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

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

REPLY COMMENTS OF SPRINT CORPORATION

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Sprint Corporation hereby replies to the initial comments of other parties in response to the second remand of the Commission's decisions in this docket by the U. S. Court of Appeals for the District of Columbia Circuit.[1]

I. INTRODUCTION AND SUMMARY

The comments of other parties provide substantial support for Sprint's position that the Commission should either follow a true market-based approach to payphone compensation and adopt a caller pays plan, or, alternatively, should adopt a cost-based rate, using the costs of an efficient bellwether PSP.

The PSPs give scant attention to the caller pays plan, and what little they offer against it is without merit. The only new detailed cost data in the record is a cost study presented by MCI which shows coinless call costs amount to 8-12 cents per call. This study underscores the soundness of Sprint's position that a cost-based rate should not exceed 14.3 cents. The PSP arguments against a direct cost-based approach are specious and do not withstand analysis.

[1] MCI Telecommunications Corporation, et al. v. FCC, No.97-1675, May 15, 1998 ("Payphone II").

The efforts of the PSPs to shore up the Commission's past "apples and oranges" approach – clearly rejected and discredited in Payphone II – of taking a "market-based" rate for local coin calls and subtracting cost differences between local coin calls and coinless calls are unavailing. The PSPs buttress their arguments with declarations of a number of distinguished economists. Despite the impressive credentials of these experts, their views and analysis are only as good as the assumptions they rest on, and, time and time again, to borrow the punch line of an old joke, they simply assume can openers. The PSPs cannot escape the fact than any attempt to "prescribe" a "market-based" rate is an oxymoron. Either the Commission must rely on the market (and adopt a caller pays plan) or its should prescribe a cost-based rate. If it chooses the latter, it makes far more sense for the Commission to prescribe a rate based directly on costs, rather than to go through a complex process, that is dependent on unreal assumptions, of constructing an indirect approach to costs.

The PSPs' arguments that the Commission previously overstated the cost differences between local coin and coinless calls are without merit[2] as are their shopworn arguments that the Commission should rely on other so-called market surrogates in setting a rate.

Finally, Sprint emphatically agrees with AT&T that if the Commission prescribes a carrier-pays rate, the rate must be fixed for all payphones and should not be allowed to vary from one payphone to the next.

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[2] Indeed, Sprint and others have shown that those differences are significantly greater than the Commission assumed.

II. THE COMMISSION SHOULD EITHER ADOPT A CALLER PAYS PLAN OR SHOULD SET A RATE BASED ON THE COSTS OF A REPRESENTATIVE EFFICIENT PAYPHONE PROVIDER

A. A Caller Pays Plan Is The Only Market Based, Deregulatory Approach

There is wide support from a number of different parties for their adoption of a caller pays plan for access code and subscriber 800 calls, either as their preferred position or as an acceptable alternative to the prescription of a cost-based rate. Among IXCs, caller pays plan is supported by AT&T (at 13-14), Cable & Wireless (at 11), CompTel (at 17-18), Excel (at 4-9), Frontier (at 9-10), International Telecard Association ("ITA") (at 6-9), LCI (at 10), TRA (at 9) and WorldCom (at 5-8). A caller pays plan is also supported by a number of paging companies: AirTouch Paging (at 2-6), PCIA (at 7-13) and SkyTel (at 5-6).

Significantly, there is virtually no opposition to adoption to the caller pays approach in any of the comments. The RBOC/GTE/SNET Payphone Coalition ("RBOCs") (at 28) defends the carrier pays approach in lieu of a caller pays plan on the mistaken and illogical ground that

> the Commission's decision to impose the payphone compensation fee on the 800 subscriber, rather than the caller, is simply a particular example of the general rule that the called party, rather than the calling party, pays tolls associated with calls that are "toll-free" to the caller.[3]

In fact, the Commission did not "impose the payphone compensation fee on the 800 subscriber." That option was the "set use fee approach" that the Commission explicitly rejected in its Report and Order herein (11 FCC Rcd 20541, 20584-85 (1996)) in favor of

[3] The RBOCs (n.21 at 28-29) also simply parrot the reasons the Commission previously gave for rejecting a caller pays plan, reasons that were discussed at length in Sprint's Comments at 6-11).

a carrier pays plan that imposed the compensation directly on carriers, and left it to each carrier to determine whether and how to recover the compensation.[4] In any event, there is no logical nexus between who should pay for a telephone call, and who should be responsible for the rental of equipment used to make that call. Using the RBOCs' logic, 800 subscribers should also be responsible for at least part of the costs of business and residential telephones.

As Sprint explained in its Comments (at 7, 11) a caller pays plan avoids the considerable administrative complexities and transaction costs that result from any form of carrier-paid compensation. Sprint also pointed out (at 12) that any form of carrier pays compensation would continually burden the Commission, the PSPs and the carriers with litigating payment disputes and considering periodic requests to change the level of compensation.[5] These inherent costs and complexities of administering a carrier pays plan (no matter what the basis for the rate is) are amply documented in the comments of other parties as well. As WorldCom put it (at 2), unless the Commission adopts a caller pays plan, it

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[4] As Sprint pointed out in its Comments (at 7), the IXCs have chosen to recover their costs by surcharging the party paying for a payphone-originated call (in circumstances where such calls can be identified), and thus the carrier pays system creates the same types of transaction costs that would be associated with the set-use-fee plan and that were the basis for the Commission's rejection of the set-use fee plan. Nonetheless, the RBOCs are incorrect in asserting that the Commission directly imposed the compensation obligation on the 800 subscriber.

[5] Sprint argues in Section II.B., below, that if the Commission properly set a cost-based carrier pays rate, it would not need to continually review the rate and indeed could adopt an automatic adjustment mechanism, such as it uses in price cap regulation, to periodically reduce the rate to reflect declining equipment costs and rising call volumes. However, following Sprint's approach would not prevent the PSPs from continually asking for higher compensation.

> will remain mired in a regulatory and appellate morass of its own making, caught between over-burdened "facility-based" carrier payors, blissfully unaware and sometimes evasive resellers, unappeasable PSPs, [and] non-compliant and intransigent incumbent local exchange carriers... .

ITA (at 2) agrees that "implementation of carrier pays has proven to be confusing, costly and inefficient... ." That payment disputes and high transaction costs will inevitably arise from a carrier pays plan is also reflected in the Comments of APCC at 17-19, in which it addresses ANIs disputed by certain IXCs, allegedly erratic per call counts on the part of one IXC, and the difficulties engendered by identifying and collecting from resellers.[6] In the latter regard, APCC (at 19) asserts that "the total cost of billing resellers will be very high in relation to the amount collected."

PCIA points out (at 4-5) that a caller pays plan would avoid demands by 800 subscribers for IXCs to develop targeted call blocking. Even the non-selective (or non-targeted) form of call blocking that is now available cannot perfectly perform its limited function,[7] since (because of the generous waivers the Commission has granted to the LEC industry) many calls cannot be identified real-time as payphone originated. Moreover, as

[6] Sprint's citation of APCC's arguments should not be taken as an endorsement of the validity of any of the assertions made by APCC, much less APCC's underlying claim that the compensation rate should build in an allowance for collection costs and uncollectibles. Sprint merely cites APCC's comments to illustrate that administrative complexities do exist and disputes are arising. With respect to disputed ANIs, one can hardly expect IXCs to pay all claims without trying to verify that an ANI for which a claim has been submitted is in fact a payphone, or without avoiding paying two different PSPs for the same ANI. This is but one of the administrative burdens the Commission has imposed on carriers. In the latest payment period (the first quarter of 1998), Sprint found that more than 85,000 ANIs either were not verifiable as payphones or were claimed by more than one PSP.

PCIA notes (at 4), call blocking "imposes its own costs on carriers and consumers by discouraging toll-free calls from payphones." Indeed, the demand for call blocking by the IXCs' customers puts IXCs in the awkward position of having to spend money to develop systems that will keep them from carrying revenue-producing calls.

A carrier pays system, regardless of how the rate is set, is an economically inefficient way to collect for the use of a pay telephone. As a general rule, the caller has the option of placing the call from a different phone, in a different location, and/or at a different time. Thus, use of a payphone provides convenience primarily to the caller, but is presumably of little or no value to the carrier. The call will be made anyway, albeit from a different phone and possibly at a different time. As WorldCom explains (at 3-4, footnote omitted):

> It is axiomatic that telephone network usage can occur only in the presence of telephones. WorldCom benefits every time its customers use a telephone to access its long distance telephone network and pay for its services. WorldCom is disinterested, however, in whether a particular customer makes its call(s) from a payphone, *unless the only alternative is that a given call not be made at all.* Accordingly, WorldCom has an interest in the fact that payphone equipment is available for use by its transient customers. However, this interest in payphones is no more ardent than WorldCom's interest in whether its business customers access its network from hotel rooms or wireless phones, or whether its residential subscribers have a telephone in every bedroom. WorldCom's interest is straightforward – more calling is generally a good thing. However, as end users, carriers, prepaid service providers, and paging and dispatch companies repeatedly have emphasized throughout this proceeding, the transport carrier of a call is not the true beneficiary of payphone usage. No economic advantage is conferred by the fact that the call originated from a payphone. Nor is the recipient of an "800" call dialed from a payphone

[7] Under this form of call blocking, an 800 subscriber can block all payphone-originated calls to its 800 number, but cannot choose to block calls only from selected payphones.

> a beneficiary. Such a subscriber clearly is indifferent to where a call originated, and may or may not have an interest in receiving a particular call at all.

Under these circumstances, social efficiency would require that payphone calls be made so long as the convenience value to the caller is greater than the costs imposed on the payphone provider for accepting the call. Since it is the caller, not the carrier, that decides from which phone the call will be made, and knows the convenience value of using a particular phone, efficiency is assured only if the caller incurs the cost of making the call. Under a carrier pays system, however, callers face no cost in placing a call on a payphone. As a result, they will place calls even when the value to the caller is less than the costs.[8]

Put differently, the costs faced by the caller affect his incentives to place the call. This is implicitly recognized in the analyses put forth by the PSPs' own economists. For example, Becker (¶27)[9] describes the process by which margins on coin and coinless calls would be equalized under competition. He observes that payphone providers could induce consumers to reduce their use of payphones for dial-around calls by increasing the price of access for dial-around calls. But caller behavior can be affected in this way only if the caller pays the price. In other words, Becker is

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[8] This assumes that the caller is not surcharged by the carrier in a way that is transparent to the caller at the time he places the call. Even if that were the case, however, a caller pays plan has the virtue that the price can vary by payphone location. As we explain below, it is not feasible under a carrier pays plan to have rates that vary by location. Thus, even under surcharging with full transparency, the price signal to the caller would be muted by the fact that it would be an average price rather than one specific to that location.

[9] Declaration of Professor Gary Becker, RBOC Comments, Exh. A.

implicitly describing a caller pays system. Likewise, Kahn (p.8)[10] refers to second-best economic efficiency being achieved on the basis of differences in demand elasticities among the several services. Again, demand elasticities are relevant are relevant only to the extent that the party making the decision whether to place the call (i.e., the caller) is the party that pays the price of the call.

Given that the price, if any, faced by the caller influences his decision to place the call, it follows that the number of calls placed will be different under a caller pays plan than a carrier pays plan *even if the same rates were imposed under both plans*. It is thus a logical fallacy to determine a "market-based" price based on what the outcome would be if callers paid, but then levy that price on the carrier rather than the caller.

What is involved here, simply, is a desire by the PSPs to receive rent from the use of their equipment. Caller pay for the equipment they use in their homes and offices and there is no logical reason why they should not pay the PSP directly when they rent the PSP's payphone. Requiring carriers, rather than the callers themselves, to pay the rent for the use of a phone is every bit as illogical as allowing someone to rent a house – and choose the size of the house, the location, etc. – and require the rent to be paid not by the occupant, but by the local phone company, the electric company, the gas company and the furniture companies and local grocery chains used by the occupant, simply because they happen to provide goods and services to the occupant of the house.

Finally, Sprint's Comments (at 8-9) demonstrated that Section 226(e)(2) is not a bar to the adoption of a caller pays plan. In this regard, Sprint notes that Excel (at 9) argues that the caller pays plan would only apply to subscriber 800 calls, and not to the

[10] Declaration of Alfred E. Kahn, RBOC Comments, Exh. B.

access code calls addressed in Section 226(e)(2). Sprint takes a different view of the scope of the caller pays plan: it should encompass both access code calls and subscriber 800 calls, not just the latter, or else carriers will still be mired in all of the tracking, surcharging and administrative complexities they now face (albeit for a smaller universe of calls). Sprint's proposal would not preclude Excel or any other carrier from negotiating with PSPs to make access code calls subject to agreed upon carrier paid compensation in return for not requiring caller-paid compensation for such calls.[11] However, the caller pays plan should (in the absence of such carrier-negotiated arrangements) encompass all calls and, for the reasons explained in Sprint's Comments, such a plan for access code calls does not run afoul of Section 226(e)(2).

B. If The Commission Does Not Adopt A Caller Pays Plan, It Should Prescribe A Cost-Based Rate No Higher Than 14.3 Cents

In its Comments, Sprint argued (at 15-18) that the only logical and supportable alternative to a caller pays plan would be a cost-based rate, based on the costs of an efficient PSP. Sprint reviewed the evidence in the record thus far and argued that even using assumptions that are generous to PSPs, such a cost based rate could be set at as low as 10.1 cents per call, and in no event should be higher than 14.3 cents per call.

There was widespread support among other parties for a cost-based rate alternative.[12] In addition to the cost data that was discussed in Sprint's Comments, MCI, using publicly available information about the costs of operating a payphone business, conducted cost study (appended as Exhibit 2 to its Comments) showing that the cost of

[11] Cf., Sprint's Comments at 15; see also, WorldCom at 7-8.

[12] See e.g., AT&T at 15-17; Cable & Wireless at 9-11; CompTel at 18-19; Excel at 9-12; Frontier at 8-9; ITA at 6; LCI, at 8-9; MCI at 7-8; TRA at 6-7; VoCall and Galaxy at 7-8; and PageNet at 10-12.

subscriber 800 and access code calls amount to only 8-12 cents per call. This evidence further underscores the reasonableness of the compensation range that Sprint and other IXCs are advocating. In addition, the New York Department of Public Service ("NYDPS") states (at 1-2) that a 1997 analysis by Bell Atlantic-New York showed that its long-run incremental costs for local coin calls are less than 25 cents per call (although NYDPS does not state BA-NY's exact unit cost). NYDPS recommends (at 2) that the compensation rate for coinless calls in New York should be less than $.20.

It may also be noted that the costing approach that Sprint and others are advocating largely rests on evidence of fully allocated costs.[13] Other parties advocating cost-based rates urge the Commission to use incremental or marginal costs.[14] Given the circumstances that are present here, Sprint believes that an incremental or even marginal cost approach would be fully appropriate. The decision to install a payphone has historically been made without regard to any revenues from dial-around or subscriber 800 calls. Shortly after the Commission's initial orders in this docket had been issued, the CEO of one PSP explained how the business really works:[15]

[13] The RBOCs have claimed that the Bell Atlantic-Massachusetts cost data represent "incremental" costs (without describing whether those are short run incremental or long run incremental costs), but as Sprint explained in its Comments (n.21 at 16), Bell Atlantic's refusal to submit the underlying cost study into the record precludes the Commission from accepting the RBOCs' self-serving and unsupported characterizations of the contents of that cost study.

[14] See e.g., Consumer-Business Coalition for Fair Payphone 800 Fees ("Consumers") at 10; and IXC Communications at 2-3.

[15] "FCC Order Jump Starts Industry," Phone+, December 1996, at 64-66.

> "I've always maintained one thing," says Jerry Berger, chief executive officer of AmeriCall. "I did not accept a location if I could not amortize 100% of my interest and principal payments and all my salaries, general and administrative expenses strictly out of coin. If I had to depend on the revenue from operator services, let alone surcharges, I didn't want the phone. To me, operator services and any type of surcharges revenue is strictly gravy."

Since the reality that payphones are placed with the expectation that their costs will be covered entirely by local coin calls (or perhaps commissions from the presubscribed 0+ carrier as well), and since the average payphone is in use for all types of calls only about 6% of the time,[16] the ability to use the payphone for an access code or subscriber 800 call could be considered a joint product of the coin and 0+ calls which the phone is placed to serve. In such circumstances, it may well be appropriate to price the use of the phone for access code and subscriber 800 calls at their marginal costs (wear and tear on the instrument).[17]

Any effort to set a carrier-paid compensation rate above marginal costs would not only unjustly enrich either the PSPs, or location owners, or both, but would also give rise to an obvious opportunity for fraudulent dialing of subscriber 800 numbers by unscrupulous PSPs, simply to generate additional revenue, a concern voiced by 800 service subscribers.[18] Because such fraud can be spread among millions of subscriber 800 numbers and a large number of carriers, it is a form of fraud that would be very

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[16] Based on RBOC reported monthly call volumes of 478 calls and an assumed average call duration of five minutes.

[17] Cf. Kahn, The Economics of Regulation (1970), v.I at 79-82.

[18] See Allen Lund Co., L & M Transportation Services, Inc., and Trans Dynamics, Inc., at 1.

difficult to detect. (A caller pays plan, by contrast, would eliminate the incentive to make such fraudulent calls.)

The adequacy of even a marginal cost approach to compensation is all the more reasonable in light of the fact that the Commission has never attempted to regulate the level of 0+ commissions the PSPs receive from the presubscribed 0+ carrier, or the level of rates the PSPs charge for 0+ calls when they act at their own operator services provider, and now has deregulated the rates for local coin calls (which account for 70% of payphone originated calls). If the Commission were to regulate the PSP industry comprehensively, and reduce local coin rates (or PSP-set rates for 0+ calls) to preclude any unjust enrichment from occurring from receipt of compensation for additional types of calls, it might make sense to take a fully allocated cost approach to setting the rates for both types of calls. However, the Commission has shown no inclination to undertake such regulation. In making this point, Sprint is not backing away from its willingness to accept a rate, under a carrier pays approach, of as much as 14.3 cents per call, simply to put this contentious matter to rest. However, the Commission should be aware that such a rate is a generous one for the PSPs.

The PSPs' arguments against a cost-based approach are not well founded. The RBOCs (at 4) and APCC (at 9-10) claim that it is too complex to determine costs, particularly for an industry that is otherwise not regulated. In this regard APCC (id.) points to the difficulties of allocating joint and common costs that are shared among several types of calls using a payphone. However, that is precisely what the PSPs are asking the Commission to do with their "apples and oranges" "market-based" approach, which requires the Commission to consider cost differences between various types of payphone calls. Furthermore, the Commission need not look at the costs of all PSPs, and indeed need not attempt to subject independent payphone providers (IPPs) to extensive costing proceedings. Instead, the Commission, need only follow decades of precedent on the use of a bellwether approach, and look at the costs of one efficient provider in order to determine the rate. In addition, given the fact that the bulk of the costs in question are equipment related, and in view of the secular downward trend in equipment costs, unit costs are likely to remain constant or decline over time.[19] Thus, there would seldom be a need to entertain upward adjustments in the rate once it is properly initialized. If anything, a mechanism similar to the price cap X factor could be used to effect periodic downward adjustments to reflect the expectable declines in unit costs. Such a mechanism would minimize the need for formal proceedings to make downward adjustments to the rate.

The RBOCs claim (at 4) that cost-based regulation is "inaccurate" and "contentious" and cite to ¶40 of the Becker Declaration, in which he says that there are "ambiguities" in determining a cost-based rate because of the wide range of costs that various parties advocate (he cites a range of $.14-.25). However, the PSPs' prescriptive carrier-paid approach is no less contentious. After all, the IXCs have taken the Commission to court twice on this issue and hotly dispute the so-called market-based approach to ratemaking that the PSPs advocate. And if the "ambiguity" of an approach is defined by the range of rates that are advocated under that approach, a carrier-paid "market-based" approach is even more ambiguous than a cost-based approach; the estimates of a carrier-paid market rate have ranged from zero to 90 cents per call. Cost-

[19] Unit costs would also decline if calling volumes rise.

based ratemaking can be "inaccurate" if the Commission adopts the wrong rate, as it did in its alternative cost analysis in its Second Report and Order.[20] But here the Commission has an opportunity to correct its past error by instead adopting a rate based on the costs of a bellwether PSP.

The RBOCs (at 5) argue that cost-based rate regulation creates the perverse incentive to install too many phones at inefficient locations, simply in order to raise unit costs in order to justify a higher rate. This is highly distorted view of a proper approach to cost-based rate setting. Sound cost-based ratemaking is not "cost-plus" regulation, in which the Commission takes, as a given, whatever inefficiencies it finds in the way a regulatee conducts its business. Rather, it can adopt rates that reflect the costs of a reasonable, efficient provider, thus insulating the public from the effects of inefficiency. Indeed, that is the very rationale behind the Commission's bellwether policy.

Setting the rate based on the costs of an efficient PSP also addresses the concerns of APCC (at 10-11) and the RBOCs (at 5-6) that a cost-based rate will under-compensate some phones and lead to a contraction of the supply of payphones. If an inefficient PSP were driven from the market, there is no reason to believe that efficient PSPs would not expand to replace the phones of the inefficient PSP. Furthermore, there is not a shred of evidence in the record that historically, the number of payphones was insufficient to meet reasonable public demand. And since all the revenues from access code and subscriber 800 calls (other than possibly the $6.00 per month that independent payphone providers received for access code calls) are "new" money for PSPs, there is no reason to believe the Commission's prescription of a rate based on the costs of an efficient PSP will

[20] See Sprint Comments, n.20 at 16.

contract the supply of payphones as compared with pre-competition levels. On the contrary, these additional revenues, if anything should induce some expansion in the number of payphones deployed. To the extent there is any concern that compensation based on costs would be inadequate to ensure a sufficiently widespread availability of payphones, such concern is properly addressed through the Commission's public interest payphone program, adopted pursuant to Section 276(b)(2).

III. THE PSPs' ALCHEMY CANNOT TURN "ORANGES" INTO "APPLES"

As Sprint and a large number of other parties have discussed in detail, the very notion of a "market-based" rate (or rate formula) that is prescribed by the Commission is an oxymoron, and the Commission's attempt in the Second Report and Order to derive a market-based rate by subtracting cost differences from the rate for local coin calls is fatally flawed because of the difference in the markets for the different types of calls and because of the fact that the local coin rate has no relationship to the efficient cost of providing local coin service.[21] The PSPs rely on their stable of economists to support a continuation of the approach taken in the Second Report and Order. In general, their economists assume that local coin rates are cost-based and on that basis, argue that subtracting the differences in costs between two products from the cost of one of the products is a reasonable means of setting a regulated rate for the other product. Thus, the PSPs argue that in fact the Commission's approach is an "apples from apples" or costs from costs approach.[22] However, the analysis of the most learned and distinguished economists can only be as sound as the information with which they are supplied and the

[21] See, e.g., AT&T at 2-12; CompTel at 9-17; MCI at 2-6; Consumers at 7-10; and WorldCom at 3-5.

[22] RBOCs at 15.

assumptions they make. In this case, the PSPs' economists make a host of assumptions that have no relationship to reality, have been given unduly restrictive assignments by their clients and are misinformed as to certain key facts. Their analyses are necessarily deeply flawed as a result.

As a threshold matter, the scope of the PSPs economists' analyses is artificially narrow. None considers the more direct approach of a caller pays plan that would allow a freely functioning market to set the rate in question.[23] Nor do any of the economists show an awareness of the market conditions (as between IXCs and PSPs) that existed before the enactment of Section 276 for subscriber 800 calls, or the pre-Section 226 market conditions for dial-around calls. Indeed, both Kahn (at 6) and Becker (¶7) assume that PSPs are legally required to permit both access code and subscriber 800 calls to be made.[24] That clearly is not the case for subscriber 800 calls, and is also not the case for certain access code calls.[25] As Sprint explained in its Comments (at 13-14), in the period before Section 226 was enacted, the IPPs at least were free to block all such calls, and indeed some did block access code calls, but IXCs never agreed to pay them for receipt of either type of call, and thus the market-determined rate was zero for both types of calls. And subsequently, when PSPs remained free to block subscriber 800 calls, they did

[23] Indeed, Kahn has obviously been misled when he states (at 6) that "[t]here appears to be no disagreement with the necessity of the FCC actually prescribing a default rate for dial-around and 800 calls... ."

[24] Haring and Rohlfs (APCC Comments, Exhibit 1, at 3) make a similar assumption with respect to "dial-around" calls without defining that term. However, APCC itself (n.2 at 2) uses that term to refer to both access code calls and subscriber 800 calls.

[25] Section 226 of the Act and Section 67.704 of the Commission's Rules prohibit blocking of access code calls only with respect to carriers who are also "providers of operator services" as defined in the Act, i.e., only carriers who offer 0+ services from aggregator phones. Many carriers that have access codes are not "providers of operator services."

not do so, but instead permitted access for these calls at no charge to either the caller or the carrier. Knowledge of this evidence of actual market behavior before governmental intervention occurred could have led the PSPs' economists to take a very different view of both the supply and demand factors.[26]

In any event, the linchpin of their analyses is a bald assumption that the local coin market is sufficiently competitive that it produces a rate that reasonably approximates costs. However, Becker carefully avoids asserting that the payphone market is, in fact, competitive, and Kahn (at 2) disclaims any knowledge of whether the payphone market "is indeed effectively competitive." Instead, Kahn relies on the Commission's belief that market forces will keep payphone prices at a competitive level. That assumption cannot rest on the bare fact that the Commission says it is so – when the Commission has previously acknowledged that competition in the payphone market may not be effective[27] – or the fact that there are no barriers to entering the business of providing payphones.[28] The PSP economists' simplistic assumptions that the local coin market is competitive cannot overcome the overwhelming evidence that the cost of a local coin call is well

[26] Cf. Haring and Rolfs Declaration (APCC Exhibit 1) at ¶42 ("An even better approximation could be developed" by considering differences in demand elasticities for coin and coinless calls).

[27] Report and Order, 11 FCC Rcd at 20548-49. The fact that no state sought to demonstrate that market failures are occurring (relied on by APCC at 6-7 and Declaration of Prof. Jerry A. Hausman (RBOC Comments, Exhibit C) at ¶20) is hardly surprising in light of the Commission's preemption of state jurisdiction and of the heavy evidentiary burden it placed on states to show that market failures exist (11 FCC Rcd at 20572-73). The states have had their hands full implementing their other responsibilities, and could not be expected to devote substantial resources to matters over which they have been preempted. The one state commenting in this proceeding argues that the disparity between rates and cost for local coin calls shows that the market is not truly competitive. NYDPS at 2.

[28] See Hausman at ¶19.

under the prevailing rate of $.35.[29] The PSPs and their consultants fail also to appreciate fully the fact that competition in the payphone market is directed not at the caller, but at the premises owner.[30] Thus, the mere fact that there are no entry barriers does not mean that competition will lead to cost-based rates. The PSPs quickly raised their rates after the Commission deregulated local coin rates, and some have publicly admitted[31] that they took that step solely for the purpose of paying higher commissions to premises owners. As AT&T's and MCI's economic consultants have explained, these commissions expenses do not reflect economic costs but rather monopoly rents.[32] As Beard, Ekelund and Saba put it (at 13):

> Free entry into the payphone industry only increases competition by providers for good sites – it does not create more good sites.

Thus, the theoretical economic model that blithely assumes competition will drive prices down to economic costs simply does not apply to the payphone market.

In addition to these fundamental flaws in the PSPs' analyses, their consultants make other faulty assumptions and factual errors as well.

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[29] Bell Atlantic's costs in Massachusetts are $.167 (Comments of Sprint Corporation on Remand Issues, August 26, 1997, Attachment A) and in New York are less than $.25 (NYDPS at 1, 2). Southwestern Bell's total per-call costs (including commissions) are $.238-243 (AT&T Reply, January 20, 1998, Reply Affidavit of David C. Robinson at ¶3). The Sprint local coin costs (allocating all site owner commissions costs to such calls) are $.263 (Reply of Sprint Corporation on Remand Issues, September 9, 1997, Exhibit 1, p.2). And MCI's study shows local coin costs of $.11-.16 (Comments, Exhibit 2, p.7).

[30] Hausman at least acknowledges (¶22) that location owners can determine the price of local calls. If they have the power to do so, it follows that they can extract monopoly rents.

[31] See Sprint's Comments at 19-20.

[32] See Warren-Boulton, quoted at p.21 and cited at p.20 of Sprint's Comments, and Beard, Ekelund and Saba (MCI Exhibit 1) at 1-13.

For example, Becker's analysis, built upon analogizing the operation of a payphone to a hairdressing salon, rests on a number of highly unrealistic assumptions. First, he assumes (¶25) that "payphones are fully utilized" and later (in ¶30) he alters his analysis for the possibility that payphones may "not be fully utilized," but still assumes that utilization is sufficiently high that the use of a payphone for one type of call imposes an opportunity cost on the PSP by preventing "an expected use of that phone for other types of calls." However, the reality is that the typical payphone is idle roughly 94% of the time,[33] and thus the opportunity costs can be expected to be virtually nil.[34] Becker's analysis also assumes (¶25) that various types of calls have the same average length. However, there is record evidence showing that there are differences in call length for various types of calls. See e.g., Petition of Sprint for Reconsideration, October 21, 1996, at 7 (differences in call lengths as between calling card calls and prepaid card calls).

Becker argues (¶27) that under competition, payphone access for different types of calls would be priced so that the margins for each are equal – or otherwise the PSP would be increase the use of its payphones for the higher-margin product by lowering its price, thus displacing lower margin calls. In addition to the fact that actual utilization is too low for this displacement to take place realistically, Becker fails to explain how a PSP could expect price adjustments to affect use of its phones if, for example, the higher margin product is a subscriber 800 call or an access code collect call. In that case, the

[33] Based on average RBOC reported call volumes of 478 calls per month (RBOC Reply Comments, September 9, 1997, Attach. at 5) and an average call duration of five minutes.

[34] Moreover, in locations where there are multiple phones from the same PSP, the opportunity costs are zero unless all of the payphones are in use. As long as one payphone remains available in the location, the fact that a caller is placing one type of call does not preclude another caller from using a different payphone owned by the same PSP for a different type of call.

price for the use of the phone is paid in the first instance by a carrier and ultimately by the 800 subscriber or the person accepting the collect call. None of these parties is realistically in a position to induce callers in a distant location to use a particular payphone more often. Rather, Becker's analysis, as noted above in Section II.A., seems to be describing a caller pays system, instead of carrier-paid compensation.

In this regard, Kahn (at 16-17) and Hausman (¶¶29-30) both attempt to circumvent the problem that under carrier pays, the calling party has no incentive to shop around for a less expensive payphone, but their answers are unconvincing. Kahn assumes that since individuals placing local coin calls would have an incentive to avoid higher-priced payphones, that would be sufficient to protect the parties paying for the 800 calls from excessive charges, since the rates for both types of calls are tied together. However, he overlooks the fact that in some locations (e.g., a truck stop on an interstate highway) the demand for local phone calls may be so slight that the PSPs would be more than willing to send away some local callers by charging excessive local coin call rates in return for being able to charge high rates for access code and subscriber 800 calls. In other words, in locations where local calling demand is intrinsically low, local callers may not effectively discipline the PSP.[35]

Kahn also responds (id.) that the Commission has prescribed a uniform rate for a two-year period, so no location will cost more than another. However, this response is irrelevant if the Commission lets the rates float thereafter. Finally, Kahn and Hausman

[35] Hausman makes a "Let them eat cake" response to this point: a local caller must perceive a lot of convenience in making a call from a high-priced payphone, and the 800 caller is receiving the same convenience he would receive had he made a local call. But the 800 caller is not making a local call and is not paying either for the 800 call or for the

claim that targeted call-blocking will be "virtually universally available" (Kahn at 17) or "almost universally available" (Hausman ¶30) by the end of the phase-in period, i.e., October 1999. This, they argue, would give the 800 subscriber the ability to deny calls from higher-priced payphones. Kahn and Hausman do not cite the source of their information, but Sprint is not aware that targeted call blocking will be available by anyone, much less "virtually universally available" by October of next year. Even if targeting call blocking were available, they overlook the fact that the Commission, in its prior orders, has refused to require PSPs to provide IXCs with advance information as to the level of their charges, and indeed has given them up to one year after a call is made to present a claim for payment for such a call. This would preclude even a carrier with targeted blocking capabilities to know which payphones to target.

In short, the Commission should not be dazzled by the impressive economists that the PSPs use to support the Commission's "apples and oranges" approach to payphone compensation. All the theory in the world cannot negate the glaring facts that locational monopolies exist, that local payphone rates are far higher than costs, and that the demand for carrier-paid compensation for subscriber 800 and access code calls is entirely different than the demand for local coin calls.

Even if one accepts the Commission's approach, however, this does not mean that the calculated 28.4 cents rate is correct. There are two reasons for this. First, the 35 cent coin rate, which is the starting point for the Commission's calculation, is almost certainly

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use of the phone he elects to employ. This theoretical "convenience" may simply not be worth the cost to the party paying compensation to the PSP.

too high. Second, the Commission's estimate of 6.6 cents for the differential costs of coin and coinless calls is too low.

The 35 cent coin rate is advanced by the Commission as a competitive market rate. There are several reason to be skeptical about this conclusion. First, the fact that the 35 cent rate became so widely employed, [36] once the Commission deregulated local coin rates, may result from the fact that the Commission, in its Report and Order, indicated that it would consider such a rate a market-based rate.[37]

Second, as is generally recognized, the local coin rate includes an unknown amount of locational monopoly rents. Thus, to the extent that the coin rate is being used to determine the competitive coinless rate, it is excessive.

In addition, if the coinless rate is tied to the coin rate, and if carriers must pay for dial-around and 800 calls and these costs are not passed on to callers directly, payphone operators have an incentive to inflate the price of coin calls. This occurs because, under these assumptions, callers have no incentive to take the price imposed by the payphone operator into account in determining whether the convenience of using a payphone exceeds the price of doing so.

Not only is the price that is used in the Commission's calculation excessive, the cost differential between coin and coinless calls also appears to be significantly understated. In the Reply Affidavit of David Robinson appended to AT&T's September 9, 1997 Reply Comments, he calculates that the cost differential is between 12.5 and 17.5 cents, or between two and three times the Commission's estimate of 6.6 cents. Using

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[36] See APCC at 21.

[37] 11 FCC Rcd at 20578.

Robinson's estimate, the appropriate price for coinless calls is between 17.5 and 22.5 cents even if one starts from an unreasonably high 35 cent coin rate.

IV. OTHER ISSUES

A. Cost Differences Between Coin and Coinless Calls

The PSPs argue that the cost differences between coin and coinless calls are far less than the 6.6 cents estimated by the Commission and indeed may be zero.[38] Both PSP parties also argue that the Commission could properly use other "market surrogates" to set a carrier pays rate that is above the local coin rate.[39] These arguments have been addressed at length and Sprint will rely largely on its earlier submissions.[40] Only a few points merit additional elaboration. First, the claimed allowance for ANI digit cost remains speculative at this juncture. This is made clear by the Geppert study (RBOC Comments, Exh. D) which states (at 4) that the claimed allowance is what "Coalition members pay (or expect to pay)." Similarly, APCC (at 20) states that such costs "may" amount to one or two cents per call for a two year period. The PSPs do not show what costs are being incurred today, and unless or until they can show what those costs are, they should not be considered in setting a compensation rate.

Second, the payment delays and problems that have occurred in the initial stages of per-call compensation are not grounds for building in permanent allowances for uncollectibles and bad debt. These problems are the typical "teething" problems that

[38] See APCC at 16-20; RBOCs at 29-33.

[39] See APCC at 25-29; RBOCs at 8-12.

[40] See Sprint's July 1, 1996 Comments at 19-21; Sprint's July 15, 1996 Reply Comments at 15-16; Reply Comments of Sprint Corporation on Remand Issues, September 9, 1997 at 16-17; and Opposition of Sprint for Petitions to Reconsideration, January 7, 1998 at 9-13. See also, Section III above.