

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

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

SECOND REPORT AND ORDER

Adopted: October 9, 1997

Released: October 9, 1997

By the Commission: Commissioners Quello and Ness issuing *separate* statements.

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I. INTRODUCTION

1. In this order, we address the default per-call compensation rate¹ for subscriber 800 and access code calls² originated from payphones in light of the decision of the United States Court of Appeals for the District of Columbia Circuit (the court) in *Illinois Public Telecommunications Ass'n v. FCC*,³ which vacated and remanded portions of the *Payphone Orders*.⁴ In that decision, the court concluded that the Commission did not justify adequately setting the per-call compensation rate for subscriber 800 and access code calls at the deregulated local coin rate of \$0.35,⁵ because it did not justify its conclusion that the costs of local coin calls are similar to those of subscriber 800 calls and access code calls.⁶ After seeking additional comment on this issue, we conclude in this order that the default rate for per-call compensation of subscriber 800 and access code calls from payphones is the deregulated local coin rate adjusted for cost differences. As discussed herein, based on our analysis of the record and the statutory policy goals of Section 276 of the Communications Act,⁷ we establish a rate of \$0.284 per call as the default per-call compensation rate for subscriber 800 and access code calls for the first two years of per-call compensation.⁸ This rate will continue to be the default rate for coinless payphones absent a

¹ The default per-call rate is the rate that shall apply in the absence of a negotiated agreement between parties during the first two years of per-call compensation (October 7, 1997, through October 6, 1999). Thereafter, the default rate, in the absence of a negotiated agreement, is the market-based local coin rate less \$0.066. For coinless payphones, \$0.284 will continue to be the default rate, absent a negotiated agreement.

² An "access code" is a sequence of numbers that, when dialed, connect the caller to the operator service provider ("OSP") associated with that sequence, as opposed to the OSP presubscribed to the originating line. Access codes include 800 numbers, 10XXX in equal access areas and "950" Feature Group B dialing (950-0XXX or 950-1XXX) anywhere, where the three-digit XXX denotes a particular interexchange carrier. See Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd 3251, 3251 n.1 (1993) ("*OSP Second Report and Order*"). "Subscriber 800 calls" consist of calls to an 800 number assigned to a particular subscriber. See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Notice of Proposed Rulemaking, 11 FCC Rcd 6716 (1996) ("*NPRM*"). In this order, subscriber 800 encompasses toll-free subscriber calls, including 888 numbers. See Toll Free Service Access Codes, 11 FCC Rcd 2496 (1996).

³ 117 F.3d 555 (D.C. Cir. 1997) ("*Illinois Public Telecomm.*").

⁴ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Report and Order, 11 FCC Rcd 20,541 (1996) ("*Report and Order*"); Order on Reconsideration, 11 FCC Rcd 21,233 (1996) ("*Order on Reconsideration*") (collectively the "*Payphone Orders*").

⁵ *Illinois Public Telecomm.*, 117 F.3d at 564.

⁶ *Id.*

⁷ 47 U.S.C. § 276 Communications Act of 1934, Section 276 was added by the Telecommunications Act of 1996 ("*1996 Act*").

⁸ In the *Payphone Orders*, we established a two-part compensation scheme for subscriber 800 and access code calls, as well as for local coin calls, to facilitate the transition from a highly regulated industry to a deregulated one. As noted above, the court vacated the interim compensation plan regarding compensation for subscriber 800 and

negotiated rate. Interexchange carriers (IXCs) must pay this per-call amount to payphone service providers (PSPs) for access code and subscriber 800 calls beginning October 7, 1997, as required by the *Payphone Orders*.⁹ After the first two years of per-call compensation, the market-based local coin rate adjusted for certain costs is the surrogate for the default per-call rate for subscriber 800 and access code calls.¹⁰

2. The compensation amount we adopt in this *Second Report and Order* is applicable, as Section 276(d) provides, to "[t]he provision of public or semi-public pay telephones, the provision of inmate telephone service in correctional institutions, and any ancillary services."¹¹ We previously have declined to treat 0+ and calls from inmate payphones differently from other payphone calls,¹² and we reaffirm that decision here. As of October 7, 1997, PSPs must be compensated for all payphone calls not otherwise compensated pursuant to contract, including 0+ and inmate calls.

3. The immediate implementation of the rule provisions adopted herein is crucial to the Commission's efforts to ensure fair compensation for PSPs, encourage the deployment of payphones,

access code calls; the court, however, upheld the interim compensation plan for local coin calls. Phase one, or the first year of interim compensation for access code and subscriber 800 calls, required that IXCs with a certain annual toll revenue pay PSPs a flat-rate compensation of \$45.85 per payphone per month in shares proportionate to their share of total market long distance revenues. During the second year of interim compensation (also, the first year of per-call compensation) we required the IXCs to pay the PSP for each completed subscriber 800 and access code call. *See Report and Order*, 11 FCC Rcd at 20,568 at para. 51. This order addresses specifically the first two years of per-call compensation, and as noted above, establishes a default rate for per-call compensation at \$0.284. *See infra* paras. 117-121.

⁹ The *Payphone Orders* state that LEC PSPs are entitled to be paid per-call compensation by IXCs for access code and subscriber 800 calls when they have complied with the requirements of the *Payphone Orders* and will certify to that effect. *Order on Reconsideration*, 11 FCC Rcd at 21,293-94, paras. 130-32. We note that the Commission did not establish a requirement that LEC PSPs obtain a formal certification of compliance from the Commission or the states to receive per-call compensation pursuant to the *Payphone Orders*.

¹⁰ As determined in this order, the difference between the per-call rate for subscriber 800 and access code calls and the local coin rate is \$0.066.

¹¹ 47 U.S.C. § 276(d).

¹² *See Report and Order*, 11 FCC Rcd at 20,579, para. 74; *Order on Reconsideration*, 11 FCC Rcd at 21,259, para. 52. A 0+ call occurs when the caller dials "0" plus the called telephone number. 0+ calls include credit card, collect, and third number billing calls. *See OSP Second Report and Order*, 7 FCC Rcd at 3251 n.4. 0- calls are calls in which the caller dials only the digit "0" and then waits for operator intervention. 0- transfer service is a service offered by LECs to OSPs under which LECs transfer a 0- call to the OSP requested by the calling party. *See OSP Second Report and Order*, 7 FCC Rcd at 3255 n.44.

and enhance competition among payphone providers, as mandated by Section 276 of the Act.¹³ The Commission's *Payphone Orders* require that per-call compensation for certain payphone calls begin by October 7, 1997. To meet this obligation, we must revise those rules vacated by the court in *Illinois Public Telecomm.* that relate to the implementation of a per-call compensation scheme and commence on October 7, 1997. The *Report and Order*, released September 20, 1996, informed parties that per-call compensation would commence on October 7, 1997.¹⁴ Therefore, parties affected by this rule change have had notice since the release of that order that they would be subject to certain obligations beginning October 7, 1997. Making this order effective immediately minimizes disruption within the payphone industry by eliminating disputes about payment obligations and enhances the general availability of payphone services to the public.

4. This order does not address other issues vacated and remanded by the court or otherwise alter the requirements of the *Payphone Orders*. Other requirements remanded in *Illinois Public Telecomm.*, including the compensation obligations applicable during the period from November 1996, through October 6, 1997, will be addressed in a subsequent order in this proceeding. We tentatively conclude in this regard that the \$0.284 per-call rate we are adopting as a default rate on a going forward basis should also govern compensation obligations during the period ending October 6, 1997. We also tentatively conclude that PSPs are entitled to compensation for all of their access code and subscriber 800 calls during this period. We plan to address the manner in which the total payment obligation for that period will be calculated and allocated among IXCs in a subsequent order.

5. We note that the Common Carrier Bureau (Bureau) has granted a limited waiver, until March 9, 1998, for those payphones that cannot provide payphone-specific digits as required by the *Payphone Orders*.¹⁵ This limited waiver applies to the requirement that local exchange carriers (LECs) provide payphone-specific coding digits to PSPs, and that PSPs provide coding digits from their payphones before they can receive per-call compensation from IXCs for subscriber 800 and access code calls. This limited waiver was granted by the Bureau to afford LECs, IXCs, and PSPs an extended transition period for the provision of payphone-specific coding digits without further delaying the payment of per-call compensation as required by Section 276 of the Act and this order. The Bureau made this limited waiver effective immediately in order to ensure that PSPs receive per-call compensation beginning October 7, 1997.

¹³ The normal period until effectiveness in a rulemaking is thirty days after publication of the changed rules in the *Federal Register*, but we accelerate that period here for good cause, pursuant to Section 553(d) of the Administrative Procedure Act. See 5 U.S.C. § 553(d).

¹⁴ This requirement established in the *Report and Order* becomes effective October 7, 1997, one year after publication in the *Federal Register*, 61 FR 52,307 (1996).

¹⁵ *Order on Reconsideration*, 11 FCC Rcd at 21,278-79, paras. 93-95. See *Bureau Waiver Order*, DA 97-2162 (released Oct. 7, 1997).

II. BACKGROUND

6. In the *Payphone Orders*,¹⁶ the Commission adopted new rules and policies governing the payphone industry to implement Section 276 of the Act. Those rules and policies: (1) establish a plan to ensure fair compensation for "each and every completed intrastate and interstate call using [a] payphone[;]"¹⁷ (2) discontinue intrastate and interstate carrier access charge service elements and payments in effect on such date of enactment, and all intrastate and interstate payphone subsidies from basic exchange services;¹⁸ (3) prescribe nonstructural safeguards for Bell Operating Company ("BOC") payphones;¹⁹ (4) permit the BOCs to negotiate with payphone location providers on the interLATA carrier presubscribed to their payphones;²⁰ (5) permit all payphone service providers to negotiate with location providers on the intraLATA carriers that presubscribed to their payphones;²¹ and (6) adopt guidelines for use by the states in establishing public interest payphones to be located "where there would otherwise not be a payphone[.]"²²

7. In the *Report and Order*, the Commission noted that the 1996 Act erects a "procompetitive deregulatory national framework designed to accelerate rapid private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."²³ Thus, we sought to advance the twin goals of Section 276 of the Act of "promot[ing] competition among payphone service providers and promot[ing] the widespread deployment of payphone services to the benefit of the general public . . .,"²⁴ by eliminating the effects of some long-standing barriers to full competition in the payphone market. To effectuate this objective, we concluded that we would continue to regulate certain aspects of the payphone market, but only until such time as the market evolves to erase these sources of market distortions.²⁵

¹⁶ *Report and Order*, 11 FCC Rcd at 20,541; *Order on Reconsideration*, 11 FCC Rcd at 21,233.

¹⁷ 47 U.S.C. § 276(b)(1)(A).

¹⁸ 47 U.S.C. § 276(b)(1)(B).

¹⁹ 47 U.S.C. § 276(b)(1)(C).

²⁰ 47 U.S.C. § 276(b)(1)(D).

²¹ 47 U.S.C. § 276(b)(1)(E).

²² 47 U.S.C. § 276(b)(2).

²³ S. Conf. Rep. No. 104-230, 104th Cong. 1 (1996).

²⁴ 47 U.S.C. § 276(b)(1).

²⁵ A number of parties subsequently filed petitions requesting that the Commission reconsider or clarify the rules the Commission adopted in the *Report and Order*. In the *Order on Reconsideration*, we substantially affirmed the rules adopted in the *Report and Order*. We denied all but two of the requested reconsiderations: those exceptions

8. Section 276(b)(1)(A) of the Act directs the Commission to establish a plan to ensure that all PSPs are fairly compensated for every completed call.²⁶ We defined "fair compensation" as the amount to which a willing seller (*i.e.* PSP) and a willing buyer (*i.e.* customer, or IXC) would agree for the completion of a payphone call. For certain calls, the PSP received no revenue for originating certain calls (*i.e.* for subscriber 800 and other toll-free number calls) and could not block callers from making such calls (access code calls). Based on evidence in the record, we noted in the *Report and Order* that the number of these types of calls completed from payphones had proliferated in the past several years,²⁷ and we concluded that PSPs must be compensated for access code, subscriber 800, and other toll-free number calls, whether they are jurisdictionally intrastate or interstate.²⁸

9. In the *Report and Order*, we concluded that the payphone marketplace has low entry and exit barriers and likely will become increasingly competitive,²⁹ and that the market generally is best able to set the appropriate price for payphone calls, including local coin calls, in the long term.³⁰ Therefore, because we have an obligation under Section 276 to ensure that the compensation for all local coin calls is fair, we concluded that the local market should be allowed to set the price for all compensable calls unless a state demonstrated that competition would not constrain prices; for example, payphones at certain locations would be priced at monopoly rates. This approach is appropriate, because once PSPs are free to enter the market, and once callers are free to choose payphones for their calls, the market ultimately will determine whether a particular payphone is economically viable. Therefore, in the *Payphone Orders*, we concluded that the appropriate per-call compensation amount, in the absence of a negotiated agreement, ultimately is the amount the particular payphone charges for a local coin call, because the market will determine the fair compensation rate for those calls. We further concluded that if a rate is compensatory for local coin calls, then it is an appropriate compensation amount for other calls as well, because we found the costs of originating various types of payphone calls such as access code and subscriber 800 calls to be similar to the costs incurred when initiating a local coin call.³¹

are not at issue here. In the *Order on Reconsideration*, the Commission modified: (1) the requirements for LEC tariffing of payphone services and unbundled network facilities; and (2) the requirements for LECs to remove unregulated payphone costs from the carrier common line charge and to reflect the application of multiline subscriber line charges to payphone lines. See *Order on Reconsideration*, 11 FCC Rcd at 21,234, para. 3.

²⁶ See 47 C.F.R. § 276(b)(1)(A) (directing the Commission to establish a plan "to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone"). See also *Report and Order*, 11 FCC Rcd at 20,566, para. 48.

²⁷ See *Report and Order*, 11 FCC Rcd at 20,568, para. 52 n.187.

²⁸ See *id.* at 20,568, para. 52.

²⁹ See *id.* at 20,547, para. 11.

³⁰ See *id.* at 20,567, 20,577, paras. 49, 70.

³¹ *Id.* at 20,577-78, para. 70; *Order on Reconsideration*, 11 FCC Rcd at 21,268-69, para. 71.

10. Before we moved to a local coin call default rate, however, we found that it was necessary to observe over time how the payphone marketplace would function in the absence of regulation. In particular, we concluded that consumers facing time constraints may not be able to find, in certain locations, a reasonable substitute for a payphone located on the premises. We stated that in these cases where the location provider has an exclusive contract with a PSP, the PSP may be able to charge supra-competitive prices. The location provider would share in the resulting "locational rents" through commissions paid by PSPs. We concluded that to the extent that market forces cannot ensure competitive prices at such locations, we may want to continue regulating, along with the states, the provision of payphone services generally or in particular types of locations where the size of the location or the caller's lack of time to identify potential substitute payphones could lead to locational monopolies. To allow us to ascertain the status of competition in the payphone marketplace, we concluded that we should establish the default per-call rate before leaving it to the market to set the rate, absent any changes in our rules.

11. We recognized that competitive conditions, which are a prerequisite to a deregulatory market-based approach, did not exist yet, and would not be achieved instantaneously. Therefore, we established an interim compensation plan to ease the transition to market-based local coin rates and ensure fair compensation for coin and noncoin calls. In particular, we established a two phase interim plan to address coin calls. During the first year (phase) the states would be responsible for ensuring that PSPs were fairly compensated for local coin calls as well as for protecting consumers from excessive rates. We concluded that states could continue to set the local coin rate during the year prior to market-based per-call compensation. During the second phase, beginning October 7, 1997, we stated that the market would set the price for the local coin call, absent particular state concerns, and the need for modification.³²

12. Additionally, in the *Payphone Orders*, the Commission established a two-year interim plan for payphone compensation for subscriber 800 and access code calls based on a rate of \$0.35 per call that began November 7, 1996. For the first year after the effective date of the rules adopted in this proceeding, we required that IXC's pay flat-rate compensation to PSPs. More specifically, under the first year of the interim plan, IXC's with annual toll revenues in excess of \$100 million were required to pay, collectively, a flat-rate compensation of \$45.85 per payphone per month in shares proportionate to their share of total market long distance revenues. During the second year of the interim plan, which is the first year of per-call compensation, all IXC's were required to pay \$0.35 per subscriber 800 call or access code call unless they contracted with the PSP to pay a different amount.³³

³² See *Report and Order*, 11 FCC Rcd at 20,572, para. 60 (further stating that states are empowered to act where concerns exist about market failures, and that the Commission could address such market concerns if necessary).

³³ We noted that \$0.35 was the local coin rate in four of the five states where the local coin rate had been deregulated and concluded that the market-based rate in those states was the best evidence of the per-call compensation amount for PSPs for the first two years of interim compensation. See Letter to William Caton, Acting Secretary, FCC from Michael Kellogg, Counsel, Coalition (Aug. 30, 1996) (noting that the local coin rate is \$0.35 in four of the five states that have deregulated the local coin rate). The Coalition is comprised of the Bell Operating Companies ("BOCs")—Ameritech, the Bell Atlantic Telephone Companies, BellSouth Corporation, Pacific Bell,

13. Numerous parties filed petitions in federal court seeking review of the *Payphone Orders*. In *Illinois Public Telecomm.*, the court affirmed important parts of the Commission's rules implementing Section 276, but also vacated and remanded certain other aspects of those rules. The court overturned our determination in the *Payphone Orders* regarding: (1) the interim and permanent compensation rates established for access code and subscriber 800 calls; (2) the requirement that only those IXCs with annual toll revenues over \$100 million pay PSPs for these calls during the first year of the interim period; (3) the failure to provide any interim compensation to BOC PSPs for "0+" calls and calls made from inmate payphones; and (4) the use of fair market value for payphone assets transferred from a BOC to a separate affiliate.³⁴

14. By Public Notice released August 5, 1997, we sought comment on the issues remanded by the court.³⁵ We sought comment on the differences in costs to the PSP of originating subscriber 800 and access code calls as compared to local coin calls.³⁶ We sought comment on whether these potential differences in costs should affect a market based compensation amount, and if so, how.³⁷ We sought comment on whether the local coin rate—subject to an offset for expenses unique to those calls—is an appropriate per-call compensation rate for calls that are not compensated pursuant to a contract or other arrangement, such as subscriber 800 calls and access code calls.³⁸ We stated that parties should respond specifically to concerns raised by the court in setting forth their views on the appropriate per-call compensation amount.³⁹

Nevada Bell, Southwestern Bell Telephone Company, and US West—together with GTE Service Corporation ("GTE") and Southern New England Telephone Company ("SNET"). See also *Report and Order*, 11 FCC Rcd at 20,578, para. 72. As we noted above, we believed the costs to originate access code and subscriber 800 calls were similar to those incurred when initiating a local coin call, and thus established a default rate based on the deregulated local coin rate. We note that of seven states that now have deregulated local coin rates, in five states (Michigan, Iowa, Nebraska, North Dakota and Wyoming) the rate is \$0.35, and in two states (Montana and South Dakota) the rate is \$0.25. See *Ex Parte Presentation* to FCC from Michael Kellogg, Counsel, Coalition (Sept. 26, 1997). In this order, the one year per-call compensation period subject to the \$0.284 default rate is extended to two years.

³⁴ *Illinois Public Telecomm.*, 117 F.3d at 558.

³⁵ See *Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, CC Docket No. 96-128, DA 97-1673, rel. Aug. 5, 1997 (*Notice*). In the *Notice* we indicated that we placed the industry on notice that payphone compensation obligations, or the absence of such obligations, incurred by providers of interexchange services, and compensation levels paid or received under our existing rules pending action on remand, may be subject to retroactive adjustment. *Id.* at 1. With regard to the interim compensation plan, we specifically sought comment on compensation for subscriber 800, access code, and 0+ calls, and on retroactive adjustments to interim compensation levels and obligations. See *id.*

³⁶ See *id.* at 2.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 3.

15. This order addresses only the amount of default per-call compensation. We decline to address in this order other issues related to the implementation of the per-call compensation structure.⁴⁰ Because the court vacated and remanded the per-call compensation rate for access code and subscriber 800 calls, we have sought to act expeditiously to reevaluate the default per-call rate. We conclude, because of the exigency of the situation wherein PSPs are not receiving per-call compensation as required by Congress in Section 276, that we must address quickly and efficiently the most urgent issue -- the per call compensation amount to be paid by IXCs to PSPs beginning on October 7, 1997, the beginning of per-call compensation.

III. PER-CALL COMPENSATION

A. The Standard for Determining Per-Call Compensation

16. In the *Notice*, we sought comment on whether the market-based local coin rate—subject to an offset for expenses unique to those calls—is an appropriate per-call compensation rate for calls that are not compensated pursuant to a contract or other arrangement, such as subscriber 800 and access code calls.⁴¹ In *Illinois Public Telecomm.*, the court in particular concluded that the Commission did not adequately justify "tying the default rate [for per-call compensation] to local coin rates."⁴² The court found evidence in the record that the costs of coin calls are higher than those for coinless calls because: (1) additional costs are incurred for equipment and coin collection; and (2) the PSP pays for originating and terminating local calls, while for coinless calls the PSP only pays for originating the calls.⁴³ Therefore, the court stated that setting the per-call compensation for subscriber 800 calls and access code calls at the deregulated local coin rate of \$0.35 was not justified, and vacated and remanded the issue to the Commission for further consideration.⁴⁴

⁴⁰ See *infra* paras. 123-33.

⁴¹ See *Notice* at 2-3.

⁴² *Illinois Public Telecomm.* 117 F. 3d at 564.

⁴³ *Id.* at 563-64.

⁴⁴ See *id.*; *Illinois Public Telecomm., Supplemental Opinion*, slip op. at 2.

1. Comments⁴⁵

17. APCC asserts that *Illinois Public Telecomm.* affirms the Commission's market-based approach to determine compensation and does not mandate an analysis of costs.⁴⁶ According to APCC, the court also affirmed the Commission's finding that the payphone marketplace is competitive, even if market forces do not yet operate freely for dial-around calling.⁴⁷ APCC further argues that the court did not preclude the Commission from relying on market-based surrogates, such as the local coin rate, or require the Commission to calculate an exact cost differential to be reflected in the per-call compensation figure.⁴⁸ The Commission, APCC asserts, could exclude consideration of cost evidence altogether and focus solely on market price indicators.⁴⁹ APCC contends that the court objected only to the Commission's attempt to compare the costs of dial-around calls and local coin calls.⁵⁰ Only if the Commission continues to rely on cost comparisons as a factor in the application of a market-based approach, must the Commission adhere to the reasoning issues raised by the court, states APCC.⁵¹ Parties further contend that a market-based approach will fulfill the requirements of the statute, *i.e.*, provide rates that "fairly compensate" PSPs and "promote competition among payphone service providers and the widespread deployment of payphone services."⁵² APCC alleges that the IXCs do not provide any arguments for rejecting a market-based approach, and challenges the arguments that there are local payphone provider monopolies that prevent the payphone market from being competitive.⁵³ Peoples adds that PSPs are not monopoly providers because Commission rules require PSPs to unblock access code calls, giving every caller the option to dial around a PSP's presubscribed service provider or to use a debit card to reach a carrier of their choice.⁵⁴

⁴⁵ Abbreviations for parties are listed in Appendices A and B. The following section includes the analyses of the comments and reply comments submitted in this proceeding. Although for presentation the comments are summarized generally by subject area, we consider these comments and replies in reaching our decisions wherever the comment and reply comments are appropriate.

⁴⁶ See APCC Comments at 2-3; see also CCI Comments at 5.

⁴⁷ APCC Comments at 2-3.

⁴⁸ *Id.* at 3-4.

⁴⁹ *Id.*

⁵⁰ APCC Reply at 5.

⁵¹ *Id.* at 6.

⁵² APCC Comments at 2 (citing 47 U.S.C. §§ 276(b)(1), (1)(A)). See Coalition Reply at iv, 2, 5.

⁵³ APCC Reply at 7.

⁵⁴ Peoples Reply at 4.

18. The Coalition argues that the court did not question the Commission's decision to rely on market-determined prices rather than regulatory accounting procedures.⁵⁵ The Coalition asserts that the court did not require the Commission to abandon its market-based proxies, but instead required the Commission to consider appropriate differences, such as originating costs, between coin and coinless calls.⁵⁶

19. AT&T asserts that the court found that the Commission acted unlawfully in establishing an assumed market rate for coinless calls, because the Commission ignored record evidence on the cost differences between coin and coinless calls.⁵⁷ Because of this error, AT&T states, the court found that there was no rational basis for the Commission's conclusion that per-call compensation should be set at the assumed deregulated market price, and therefore, that the Commission's compensation rate could not stand.⁵⁸

20. Frontier similarly argues that the court did not endorse the Commission's market-based approach,⁵⁹ and further, that the court found the Commission's conclusion that the local coin rate represents the best surrogate of the costs of completing local calls unjustified.⁶⁰

21. Sprint asserts that although the Commission used a market-based approach to determine local coin rates, the Commission never purported to use a market-based approach for per-call compensation for access code and subscriber 800 calls.⁶¹ Instead, Sprint contends that the Commission has viewed costs as the appropriate approach from the outset, and has sought surrogates for originating costs while rejecting non cost-based market surrogates.⁶²

22. PageMart and CPI argue that the great disparity in the record between the market rates and costs demonstrates that the payphone market is not yet competitive,⁶³ because price in a truly

⁵⁵ Coalition Reply at 6; Coalition Comments at 11-13.

⁵⁶ *Id.*

⁵⁷ AT&T Reply at 2; *see also* ACTA Comments at 3, CWI Comments at 11.

⁵⁸ AT&T Comments at 3-4.

⁵⁹ Frontier Reply at 3-4.

⁶⁰ *Id.* (stating that the "court plainly tied its assessment of what constitutes reasonable compensation to the costs of completing coinless calls").

⁶¹ Sprint Reply at 14.

⁶² *Id.* at 14-15.

⁶³ CPI Comments at 3 (arguing that a market-based rate is inappropriate because the payphone industry is not competitive, and because PSPs are monopolies or near monopolies).

competitive market would have been driven closer to cost.⁶⁴ PageNet argues that market rates are misleading, because, as consumers, IXC's cannot decline a sale, *i.e.*, block incoming payphone calls, and thus have a weakened market power.⁶⁵ WorldCom asserts that market-based rate would be more arbitrary and artificial than rates based on objective and verifiable costs.⁶⁶

2. Discussion

23. Despite a careful review, we find no statement in the court's decision that precludes us from relying on market-based surrogates, or requires us to determine a rate based on cost data submitted by incumbent LECs, independent PSPs, and other parties to determine the new per-call rate. The court did not reject the concept of linking the market-based local coin rate to the per-call rate for access code and subscriber 800 calls based on the similarity in costs, nor conclude that our approach was irrational. Rather, the court concluded that the Commission had not responded to information on the record regarding the cost disparities between the cost of providing coin calls and subscriber 800 and access code calls. Therefore, the court concluded that adoption of the default rate without further explanation was arbitrary and capricious.⁶⁷

24. The 1996 Act does not prescribe a particular course to ensure that all PSPs are fairly compensated for each and every call.⁶⁸ Nothing on the record in response to the *Notice* persuades us to change the deregulatory scheme established in the *Payphone Orders*. Based on the record in this proceeding, we affirm our decision in the *Payphone Orders* to use a market-based default rate for per-call compensation for subscriber 800 and access code calls. We conclude for the reasons stated there that a market-based rate best responds to the competitive marketplace for payphones consistent with the deregulatory scheme we adopted in the *Payphone Orders* for the provision of payphone services pursuant to Section 276, and also will effectively advance the statutory goals of encouraging competition and promoting the deployment of payphones.

25. As discussed above, because of market imperfections such as the inability of PSPs to block access code and subscriber 800 calls, we concluded in the *Payphone Orders* that a default rate was necessary to ensure that PSPs received fair compensation during the transition to a deregulated market. We also concluded in those orders, as we conclude here, that the default rate should be market-based. The method we use in this order to estimate a reasonable default per-call compensation rate

⁶⁴ PageMart Reply at 7.

⁶⁵ See PageNet Comments at 9-11; PageNet Reply at 5, 7. See also Section D *infra* (discussing reconsideration of caller pays and the paging carriers arguments that only a calling party pays system would result in a true market rate); see also WorldCom Comments at 3-4 (arguing that the rates being proposed by the LECs and PSPs—between \$0.42 and \$0.63 per call—would not be accepted if the consumer paid them directly).

⁶⁶ WorldCom Reply at 3.

⁶⁷ See *supra* para. 13.

⁶⁸ 47 U.S.C. § 276(b)(1).

addresses the court's concerns as well as those raised on the record in response to the *Notice* by LECs, IXCs, and PSPs. Specifically, our approach continues to rely on a market-based rate (the local coin rate).

26. We, however, adjust the market-based local coin rate for differences in the costs of coin and coinless operation, reducing the market-based local coin rate for coin-related costs and increasing the market-based local coin rate to reflect costs that are related to access code and subscriber 800 calls. In addition, in response to the arguments of parties in this proceeding that a market-based rate would be unreasonable and that we must establish a rate based on cost data submitted by the parties, we also have performed an analysis of those cost data to test the reasonableness of the selected per-call market-based rate. As discussed below, we find based on this analysis that the adjusted market-based rate is reasonable. Accordingly, we conclude that the deregulated local coin rate, adjusted for cost considerations, is a reasonable market-based surrogate for determining the default per-call compensation rate and specifically responds to the court's concerns that cost differences between coin calls and coinless access and subscriber 800 calls be explained. Furthermore, we conclude that the per-call rate established in this order will further the goals of Section 276 and is in the public interest.

27. The record on remand supports our prior conclusion that per-call compensation should be set by the marketplace and that full and unfettered competition is the best mechanism to achieve Congress' dual policy objectives.⁶⁹ Competition over time will lead to the more efficient placement of payphones, improved payphone service, and lower prices for consumers. To encourage competition in the payphone marketplace, we ensure in this *Second Report and Order* that PSPs are fairly compensated for "each and every completed intrastate and interstate call."

28. We conclude that because we make the per-call amount subject to negotiations, the marketplace will make the appropriate adjustments in the per-call rate. We established the per-call default rate to be applied only if the PSP and the IXC are unable to negotiate some other rate of compensation for compensable calls. Negotiations may lead to rates other than the default rate for several reasons. First, because virtually all of the costs are fixed costs and are not incurred on a per-call basis, an IXC and a PSP might agree to a flat-rated charge rather than a usage-based compensation rate. Second, there may be locations where a payphone would not be viable financially if compensated at only the default rate per compensable call, but would be viable at a higher compensation rate. If an IXC found it profitable to carry calls at this higher rate, it would be in the mutual interest of the two parties to agree on a higher rate. Third, IXCs may choose to pass on the per-call compensation rate to their customers. In the case of 800 subscriber calls, the IXC could pass on the cost to the called party. If the called party refused to accept calls for which it was charged the default rate, but was willing to accept calls with a lower charge, the IXC and the PSP may find it in their mutual interest to negotiate a per-call rate lower than the default rate. Fourth, in locations where a competing payphone could be placed without the permission of the location provider, a PSP may be willing to negotiate a lower rate than the default rate, rather than give an IXC the incentive to place a competing payphone.

⁶⁹ 47 U.S.C. § 276(b)(1).

B. Market-Based Analysis

29. As discussed above, we conclude that the appropriate rate of per-call compensation for access code and subscriber 800 calls is the market-based local coin rate adjusted for costs. In setting the per-call compensation rate for the first year of per-call compensation, we begin with the \$0.35 market-based local coin rate established in the *Payphone Orders* and adjust that rate to remove coin-related costs and add costs specific to subscriber 800 and access code calls.

1. Comments

30. Market Rate. APCC, the Coalition, Peoples, and CCI request that the Commission adopt a market-based per-call compensation rate, and furthermore, assert that the underlying costs attributable to both coin and noncoin calls are similar.⁷⁰ APCC contends that any market-based rate-setting mistakes are self-corrective, because the market will demonstrate the mistake.⁷¹ APCC further contends that contrary to the IXCs position, the market will prevent PSPs from gaining any long term windfall, and would force any such "windfall," to be passed on to consumers.⁷² APCC contends that market-based rates are more objective than the subjective components of cost-based rates.⁷³

31. The Coalition further maintains that the market will reflect variations from region to region and payphone to payphone.⁷⁴ The Coalition urges that the market rate be the local coin rate adjusted to reflect the relative elasticities of demand of the various types of calls.⁷⁵ The Coalition contends that under market conditions sellers will tend to load costs onto services for which prices are less likely to fluctuate, *i.e.*, that have a lower elasticity of demand, than onto services that have a higher price sensitivity. The Coalition further argues that the elasticity of demand for local coin calls is higher than for long distance calls. In other words, the Coalition argues, customers of local calls will respond more quickly to price changes than customers of 0+, subscriber 800 and dial-around calls.⁷⁶ Thus, the Coalition contends, the price of long distance calls should be the local call rate adjusted upward to reflect the lower elasticity of demand and the greater proportion of costs, relative to local calls, that such calls will carry

⁷⁰ See APCC Comments at 4; APCC Reply at 10 (stating that the Commission adopted a market-based approach in the *Payphone Orders*, and that the Commission should apply that approach in the instant proceeding); Peoples Comments at 8 (stating that the cost of a dial around call is similar to the deregulated market rate). See also Coalition Reply at 2-3 (stating that once the cost analyses provided by the IXCs are corrected for costs that should be included, the cost of a call reaches, and in some cases exceeds, the market rate).

⁷¹ APCC Comments at 5.

⁷² APCC Reply at 14.

⁷³ APCC Comments at 6.

⁷⁴ Coalition Reply at 6 (citing *Order on Reconsideration*, 11 FCC Rcd at 21,268-69, para. 71).

⁷⁵ Coalition Comments at 22.

⁷⁶ *Id.* at 23.

under true market conditions.⁷⁷

32. CCI, an independent payphone provider, argues that the Commission should adopt a market-based surrogate, and contends that there are few differences between the costs of a local coin call and a subscriber 800 or access code call.⁷⁸ CCI argues, however, that even under a cost-based approach, the cost of a local coin call and a dial around call is approximately \$0.35.⁷⁹

33. Several of the IXCs assert that the retail price for local coin calls is not an appropriate surrogate for the costs of a noncoin call, because there are substantial cost differences between these two types of calls.⁸⁰ AT&T and MCI assert that if the Commission develops a rate based on an offset from the local coin rate, the offset should be at least fifty percent,⁸¹ or based on the rate negotiated between AT&T and APCC in 1994 for dial-around access code calls.⁸² MCI asserts that a market-based rate, being higher than a cost-based rate, would lead to increased blocking by 800 subscribers, as those subscribers try to avoid having to pay IXCs for unduly high payphone charges.⁸³ MCI also asserts that market-based rates are artificially driven up by location owners holding out for the highest bidding PSP.⁸⁴ These higher, market-based rates will lead to an unwarranted income transfer from consumers to payphone providers, MCI contends, because excessively high rates will encourage PSPs to place payphones in increasingly marginal locations.⁸⁵ The Coalition disputes MCI's assertion that a market-based rate would lead to increased blocking arguing that PSPs have an interest in seeing calls completed, which call blocking would defeat, and an acceptable market rate would result in more completed calls.⁸⁶

⁷⁷ *Id.* at 12-14; Coalition Reply at 4, 14-15.

⁷⁸ CCI Comments at 2.

⁷⁹ *See id.*

⁸⁰ *See, e.g.,* AT&T Comments at 4, 6; AT&T Reply at 4 (stating that market-based compensation is unrelated to and in excess of costs to originate coinless calls); Excel Reply at 1; MIDCOM Comments at 4-6 (stating that any alleged market rate would be distorted by the binding contracts to which the majority of payphone locations already are subject).

⁸¹ *See* AT&T Comments at 13; MCI Reply at 3.

⁸² *See* AT&T Reply at 12-13 (explaining that since AT&T negotiated the 25 cent rate, the average price of a dial around call has declined).

⁸³ MCI Comments at 4.

⁸⁴ MCI Reply at 10.

⁸⁵ *Id.*

⁸⁶ Coalition Reply at 8-9.

34. Local Coin Rate as Surrogate. Several of the PSPs argue that if the local coin calling rate is used, no significant adjustment for cost differences between the coin rate and dial-around calls is required, because any cost differences are minimal.⁸⁷

35. Peoples argues that a single, flat default rate would simplify procedures, much as a first-class postage stamp covers mail that goes various distances.⁸⁸ Peoples further argues that the local coin rate is such a flat rate, because it is used to originate all types of calls from a payphone.⁸⁹ Moreover, Peoples argues, coinless calls alone do not justify installing a payphone; payphones are installed for coin calls, thus, the local coin rate is a good market measure for all of the calls that originate from it.⁹⁰

36. Several of the IXC's oppose the use of the local coin rate as a surrogate, but state that if the Commission uses the local coin rate, then the Commission should reduce the local coin rate so that it reflect only expenses unique to access code and subscriber 800 calls.⁹¹ CPI objects to the use of the local coin rate as a starting point because the coin rate does not represent the result of a competitive market.⁹² TRA says that using the local coin rate will lead to a grossly inflated default rate.⁹³ Frontier states that the coin rate bears little relationship to the costs of completing a coin call, much less a coinless call.⁹⁴

37. Other Surrogates. APCC requests that the Commission consider other surrogates for the market rate, such as 0+ commissions, 0- transfer rates and sent-paid toll call surcharges.⁹⁵ According to APCC, the 0+ call commissions are the only known instance where carriers and PSPs meet in the marketplace to negotiate a price for routing a call from the payphone to the carrier, and therefore,

⁸⁷ See APCC Comments at 11-15 (arguing that fixed payphone costs do not change with the presence of dial-around calls, and further that there are no major differences in the variable costs); see also TEI Comments at 2; CCI Comments at 6-8 (arguing that the deregulated coin rate of \$.35 per call is an appropriate surrogate).

⁸⁸ Peoples Comments at 7.

⁸⁹ *Id.*

⁹⁰ *Id.* at 6-7.

⁹¹ CWI Comments at 9 n.7; CompTel Comments at 14 n.7; LCI Comments at 8; RCN Reply at 1.

⁹² CPI Comments at 7.

⁹³ TRA Comments at 20.

⁹⁴ Frontier Reply at 5.

⁹⁵ APCC Comments at 8-10.

the Commission should reconsider 0+ commissions.⁹⁶ APCC further contends that sent-paid tolls are another reasonable indicator of the market price.⁹⁷ Additionally, APCC contends that the 0- transfer rates are a reasonable surrogate, because these rates indicate the minimum price IXCs are willing to pay to obtain telephone traffic.⁹⁸ APCC concludes that the most appropriate market-based surrogates are local coin calls, operator-assisted call commissions and sent-paid toll surcharges, because these three surrogates are based on prices actually charged in the marketplace for origination of payphone calls. APCC states that a weighted average price for these three charges is \$0.45 per call.⁹⁹

38. Several of the IXCs argue that 0+ commissions cannot be used as a market guide because these commissions include factors unrelated to the use of payphones for the use of access code and subscribers 800 calls.¹⁰⁰ Furthermore, carriers argue, sent-paid calls are not a reliable surrogate, because these charges cover such services as a payphone's capability to track time and amount, and recognize types of coins, services not needed for 800 subscriber calls.¹⁰¹ MCI argues that these surrogates are not representative because they are narrowly tailored to specific types of calls.¹⁰² Moreover, MCI contends, some of so-called surrogates apply to calls from telephones that are not even payphones.¹⁰³ Sprint argues that the only truly reliable indicator of the market for subscriber 800 and access code calls

⁹⁶ *Id.* at 7-8 (arguing that the Commission erroneously rejected 0+ commissions in its *Report and Order* in this proceeding, but accepted them as a benchmark in CC Docket No. 91-35). The mid-range level of these commissions, according to APCC's 1996 data, is \$0.62 per call. *See id.*

⁹⁷ *Id.* at 9-10 (explaining that the sent-paid toll call surcharge is the amount, above the standard transmission charge, that a PSP charges for the convenience of making a toll call from a payphone). The middle-range price of such a call is \$1.40 per call. *See id.*

⁹⁸ *Id.* at 9 (stating that the average price of a completed 0- transfer call is \$0.41).

⁹⁹ *Id.* at 10.

¹⁰⁰ *See, e.g.*, AT&T Reply at 35; CWI Reply at 2-4; CompTel Reply at i. 2-3; RCN Reply at 7-8, Sprint Reply at 17; WorldCom Comments at 4; Excel Reply at 7 (arguing that these surrogates do not overcome the uncompetitive characteristic of the current payphone market by virtue of the fact that payphone callers are a captive audience); Frontier Comments at 3 (arguing that commissions paid on 0+ calls include monopoly rents and locational monopolies); ITA Comment at 6-7 (arguing that compensation for 0+ calls includes other compensation factors, such as the PSP's promotion of the operator service provider through payphone placards, and that market surrogates in general include costs not incurred in PSP origination of dial-around calls, such as LEC line costs, premise owner commissions, and billing and collection charges); PageNet Reply at 11 (arguing that 0- transfer rates include compensation for operator assistance services that subscriber 800 calls do not use). *See infra* para. 62 for a more thorough discussion regarding commissions.

¹⁰¹ PageNet Reply at 11-12.

¹⁰² MCI Reply at 6 (arguing that the 0+ commission represents the value to the IXC of being a payphone's presubscribed carrier).

¹⁰³ *Id.*

is what the market provided to PSPs for such calls prior to the imposition of the Commission's orders in CC Docket No. 91-35.¹⁰⁴ At that time there was no compensation to PSPs for these calls, and therefore, Sprint contends, the market price was zero.¹⁰⁵

39. Excel argues that the Commission should start with a local coin rate at \$0.25,¹⁰⁶ then subtract those costs unique to the local coin service—coin equipment and collection, coin rating, originating and terminating access from the local coin rate.¹⁰⁷ AT&T, CompTel, and CWI argue that the Commission should not rely on avoided costs in establishing the default compensation rate, because this method inappropriately compares the price of coin calls with the costs of coinless calls and may overcompensate PSPs. Nonetheless, if the Commission adopts this method, AT&T argues, the Commission must set the local coin rate at \$0.25 and determine the actual avoided costs related to coinless calls,¹⁰⁸ and CompTel and CWI argue that the Commission should subtract the costs of tracking and billing compensation.¹⁰⁹ MCI argues that if the Commission adopts a top-down approach, it should calculate the default rate by subtracting the coin specific costs from the cost of a coin call, not from the market rate.¹¹⁰ RCN argues that the Commission should determine a nationwide default rate and then subtract those costs that are unique to coin calls.¹¹¹

40. The Coalition argues that the avoided cost methodology will not produce a per-call compensation rate lower than the deregulated coin rate, and in fact, will increase the amount of compensation owed to the PSPs.¹¹² Furthermore, the Coalition argues, avoided cost methodology will not produce competitive outcomes, because joint and common costs are a significant portion of the total costs.

¹⁰⁴ Sprint Reply at 18.

¹⁰⁵ *Id.*

¹⁰⁶ Excel Reply at 3, 9 (arguing that setting the default rate at the highest deregulated rate in the country is contrary to competition, and further that the proceeding before the Massachusetts DPUC regarding NYNEX's payphone rates demonstrates that the market rate for local coin calls should not be higher than \$0.25 per call).

¹⁰⁷ Excel Comments at 4.

¹⁰⁸ AT&T Reply at 24 (stating that no charges should be added to this rate such as ANI or completion costs for local coin calls).

¹⁰⁹ CompTel Comments at 14 n.7.

¹¹⁰ MCI Comments at 3.

¹¹¹ RCN Comments at 4 (stating that the per-call rate should not exceed the market-based local coin rate).

¹¹² Coalition Reply at 13-15 (arguing that an avoided cost methodology not only requires the deduction of certain costs, but also the addition of costs that PSPs must incur for a noncoin call).

and the market does not price goods or services on costs alone.¹¹³

2. Discussion

41. In the *Payphone Orders*, we found that the market rate for a local coin call is \$0.35 and we stated that this is also the rate for access code and subscriber 800 calls for the first two years of per-call compensation. In response to the court's concern that there may be differences in cost in between providing local coin calls and subscriber 800 and access code calls, we have evaluated the evidence on the record to develop a default rate for access code and subscriber 800 calls that reflect those cost differences. On the record, parties discuss several cost factors suggesting that compensation for access code and subscriber 800 calls should be either above or below the market price for coin calls.¹¹⁴ In section (a) we conclude that based on differences in costs, a market rate for access code and subscriber 800 access calls likely would be between 5.9 and 7.3 cents lower than the market rate for a local coin call, resulting in a rate of \$0.284. In section (b) we conclude that the parties failed to provide sufficient information to adjust the default dial access and subscriber 800 rate to reflect differences in the elasticities of access code and subscriber 800 calls compared with local coin service. Thus, we do not make any adjustment for elasticity differences.

a. *Adjustments to the local coin market rate based on cost differences*

i. *General approach*

42. Our general approach is to start with the market rate for local coin service (\$0.35), and subtract costs directly attributable to coin calls and add costs specific to access code and subscriber 800 calls. The majority of the costs associated with a payphone are joint and common costs that are shared by the different types of calls made by means of the payphone. These costs do not increase or decrease as the number or composition of calls changes at a particular location. By making no adjustment to the coin rate for these costs, we conclude that each call placed at a payphone should bear an equal share of joint and common costs.

43. The long distance and paging companies argue that we should limit the costs attributed to access code and subscriber 800 calls to the costs that would be incurred from providing access at a coinless payphone; coin-related costs should not be included. Under this theory, all other costs that are incurred to support a payphone coin call would be attributed to coin calls and either removed from any market-based rate or excluded from any other type of cost estimate.¹¹⁵ PSPs, however, maintain that

¹¹³ *Id.* at 14. See *infra* paras. 64-67 regarding demand elasticity.

¹¹⁴ See, e.g., AT&T Comments at 11 (per-call compensation should be lower than the default rate); Sprint Comments at 9; APCC Comments at 8; Coalition Comments at 30-33 (stating that per-call compensation should be above the local coin rate to account for implementing ANI and other costs).

¹¹⁵ AT&T Comments, Analysis of Economist David Robinson at 6 [hereinafter AT&T Comments, Robinson]; MCI Comments at 3.

few locations could support a coinless instrument¹¹⁶. Instead, they explain that most payphones are installed to handle both coin and coinless calls.¹¹⁷

44. We agree with the IXCs, and paging companies, that costs directly associated with the coin mechanism should be borne by coin calls. Under their general approach, however, compensation for subscriber 800 and access code calls would not fairly contribute to the recovery of joint and common costs of payphone service that would occur, even if the payphone is used solely to place such calls. In our view, such joint and common costs are not "additional" costs occurred to provide local coin calls. Hence, compensation for subscriber 800 and access code calls should contribute to the recovery of such costs. Our calculation assumes that each call will contribute to a multi-use payphone's joint and common costs.

45. We reject AT&T's contention that using a coinless payphone results in a per-call compensation rate of 11 cents per call and that this rate should be the basis for selecting a per-call compensation rate. We note that AT&T divided its monthly costs to install, operate, and maintain a coinless payphone (\$76.85) by the number of calls at a coin payphone estimated by APCC.¹¹⁸ The APCC study showed that the average payphone carried 713 calls per month, and that 511 of these calls were coin calls and 202 of these calls were coin-less calls.¹¹⁹ It is more reasonable to assume that you would divide AT&T's estimated monthly costs for a coinless payphone (\$76.85) by 202, the number of coinless calls. This calculation results in a cost of 38 cents per call, rather than the 11 cents estimated by AT&T. If the number of calls at coinless payphone were adjusted for a marginal location as we do in our analysis above, the per-call cost would be even greater. Thus, we conclude that the 11 cent rate obtained by AT&T in its analysis would not be an appropriate per-call compensation rate for subscriber 800 and access code calls.¹²⁰

46. Selecting the number of calls to represent a low traffic location. Any analysis of the costs incurred for a call from a payphone must be based on a particular number of calls. Most of the parties presented cost information based on coin payphones serving locations with an average amount of calling. We believe, however, that it is appropriate to analyze cost for a location with less than average calling. Prices in competitive markets tend to be set at the marginal cost of production. For payphone service, the marginal unit of production is the installation of a payphone at a low traffic location. If prices for payphone calls increased, providers would be willing to install more payphones; however, customers would likely place fewer calls. At the equilibrium price for payphone calls, newly installed payphones

¹¹⁶ See Peoples Comments at 7.

¹¹⁷ Coalition Comments, Analysis of Economist Jerry A. Hausman, Ph.D. at 9 [hereinafter Coalition Comments, Hausman].

¹¹⁸ AT&T Comments, Robinson at 12.

¹¹⁹ APCC Comments, Attachment 4 at 2.

¹²⁰ Other parties believe that AT&T's estimated monthly cost of a coinless telephone is too low. Coalition Reply at 29.

would be expected to generate just sufficient calls to earn only a normal return on investment. Thus, we believe that setting a default compensation rate to achieve fair and reasonable compensation requires that a payphone operator be able to cover costs at a low traffic location. A single instrument would be required to provide both coin and coinless calls at such a location, with neither class of calls, by itself, sufficient to justify installation of a payphone.

47. We select the number of calls to represent a low traffic location by estimating the number of calls that could cover all of the costs of operating a payphone with the exception of commissions paid to location owners. This number represents the lowest number of calls at which a payphone could be operated without requiring a subsidy. Most of the costs associated with a payphone do not vary with the number of calls made at an individual payphone. Thus an individual call must cover its own marginal costs as well as a share of the non-varying costs. The contribution made by an individual call is the price of the call less the marginal costs of the call. If the price of calls remains constant, each additional call adds a fixed amount of contribution. If the number of calls is high enough, the total of this contribution will exceed the total of non-varying costs, including a normal return on investment. The amount by which total revenue exceeds total cost is referred to as economic rent. In the long run, premises owners will be able to extract any economic rent from payphone owners through commissions.¹²¹ If a location generates only enough traffic to support the installation and upkeep of a payphone, however, there will not be any commission payments. Some PSPs may choose to pay standardized commission amounts.¹²² These companies will not serve as wide a mix of locations. All things being equal, the owner of a high traffic location would seek out the potential profits by choosing the PSP that is willing to pay the highest commissions. On the other hand, if the owner of a low traffic location insisted on a commission, no PSP would be willing to install a new payphone at that location because no PSP could pay the commission and generate a sufficient return on its new investment.¹²³ Accordingly, a marginal location is a location where traffic just covers costs other than premises owner commissions.

48. Based on the data provided by the commenters, it is necessary to complete several steps to determine the appropriate number of calls needed to sustain a payphone at a marginal location. As explained more thoroughly below, we rely on APCC cost data, because these data are representative of the payphone industry as a whole. However, APCC did not provide a breakdown of the 689 calls that it reported as the average per payphone when it collected the cost data. Therefore, we first used APCC data from the call type study—which provided data based on an average of 713 calls—to determine the proportion of access code and subscriber 800, coin and other calls for the 689 calls reported in the cost study. Second, using these derived call numbers, we estimated the amount of coin and other calls necessary to generate commission payments, and subtract those calls to yield the number of calls needed

¹²¹ Several PSPs suggested that commissions should be included in the cost of providing access code and subscriber 800 calls. *See infra* para. 62.

¹²² *See* TEI Comments at 8.

¹²³ Existing LECs require premises owners to pay for placement of payphones, rather than receive a commission, if there is a sufficiently low volume of coin traffic at a location.

to sustain the marginal payphone.

49. We use APCC data to estimate the number of calls per month that an average PSP would need at a location to cover costs other than commissions.¹²⁴ APCC reported \$240 monthly cost per payphone, including \$45 in commissions, based on an average of 689 calls of all types.¹²⁵ Until October 1996, \$6 of the monthly cost per payphone was met from dial around compensation and the balance of the monthly cost per payphone had to be met with coin revenues and revenues from 0+, 0-, and 00-calls.¹²⁶ To determine the amount of revenue that the average coin, 0+, 0-, and 00- call had to produce so that the average number of calls would cover total costs, we had to determine the total number of each such call type. Therefore, we used the data in the APCC call distribution study, which produced a total of 713 calls of all call types—154 access code and subscriber 800 calls and 561 coin and other calls—and applied this breakdown to the 689 calls in the cost study to develop a call distribution. Applying the representative percentages of the call types resulted in the following distribution: 147 access code and subscriber 800 calls, 494 coin calls, and 48 other calls.¹²⁷ Thus, to recover the \$240 in monthly costs at an average location, the PSPs surveyed by APCC had to collect an average of 43.5 cents per call in revenue from coin and other calls.¹²⁸

50. The APCC data illustrate that PSPs pay an average of \$45 per month in

¹²⁴ APCC submitted data from two different studies: one pertaining to cost, and one pertaining to call type volumes. See APCC Comments, Attachment 3 ("Weighted Average of Cost and Call Volume Data from 46 Payphone Companies"), Attachment 4 ("Results of APCC's 1996 Survey of Payphone Call Volumes"). For this analysis we needed the following information: average cost per payphone; average commissions paid to premises owners per payphone; average number of calls per payphone; the marginal cost per coin call; and breakdown of average call types per payphone. APCC and CCI provided a breakdown by call type; in relying on APCC's data, we note that other commenters supplied APCC's call type data in their comments as representative of the payphone industry, and further, that CCI's call data is similar to that of APCC. See, e.g., CWI Comments, LCI Comments, CompTel Comments. APCC and several other commenters, such as Peoples and CCI, provided cost data; however, we selected the APCC data because it is the most thorough and representative of the payphone industry averages.

¹²⁵ See APCC Comments, Attachment 3.

¹²⁶ See *OSP Second Report and Order*, 7 FCC Red at 3251.

¹²⁷ See APCC Comments, Exhibit 4 (providing specific amount of numbers of each call type). The APCC survey found \$240 per month total cost based on an average of 689 calls per month. The APCC call distribution study (APCC Comments, Exhibit 4) showed 713 total calls, comprised of 154 access code and subscriber 800 calls (22%), and 561 coin and other calls (78%). We applied this breakdown to 689 calls to estimate 147 access code and subscriber 800 calls and 542 coin and other calls.

¹²⁸ The quantity (\$240 less \$6 dial around compensation) divided by (494 coin plus 48 other calls) results in 43.5 cents per call. The \$6 in dial around compensation is based on historic data. We have used historic data rather than the default compensation rate times projected access code and subscriber 800 calls in order both to meet the concern that the compensation rate be fair to existing payphone providers and also because it is difficult to forecast the future number of access code and subscriber 800 calls.

commissions. For the purposes of this analysis, we impute the number of calls at a low traffic location by taking the number of calls at an average location, and subtract the number of coin and other calls that would produce marginal revenue of \$45. As explained above, to break even at an average location, PSPs must have generated 43.5 cents per call from an average number of coin and other calls. This revenue per call, however, is offset by about 4.7 cents of marginal cost per call,¹²⁹ meaning that payphone providers must realize about 38.8 cents in average net revenue per call. Dividing \$45, the average compensation to premises owners, by 38.8 cents, which is the marginal revenue per call, results in 116 coin and other calls. In other words, if the number of coin and other calls is decreased by 116, all other things being equal, the PSP's net revenue would be reduced by \$45 (116 calls times 38.8 cents per call). Assuming a proportionate reduction in all calls, a break even or low traffic location would have 116 fewer coin and other calls and 31 fewer access code and subscriber 800 calls.¹³⁰ Using the total number of all calls from the cost study (689), we subtracted 116—the number of coin and other calls that would generate \$45 in commissions. This resulted in 573 calls. We also expect that the number of access code and subscriber 800 calls at a marginal payphone location would be less. As noted above, we determined that 147 of the 689 calls at an average location would be subscriber 800 and access code calls. To reduce that amount (147) by the decrease in access code and subscriber 800 calls that would be originated at a marginal location, we then determined how many of the remaining calls were subscriber 800 and access code calls. Comparing the numbers from the APCC call volume study, we determined that the number of coin and other calls (excluding subscriber 800 and access code calls) was approximately 20.68% less in the cost study.¹³¹ Assuming that the subscriber 800 and access code calls also would decrease proportionately, we determined that there would be 31 fewer subscriber 800 and access code calls.¹³² Thus, we subtracted 31 from 573, which results in 542 calls. Accordingly, we use this number, 542, as

¹²⁹ We find below that the marginal collection, maintenance, and lines costs of a coin call are between 4.5 and 5.9 cents per call. The APCC usage study shows that if access code and subscriber 800 calls are omitted, about 91% of the remaining calls are coin. To determine an average cost for coin and other call types, we used an average marginal cost for a coin call multiplied by the percentage of coin calls. This translated to 5.2 cents of marginal cost for a coin call [(4.5+5.9)/2] multiplied by the percentage of coin calls (91%), which results in 4.7 cents per average coin and other call.

¹³⁰ Since our default compensation rate will cover more joint and common costs than the \$6 per month compensation rate in effect through October 6, 1996, payphones will become economically viable at more locations, satisfying one of the goals of the 1996 Act.

¹³¹ Using the number 116 calls, we divided 116 coin and other calls (excluding subscriber 800 and access code calls) by 561 total coin and other calls (again excluding subscriber 800 and access code calls). This resulted in a reduction of 20.68%. This percentage does not indicate that the type of calls declined, but rather, is a percentage used to develop the relative proportions of the various call types from the call volume study to the cost study.

¹³² This assumes that access code and subscriber 800 calls also would decline by the same percentage as would coin and other calls. 116 coin and other calls times (152 average access code and subscriber 800 calls / 561 coin and other) equals 31 fewer access code and subscriber 800 calls.

the total number of calls that would be made from a low traffic location.¹³³

ii. *Estimate of avoided and added costs.*

51. The parties submitted data on avoided and added costs of dial access and subscriber 800 calls compared with local coin calls. Different parties have different costs by category due to differences in the type of location served and differences in accounting treatments. Line charges, for example, vary from state to state. One party may treat a specific cost as overhead while another party might include the same sort of cost a direct cost of maintenance. It is not possible to fully reconcile differences in cost estimates by analyzing the data filed on the record. Accordingly, we have used the information submitted by the parties along with information from Securities and Exchange Commission 10K filings to develop ranges within which cost for an average PSP might reasonably be expected to fall.¹³⁴

52. Coin Mechanism Capital Costs. While a single payphone may be installed to handle both coin and coinless traffic, the direct costs of the coin mechanism should be recovered by coin calls. After installation, the capital costs of a payphone become fixed. Because we are looking at the long run, where all costs are avoidable, we consider the decision made by the PSP at the time the phone is installed. When a payphone provider considers installing a telephone at a new location, it must consider whether the additional coin traffic at that location would justify the additional cost of installing a coin telephone. The PSP would not install a coin payphone instead of a coinless payphone unless the additional coin traffic would at least cover the additional costs of a coin mechanism. Therefore we conclude that costs directly associated with the coin mechanism should be attributed to coin traffic. We assume that the market rate for local coin calls recovers these costs and therefore conclude these costs should be removed from the adjusted market rate.

53. David Robinson, in a study submitted by AT&T, provided the most detailed information on the costs of purchasing and installing different types of telephones. Independent PSPs typically use smart payphones. Robinson estimated that new smart coin payphones cost about \$900 to \$1200 per unit compared with \$200 to \$250 per unit for coinless units.¹³⁵ The differences in cost are primarily due to equipment used to accept, count, and hold coins.¹³⁶ Some cost differences, however, may

¹³³ We use the 542 number of calls at a low traffic payphone location in the following sections of the market based analysis: coin mechanism capital costs; line savings (in part); and ANI ii.

¹³⁴ *Bell Atlantic Telephone Companies v. FCC*, 79 F.3d 1195, 1202-04 (stating that the Commission is not required to include all data when determining a rate, and that the Commission has the authority to exclude suspicious data or statistical outliers).

¹³⁵ AT&T Comments, Robinson at 3.

¹³⁶ See Coalition Comments, Report of Arthur Andersen on per-call compensation and cost calculations, Carl Geppert, at 8 (Aug. 26, 1997). Local exchange carriers, in contrast, have an installed base that typically consists of "dumb" payphones that must rely on telephone company central offices for functionality. The Coalition submitted a study by Carl Geppert for Arthur Andersen citing New England Telephone data for New Hampshire to show that

be due to quality features that allow the payphone to be used in harsher environments. We selected the \$900 figure for smart coin telephones as an amount that would be suitable for general locations instead of the \$1200 figure, because the latter figure, likely included additional features that go beyond the standard smart coin telephone that would not be necessary at the general location. We determine that \$250 is an appropriate amount for the coinless phone operated in a general location, to reflect some quality features, and further, because there is not a significant difference in the capabilities among the coinless phones and the difference between the estimates (\$200 to \$250) is not significant. The difference in price, from \$900 to \$250, \$650 per telephone, would be due to added costs associated with coin traffic. Robinson also estimates that a smart coin telephone requires \$60 more for installation than does a coinless telephone due to additional testing and programming for the coin rating and collection functions.¹³⁷ Thus, we estimate a total investment cost of \$710 per payphone that is related to coin functions.¹³⁸ This equates to \$12.36 in investment costs per month for a coin telephone.¹³⁹ Thus, we impute that the market rate for local coin service includes 3.2 cents per coin call at a low usage location and that this amount represents an avoided cost for dial around and subscriber 800 calls.¹⁴⁰

54. Line Savings. In some areas, all payphones are charged per-message or per minute charges for all local calls. In other areas, all payphones use unmeasured lines. In still other areas, payphone providers can choose between using some form of measured service and unlimited calling. PSPs taking measured service pay message charges for local coin calls, but not for access code or 800 subscriber calls. This represents a marginal cost difference of coin versus coinless service. Based on the

the average costs of coin and coinless telephones were similar. Other parties have presented information to the effect that a coin mechanism by itself would cost less than \$100. A stronger, theftproof house, however, is also required if a coin mechanism is to be included. We conclude that the best information is the current prices of comparable telephones with and without coin mechanisms and that the Robinson data is most suitable for this comparison.

¹³⁷ AT&T Comments, Robinson at 3.

¹³⁸ In reviewing costs *infra*, we use data from Peoples and CCI's 10K reports to estimate that the total new investment for a payphone would be about \$3000, including support facilities. Thus, the \$710 in coin related costs represents about a quarter of the total new investment.

¹³⁹ Equal monthly payments of \$12.36 would depreciate \$710 over a 10 year life and earn a return of 11.25% on net plant, allowing for the statutory federal income tax rate of 34%. We selected a 10 year life consistent with AT&T and Peoples. See AT&T Comments, Robinson at 5; Peoples 1996 10K at 31 (using a 10 year straight line depreciation rate for public payphones. Cf. CCI Comments at 10 (using a 7 year life). See also *infra* para. 59 for further explanation of interest rates.

¹⁴⁰ This is not a marginal cost per coin call. Rather, it represents the amount included in the market rate of local coin calls to recover the costs of equipment attributed to coin service. For this purpose, the market rate was assumed to be based on a low traffic location, meaning 542 total calls including 388 coin calls.