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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
Office of the Secretary
1919 M Street, NW - Room 200
Washington, DC 20554

Re: Exparte CC Docket No. 96-128
Payphone Compensation

Dear Ms. Salas:

Please enter the attached document in the record of the above-cited proceeding. If you have any questions, please contact me at the above telephone number.

Two (2) copies of this letter are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Bob Castellano

Attachment

cc: Larry Strickling
Bob Spangler
Rose Crellin
Craig Stroup

No. of Copies rec'd 0+2
List A B C D E

AT&T Response to PCA's Flawed Study on Payphone Compensation

PCA, an organization representing payphone owners, has recently released a study alleging that IXCs have overcharged customers after adoption of the FCC's payphone compensation requirements. PCA's claims are false.

AT&T's Policy

AT&T's consistent policy on payphone compensation is that it does not intend to profit from the huge new payphone charges that have been assessed against carriers. These charges, in the aggregate, could total $1 billion or more on an annualized basis.

AT&T has continuously and vigorously opposed the payphone compensation rate ordered by the FCC, and it is working through the legal and regulatory processes to have such charges lowered to the "fair" level required by law.

In the interim, AT&T and other carriers facing these additional burdens must recover these new costs, like all other costs, from customers -- as the FCC's payphone orders contemplated they would. Indeed, the FCC rejected a "caller pays" approach to payphone compensation.[1] One of the FCC's principal rationales for this decision was that it felt carriers would be in a better position to track, collect and pay compensation to PSPs, and pass the costs through to consumers.[2]

Payphone Owners' Double Bonus

At the same time that IXCs have had to introduce charges to cover their increased payphone compensation expenses, payphone owners have generally raised local coin rates to 35 cents per call. These calls represent about 70% of all calls made from payphones.

For payphone owners (and especially LECs, who own the vast majority of all payphones), this results in a double bonus -- a significant increase (typically about 40%) in local coin revenues and non-cost-based payphone compensation for coinless calls.

PCA's Analysis Is Wrong

PCA alleges that IXCs have imposed excessive payphone compensation charges on their customers for three reasons. First, it claims that the IXCs have not accounted for the fact

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[1] Under the "caller pays" approach, payphone owners would collect compensation directly through a charge assessed on the caller using the payphone.

[2] The prepared testimony of Glenn Reynolds of the FCC (p. 9) specifically states that "carrier[s are] . . . free to recover those costs as [they] see fit, but in a manner that is restrained by the market since long distance service is highly competitive."

that there were access charge reductions associated with the imposition of payphone compensation. Second, it alleges that IXCs have raised rates more than their payphone compensation costs. Third, it makes claims regarding IXC "savings" in commission costs. Each of these claims is wrong.

Access Charge Reductions Are Already Considered

Contrary to PCA's claim, AT&T has always deducted anticipated access costs savings in calculating its increased payphone costs and its associated rate actions to recover those costs.

Under The FCC's Current Rules, AT&T's Rate Actions Underrecover Its Payphone Expenses

AT&T has analyzed its expected net incremental payphone-related costs (i.e., costs net of access savings) under the FCC's Payphone Orders and compared that amount to the anticipated revenues from its rate actions. Contrary to PCA's claim, as of today, AT&T's increased rates have recovered substantially less than the expected net costs under existing FCC rules.

IXCs are liable to pay payphone compensation as of November 1996. However, the FCC's rules governing the amount and allocation of such compensation were vacated by the D.C. Circuit because the Court found the FCC's methodology was arbitrary and capricious. Therefore, IXCs can expect to face added liabilities of significant amounts when the FCC issues its order on remand for the initial phase of per-phone compensation. Responsible carriers have accrued anticipated liabilities for such costs, which could be substantial.

IXCs also had no way to track payphone calls for the initial phase of per-phone compensation, because systems had not been built to do the tracking, and because LECs were not sending payphone coding digits that would enable IXCs to track payphone calls and bill customers directly for those increased costs. Therefore, the only way to begin to collect the incremental payphone costs was to institute indirect charges, such as general rate increases.

AT&T's rate increases for payphone-related costs were not put in place coincident with the onset of its compensation obligations. Even though IXCs' compensation obligations for independent payphone owners began in November 1996, its first general rate increase (for business services only) did not occur until February 1997. And even though IXCs' compensation obligation to LECs generally began in mid-April 1997, the second general increase (also for business calls only) did not occur until May 1997.

AT&T did not impose any per-call charges on any consumer 0+ calls until June 1997. Moreover, AT&T's per-call tracking systems have not been able to track many payphone

calls, because the payphone identification information required by the FCC's orders is not fully available. Thus, AT&T still cannot assess the per-call charge on all payphone calls.

In addition, AT&T has had to incur tens of millions of dollars of expense to build the systems required to track and pay payphone compensation.

AT&T does not know how PCA calculated its projected revenues from the AT&T general rate increases for business services or its per-call payphone charges. PCA's analysis, however, grossly overstates the actual impact of such increases.

In fact, AT&T's net incremental revenues from per-call charges for payphone calls, even when added to the general business services rate increases, still leave AT&T in a substantially negative overall financial position, assuming that the FCC adopts its tentative conclusion that the per-phone compensation for the initial interim period should be based on a rate of 28.4 cents per call. As of today, AT&T estimates that its net costs and liabilities significantly exceed its additional revenues.

If the FCC's rules on payphone compensation are modified as a result of the current legal and regulatory challenges, the overall financial impact on AT&T could change. If such a change occurs -- as AT&T hopes it will -- AT&T will take appropriate steps to modify future rates so that it does not profit from payphone compensation.

Reduced Commission Expenses

PCA's arguments regarding reduced payments for 0+ commissions are at best disingenuous. The FCC has always treated 0+ commissions as marketing expenses. These commissions are certainly not entitlements for payphone operators, yet the PCA analysis assumes they are.

More fundamentally, the change in consumer dialing patterns has principally been the result of customer decisions to use access codes to assure that they are dealing with the carrier of their own choice, rather than the carrier selected by a payphone operator or a location owner.

Customers' ability to exercise such choice was not assured by the operation of the market. Indeed, private payphone owners initially blocked all calls dialed with access codes, forcing customers to use the carriers they selected.

Consumers did not gain the opportunity to make a choice until after there were huge numbers of consumer complaints regarding outrageously high rates for 0+ calls. This outcry led to Congress' adoption of TOCSIA (Section 226 of the Communications Act).

TOCSIA assured that consumers who use payphones (and other aggregator phones) would have a choice of carriers for all interstate operator services calls. This statutory mandate, not the operation of the market, is what ultimately broke the payphone

operators' (and location owners') unilateral control over the selection of the carrier for such calls.

Moreover, carriers incurred substantial marketing expenses to inform consumers about access code calling and convince them to use this form of access, which is much less convenient than 0+ calling. Access code calls typically require customers to dial at least 10 digits more than 0+ calls. Consumers would not likely incur such inconvenience if they felt that they would always pay a reasonable rate for 0+ calls.

The FCC's Payphone Compensation Rate Is Too High

AT&T wholeheartedly concurs with the testimony of consumer witnesses who argue that payphone compensation rate is too high. These witnesses correctly point out that:

- There is no effective competition for payphone services at the end user level. The only competition that exists is between payphone owners for the right to place payphones -- on an exclusive basis -- at individual locations.

- In a non-competitive market, fair compensation can never be "market based" and must be based on costs.

- Call blocking -- which is only partially available even now -- is not an effective mechanism to establish a market rate for payphone compensation. The only way that the FCC could have developed a fair market-based compensation rate would have been to use a "caller pays" collection system. Direct market pressure can only be effectively exerted at the point of sale by the party who is adding the costs to the system by choosing to use a payphone to place a call.