

MCI Telecommunications Corporation

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Leonard S. Sawicki
Director
FCC Affairs

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EX PARTE

DOCKET FILE COPY ORIGINAL

October 2, 1997

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

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OCT - 2 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: CC Docket 96-128; Payphone Compensation

Dear Mr. Caton:

On October 1, Mary Brown, George Ford, Michael Pelcovits and I met with John Muleta, Glenn Reynolds and Brad Wimmer of the Common Carrier Bureau. The purpose of the meeting was to review recent research performed on the consumer welfare effects of the FCC's payphone decisions. The attached material details the discussion of that matter and concludes that there would be only a small increase in the number of payphones compared to the huge subsidies generated by 35 cents per call compensation. MCI reviewed the FCC's options for payphone compensation. MCI also distributed copies of its response to the LEC ANI coalition.

Please add this letter and the enclosed copy to the record of this proceeding.

Sincerely,



Leonard S. Sawicki

Attachments

cc: Mr. Muleta
Mr. Reynolds
Mr. Wimmer

96-128-012





**MCI Telecommunications
Corporation**

1801 Pennsylvania Avenue N.W.
Washington, D.C. 20006
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Mary J. Sisak
Senior Counsel
Regulatory Law

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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September 30, 1997

Michael K. Kellogg
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.
1301 K Street, N.W.
Suite 1000 West
Washington, DC 20005-3317

Dear Mr. Kellogg:

This letter responds to your letter dated September 10, 1997, on behalf of the LEC ANI Coalition (Coalition) to Leonard S. Sawicki, concerning the obligations of local exchange carriers (LECs) to provide unique payphone coding digits to payphone service providers (PSPs) that can be transmitted as part of ANI by PSPs to carriers.

In the letter, you state that it is the position of the Coalition that paragraph 64 of the Commission's Payphone Reconsideration Order must be read consistently with the Commission's OLS Order, in which the Commission found that LECs could satisfy their obligation to provide additional coding digits by offering either Flex ANI or OLNS/LIDB. You also state that the Coalition believes that additional coding digits other than "07" and "27" are not necessary for carriers to perform per call tracking and blocking. However, in the spirit of "cooperation" you propose:

1. That LECs, at their sole discretion, will make Flex ANI or OLNS/LIDB available at no charge to carriers for per call compensation purposes.
2. Carriers who receive Flex ANI and/or OLNS/LIDB pursuant to this offer cannot use the coding digits for any other purpose and if a carrier wants to use the digits for another purpose, it must bear a proper allocation of the tariffed rate of that service.
3. LECs will bill all PSPs for providing Flex ANI and/or OLNS/LIDB coding digits to carriers and PSPs must use payphone lines where such lines are available.
4. In order to put this regime in place and test the use of the new digits, per call compensation would begin as scheduled on October 7, 1997, but for a period of six months, per call tracking would be conducted using LEC ANI lists, which would be provided on a monthly basis.



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MCI believes that the Coalition's proposal is not in compliance with the Commission's payphone orders and, therefore, it is unacceptable. The Commission's Payphone Reconsideration Order clearly requires LECs to make available to PSPs unique coding digits as part of ANI. In addition, the order states that each payphone must transmit coding digits that specifically identify it as a payphone, and not merely as a restricted line¹ in order for the PSP to be eligible for compensation. Based on information filed by the LECs, it is clear that the coding digit "07" would be transmitted as part of ANI in the OLNS/LIDB mechanism and carriers would need to query LIDB to get a payphone-specific information digit. There is no dispute that "07" is not a unique payphone coding digit. LEC OLNS/LIDB service, therefore, does not comply with the Commission's orders.

Your characterization of the OLS Order and its relationship to the payphone orders -- namely that because the Commission allowed LECs to provide OLS service through either Flex-ANI or LIDB, its payphone order also must allow the provision of screening digits through Flex-ANI or LIDB-- is incorrect. The Commission's originating line screening (OLS) proceeding, in which it required LECs to make OLS service available to aggregators, including payphone providers (PSPs), and operator service providers (OSPs), was for the purpose of ensuring that aggregators had a mechanism available to protect themselves from fraudulent operator service call charges billed to the telephone line and that OSPs had a mechanism to enable them to prevent such fraudulent calls. Importantly, this proceeding never considered and had no impact on subscriber 800 calls or other dial-around call types because these calls are never billed to the payphone-- they are billed to the 800 customer. Attempting to link the technical considerations, business purposes and policy bases of OLS for operator service call charge fraud and unique ANI information digits for payphone call origination is simply an attempt to unnecessarily mingle issues.

Although the Commission found that LECs could provide OLS information through LIDB or Flex-ANI, the Commission did not find that there was no other way for LECs to provide aggregator specific coding digits. The Commission simply found that in this case, it would allow LECs to fulfill their obligations through Flex-ANI or LIDB and it would not require LECs to implement other mechanisms. This decision did not significantly impact interexchange carriers (IXCs) because of the nature of the operator services that were affected. Specifically, MCI, for example, performs LIDB queries for operator service calls to determine whether the call is fraudulent. Thus, when MCI performs a query for its own internal fraud purposes, the payphone coding information will also be available to further enhance MCI's ability to determine whether to allow the call to be completed. Also, the OLS Order did not require carriers to do

¹ Reconsideration Order at para. 64.

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LIDB queries. Rather, the OLS Order simply made available to PSPs and carriers an additional mechanism with which to protect themselves from fraud.²

Payphone compensation is an entirely different situation. Carriers do not have discretion as to whether to track calls from payphones-- carriers must track all calls from payphones, including subscriber 800 calls. Therefore, if a LIDB solution is implemented, a LIDB query would have to be performed for all calls that are potentially from payphones. In addition, payphone compensation is not limited to operator service calls-- subscriber 800 calls also are compensated. As MCI explained in its letter dated April 18, 1997, to William F. Caton, MCI's current network configuration simply does not allow the use of LIDB to determine whether subscriber 800 calls originate from payphones. MCI can only launch LIDB queries from its operator service platform. The network was designed in this way because-- before the advent of per-call payphone compensation-- there was no need to know if a subscriber 800 call originated from a payphone.

In addition, while it may have been appropriate for the Commission to allow LECs to comply with their OLS obligations in a manner which imposed minimal burden on them because LECs were not the primary beneficiaries of the order, MCI estimates that the LECs' revenues will increase by \$1 billion annually and possibly even more as a result of payphone compensation. Accordingly, the analysis of who should bear the cost of ensuring the implementation of the Commission's payphone compensation scheme is very different from the OLS Order. In light of the fact that IXCs have already spent millions of dollars to modify their networks to track calls from payphones upon the receipt of unique information digits-- and in light of the fact that the IXCs will be required to pay PSPs, and primarily LECs, over one billion dollars in payphone compensation annually, it is reasonable to require the LECs to make any necessary upgrades to transmit unique payphone coding digits as part of ANI.

Moreover, providing payphone coding digits through LIDB is inefficient, expensive, represents older technology, and cannot be implemented for at least 12 months. As demonstrated, MCI currently cannot perform LIDB queries for subscriber 800 calls. And, although it is technically possible to reconfigure the network to perform LIDB queries for subscriber 800 calls, MCI would have to spend between eight million and 50 million dollars in vendor costs alone to do so. Hardware and software upgrades to the operator service platform would cost, at a minimum, six million dollars. Switch software would have to be developed by our vendors at additional cost. In addition, MCI would face internal costs-- such as the costs

² If a carrier fails to perform a LIDB query and the call turns out to be fraudulent, the facts of whether the appropriate information digits were available and whether the OSP queried LIDB, most likely, could affect the determination of which entity is responsible for the fraud.

incurred to increase capacity to accommodate an increased number of LIDB dips and to change the routing for certain kinds of traffic (e.g. toll free) that would otherwise not require LIDB queries. Even with accelerated vendor turn-around, this process would take at least a year.

The use of LIDB would be an extremely inefficient mechanism to identify calls from payphones. Every "07" call would have to be queried, whether it was from a payphone or not, including calls from hotels, hospitals, and student dormitory rooms. A LIDB query for every one of these calls would add network delay and increase carrier access charges. For example, the typical internal processing time for a toll free call is ten milliseconds. However, if a LIDB dip is required, MCI must allow up to 850 milliseconds for the query and response-- 200 milliseconds of which is allowed for internal LIDB processing. Based on the volume of "07" calls, this would significantly increase network delay and access charges.

The additional cost to reconfigure the network and the network delay simply cannot be justified especially when more efficient and more cost effective alternatives, namely, Flex-ANI or hard-coding digits at the switch, are available.

Although the Coalition argues that these options are too costly, based on the data provided by USTA in its letter to the Commission dated July 28, 1997, and Bellcore data, it appears that LECs could implement Flex-ANI with minimal cost. USTA claims that it would cost \$770.5 million to upgrade central office switches to provide Flex-ANI. This is based on upgrades for 3,400 non-equal access digital offices at an average cost of \$35,000 each (total \$119 million); 1,100 electro-mechanical switch replacements at \$400,000 each (totaling \$440 million); and implementing the Flex-ANI feature for digital equal access offices (estimated cost \$171 million) and for the upgraded non-equal access electro-mechanical offices (estimated cost \$40.5 million).

As an initial matter, the majority of the cost (\$559 million of \$750 million) is for converting non-equal access offices. However, given that there may not be smart payphones in non-equal access areas, the LECs may want to request a waiver of the Commission's Payphone Orders to delay per-call compensation in these areas.³ Of course, any continuation of per-phone compensation would have to be based on a greatly reduced estimate of the number of compensable calls given the rural nature of the areas and any such waiver should only apply until a switch is converted to equal access. Dealing with non-equal access offices, separately, however, would greatly reduce the scope of the LECs' problem.

³ USTA states that many of these switches are located in rural areas, "serve few if any smart payphones, and most do not have prisons located in their serving territory." USTA Letter at 4.

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The Coalition suggests that a waiver is not necessary because LECs with non-equal access switches could comply with per-call compensation if they are allowed to use OLNS/LIDB. According to USTA, however, the Coalition is incorrect.⁴ USTA states that many small companies technically are not able to implement OLNS immediately.⁵ According to USTA, OLNS is a long-term option for certain companies and "some accommodation will be required in the short term because of technical inability to implement OLNS immediately."

In any event, USTA's cost estimate for implementing Flex-ANI or hard-coding switches in non-equal access areas is incorrect. According to information provided by Bellcore ("Non-Equal Access Data" (NEAD)), it appears that there are only 485 non-equal access electro-mechanical switches-- not 1,100 as stated by USTA. Based on USTA's cost estimates, it would cost \$194 million to upgrade these offices. (485 X \$400,000= \$194 million). In addition, even this estimate may be high because it assumes that all of the 485 non-digital, non-equal access offices must be replaced.

USTA's statement that there are 3,400 digital non-equal access offices also is incorrect. Based on the Bellcore data, it appears that there are only 2,096 non-equal access offices. Of these, approximately 485 are the electro-mechanical type mentioned above and approximately 339 are Remote Digital switches which would not require upgrades because remote switches subtend Host switches and take on the characteristics of those respective Host switches. After deducting other special purpose switches, the actual number of non-equal access digital switches requiring upgrades is approximately 1,200 Host switches. After further examination and clarification of the exact meaning of some of the switch ID (CLLI codes) used in the Bellcore NEAD report, MCI expects that this number could decrease to only 500 switches needing upgrades.

USTA's estimate of the cost to upgrade equal access switches also is wrong. It is likely that USTA's estimate of 21,000 equal access offices is high because it also incorrectly includes remote offices. Most host switches can accommodate up to 5 remote switches, and some up to 10. If we assume only 3 remotes for every host as an average nationwide, then the number of equal access switches would be less than 5,500. This number makes more sense in light of USTA's estimate that only 3,000 equal access offices are equipped with Flex-ANI-- even though five of the seven RBOCs currently offer Flex-ANI (Ameritech, Bell Atlantic, NYNEX, SWBT and US West).

⁴ LEC ANI Coalition letter dated September 22, 1997, to Richard H. Rubin at 5.

⁵ USTA Ex Parte, filed September 10, 1997, attachment at 2.

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In addition, USTA's estimate that it would cost \$171 million to implement Flex-ANI in equal access switches is based on an incorrect cost per switch. USTA's calculation is based on a cost of \$9,000 per switch, which was developed by soliciting quotes from equipment vendors and then averaging the low quote of \$4,000 per switch with the high quote of \$14,000 per switch.⁶ A far more accurate approach would have been to determine the average cost by weighting the prices quoted by vendors according to the population of each switch type. Even at \$9,000 per switch, however, the cost to implement Flex-ANI is only \$22.5 million (5,500-3,000=2,500 switches needing upgrades times \$9,000= \$22.5 million).

Also, in their interstate cost support, the BOCs cite software right-to-use fees of \$2.1 million (USW), \$2.6 million (SWBT), and \$1.8 million (NYNEX). All five BOCs introduced Flex-ANI into their networks approximately in 1991/92. USTA's figure that 21,000 switches need upgrades costing \$171 million is not consistent with these facts. In any event, as stated by USTA,⁷ "implementation of Flex ANI, ANI ii or hard coding is determined by the individual company based on it's own business strategy and arrangements with other carriers." Even a \$171 million one-time cost seems like a reasonable investment for the LECs to make to obtain over \$1 billion annually in payphone compensation. Based on USTA's estimate of the cost of Flex ANI -- \$171 million-- the per-call cost to recover that amount would be only \$0.01.⁸ Thus, the per-call cost of Flex ANI is clearly no more than \$0.01, (without adjusting the \$171 million USTA estimate) and almost certainly a fraction of this amount.

MCI also rejects your suggestion that per-call compensation should be implemented through the use of LEC ANI lists. As an initial matter, this approach would be an administrative nightmare-- if it could be done at all-- because carriers would have to store the call records for billions of calls per quarter that have a "07", "27", "29", or "70" information digit and then match those call records against the LEC ANI lists to determine which calls are compensable.

In addition, this approach would negate one of the basic tenets of the Commission's approach to per-call compensation-- namely, that carriers and 800 customers can avoid excessive compensation amounts by blocking calls from payphones. Without the ability to identify a call as coming from a payphone on a real-time basis, carriers and 800 customers cannot block these calls to avoid compensation.

⁶ USTA Letter at 4.

⁷ USTA Letter at 3.

⁸ This cost figure was derived by depreciating the cost over seven years and assuming a 15.75% return on investment. No "commission adjustment" was used, however.

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This approach also would severely limit the ability of carriers to recover the cost of compensation from the consumer because carriers must be able to submit the compensation charge with the monthly bill for the telecommunications service to the consumer. Carriers receive the LEC ANI lists months after a call has occurred, and it takes months more for carriers to verify the accuracy of those lists. The result is that it could be 6 months or more after a call is made before the carrier could submit the charge for payphone compensation to the consumer. It is unlikely that consumers would even remember the call, let alone pay the compensation charge.

With respect to the Coalition's charge that because MCI did not clearly indicate its position on LIDB in a timely fashion, MCI is not responsible for the fact that LECs did not implement the ability to provide unique payphone coding digits by October 7, 1997,⁹ MCI refers you to its Petition for Reconsideration filed on October 21, 1996, in which MCI asks the Commission to define a compensable phone as one that transmits specific payphone coding digits. In the Petition, MCI also clearly explains that "07" is not a specific payphone coding digit. Thus, it should have been clear to the Coalition at that time that LIDB would not be an acceptable mechanism to MCI. MCI also refers you to its Reply Comments in connection with BellSouth's CEI plan, dated January 15, 1997, in which MCI argues that BellSouth's plan is not in compliance with the Commission's payphone orders because BellSouth intended to provide the coding digit "07" as a part of ANI with payphones and "07" is not a specific payphone digit. Thus, MCI argued that "PSPs purchasing payphone service from BellSouth will only be able to transmit the coding digit "07" and, therefore, they will not be eligible for compensation."¹⁰ MCI filed similar arguments in the CEI proceedings for Ameritech, NYNEX, US West, and Pacific Bell and Nevada Bell.

Finally, it must be recognized that over the last year MCI and other IXCs have spent millions of dollars and thousands of man-hours implementing the mechanisms necessary to track unique payphone coding digits and to pay per-call compensation by October 7, 1997. If MCI

⁹ Coalition letter dated September 22, 1997, to Richard H. Rubin at 4.

¹⁰ MCI Reply Comments, BellSouth CEI Plan, CC Docket No. 96-128, January 15, 1997, at 2-3.

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September 30, 1997
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receives unique payphone coding digits with ANI-- which the industry standards committee has identified as 27, 29 and 70-- we will be able to track and pay compensation for these calls. If we do not receive these digits, we will not pay compensation.

If you have further questions on this matter, please contact Len Sawicki (202) 887-2048 or me.

Sincerely,


Mary J. Sisak

cc: Richard Metzger
John Muleta
Rose Crellin
Greg Lipscomb
Jennifer Myers
Robert Spangler
Al Barna

Consumer Welfare Effects of Payphone Compensation Policies

DOCKET FILE COPY DUPLICATE

Will the Public Interest be Served by Higher Compensation Rates for Access/800 Calls?

- Two Effects of Increased Compensation:
 - Higher Costs for Consumers at Existing Payphones
 - Placement of Payphones at “New” Locations
- Effect on Consumer Welfare:
 - Reduced Consumer Welfare at Existing Payphones
 - Increased Consumer Welfare at “New” Payphones
- Question: Which Effect Dominates?

Payphone Economics

- Payphones are placed where expected revenue equals or exceeds cost of operating the payphone.
- Revenue potential will vary by location.
- Payphones are placed sequentially where expected revenues are greatest.
- Revenues in excess of costs are profits that will be extracted by premise owners due to “competition” in the payphone industry.

Welfare at New Phones

- It is possible that higher compensation rates will increase revenue at “marginal” locations.
- If large enough, the increased revenues may lead to payphone placement.
- These “new” payphones will increase consumer welfare.
- Question: How many new payphones can be expected at higher prices?

Welfare at Existing Phones

- Higher compensation rates will increase revenues at existing locations.
- Consumers at Existing Locations Lose!
 - Fewer Calls
 - Higher Prices
- Premise Owners Win!
 - Higher revenues at existing locations will be extracted by premise owners.
- *Gain to Premise Owners is less than the loss to Consumers!!!*

PAYPHONE ANALYSIS

Demand Elasticity 0.31
Supply Elasticity 0.19

EXISTING PHONES		BEFORE	AFTER	CHANGE
Revenue Per Phone	\$	280.00	\$ 316.12	12%
Price Per Call	\$	1.00	\$ 1.30	26%
Access/800 Calls Per Phone		131	120	-8%
Number of Payphones		1,850,000	1,850,000	0%
Access/800 Calls Per Month		242,350,000	222,751,261	\$(19,598,739)
Annual Revenue For Access/800 Calls	\$	133,200,000	\$ 935,555,296	\$ 802,355,296
MARGINAL PHONES		BEFORE	AFTER	CHANGE
Revenue Per Marginal Phone	\$	140.00	\$ 155.00	
Access/800 Calls Per Phone		66	60	
New Revenue at Marginal Phone		...	\$ 15.00	
% Increase in Revenue at Marg. Phone		...	11%	
New Phones		...	37,661	

Subsidy from Users of Existing Phones 802,355,296
Annual Subsidy Per Marginal Phone \$ 21,304.83