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JUL 13 1998

Federal Communications Commission
Office of Secretary

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

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

AT&T Comments

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July 13, 1998

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Summary

These comments are necessary because the Court of Appeals rejected -- for the second time -- the Commission's efforts to establish a fair payphone compensation rate, as required by Section 276 of the Telecommunications Act. The Court's latest rejection requires that the Commission justify again its efforts to establish a carrier-pays system that relates the compensation rate for coinless calls to a deregulated "market rate" for local coin calls. In fact, the record shows that it is impossible to do so. Thus, the Commission has only three realistic options:

(1) Adopt a market-based compensation system for compensable coinless calls based on the calling party pays methodology;

(2) Retain the carrier pays methodology but develop a market surrogate default rate based on the actual market dynamics between PSPs and compensating carriers; or

(3) Adopt a reasonable efficient cost-based method for calculating the default payphone compensation rate that is based on the costs of LEC PSPs, who operate 75% or more of all payphones and who have costs that are significantly lower than those of independent PSPs ("IPPs").

In all events, the Commission should not establish a "floating" default compensation rate, because such a rate

will lead to unjustifiable manipulation of local coin rates and create administrative chaos.

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

AT&T Comments

Pursuant to the Commission's Public Notice (DA 98-1198), released June 19, 1998 ("Notice"), AT&T Corp. ("AT&T") submits the following comments on the issues remanded to the Commission by the Circuit Court of Appeals for the District of Columbia Circuit.

Introduction

None of the issues discussed here are new. They have all been presented by AT&T and others in the comments and replies filed in conjunction with the Second Report and Order and the Petitions for Reconsideration of that order. The Notice (p. 3) states that these pleadings will be incorporated into the record here. Therefore, AT&T will not engage in extensive repetition of its prior filings.[1]

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[1] Those filings include AT&T Comments dated August 26, 1997 ("8/97 Comments"); AT&T Reply, dated September 9, 1997 ("AT&T Reply"); AT&T Petition for Reconsideration, dated December 1, 1997 ("AT&T Petition"); AT&T's Opposition to and Comments on Petitions for Reconsideration, dated January 7, 1998 ("Petition Comments"); and AT&T Reply, dated January 20, 1998 ("Petition Reply"), all of which are incorporated herein by reference.

Rather, these comments will focus on the specific questions asked in the Notice and relate them to facts presented in AT&T's earlier filings.

Argument

I. Competition In The Payphone Marketplace Is Strictly For Locations, Not For End Users, And Has Only Led To Higher Prices For Local Coin Calls.

The Notice (p. 2) first seeks comment on competition in the payphone market since the deregulation of payphones, and the impact of deregulation on the local coin rate. As an initial matter, it should be noted that the record here is devoid of evidence that PSPs compete for end users. Indeed, the record to date points solely to a battle among PSPs for the right to be the exclusive provider of payphone services at individual locations.[2] Nothing has changed.

In fact, the lack of competition for end users has simply become more pronounced -- and openly admitted -- as PSPs around the country have almost uniformly raised their local coin rates to 35 cents per call, irrespective of the conditions of supply and demand between end users and PSPs. For example, a March 2, 1998, U S WEST press release entitled "U S WEST Raising Price of a Local Phone Call to 35 Cents in Idaho" states:

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[2] Petition Reply, pp. 3-7.

> "We are taking a market-based approach in Idaho," said David Anastasi, vice president and general manager of U S WEST Public Services. "Competition is a reality in the pay phone market. There are many other Pay Phone Service Providers competing vigorously for sites where customers want pay phones. In order for U S WEST to be competitive with these PSPs we must pay market based commissions to our location providers to place our pay phones at their businesses. The only way to do that is to charge a competitive [sic] price to users of the phones" (emphasis added).

Similarly, a July 2, 1998 press report in Communications Daily (Vol. 18, Number 131, p. NA(1)) states:

> Bell Atlantic raised price of local payphone call in Mass. Wed. to 35 cents from 25 cents. . . . It said [the] need to pay competitive location commissions and charge competitive retail prices drove [the] increase. Mass. boost means Bell Atlantic has raised its payphone rates in every location except N.Y., R.I. and portions of Conn. it serves.

This is crystal clear evidence that the "competition" in the payphone marketplace is not directed at either end users or competitive carriers.[3] Rather, the PSPs' so-called "market based" competition is focused exclusively on extracting "competitive" -- i.e., higher -- prices from end users, so PSPs can pay more commissions in competition with one another to secure locational monopolies at specific sites.

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[3] AT&T is also unaware that any PSP has expressed a willingness to accept a lower compensation rate for dial-around or subscriber 800 calls than the rate adopted by the Commission.

Similarly, there is no evidence that the local coin rate reflects competitive market conditions between end users, who are the buyers of local coin service, and the PSP sellers of such services. First, there is no evidence of price competition for local coin rates. The PSPs' virtually uniform action in raising prices to 35 cents per call shows that they have no interest in, and indeed are not, competing with each other on price. Rather, their announced strategy is to increase prices and share the increased revenues with location owners.

Second, there is no evidence of any trend that location owners are selecting multiple PSPs to provide competing payphone services at their premises.[4] There are almost no places where competing local coin service providers have placed payphones at the same location.[5] And as AT&T previously showed,[6] neither location owners nor PSPs have any economic incentives to reduce these locational

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[4] Consumer-Business Coalitions' Petition for Reconsideration, dated December 1, 1997, pp. 3, 17-22; Petition Comments, p. 3; Petition Reply, p. 3.

[5] In the few instances where this has occurred, it is typically in quasi-governmental locations such as airports, where a portion of the phones are required to be let to minority and women business enterprises ("MWBEs"). In AT&T's experience, however, MWBE phones are typically covered by contractual terms, and particularly commission obligations, that are virtually identical to those of the principal PSP at that location.

[6] Petition Reply, pp. 5-6.

monopolies. Moreover, the Commission does not have the authority to affect the property rights of location owners to select the PSP that will serve their locations. Indeed, when this issue was raised in connection with the First Report and Order, comments from State parties made this point clear: [T]he [state] does not possess any jurisdiction or authority to require private site owners to contract with multiple PSPs or to solicit contracts through a competitive bidding process in order to avoid monopoly situations.[7] Thus, there is no reason to believe that this situation will ever change.[8]

Furthermore, significant consolidation has occurred in the payphone industry in the past 18 months. Bell Atlantic and the former NYNEX now operate a consolidated payphone operation, as do SBC and Pacific Bell. Independent LECs now negotiate with carriers through trade associations to maximize their negotiating leverage. Consolidation is also occurring in the IPP segment. Davel, an IPP that formerly operated about 20,000 payphones, acquired CCI, another large IPP, and has announced plans to acquire both Phonetel and Peoples Telephone, which had been the largest IPP. When

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[7] Petition for Reconsideration of Oklahoma Corporation Commission, dated October 21, 1996, ¶ 9.

[8] See AT&T Petition, p. 11.

these acquisitions are completed, Davel will own approximately 30% of all independent payphones. All of these facts support a conclusion that there is no significant competition among PSPs for end users, and no prospect that such competition will develop in the future.

II. Costs And Prices For Local Coin Calls Are Not Converging.

The Notice (p. 2) also seeks comment on whether costs and rates converge in the local coin market. There is no evidence that this has occurred, particularly for the vast majority of payphones that are owned by LECs.[9] As AT&T previously demonstrated, SBC cost data, adjusted for appropriate additional costs in response to comments of the LEC Payphone Coalition, indicate that RBOCs have a total cost per call, including a 0.9 cent return on assets, of 24 cents per call.[10] Just as important, the data from the SBC study are fully consistent with the evidence Sprint placed on the record regarding its own costs as a LEC PSP, and higher than the costs reported by NYNEX in Massachusetts. This evidence shows that LEC PSPs were already profitable at

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[9] See Petition Comments, pp. 6-7; Consumer-Business Coalition Petition, pp. 19-22.

[10] Petition Reply, pp. 15-16 and Reply Affidavit of David C. Robinson, ¶ 3. Contrary to some claims, the SBC study cited by AT&T was not a "second hand study." Rather, it was prepared by SBC's Corporate Development organization.

a 25 cent per call rate for local calls. And except for the possible voluntary (but undisclosed) increase in commission costs, there is no indication that LEC PSP costs have increased in any significant way in recent months. Yet despite this fact, nearly all LEC payphones charge 35 cents for a local coin call. Thus, the LEC Coalition members can now be expected to earn profits of as much as 11.9 cents (or more) per call.

III. Under A Carrier Pays Compensation System, The Coin And Coinless Calling Market Segments Are Unrelated.

The Notice (p. 2) next requests comments on the similarities and differences between the market segments for coin and coinless calls, and whether and how the distinctions between those market segments should affect the determination of a reasonable default compensation amount for coinless calls. Again, the record clearly demonstrates that under the carrier pays compensation system selected by the Commission, there is no relationship between the coin and coinless market segments.[11] Thus, if the compensation rate is to be set on a carrier pays basis, there is no rationale that can support the establishment of a "market based" default compensation amount for coinless calls based on the deregulated local coin rate.

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[11] E.g., AT&T Petition, pp. 4-5; Petition Reply, pp. 7-10.

The Commission has repeatedly tried to find a "market based" solution to the question of setting the compensation rate for coinless calls. In doing so, it has sought to determine an amount upon which a "willing buyer" and a "willing seller" would agree.[12] However, the Commission has consistently mismatched the buyers and sellers whose interests and decisions must be considered.

In the local coin market segment, the "buyers" are end user customers who wish to place calls from payphones and the sellers are the PSPs who are offering end users the opportunity to purchase local coin service. Thus, the market dynamics that must be reviewed in this segment are those between the prospective callers and PSPs. Here, the decision of whether to incur the cost of using a payphone rests solely with the end user. To the extent that there is any market leverage on the buyer's side, it rests solely with the prospective caller, who must decide whether or not to pay the price that the PSP demands for the call.[13] If the customer agrees, then the call is made. If customer thinks the PSP's price is too high, he declines to call.

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[12] First Report and Order, ¶¶ 52, 164.

[13] There is, of course, no opportunity for price negotiation here. A potential caller must simply decide whether or not to place the call at the demanded rate.

Once the decision is made, the transaction is complete, and no other party is involved.

Under the carrier pays system of payphone compensation, the market dynamics are completely different. Because the carriers that handle compensable calls must pay compensation to the PSPs, they become the buyers. Moreover, what they are buying is fundamentally different from what end users purchase when they make local coin calls. In the local coin market segment, the caller buys an end-to-end call, all elements of which are provided by the PSP. In the coinless calling segment, carriers are paying for an input to their total service, not a complete phone call. Moreover, the carriers' economic decisions must be based upon the economics of two very different products -- dial-around operator services calls and subscriber 800 services (i.e., toll-free) calls.

In order to determine the "market" price a willing carrier would pay to use a payphone as an input to its service, the carrier must consider the revenue streams from both types of affected services. The record shows that the average revenue for dial-around calls is now under $2.50 per call, while the average revenue for a subscriber 800 call is between 35 and 50 cents.[14] Thus, there is no economic basis

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[14] AT&T Reply, p. 13.

for a carrier to agree, on a pure market basis, that the market value of the use of a payphone is the same for both types of calls. Moreover, a large majority (about two-thirds) of the compensable calls from payphones are the lower priced 800 subscriber calls.

There is yet another crucial difference between the coin and coinless calling market segments. In the former, the buyer (the end user) makes all the decisions and either deposits coins or not. In contrast, in the coinless calling segment, the caller -- especially for 800 subscriber calls -- makes the decision of whether to place the calls but is not directly responsible for incurring the costs of payphone use. This difference is particularly critical in the 800 subscriber segment, because the caller will never have to bear the direct charges for using the payphone, and thus neither knows nor cares what they are.[15] Instead, the carrier and 800 subscriber must bear those costs. Moreover, the only way for 800 subscribers and carriers to exercise any market leverage in such cases is for the carriers to construct complex and extremely costly systems that would allow selective call blocking from individual payphones.[16]

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[15] Petition Comments, pp. 4, 7-8.

[16] See, e.g., 8/97 Comments, pp. 16-18.

Thus, unlike the local coin calling market segment, the carriers' costs of exercising any countervailing market leverage are very high. Accordingly, there is simply no rational basis to conclude that, under a carrier pays compensation system, a "market based" payphone compensation rate for coinless calls could be based on the deregulated local coin rate.[17]

The irrationality of the current rules is compounded by the fact that the default compensation rate is fixed only through October 1999, and thereafter will "float" based on the local coin rate at each individual payphone. This rule further perverts the economic underpinnings for the Commission's analysis and will create administrative havoc.

By allowing the default rate to float (with or without a deduction for coin-related costs), the rules encourage manipulation of the prices in the local coin market segment. As AT&T showed, once the compensation rate begins to float, PSPs will have the incentive to raise the price of local coin calls for the sole purpose of increasing their

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[17] The additional irrationality of attempting to derive a default compensation amount by deducting coin-related costs from the deregulated market rate for local coin calls has also been demonstrated. e.g., AT&T Petition, pp. 5-6; AT&T Reply, Affidavit of Dr. Frederick R. Warren-Boulton, pp. 6-7.

compensation from carriers for coinless calls.[18] In addition, the carriers' job to track and pay compensation will become exponentially more difficult if they must pay different (and ever changing) rates for calls from over 2 million payphones.[19] This, in turn, is likely to lead to interminable complaints lodged with the Commission regarding payphone compensation issues. Thus, to the extent the Commission chooses to retain a carrier pays payment system, the default compensation rate should remain fixed.[20]

IV. The Commission's Alternatives

A. Market Based Compensation Schemes

The Commission has repeatedly attempted to find a supportable basis for establishing a market based

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[18] See, e.g., 8/97 Comments, pp. 16-17; AT&T Petition for Reconsideration, dated October 21, 1996, pp. 14-15; AT&T Opposition to and Comments on Petitions for Reconsideration, dated October 28, 1996, p. 6; AT&T Reply, Warren-Boulton Aff., p.6. For example, a PSP who places phones at a stadium could raise the price of a local coin call to a dollar with virtual impunity. Customers in that location who do not want to pay that amount have no other alternatives to the local coin rate but to place coinless calls. By forcing callers to that mechanism, the PSP could increase its overall revenues from carriers and assure that it would collect almost a dollar on every call from those phones, irrespective of the actual costs of providing the payphone.

[19] 8/97 Comments, p. 17.

[20] If the Commission adopts a proper cost-based method for developing the default rate, it could periodically review any changes in PSP costs to determine if the rate should be changed over time.

compensation rate for coinless calls. If the Commission wishes to continue in this vein, AT&T has identified two possible alternatives: use of a calling party pays payment mechanism or development of a surrogate market rate based upon actual experience with dial-around calls.

1. Calling Party Pays

In a calling party pays system, the market dynamics of the coinless calling market segment exactly mirror those of the local coin market segment. All transactions are made between end users and the PSP. The compensation rate is publicly disclosed to the party that chooses to use the payphone, and that party makes the market decision to accept the PSP's rate or not by depositing coins (or making other payment) at the phone. No party would incur transaction costs for the decision, and carriers and 800 subscribers would not be impacted. Rather, they would be able to treat calls from payphones exactly the same as calls from any other type of phone. Thus, to the extent the Commission wishes to establish a true market-based approach to payphone compensation, the calling party pays mechanism offers the most direct and supportable way to do so.[21]

A calling party pays system would also eliminate any need for the Commission to establish a default rate for

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[21] See Petition Comments, pp. 14-20.

payphone use. All transactions would take place at individual phones under the same market conditions as deregulated local coin calls. The rate charged for payphone use in such cases would be a deregulated rate, just as the local coin rate, and could be set at whatever level the PSP chooses and callers agree to pay. As with the local coin rate, costs would be considered by the PSP, but the rate would be determined principally based on customers' willingness to pay the price set by the PSP.[22]

2. Market-Based Surrogate Rate

If the Commission insists on retaining a carrier pays system, AT&T has also provided a method for developing a market-based surrogate to establish the default payphone compensation rate.[23] Actual negotiation between AT&T and IPPs previously resulted in an agreement, which ultimately was incorporated into a Commission order, that a 25 cent per call rate was fair compensation for dial-around calls. At that time, such calls generated an average AT&T revenue of about $2.50, resulting in about a 10% payment rate. Applying a 10% rate to the current average revenue of about $2.20 for such calls yields a rate of 22 cents for dial-

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[22] See Notice, p. 3. The nondiscrimination requirements of Section 226(c)(1)(C) would also apply to access code calls.

[23] AT&T Reply, pp. 12-14.

around calls, which are in turn only about one-third of all compensable calls. Applying a similar analysis to 800 subscriber calls, which generate average revenues of less than 50 cents per call, yields a "market" rate of no more than 5 cents per call.[24] Thus, a blended (weighted average) rate for the two different types of calls yields a market rate -- from a willing buyer's perspective -- of under 11 cents per call.[25]

B. Cost-Based Rate

If the Commission declines to adopt either of the only two rational market-based methodologies, its remaining option is to develop a cost-based default compensation rate. However, any cost analysis must also be reasonable. Carriers in this proceeding, particularly AT&T, have repeatedly pointed out how this can be accomplished.

The Second Report and Order assumed that the IPP data in the record were representative of the payphone industry as a whole. The record shows, however, that that assumption is false, and that the costs of IPPs, who represent a small

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[24] Indeed, at 5 cents per call, carriers would typically be paying at a rate of more than 10%.

[25] A blended rate is more appropriate than a split rate in the current marketplace, because 800 numbers are used both to provide toll-free calls and dial-around calls, and it would be administratively difficult, if not impossible, to separate the two for payment purposes.

minority of PSP payphones are substantially higher than the costs of LEC PSPs. Any cost analysis that relies on data from a small -- and unrepresentative -- sample of PSPs cannot yield a reasonable result.[26]

A reasonable cost analysis must account for, and be based on, the efficient costs of the majority of industry participants, i.e., LEC PSPs. Unfortunately, LEC PSPs largely ignored the Commission's request for detailed cost information, seeking instead to rely upon the data presented by their higher-cost competitors. However, the Commission did receive reliable data from at least two sources that could be used to develop a fair cost-based compensation rate.

First, AT&T presented a cost analysis based upon its experience in the payphone business, including its operation of over 20,000 coinless payphones, showing the actual cost of providing payphone access for coinless calls. In addition, Sprint provided data on the payphone costs of its LECs. Both of those analyses showed that a LEC PSP's efficient costs of providing carriers with access to payphones are substantially less than the 28.4 cent rate in the Second Report and Order.[27] In addition, the AT&T and

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[26] See AT&T Petition, pp. 12-13.

[27] See AT&T Petition, p. 13-15; Petition Reply, pp. 13-17.

Sprint data were supported by information that SBC's costs are directly in line with Sprint's and that NYNEX's average total costs per call in Massachusetts were 16.7 cents per call.[28] Accordingly, the Commission has sufficient data in the record to perform a reasonable bottom-up cost analysis, using the cost categories identified in the Second Report and Order and the data identified above.[29]

Finally, the Commission must still provide a mechanism for apportioning payment responsibilities among carriers for the initial phase of per-phone compensation, i.e., the period from November 1996 to October 1997. Now that actual data regarding payphone use are available as a result of the Commission's rules regarding delivery of Flex ANI, those data should be used retrospectively to establish carriers' obligations for the initial payment period.

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[28] Because NYNEX's reported costs were significantly lower than those of Sprint and SBC, the fact that NYNEX's analysis was based on "incremental" is irrelevant (see AT&T Petition, p. 14), especially if this information is used principally as a cross-check on the other reported data.

[29] LEC PSP claims that a cost-based rate could lead to the removal of many payphones are simply unfounded. PSPs, under any likely scenario, will be receiving substantially more compensation under the rules adopted here than before the passage of the Act. Moreover, the Act specifically provides for the placement of public interest telephones in places where market economics do not result in the placement of payphones where they are needed. See AT&T Reply, pp. 10-12; AT&T Petition, pp. 9-10; Petition Reply, pp. 11-13.

Conclusion

For the reasons stated above and in all of the referenced filings, the Commission should provide for fair payphone compensation by adopting a calling party pays compensation system, using a market surrogate analysis as suggested herein, or developing an efficient cost-based rate based on the costs of LEC PSPs.

Respectfully submitted,

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July 13, 1998

Certificate of Service

I, Rena Martens, do hereby certify that on this 13th day of July, 1998, a copy of the foregoing "AT&T Comments" was served by U.S. first class mail, postage prepaid, to the parties listed below.

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