DC CIRCUIT'S PARTIAL REMAND OF THE PAYPHONE PROCEEDING (cont'd)

Court Upheld The Fundamental (De)Regulatory Framework Adopted by the Commission

1) Federal jurisdiction over local coin calls (states are preempted from setting the local coin rate)

    -- A single state has sought U.S. Supreme Court review of this holding

2) A "carrier pays" compensation system (carriers compensate PSPs for coinless calls originated by payphones)

DC CIRCUIT'S PARTIAL REMAND OF THE PAYPHONE PROCEEDING (cont'd)

<u>Court Remanded Two Significant Issues to the Commission</u>

1) **The default compensation rate linked to the deregulated local coin rate *without an analysis of the cost differences* between coin and coinless calls**

   -- Some parties, particularly the IXCs, argue that the Court invalidated use of the local coin rate, or any other market-based surrogate, as a basis for compensation

2) **The interim flat-rate compensation mechanism**

   a) Amount of interim compensation, which was based on the deregulated local coin rate, as remanded by the Court

   b) Which carriers must pay

      -- Why carriers with less than $100 million in annual toll revenues were excluded

   c) Allocation of interim compensation among carrier-payors

      -- Relationship between annual toll revenues and dial-around calls

COMMISSION'S REMAND ORDER

- o After notice and comment, on October 9, 1997, the Commission adopted a Second Report and Order in response to the Court's remand

COMMISSION'S REMAND ORDER (cont'd)

Per-Call Compensation Rate

- o Concluded that the default compensation rate for dial-around call should continue to be linked to the deregulated local coin rate at each payphone after adjusting for the costs differences between coin calls and dial-around calls

- o Adopted a per-call compensation rate for PSPs that is almost 20% *less* than the rate originally prescribed

  - -- $0.35 (prevailing deregulated local coin rate) minus approximately $0.084 (avoided costs) plus $0.018 extra costs equals $0.284 per call

  - -- "Avoided costs" include expenses associated with the payphone's coin mechanism, coin collection costs, and local usage costs

  - -- Extra costs include cost to PSPs of providing tracking capability to carriers

  - -- The per-call default compensation rate is extended to October 7, 1999, although parties can mutually agree to an alternative compensation rate at any time

COMMISSION'S REMAND ORDER (cont'd)

Interim Compensation

- Deferred consideration of all interim compensation issues to a subsequent order

  - Tentatively concluded that the $0.284 per-call compensation rate should apply to interim period

  - Commission has an adequate record before it to proceed (filed in response to the August 1997 post-remand public notice soliciting comment)

  - There is a general consensus among the commenters that PSPs continue to be legally entitled to compensation for the period of October 7, 1996 through October 6,1997

  - *Prompt resolution of these interim compensation issues is crucial to the continuing viability of independent PSPs*

COMMISSION'S REMAND ORDER (cont'd)

Status of Interim Compensation Payments

- o PSPs have been largely without revenue for significant portions of the interim compensation period

Interim compensation, quarter by quarter (payment schedule lags by one quarter)

- **o 4th Quarter 1996**
  - -- AT&T, MCI, Sprint paid
  - -- Many of the remaining IXCs-payors paid, but some did not
  - -- PSPs received approximately $43.84 per payphone per month, as opposed to the $45.85 under the Payphone Orders

- **o 1st Quarter 1997**
  - -- Only AT&T, MCI, Sprint, and three smaller carriers paid
  - -- PSPs received approximately $37.67 per payphone per month
  - -- the DC Circuit's remand decision interrupted some payments

- **o 2nd Quarter 1997**
  - -- AT&T, MCI, Sprint, and Alascom each paid a reduced rate, which they unilaterally pegged at $0.10 - $0.12 per call (using the FCC's average of 131 calls per month), depending on the carrier
  - -- These reduced payments translated into a flat rate of $10.84 per payphone per month, as opposed to the $45.85 under the Payphone Orders

- **o 3rd Quarter 1997**
  - -- AT&T, MCI, Alascom each paid their reduced rates
  - -- PSPs received a flat rate of $9.42 per payphone per month

COMMISSION'S <u>REMAND ORDER</u> (cont'd)

<u>Status of Interim Compensation Payments</u> (cont'd)

- **4th Quarter 1997**

  - Because the Common Carrier Bureau has delayed the effective date of per-call compensation for all independently provided payphones ("IPPs"), due to the inability of LECs and IXCs to agree on a call-tracking methodology (as will be discussed below), "interim," flat-rate compensation has continued for some payphones

  - Unfortunately, many IPPs cannot be paid for the 4th quarter of 1997 because the Commission has not determined how the flat-rate compensation is to be allocated among carrier-payors

  - The lack of a cash flow for the "interim" is having a significant impact on IPPs beyond the interim period

  - Stay tuned!!

FACILITATING PAYMENT OF COMPENSATION

ANI Coding Digits

- Within the "originating line number," i.e., the automatic number identification ("ANI"), which must be delivered by the LEC central office switch to the carrier receiving the call, are two coding digits that signify that the call has been originated by a payphone or a restricted line

- Effective with the commencement of per-call compensation on October 7, 1997, the Payphone Orders require carriers to track the calls for which they pay compensation, and the LECs to provide these carriers with the appropriate coding digits

    - The carrier-payers and the LECs have engaged in a lengthy, unproductive debate about what kind of network upgrades are needed to transmit payphone-specific coding digits

- Under the existing system, which is fraught with residual discrimination, LEC payphone calls can be tracked with payphone-specific coding digits, while independent payphone calls have been assigned digits that are not payphone specific

    - LEC payphones, which are central-office controlled "dumb" payphones, transmit a "27" code from the LEC central office switch

    - For independent payphones, which are "smart" payphones with the intelligence in the set, the LEC central office transmits a "07" code, which is not specific to payphones, but merely indicates that the line is "restricted," e.g., hospital phones, hotel phones, or payphones

FACILITATING PAYMENT OF COMPENSATION (cont'd)

ANI Coding Digits (cont'd)

- On October 7, 1997, the Common Carrier Bureau adopted an order on its own motion that waived the obligation for LECs to provide the coding digits, until March 1998, for LECs that are currently unable do so
  - The Bureau also sought comment on the appropriate resolution of the issues surrounding the availability of payphone-specific coding digits
  - Bureau action on this matter is pending
- Because the coding digits at issue are associated with lines used overwhelmingly by independent PSPs, many independent PSPs are not receiving compensation at all, while LEC PSPs have had no interruption in compensation payments
  - A lack of coding digits precludes payment of per-call compensation for IPPs
  - "Interim" flat-rate compensation will not be paid until the Commission allocates the monthly compensation amount among the carrier-payors

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM?

Annual Cost of Payphone Compensation for Dial-Around Calls

- o Using the Commission's conservative, somewhat out-of-date average of 131 dial-around calls per payphone per month multiplied by $0.284 per call, yields $37.20 per payphone per month

- o $37.20 multiplied by the 12 months of the year is $446.45

- o For the approximately two million payphones nationwide, annual compensation is approximately $893 million ($446.45 x 2 million), or somewhat less than $1 billion

- o Using 152 dial-around calls per payphone per month, as proposed by APCC, the total cost of annual compensation would be approximately $1.036 billion

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM? (cont'd)

Recovery Method #1: Raise Rates

- The IXCs, most notably AT&T, MCI, and Sprint have raised their rates for subscriber 800 number service

- These rate increases were, as acknowledged by the carriers themselves, a specific response to the Payphone Orders

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM? (cont'd)

Recovery Method #2: Pay Less in Access Charges

- o The Commission's rules terminated all subsidies for payphone operations, which has amounted to a payphone-specific reduction in access charges paid by IXCs to LECs of over $250 million
  - -- This reduction is distinct from reductions associated with CC Docket No. 96-262
- o Additional subsidies were terminated at the state level
- o The IXCs have not passed on any portion of these significant intrastate and interstate access charge cost reductions on to their customers, which is contrary to the pledge they made in the Commission's access charge reform proceeding

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM? (cont'd)

Recovery Method #3: Impose Per-Call Surcharges on Callers and Subscribers

- o Almost all of the IXCs place a surcharge on callers who originate calls from payphones and on 800 subscribers who receive such calls
- o The amount of these surcharges often exceeds the $0.284 per call default rate established by the Commission
  - -- At present, IXCs can track all dial-around calls (with "27" ANI coding digits) from 60% of payphones
  - -- IXCs can also track all access code calls (which are roughly one third of all dial-around calls) from the remaining 40% of the payphones, or an additional 13% of calls
  - -- Thus, IXCs can currently track 73 % of all dial-around calls and are passing on the per-call compensation costsfor these calls directly to the end users in the form of a surcharge
  - -- Once the ANI coding digit waivers expire, IXCs should be able to track all, or virtually all, dial-around calls and will impose a surcharge for them

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM? (cont'd)

Recovery Method #4: Savings in Commissions Due to Migrating 0+ Traffic to Access Code Calls

- Pursuant to individual contracts, IXCs pay commissions to PSPs for 0+ calls
  - The Commission estimated in 1992 that AT&T's average commission payment on a 0+ call was about $0.40
- IXCs have trained their customers to dial an access number to reach the carrier (such as 1-800-CALL-ATT), even when the payphone is already presubscribed to the same carrier
  - Dialing-around by callers allows the carrier to bypass 0+ commission payments, which reduces its overall costs for payphone-originated calls
- In 1993, according to APCC data, the average IPP *originated 56 commissionable 0+ calls*
- By 1997, the same data show that this IPP average had *fallen to 20 commissionable 0+ calls!*
  - This *64% reduction in commissionable 0+ calls* has dramatically lowered an IXC's costs -- directly out of the pockets of the PSPs
  - The monthly 36 call shortfall at each payphone translates into *annual 0+ commission savings for the IXCs of approximately $346 million*[1]
- Once again, the IXCs have not passed on these savings to their customers

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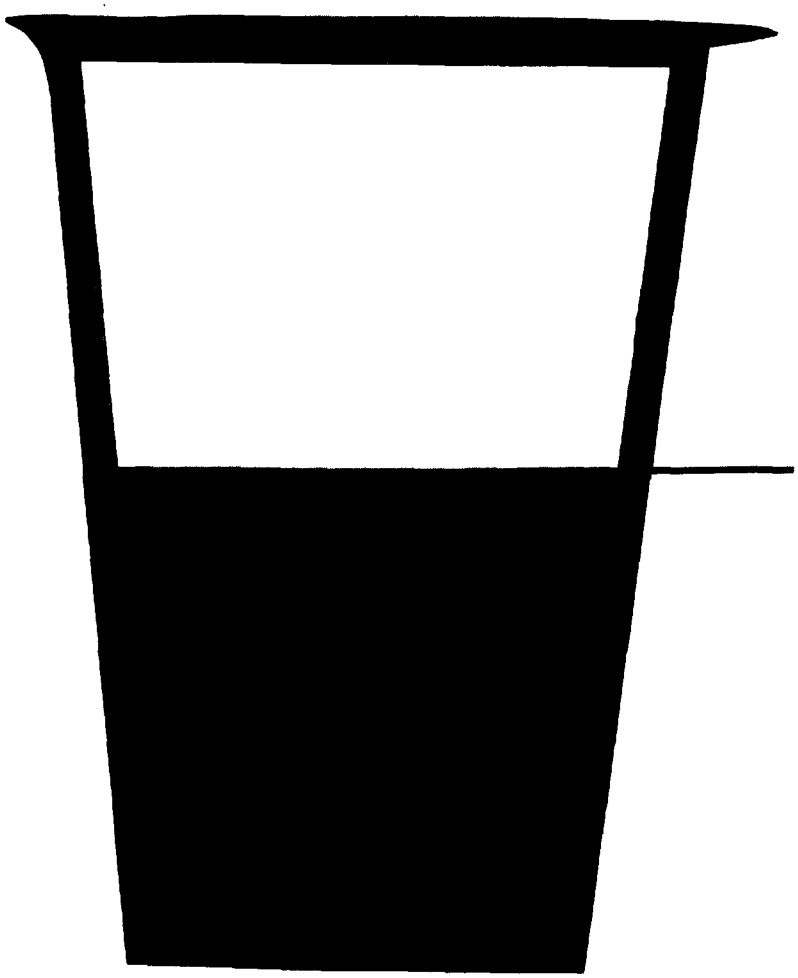
1 36 calls per month x $0.40 per call x 12 months of the year x two million payphones = approximately $346 million

WHERE DOES THE PAYPHONE COMPENSATION MONEY COME FROM? (cont'd)

Quadruple Dipping?

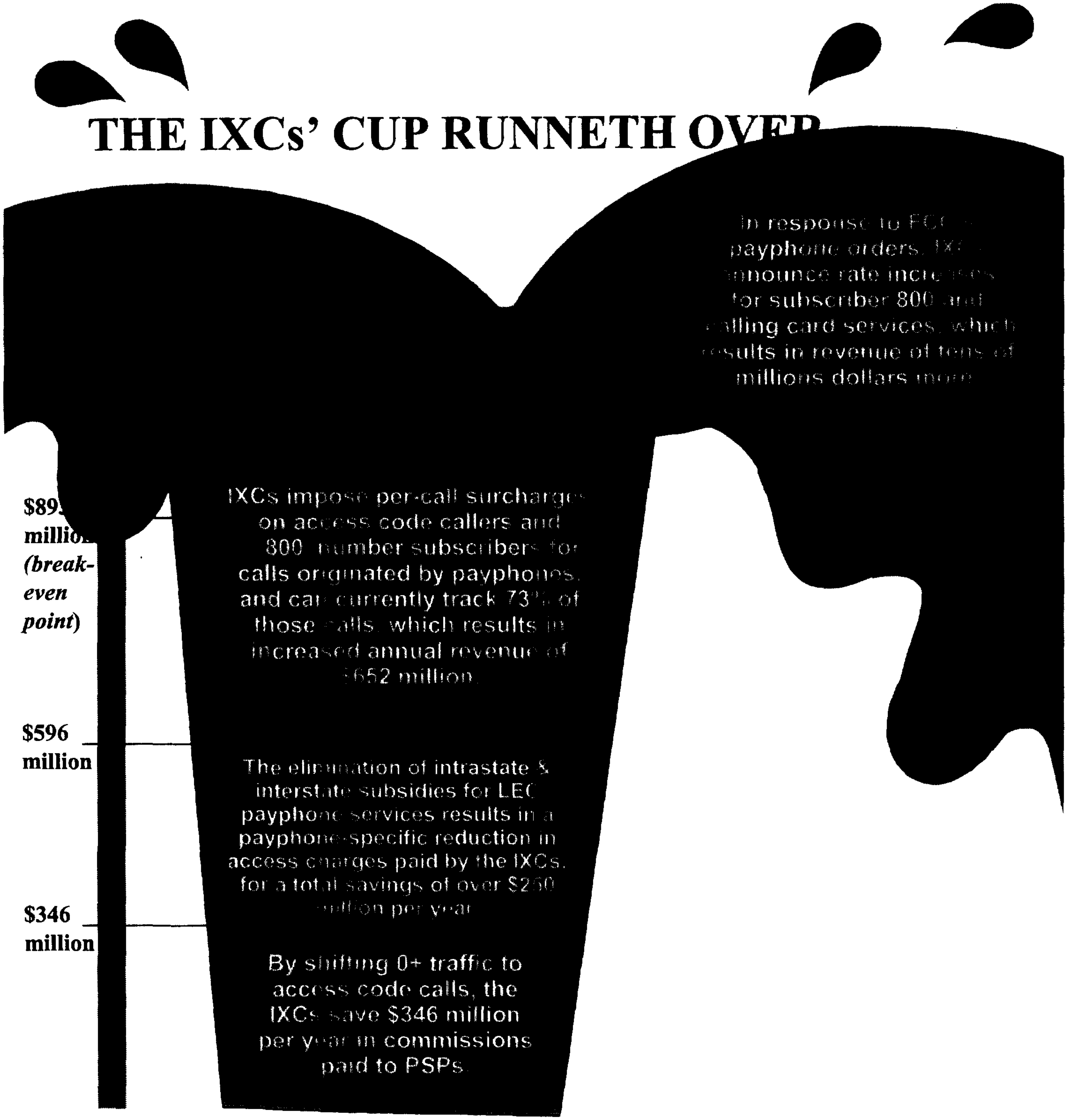
- o *These four strategies to recover the costs of payphone compensation have been applied by the IXCs simultaneously*
- o "Quadruple dipping" by the IXCs has netted far more than the "costs" of payphone compensation payments to the PSPs
- o Despite their claims of financial injury, the IXCs have converted the payphone compensation mechanism as an opportunity to *increase* their revenues

BREAKING EVEN



By recovering $893 million dollars per year, the IXCs break even on payphone compensation costs.

THE IXCs' CUP RUNNETH OVER



The IXCs are recovering far more than the $893 million cost of payphone compensation.

PSPs AND UNIVERSAL SERVICE

<u>PSPs Should Pay Only Their Fair Share</u>

- o PSPs have no objection to paying, like everyone else, their fair share of the costs of universal service

- o PSPs do not agree, however, that they should be required to pay their share two or three times over

  - -- PSPs pay an end-user carrier common line charge

  - -- PSPs pay rates, as end users, to carriers that already include a mark-up to cover the end user's share of unioversal service costs

  - -- PSPs are required to pay directly into the universal service fund

SEC. 276. [47 U.S.C. 276] PROVISION OF PAYPHONE SERVICE.

(a) NONDISCRIMINATION SAFEGUARDS.—After the effective date of the rules prescribed pursuant to subsection (b), any Bell operating company that provides payphone service—

(1) shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations; and

(2) shall not prefer or discriminate in favor of its payphone service.

(b) REGULATIONS.—

(1) CONTENTS OF REGULATIONS.—In order to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public, within 9 months after the date of enactment of the Telecommunications Act of 1996, the Commission shall take all actions necessary (including any reconsideration) to prescribe regulations that—

(A) establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone, except that emergency calls and telecommunications relay service calls for hearing disabled individuals shall not be subject to such compensation;

(B) discontinue the intrastate and interstate carrier access charge payphone service elements and payments in effect on such date of enactment, and all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues, in favor of a compensation plan as specified in subparagraph (A);

(C) prescribe a set of nonstructural safeguards for Bell operating company payphone service to implement the provisions of paragraphs (1) and (2) of subsection (a), which safeguards shall, at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90–623) proceeding;

(D) provide for Bell operating company payphone service providers to have the same right that independent payphone providers have to negotiate with the location provider on the location provider's selecting and contracting with, and, subject to the terms of any agreement with the location provider, to select and contract with, the carriers that carry interLATA calls from their payphones, unless the Commission determines in the rulemaking pursuant to this section that it is not in the public interest; and

(E) provide for all payphone service providers to have the right to negotiate with the location provider on the location provider's selecting and contracting with, and, subject to the terms of any agreement with the location provider, to select and contract with, the carriers that carry intraLATA calls from their payphones.

(2) PUBLIC INTEREST TELEPHONES.—In the rulemaking conducted pursuant to paragraph (1), the Commission shall determine whether public interest payphones, which are provided in the interest of public health, safety, and welfare, in locations where there would otherwise not be a payphone, should be maintained, and if so, ensure that such public interest payphones are supported fairly and equitably.

(3) EXISTING CONTRACTS.—Nothing in this section shall affect any existing contracts between location providers and payphone service providers or interLATA or intraLATA carriers that are in force and effect as of the date of enactment of the Telecommunications Act of 1996.

(c) STATE PREEMPTION.—To the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements.

(d) DEFINITION.—As used in this section, the term "payphone service" means the provision of public or semi-public pay telephones, the provision of inmate telephone service in correctional institutions, and any ancillary services.