

[1] See, "Critique of Cost Studies and Other Issues", Carl R. Geppert (September 9, 1997), attached to the RBOC/GTE/SNET Payphone Coalition Remand Reply Comments (September 9, 1997), pg. 5.
[2] See, "Report of Arthur Andersen on Per-Call Compensation and Cost Calculation", Carl R. Geppert (August 26, 1997), attached to the RBOC/GTE/SNET Payphone Coalition Remand Comments (August 26, 1997), pg. 7.

greater volume of calls. Where a coinless payphone is used, all costs must be recovered from a much smaller population of coinless calls, consequently increasing the average cost per call substantially.

In any event, AT&T's true costs (as estimated below) and the results of the New Hampshire cost study (which shows that coinless payphones on average cost only $35 less than coin sets[3]) demonstrate that costs differences between coinless and coin sets are insufficient to affect the per-call rate.

B. Update On the Costs of AT&T Payphones

As explained in our prior report dated September 9, 1997, we do not believe that AT&T's cost model[4] accurately reflects the cost of, or avoided costs associated with, originating local coin and coinless calls.[5] Among other things, we noted that AT&T's estimate of the cost of coinless payphones was significantly understated. Accordingly, we adjusted AT&T's calculations to better reflect the cost of AT&T's coinless payphones.[6]

We have since revised our report to reflect additional information provided by the Coalition regarding the cost of coinless payphones used by AT&T. In summary, we have not changed our overall conclusion that AT&T's coinless 11A payphone cost model significantly understates the cost of AT&T's entire coinless payphone repository. We have, however, revised our estimates to account for AT&T's introduction and use of the AT&T Public Phone 2000. Once the cost of this set is taken into account, our revised figures show that the average cost of AT&T's coinless sets is higher than the cost of an average coin set.

[3] "New Hampshire Incremental Cost Study", New England Telephone and Telegraph Company (1993), Section IV C, Attachment 2 (pg. 91).
[4] See, Mr. David Robinson's affidavit, attached to AT&T's Remand Comments (August 26, 1997)
[5] See, "Critique of Cost Studies and Other Issues", Carl R. Geppert (September 9, 1997), pgs. 1, 5.
[6] Id. at 5-9.

Beginning in late 1991, AT&T began to install and support a new coinless payphone branded the "AT&T Public Phone 2000." These new phones were designed to appeal to the business travelers' increasing need for a "portable office" by providing them with "a new era of public telephone communication."[7] The following is a brief listing of functions available in the AT&T Public Phone 2000:

- Nine-inch color monitor showing instructions in English, French, Spanish & German
- Dataport for laptop or fax communications
- Built-in keyboards for access to e-mail
- On-line weather services[8]

Through our conversations with Coalition members, the estimated cost of these sets range from $2,000 to $4,000.[9] In addition, the Public Phone 2000 was designed to "replace [all] existing AT&T Card Caller Public Phones in airports, hotels and convention centers." Mr. Robinson, in his August 26, 1997 affidavit, excluded these sets from his analysis. As a result, he significantly understates the cost of carrying access code and subscriber 800 calls by analyzing only the low-cost 11A coinless payphone. A similar methodology was inappropriately employed by MCI when they used an indoor coinless set as a substitute for all payphones.[10]

If we substitute the estimated cost of the Public Phone 2000 set for AT&T's "card type" phones,[11] the average coinless set cost increases from $766[12] to $2,139 (5,500 11A sets costing $416 and 11,000 Public Phone 2000 sets costing, on average, $3,000). This is over $1,400 more

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[7] Wednesday, October 2, 1991 AT&T News Release.
[8] Id.
[9] It is our understanding that the actual cost of the AT&T Public Phone 2000 is proprietary information. The $2,000 to $4,000 is the Coalition's best estimate.
[10] See, "Payphone Compensation Cost Analysis", Hatfield Associates, Inc. (October 10, 1995), pg. 3, attached to AT&T's Comments (October 10, 1995).
[11] We were unable to determine what "TL" meant on Appendix 1 of Mr. Robinson's affidavit.
[12] See, "Critique of Cost Studies and Other Issues", Carl R. Geppert (September 9, 1997), pg. 6.

than the average cost of a dumb set and nearly $1,100 more than the average cost of a smart set. As noted in our September 9, 1997 report, we calculated, after modifying AT&T's cost model, the per-call costs for calls made from dumb and smart sets to be $0.40 - $0.41. Were we to substitute the dumb and smart set costs with the cost of AT&T's coinless sets, the per-call costs would increase to $0.45 - $0.46.[13] These figures are understated, however, because the volume of calls made from coinless payphones is much less than those made from dumb and smart sets. Even if we assume that AT&T currently has deployed only 1,000 of the Public Phone 2000 sets, the adjusted cost per call ranges from $0.39 - $0.41. These analyses thus illustrate that, using the cost of coinless rather than coin payphones increases or has no effect on the per-call costs of carrying access code and subscriber 800 calls.

C. Costs from Other Studies

We understand that AT&T's choice of using high-cost coinless set technology is not necessarily representative of the payphone industry, just as AT&T's study's reliance on the low-cost 11A set is not representative of the industry. There is, however, another reference point for comparing the cost of coin and coinless payphones. As we pointed out in our earlier remand report, the New Hampshire cost study (relied upon in part by MCI in the October 10, 1995 report prepared by Hatfield Associates, Inc.) noted minimal differences between the cost of coin and coinless sets.[14] In particular, the study estimated that outdoor coin stations cost $1,324.56, while outdoor coinless stations cost $1,289.19 -- a difference of approximately $35.

[13] We have recalculated, using AT&T's cost model and adjusting for AT&T's use of the Public Phone 2000 sets, the per-call costs of making coinless calls from coinless payphones to be $1.02. This is more than the $0.84 per-call cost noted in our September 9, 1997 report.

[14] See, "Report of Arthur Andersen on Per-Call Compensation and Cost Calculation", Carl R. Geppert (August 26, 1997), pg. 8.

Similarly, the study shows that indoor coinless stations cost about $300.39, while indoor coin stations cost about $335.76, again a difference of about $35.[15]

The $35 difference between the cost of a coin and coinless set, if properly allocated over a five to seven year period, is too insignificant to affect the cost per-call. Indeed, allocated over a seven year period, the $35 difference adds only $0.75[16] per month to payphone costs, or less than $0.002 per call if allocated over an average of 478[17] calls per month. As a result, if the cost of coin handling mechanisms were treated as an avoided cost, and we do not believe it should, it would have a de minimis effect.

ARTHUR ANDERSEN LLP

by Carl R. Geppert /om

Carl R. Geppert

[15] "New Hampshire Incremental Cost Study", New England Telephone and Telegraph Company (1993), Section IV C, Attachment 2 (pg. 91).

[16] To compute the $0.75 per month cost, we used the 26% capital investment cost figure noted in our September 9, 1997 report, pg. 7.

[17] See, "Critique of Cost Studies and Other Issues", Carl R. Geppert (September 9, 1997), pg. 5.