barriers to entry, with thousands of competing firms entering the payphone industry since competition was first permitted. MCI states that "free entry into the payphone industry. . . does not create more good sites." MCI E-Group at 13. On the contrary, as Haring and Rohlfs point out, free entry into the payphone market has *increased* both the supply and the availability of payphones: "Since competitive entry has been permitted in the payphone industry, the number of pay stations deployed has grown by about 30 percent with the addition of some 300 thousand new phones." SPR Reply at 6. The elastic supply of physical location sites for payphones, in particular, encourages competition. [12] Haring and Rohlfs argue that to the extent that any payphone at any location charges more than the market will bear, payphones will spring up at adjacent locations and will charge less, as the market makes it worthwhile for location providers to allocate space for payphones. SPR Reply at 6-7. These locations will compete with each other, particularly because payphone locations tend to be more or less fungible. See Section II(A)(1)(b) above. Any successful business risks competitors moving in to undercut existing prices, and this risk is particularly apparent in the payphone market.

Moreover, the availability of competing sites is also a check on location providers. Even though PSPs are in intense competition for locations, location providers who require high commissions will drive competing PSPs to alternative sites that require lower commissions and, therefore, have lower payphone rates.

[12] At the outset of the 1996 Payphone Order, the Commission concluded, with ample record support, that the payphone marketplace will become competitive over time. Payphone Order at paras. 11-19. Such a conclusion was within the Commission's expertise to make. The actions the Commission took in that order and in subsequent orders have fostered this competitive environment.

2. The IXCs and others concede, in their arguments supporting caller-pays approach, that "locational monopolies" do not distort the payphone market.

A number of parties urge "caller-pays" upon the Commission as a vehicle for ensuring that the end user is entering into a market-based transaction with the PSP when the end user makes a dial-around call. These parties are conceding that market-based compensation tied to the local coin rate is appropriate for dial-around calls. See Section V.A., below. For example, AT&T states that "[i]n a calling party pays system, the market dynamics of the coinless calling market segment exactly mirrors those of the local calling market segment. AT&T at 13 (emphasis added). If the two market "segments" "exactly mirror" each other, this is true whether or not the caller pays for the call by depositing coins or through a surcharge. If caller-pays yields a market result at a location, the fact that the transaction occurs through a "back end" payment does not change the character of the market. There either is or is not a locational monopoly, and changing the transaction to an up-front, cash-in-advance, deal does not affect the underlying economic structure of the market in which the transaction occurs. The IXCs willingness to let callers pay a market-based rate through the deposit of coins concedes that "location monopolies" do not "distort" a competitively functioning payphone market; the "locational monopoly," if it even existed, would be equally capable of extracting rents in cash or as charges on calling cards.

3. Competition in the payphone market consists of competition for end users.

As more payphone locations spring up in cases where the market can support them, the result is almost always increased competition for *end users.* Now that the local coin rate has been deregulated and callers are fast becoming educated on how to find the best payphone deal, PSPs and location providers are forced to find new ways of attracting callers to use their payphones, as opposed to the payphones of competitors. This has already led to some innovation, such as advertising inexpensive payphone rates on business signs or discounting local coin rates as an enticement to a customer to stop at a particular gas station or convenience store. For example, within the survey conducted by Consumers Union, Southwest Regional Office, May 1998, there is a photograph of an Austin, Texas payphone location marked by a prominent sign that advertises "Local Calls 25¢," which is less than the prevailing rate in that area.[13]

In another example, one of the articles referenced by the E-Group in its study tells the story of Patrick Palmer, an entrepreneur who offers free local calls from 15 payphones in the Houston area.[14] Palmer's payphone booths are lined with advertisements, and Palmer himself views payphones as "just device[s] to sell the advertising." The article identifies Palmer's approach as a "tiny niche in the $600 billion global telecommunications business [that could] offer a glimpse into the future."[15] More such innovation is likely,

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[13] Consumers Union survey at 6.

[14] "'Freefone' Service Rings in New Advertising Sales Era," USA Today, December 8, 1997 at 10-B.

[15] Id.

particularly since payphones are relatively fungible in the eyes of callers, and it will be a lower local call rate or other benefit that will win the most customers.

B. The prevailing 35-cent local coin rate evidences a competitive market for payphone services.

In their attempts to show that the payphone market is not competitive, the IXCs argue that the prevailing 35-cent local coin rate, and the fact that this amount represents a 40 percent increase over the previous prevailing rate of 25 cents, are evidence of the lack of price competition between PSPs. With this argument, however, the IXCs have it exactly backwards. Prices tend to be uniform in a competitive market. The prevailing 35-cent rate demonstrates only that the demand curve is flat for the ability to make a call from a payphone. In other words, 35 cents is the market price produced by differentiated competition for the majority of payphone locations. A greater variation in price might imply that local coin calls were not responding to the market in some locations. More importantly, if "locational monopolies" controlled the payphone market, as the IXCs insist, then one could expect local coin rates to be *much higher* than the prevailing 35-cent rate in at least a significant number of locations.[16] There would certainly be some variation, based on the degree of "locational monopoly."

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[16] In note 25 of the MCI E-Group study, MCI cites a number of news articles that MCI claims contain "anecdotal evidence" of variations in the prevailing local coin rate. These new articles provide no such evidence. Instead, the articles offer <u>speculation on what could happen</u>, but in fact <u>has not</u> happened, in the payphone market now that the local coin rate has been deregulated. It is obvious that with the deregulation, any PSP can charge any price for a local coin call. In view of that reality, it is quite significant that the prevailing rate is only 35 cents, and in some areas lower.

The prevalence of a 35-cent local coin rate also suggests that the ***market*** has effectively *capped* the local coin rate at 35 cents.[17] To the extent that coin rates higher than 35 cents exist on any payphone, the PSP charging the higher rate would be under considerable market pressure to bring its rate in line with the 35-cent prevailing rate. In the end, the market will determine whether individual payphones with local coin rates above 35 cents will survive, which is just what the market is supposed to do in such situations.

As to the "40 percent increase" in the local coin rate, the IXCs fail to consider in their calculations that LEC payphone subsidies were removed pursuant to Section 276.[18] For the independent PSPs, who never received any subsidies yet were forced to originate local calls at subsidized rates, the 35-cent rate comes closer to covering their costs per local call. Therefore, what the IXCs are calling an "increase" in the local coin rate is a much-needed step toward "fairly" compensating independent PSPs.

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[17] MCI cites an incident in Georgia where a PSP sought to charge excessive rates for local calls made from payphones at the site of the 1996 Summer Olympics in Atlanta. MCI E-Group at n. 26. What MCI glosses over is that complaints led to the removal of the offending payphones. In the words of Haring and Rohlfs, "consumer complaints can usually be relied upon to police unreasonable rates." SPR Reply at n. 18. Callers can and do complain to the relevant location provider and PSP about particular payphones.

[18] As a result of the removal of subsidies at the federal and state level, IXCs have reaped savings conservatively estimated at a minimum of $250-300 million annually. There should have been comparable savings at the state level, and any subsidies from local exchange revenues were also removed. With the termination of these subsidies, which were formerly borne by ratepayers, there is no effective overall rate increase, if the subsidy savings have been passed on by the IXCs and LECs, which apparently is not the case. The IXCs have not shared any of these savings with their own customers. The IXCs have also saved huge amounts on payphone commission payments, as dial-around calls increasingly supplant direct dialed "0+" operator service calls.

CompTel argues that even with an increase in the prevailing local coin rate, the deployment of payphones is unchanged, which CompTel argues is evidence of monopoly pricing. CompTel at 9. This is simply incorrect. It is the change in the local coin rate, in the face of the termination of subsidies, that has maintained the abundant supply of payphones throughout the country. As discussed above, the supply of payphones has grown measurably since competition was first permitted. With termination of LEC subsidies for payphones, pursuant to Section 276 of the Communications Act of 1934 (as amended by the Telecommunications Act of 1996) (the "Act"), many LECs removed unprofitable payphones from use. The addition of new payphones, however, has kept the net supply from declining, which is the typical result of terminating long-standing subsidies. The continuing abundance of payphones is a direct credit to the Commission's market-based compensation approach. If the Commission had elected cost-of-service ratemaking in 1996, it is most likely that the supply of payphones would be significantly less than it is today.[19]

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[19] CompTel argues that the Commission should apply the "like services" test to the markets for local coin calls and dial-around calls. CompTel at 15-16. The "like services" test is used to assess unlawful discrimination among *regulated* services under Section 202(a) of the Act. Payphone service, of course, has been deregulated and the issue here is not whether the services are "like," but whether the rate for one can be used as a proxy for the other. In any event, even if the Commission were to apply the "like services" test to the markets for local coin calls and dial-around calls, the Commission would find that the costs for the two services are the same, so the rate for one service could apply to the other, with an appropriate adjustment for avoided costs.

III. CALLERS TO SUBSCRIBER 800 NUMBERS BEAR THE ECONOMIC CONSEQUENCES OF USING A PAYPHONE

It is important to recognize that callers have at least the same options for constraining the dial-around compensation rate as they do for constraining the local coin rate at each payphone. For example, callers can defer their calls until they return to their homes or workplaces, or use their cell phones, etc. More importantly, because the dial around rate is linked to the local coin rate, a caller can exert pressure on premises owners to reduce rates charged at payphones. In the increasingly competitive world today – both in the payphone arena and in the marketplace at large – a business that has a payphone located on its premises will listen and react to customers who complain about a price that is too high.

But the IXCs contend that under the Commission's current carrier-pays approach for subscriber 800 calls, there is no true buyer-seller relationship,[20] because the caller is not the "buyer" of the call, since he or she never bears the direct charges for such calls, and therefore has no incentive to "shop around" for the best deal. See, e.g., AT&T at 7-10; CompTel at 14-15; MCI at 5-6, CBC at 9; PageNet at 8. The IXCs argue that they are nothing more than "involuntary market middlemen" who must pay for the transaction in the first instance. Frontier Corporation ("Frontier") at 3.

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[20] With regard to a "true" buyer-seller relationship, it is worth noting that PSPs do not have the freedom, pursuant to Section 226 of the Act, to refuse to "sell" callers access to "800" number services. It is this market dysfunction, brought about by government intervention, which puts the Commission and the industry in the position of exploring the next best alternative: linking the dial-around compensation rate to the deregulated local coin rate, with an adjustment for avoided costs.

The IXCs fail to acknowledge that the Commission's Payphone Orders have already created a system that is competitive because the caller is in charge and bears the economic consequences of his or her choice to use a payphone for a subscriber 800 call. This is true even in the case of subscriber 800 calls. The IXCs can and do pass the payphone compensation charges on to their subscribers, either in the form of a direct charge or through service rates that encompass the ability to receive calls from payphones. In turn, 800 subscribers can and do pass on the charges to their customers through a direct surcharge for using a payphone. The payment stream flows ultimately from the PSP — as payee — back to the originator of the call — as payor.[21] Thus, callers who do not take the time to shop around for the best local coin rate could bear the consequences of their inaction through a higher payphone surcharge from the 800 subscriber. See APCC January 7, 1998 Comments at 9-10.

Once the caller becomes cognizant of the connection between the local coin rate and direct surcharges from 800 subscribers, the caller will exercise real, measurable market power that will have an impact on both the prices charged at payphones and on competition among payphones to originate the call. Callers are also using with increasing frequency alternative means of telecommunication, such as cellular phones or two-way paging. These services provide callers with a greater range of choices in making their calls,

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[21] If any party along the payment stream elects to absorb the costs of payphone compensation rather than pass it downstream, that party has made a permissible marketing decision that is market-driven. These parties should not be heard to complain here because they made a decision not to pass the costs on.

and the availability of these services helps to ensure that payphone coin rates cannot be set above what the market dictates.

In sum, the Commission's market-based compensation approach puts the caller in charge, so that he or she bears the economic consequences of the choice to use a payphone for all calls. With the caller in charge and able to exercise options other than using payphones, the caller has the incentive to select the best calling deal in each situation.

IV. A "BOTTOM-UP" COST-OF-SERVICE RATEMAKING IS INCONSISTENT WITH GOOD PUBLIC POLICY AND WILL NOT SUPPORT THE VIBRANT PAYPHONE MARKET ENVISIONED BY CONGRESS

A. Cost-of-service ratemaking will not provide the "fair" compensation required by the Act.

Some parties contend that the Commission should abandon its current market-based approach to per-call compensation, and prescribe a payphone compensation rate based on incremental cost. See, e.g., Sprint at 15-18; IXC Communication Service ("IXC") at 2; CBC at 4; VoCall Communications Corp. ("VoCall") at 6. These parties argue, in essence, that because the market will never be able to set an appropriate compensation rate, the Commission must intervene to review PSP cost and prescribe a particular "cost-based" rate. Presumably, when that rate is no longer appropriate, these parties will expect the Commission to conduct another cost-of-service regulatory proceeding and prescribe yet another "cost-based" rate.

As any observer of the telecommunications arena is aware, the intensive regulation proposed by the IXCs and others goes against the grain of decades of federal telecommunications deregulation. The logical extension of the IXCs' rate-prescription approach would have the parties arguing that the deregulation of the local coin rate was a mistake and that re-regulation of the local calling rates would be desirable.[22] What the Commission has done in this proceeding, however, is to free the payphone market from the outdated, overly-regulatory approach of prescribing a particular rate. Instead, in its wisdom, the Commission refused to set <u>any</u> rate, other than the default rate in the near term, and elected to let the market determine the requisite rate for any given time and place. Such a market-based rate, which fosters competition and unshackles service providers from tedious regulatory ratemaking proceedings is in step with the deregulatory trend that has swept through the broader telecommunications industry. Those that are fixated on the best "rate," and thereby miss the whole thrust of the Commission's market-based approach, should not be allowed to turn back the clock to the stone age of regulation, just as the competitive market is beginning to flourish.

The other problem with cost-of-service ratemaking, as discussed at length in APCC's initial comments, is that such an approach is inherently uncertain and unstable, and it would not work over the long term for dial-around compensation. <u>See</u> APCC July 13, 1998 Comments at 9-16. Instead, cost-of-service ratemaking will likely initiate a recurring cycle that could gut the supply of payphones. Most of the costs of payphone

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[22] This position would be contrary to the Court's opinion in <u>Illinois Public Telecommunications Association v. FCC</u>, 117 F.3d 555 (D.C. Cir. 1997) ("<u>Payphone I</u>").

service are fixed costs. The per-call cost is highly sensitive to the number of calls made from a payphone. The compensation set by the Commission will itself have a major effect on the supply of payphones, and therefore on the number of calls per-payphone and the per-call cost. The supply of payphones will attempt to adjust to equalize and costs at the rate set by the Commission. But each change in the supply of payphones changes the volume of calling, and hence the cost per call, at payphones setting off another cycle. Thus, a cost-based compensation amount is inherently unstable. These problems are not apparent in a market-based compensation system, however, because a market-based rate is self-correcting.

APCC and others have consistently demonstrated throughout the more than two years of this proceeding that a cost-of-service ratemaking methodology — or any methodology which artificially sets a rate — for deriving dial-around compensation would not lead to "fair" compensation for "each and every completed intrastate and interstate call[,]" as envisioned by Congress, nor would it ensure the "widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. Section 276(b)(1). As APCC said in its comments in the instant proceeding, using a market-based rate as a "proxy" for costs is a far better approach than "cost-of-service" ratemaking. The Commission correctly based fair compensation for subscriber 800 calls and access code calls on the price a willing buyer and a willing seller find mutually agreeable to both. Payphone Order at para. 52.

From the IXCs' point of view, use of their version of cost-of-service ratemaking would dramatically reduce their compensation bill. Such an approach would also undercut the widespread deployment of payphones to the benefit of the general public, as envisioned by Congress, which would lead to fewer payphones receiving compensation. In the Second Report and Order, the Commission recognized this reality when it reaffirmed its earlier decision that reliance on cost studies "might reduce the number of payphones deployed." Second Report and Order at para. 93. Thus, the reduction of the IXCs' compensation bill would be at the expense of end-users, who would have far fewer payphones from which to make their away-from-home calls. In addition, cost-of-service ratemaking would threaten the ability of PSPs, many of whom are small businesses, to remain in business at all, because dial-around calls would be compensated at a rate below their fair market value and below the actual costs incurred by PSPs.

In other respects, the commenters' arguments for a "bottom-up" cost analysis, as an alternative to market-based compensation, are just another way of attempting to focus the Commission on an incremental cost standard and total element long run incremental cost ("TELRIC") pricing, which were previously rejected by the Commission. More recently, the Commission found that "use of a purely incremental cost standard for each type of call could leave PSPs without fair compensation for payphone calls. . ." Second Report and Order at para. 92. Consistent with this conclusion, the Commission should once again dismiss arguments that, made under the guise of seeking a "bottom-up" cost analysis, favor an adoption of incremental cost pricing.

B. MCI's cost study is incomplete and unreliable, and should be disregarded by the Commission.

As stated above, while the MCI cost study tends to validate much of what APCC has argued to the Commission throughout this proceeding with regard to ease of entry into the payphone market, the study provides little in the way of reliable cost data. The study omits entire categories of costs and contains questionable assumptions throughout.

In their reply to MCI's submissions, Haring and Rohlfs delineate a number of specific concerns with the MCI cost study. First, MCI does not make clear what it means by "the minimum economic cost of a payphone capable of providing both dial around and coin calls[,]" but it appears that under MCI's approach, it is the minimum-quality payphone that will always be supplied to the consuming public. When compensation is on the basis of average usage, however, even minimum quality will be unsustainable, if prospective usage at a particular site is below average. SPR Reply at 11-12.

Second, MCI calculates the minimum cost of a payphone's capability of providing "*both* dial around *and coin calls*," but it does not make clear why one should then deduct the equipment (i.e., non-traffic sensitive) cost of providing coin calls. Coinless calls should share responsibility for recovery of the costs of the instrument if they are to benefit from the economies of scope from an instrument that is capable of handling both coin and coinless calls. Id. at 12.

Third, MCI's conclusion that opportunity costs of physical space should be recovered contradicts the E-Group's earlier (erroneous) claim that competitive high bids for space rentals will (only) equal monopoly rents. Id.

Fourth, MCI asks the impossible when it argues that the competitive prices of coin calls and coinless calls should be calculated, and the average quantities of usage associated with these prices should be calculated. MCI's approach amounts to saying that the industry should be subjected to full regulation. As Haring and Rohlfs state, the entire purpose of the Telecommunications Act of 1996 is to substitute competition for regulation, to guide resource allocation in the telecommunications industry. If regulation were capable of duplicating the results of competition, competition would not be needed. Id.

Fifth, Haring and Rohlfs argue that MCI's conclusion that joint and common costs should be allocated based on the estimated competitive quantities of these calls flies in the face of economic analysis. This approach also conflicts with MCI's fourth conclusion. The problem is not how to *allocate* costs, but rather how to recover them efficiently. In a differentiated competitive or a perfectly contestable market equilibrium, operation of the competitive process results in prices set in inverse proportion to demand elasticities. If payphone prices are established in accordance with MCI's fifth conclusion, then MCI's fourth conclusion cannot be satisfied, because competitive prices would be established in accordance with the Ramsey principle rather than on the basis of a spurious and arbitrary cost allocation. Id. at 13.[23]

These concerns just scratch the surface of the many difficulties presented by the MCI cost study. Therefore, the Commission should not waste any time on the study before consigning it to the dustbin.

C. The LEC payphone cost data included within this proceeding's record are unreliable and understate the costs of providing payphone service.

Along with other IXCs, Sprint argues that the Commission "has sufficient cost data, from a representative segment of efficient payphone providers [such as Bell Atlantic, SBC and Sprint]" on which to base a "bottom-up" cost approach. Sprint at 16-17. See also AT&T at 17; Frontier at 9. These parties and others argue that the Commission should rely on the "cost" data from a New England Telephone study that was submitted to the Massachusetts DPU. The Commission previously rejected arguments by the IXCs on behalf of this study and properly discounted its unreliable data. Accordingly, renewed attempts to muddy the waters with this dubious "cost" data should be rejected.

As recounted by APCC earlier in this proceeding, the hastily compiled New England Telephone study was prepared by NYNEX in March 1997, in connection with a request for a temporary increase in the local coin rate, pending the full deregulation of that

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[23] As APCC pointed out in its Comments filed on July 13, 1998, while such an elasticity-based allocation of common costs is the most desirable outcome, the Commission can proceed on the basis of its determination to allocate an equal contribution to joint and common costs to each call.

rate as of October 7, 1997.[24] APCC January 20, 1997 Reply Comments at 17-22. Even in the best of circumstances, LEC cost studies are of limited value, given the numerous uncertainties inherent in the allocation of costs. NYNEX does not appear to have devoted a great deal of care to the preparation of the Massachusetts study, nor was the study carefully scrutinized by the DPU.[25]

More importantly, NYNEX-Massachusetts had every reason to keep its reported payphone costs to the absolute minimum. Although it was proposing a local rate increase, NYNEX-Massachusetts was being pressured by the DPU to reduce the level of its access charges that IXCs, including AT&T, pay for use of NYNEX's network. NYNEX-Massachusetts certainly knew that the higher level of payphone costs shown in support of a temporary local coin rate increase, the larger would be the permanent reduction in access charges -- benefiting the IXCs. Under these circumstances, NYNEX-Massachusetts had a undeniable incentive to "low-ball" its payphone costs.

In addition, there is no indication in the NYNEX-Massachusetts study that the imputation of tariffed charges or fully distributed costing were involved, as required by the Commission's accounting rules, as opposed to being an incremental cost study. An

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24 At that time, the local coin rate in Massachusetts had been frozen for years at 10 cents per call, while most jurisdictions were allowing rates of at least 25 cents per call.

25 Investigation by the Department of Public Utilities on its own motion as to the propriety of the rates and charges set forth in the following tariffs: M.D.P.U. Nos. 10 and 15, filed with the Department on December 31, 1996, to become effective January 30, 1997 [Public Access Smartline Service], and M.D.P.U. No. 10 filed January 24, 1997, to become effective on February 23, 1997 [elimination of the coin rate for local calls] by New England Telephone and Telegraph Company d/b/a NYNEX, D.P.U. 97-18, Order (April 14, 1997) at 10-11.

incremental cost analysis is generally sufficient to justify a requested increase at the state level, but not sufficient to satisfy the imputation analysis required under the Commission's nonstructural safeguards. Thus, the Commission properly rejected such an approach in this proceeding, both for compensation purposes and subsidy prevention problems.

The IXCs also urge the Commission to consider anew data submitted by Sprint. The Commission had given this data limited weight because it was not representative of the cost structures of independent payphone providers. Second Report and Order at n. 267. The IXCs claim that a LEC is more representative of the PSP industry, because most payphones are provided by LECs. AT&T at 15-16; CompTel at 18-19; Cable & Wireless at 10; PageNet at 11-12. As APCC demonstrates above, a better case can be made that the independent PSP arena has been and will continue to be where the innovation of the payphone industry takes place. There is no need for the Commission to re-examine the Sprint data, which it properly discounted in its initial examination.

The IXCs similarly urge the Commission to rely on the analysis by Southwestern Bell Company ("SBC") of the cost incurred in operating its payphones.[26] The Commission should view the SBC data with skepticism. The data attributed to SBC suffers from the same fatal flaw as the NYNEX-Massachusetts data: it was prepared for a purpose where the LEC had every reason to minimize and distort its true costs. It is fairly obvious that a LEC preparing data for a potential buyer of its payphone business would have every incentive to down play its true costs of providing service and to portray an environment where profits

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[26] According to AT&T, SBC was apparently considering the sale of its payphone business when it prepared the cost study in 1994.

would be at their maximum. In earlier comments, APCC detailed at length the many deficiencies in the made-to-order SBC data. In addition, in comments filed at an earlier juncture in this proceeding, the RBOC Coalition and its economist, Dr. Carl Geppert, modified the per-call cost amount from the SBC study to account for 1997 business realities and concluded that the appropriate cost amount was $0.363 per call.[27] See APCC January 7, 1998 Comments at 30-32. Once again, the Commission should reject this data as unreliable and inconsistent with current LEC practices since the 1996 Act.

As it previously concluded, the Commission should not rely on the deficient NYNEX, Sprint, and SBC studies in any manner. Saying the same thing three times does not make it any more reliable. Therefore, the Commission must reject these data.[28]

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27 The RBOC Coalition found that the SBC study, as submitted by AT&T, was not adjusted for return on assets and did not include any general and administrative service costs. In addition, the study was not adjusted to account for ANI ii costs, bad debt and collection expenses, and understatement of depreciation costs. See RBOC Coalition January 7, 1998 Comments at 12-13.

28 In its comments in the instant proceeding, the New York Department of Public Service ("NY DPS") contends that the 35-cent base rate used by the Commission to develop the current 28.4-cent coinless call compensation rate "significantly exceeds the costs to provide payphone service." NY DPS at 1. The NY DPS's conclusion is based on a 1997 long run incremental cost analysis, an approach specifically rejected by the Commission on more than one occasion, which indicates that local coin revenues -- based on a 25-cent local coin rate -- exceed relevant coin costs. ("NYNEX-New York study"). Since the NYNEX-New York study adds nothing new to the mix, the Commission should reject it accordingly.

D. LEC payphone cost data is not representative of the entire industry, and the Commission already has reliable cost data on record for the entire industry.

If the Commission elects to employ a cost-based study for any purpose in this proceeding, it must engage in proper economic analysis. As discussed above, the commenters continue to advance a number of flawed, unreliable "studies" that purport to show LEC "costs" in originating payphone calls that will do little to support the Commission's analysis. Instead, the Commission should continue to rely on the cost data submitted by the leading independent PSPs -- the forward-looking companies that are the leaders of the payphone industry.

It is the independent PSPs that are broad-based in their provision of service and have repeatedly stepped in to provide service to unserved low-income and rural areas, while LECs have retreated from these areas as they have shrunk their payphone base. APCC Reply Comments at 22. See also Ex Parte Letter of APCC to FCC, September 9, 1996 (detailing the public service functions provided by independently owned payphones). There is no basis for finding that LECs are more representative or more efficient providers, or that a rate based on LEC cost data will promote widespread deployment of payphones. 47 U.S.C. Section 276 (b). Independent PSP data are preferable because it is precisely the independent PSPs who represent the best prospect of service to marginal payphone locations.

The larger independent PSPs, which operate nationwide, are far more representative of the industry as a whole. As LECs have sought to shed their payphone operations,[29] the independent PSPs have worked to expand both the number of payphones available and the services offered. As such, it is the independent PSPs that are the growing, forward-looking companies of the industry's future.

APCC believes that engaging in a detailed "bottom-up" cost study, as suggested by the IXCs and others, is unnecessary and would waste valuable Commission resources. The Commission does have the option, however, of relying on the detailed cost analysis of LEC and independent PSPs released by the Illinois Commerce Commission ("Illinois") in 1995, just one year before the Commission issued its first notice of proposed rulemaking in this proceeding.[30]

The Illinois analysis is an in-depth examination by a state public utility commission of the costs of both Tier 1 LEC PSPs and independent PSPs, making it a much more reliable and comprehensive study than those introduced earlier into the record by the IXCs. Although Illinois analyzed only the PSPs doing business in its territory, Illinois is obviously a state with widely varying demographics -- ranging from urban Chicago to rural farmlands. Therefore, the Illinois data encompasses all types of population areas with corresponding differences in cost. Data within the Illinois proceeding pegs LEC PSP costs

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29 At least two of the Bell Operating Companies, SBC and Ameritech, have sought to sell their payphone operations in recent years.

30 See Independent Coin Payphone Association v. Illinois Bell Telephone Company, ICC Docket No. 88-0412, Order (rel. June 7, 1995); AAA Coin-Phone Systems, Inc. et al. v. American Telephone & Telegraph Company, et al., ICC Docket No. 92-0400, Order (rel. October 3, 1995). The Illinois orders were placed on the record by the Illinois Public Telephone Association ("IPTA"), which had participated in the study. IPTA's comments provide an overview of the Illinois proceeding. See IPTA 1996 Comments at 2-13.

at $0.36 per call[31] and independent PSP costs at $0.37 to $0.55 per call. IPTA 1996 Comments at 9-11.

In its proceeding, Illinois found that the non-usage-sensitive, or fixed, direct costs for LEC payphone operations was approximately $0.25 on the average payphone call. To this amount, Illinois added an average per-call allocation of common expenses of $0.11, for a total cost of $0.36 per LEC payphone call. For independent PSP operations, Illinois had on the record before it data from three PSPs: one operating primarily in the Chicago metropolitan area, one operating in rural areas and in downstate urban areas, and one operating throughout the state. The non-usage-sensitive direct costs per call ranged between $0.25 and $0.32. Common overhead and common expense costs added average costs of between $0.11 and $0.23 per call. Therefore, the total cost per independent PSP call was $0.37 to $0.55. See generally IPTA 1996 Comments at 7-11.

As it has consistently maintained in this proceeding, APCC does not believe that compensation for dial-around calls should be based on the "cost" of the call for the same reasons that the Commission itself has specified: a cost-based compensation "would not permit the PSP to recover a reasonable share of the joint and common costs associated with those calls." Payphone Order at para. 68. See also Second Report and Order at para. 92. The Illinois proceeding, however, provides a more reasonable cost-based analysis that

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31 In its comments, IPTA adjusted Illinois' $0.36 per call estimate to $0.42 per call to account for the length of an average call. IPTA 1996 Comments at 9. It did not make such adjustments to the independent PSP per-call estimate, because these costs "were figured on a per call average and these were not sensitive to the minutes of use per call." Id. at n. 10.

is far more reliable and useful than the incremental cost data relied upon by the IXCs and others, much of which they obtained second hand.

E. The Commission should give no credence to the claims of AT&T and Sprint that they relied on a "market-based" compensation rate negotiated in 1994 for all dial-around calls.

In an attempt to dilute true market-based compensation to an amount more to its liking, AT&T proposes a "market-based" compensation amount that is neither the product of market forces nor provides "fair" compensation. AT&T at 14-15. See also Sprint at 14. AT&T's argument is based on negotiations in 1994 between APCC and AT&T regarding a per-call compensation rate for AT&T access code calls originated by independently owned payphones. The negotiations concerned a per-call compensation alternative to the flat-rate compensation for access code calls mandated by the Commission's rules, which were adopted pursuant to the Telephone Operator Consumer Services Improvement Act ("TOCSIA"). 47 C.F.R. Section 226. Although the Commission had concluded in its 1992 TOCSIA compensation proceeding that a per-call compensation approach was preferable to other alternatives, not all of the requisite parties were able to track individual calls at that time.[32] As an interim alternative to per-call compensation, the Commission adopted flat-rate compensation in the amount of $6 per payphone per month, which was based on a record average of 15 access code calls per month at a rate of *40 cents per call.* Id. at 30. Because IXC payment obligations were

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[32] Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, CC Docket No. 91-35, Second Report and Order, FCC 92-170 (rel. May 8, 1992) at 13. ("1992 TOCSIA Compensation Order").

proportional to their respective share of total toll revenues for the industry, AT&T's share of the $6 per payphone per month was about 58 percent of the total amount.

At the time of the negotiations with AT&T, the only dial-around calls that AT&T was legally obligated to compensate were access code calls. Calls to subscriber 800 numbers, which the Commission had erroneously excluded from the compensation mechanism,[33] were not on the negotiating table. In addition, the negotiations were constrained by the fact that AT&T was obligated to pay only in excess of $3 per payphone per month for access code calls. Any attempt to negotiate beyond this point would have led AT&T to continue paying its proportionate share of the flat rate, as AT&T's legal obligation to provide any compensation at that time was artificially capped by the FCC's rules.

Under these circumstances, it is incorrect and misleading for AT&T to claim that the 25 cents-per-call rate it ultimately negotiated with APCC is a market-based rate. It was simply a more economic arrangement for both parties, because it allowed AT&T to pay individual payphone providers compensation that was directly related to the number of access code calls each month. For their part, independent PSPs received compensation for the calls their payphones actually originated (as opposed to the unmeasured flat rate). APCC acquiesced in the 25 cents per call only because it was more acceptable than the

[33] The Commission's determination that subscriber 800 calls were not subject to compensation under TOCSIA was eventually overturned, but not until mid-1995, well after the negotiations with AT&T. See Florida Public Telecommunications Association v. FCC, 54 F.3d 857 (D.C. Cir. 1995).

regulatorily-mandated compensation scheme that the Commission then had in place, not because it was a freely-negotiated market rate.

In addition, APCC found the 25-cent per-call compensation rate acceptable, in part, because it was equal to the prevailing local coin rate at that time. Apart from the 25-cent rate not being negotiated without significant constraints, the acceptance of the rate by AT&T and APCC tends to show that the costs for a local coin call and an access code call converge, so that the 25-cent local coin rate at that time was an appropriate rate for an access code call as well. The 1994 per-call compensation rate also did not include an "adjustment" for avoided costs, unlike the Commission's current rules for all dial-around calls.

AT&T's additional arguments about the average revenue for access code calls and the average revenue for subscriber 800 calls have nothing to do with what transpired in the 1994 negotiations. Subscriber 800 calls were not on the negotiating table, because APCC had no right to include them in a compensation arrangement. For AT&T to suggest that APCC agreed receive a percentage of the revenue generated by any type of call, particular subscriber 800 calls that were not even on the negotiating table, crosses the bounds of logical argument. Thus, there is no basis for AT&T's claims that the 1994 negotiations yielded either a "market-based" rate or a "blended" rate for dial-around calls.

Sprint, which also paid per-call compensation for access code calls pursuant to a waiver modeled on the one granted to AT&T, claims that the market value of a subscriber 800 call is zero, because independent PSPs were permitted to block such calls but chose not to exercise that right. Sprint at 13-14. There is no merit whatsoever to this argument. Although independent PSPs were entitled to block subscriber 800 calls as a legal matter, the payphone equipment was not technically capable of differentiating between subscriber 800 calls and 800 carrier access numbers. In addition, there is no database available that includes all "800" carrier access numbers. Therefore, if a PSP were to block subscriber 800 calls, it would almost certainly block "800" carrier access numbers, which would be in violation of TOCSIA. Because the PSPs were technically incapable of blocking subscriber 800 calls, Sprint has no basis for arguing that independent PSPs made a decision not to block. The only decision the independent PSPs made was to follow the command of the statute.

V. THOSE PARTIES OPPOSING "FAIR" COMPENSATION RAISE NO OTHER VALID ARGUMENTS

A. Caller-Pays

AT&T, Sprint, Worldcom, CompTel, PageNet, SkyTel and others argue that, if the Commission chooses not to utilize a cost-based per-call compensation approach, the Commission should establish a caller-pays approach to payphone compensation, because transactions are made directly between the end user buyer and PSP seller based on a public and mutually agreed upon rate. AT&T at 13; Sprint at 6; Worldcom at 3; CompTel at 17; SkyTel Communications, Inc. ("SkyTel") at 5-6. For its part, AT&T contends that "[i]n a calling party pays system, the market dynamics of the coinless calling market segment exactly mirrors those of the local calling market segment." AT&T at 13.