IV. SUPPORT FOR CALLING PARTY PAYS REVEALS WIDESPREAD AGREEMENT THAT THE PAYPHONE MARKET IS EFFECTIVELY COMPETITIVE

Perhaps the most striking result of the Public Notice was the support it elicited for a calling party pays compensation mechanism. For the reasons discussed below, the Coalition believes that calling party pays is legally impermissible and a bad idea as a matter of policy. But the continued calls for calling party pays confirm what the Coalition has argued all along -- that a well-functioning market for payphone services effectively constrains the price of payphone services at levels close to costs. For if calling party pays "would impose market discipline on payphone compensation rates," see PCIA Comments at 9, then it is simply undeniable that the market already imposes such discipline on local coin rates.

Directly and indirectly, numerous parties -- even those who oppose a market-based default rate -- confirm that the market for local coin service is competitive. "[A] caller placing a local coin call is well informed of the rate he or she will pay and, accordingly, exercises discretion in deciding whether to place the call." CBC Comments at 9. Excel Communications agrees that a market for payphone services in which the caller pays -- like the local coin market -- would be "competitive" because "[t]he calling party would have the incentive to 'price shop.'" Excel Comments at 6. PSPs thus have incentives "to compete with lower rates for such calls." Id.

Sprint agrees. "[T]he caller pays system sets in motion the forces that could enable a market rate to be established. This is the very same compensation plan the Commission adopted for local calls." Sprint Comments at 6. So does AT&T:

> In a calling party pays system, the market dynamics of the coinless calling market segment exactly mirror those of the local coin market segment. . . . 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 . . . .

AT&T Comments at 13. ITA also recognizes the competitive forces at work in the local coin market -- which is, after all, a market in which the calling party pays -- when it explains the benefits of calling party pays for coinless calls:

> [A] caller-pays approach will actually promote payphone competition and provide a 'market-based' mechanism for encouraging lower payphone rates. Because callers will be more aware of the actual costs of a call at the point of sale at each particular payphone, they could 'vote with their feet' by either attempting to find another payphone, using another type of phone (e.g., using a private phone . . .) or simply deferring the call until a non-payphone is available. . . . This could motivate PSPs to [assess] reasonable prices.

ITA Comments at 8. Likewise, CompTel points out that the sort of direct transaction between caller and PSP that occurs in the local coin market "sends the proper price signals for a functioning market." CompTel Comments at 17.

Indeed, PCIA is not alone in endorsing the Commission's view that competition imposes "market discipline" on local coin rates because callers will "'price-shop[]' for payphones. PCIA Comments at 9. SkyTel says much the same thing: in the local coin market, the caller has the ability "to impose market discipline on PSPs by either agreeing or refusing to pay the PSPs['] price for the use of the phone at the time the call is made." SkyTel Comments at 5-6. Among paging providers, AirTouch too is aware of the benefits of competition in the local coin market:

> Caller pays promotes competition among PSPs by incenting PSPs to establish competitive rates in order to compete for customers. Because the decision whether or not to deposit coins lies with the person placing the call, there is incentive for new entrants to compete with established PSPs on price and service. Negotiation of rates can occur, as with most consumer transactions, at the point of purchase. The market should therefore experience both competition among PSPs and an increase in the number of payphones available for public use.

AirTouch Comments at 3. Frontier also endorses calling party pays, noting that where a coin deposit is required "at the point of transaction" -- as in the local coin market -- there is "a willing seller and a willing buyer" for the service; otherwise, the transaction will not occur. Frontier Comments at 9; cf. First Report and Order 11 FCC Rcd at 20568, ¶ 52 ("we define 'fair compensation' . . . as where there is a willing seller and a willing buyer at a price agreeable to both").

The comments thus reveal strong and consistent agreement with the proposition that consumers effectively constrain prices in those markets where they pay for payphone services directly. This concession can provide crucial support for the Commission's avoided cost methodology, because the supporters of calling party pays offer no reason at all to believe that competition for end-users is any less effective at constraining price in the market for local coin calls than it would be in the market for per-call compensation eligible calls. See Kahn Reply Decl. at 8 (support for calling party pays "necessarily implies acceptance of the proposition that competition among payphone providers for callers will effectively constrain prices" in the market for local coin calling). All this provides strong support for the Commission's initial conclusion that competition will maintain prices in the local coin market at reasonable levels, ensuring that the local coin rate indeed provides a valid surrogate for the costs of coinless calls.[16]

[16]No other party has suggested an alternative market-based approach. AT&T argues that the $.25 it agreed to pay to IPPs in lieu of its flat-rate contribution under the Commission's previous compensation scheme provides a fair gauge of market rates. See AT&T Comments at 14-15. This is preposterous: the Commission's prior regulations capped AT&T's payments, and IPPs were forced to accept some payment under the cap -- and were prevented by law from blocking calls. In our view, the closest true market rate is the commission IXCs pay to PSPs for 0+ calls. Applying AT&T's weighted-average methodology to those 0+ commissions yields a default rate for subscriber 800 commissions between $.39 and $.63 per call. See Coalition Comments at 9.

V. CALLING PARTY PAYS IS LEGALLY IMPERMISSIBLE AND UNSOUND AS A MATTER OF POLICY

The calls for calling party pays provide significant support for the Commission's decision to derive a market-based default rate from the competitive local coin rate, but the Commission should continue to reject calling party pays as legally impermissible and wrong-headed as a matter of policy. The Commission has already covered this ground in its First Report and Order and the initial Order on Recon. -- and its conclusions have already been upheld by the D.C. Circuit -- but it is worth reviewing why calling party pays is not a viable alternative to the carrier-pays system now in place.

A. TOCSIA Effectively Bars Calling Party Pays

Section 226(e)(1) of the Act provides that the Commission shall require "that each aggregator ensure . . . that each of its telephones presubscribed to a provider of operator services allows the consumer to obtain access to the provider of operator services desired by the consumer through the use of an equal access code" or "that all providers of operator services . . . make available to their customers a '950' or '800' access code number for use in making operator services calls from anywhere in the United States." 47 U.S.C. § 226(e)(1). Section 226(e)(2) directs the Commission to "consider the need to prescribe compensation (other than advance payment by consumers) for owners of competitive public pay telephones for calls routed to providers of operator services that are other than the presubscribed provider of operator services for such telephones." 47 U.S.C. § 226(e)(2) (emphasis added).

In the First Report and Order, the Commission properly interpreted these provisions to mean that PSPs are prohibited from requiring an advance coin deposit for access to an operator services provider:

> TOCSIA expressly prohibits the Commission from adopting compensation rules for interstate access code calls that require "advance payment by consumers." At least two commenters argue that the Commission could interpret this statutory prohibition as applying only to the prescription of a specific compensation amount, which would not preclude adoption of compensation amount guidelines, including a coin-deposit approach, but we conclude that such an approach would contradict the congressional intent, and possibly the plain language, of Section 226(e)(2) of the Act.

11 FCC Rcd at 20585, ¶ 85.

Only two of the commenters who advocate calling party pays even attempt to address the legal issue; neither does so at all persuasively. PCIA argues that, because the definition of "operator services" in section 226(a)(7) of the Act excludes services that complete calls "through an access code used by the consumer, with billing to an account previously established with the carrier by the consumer," 47 U.S.C. § 226(a)(7)(B), calling card calls would not fall within the definition. But whether or not this is correct, so far as the Coalition is aware, no IXC restricts the services available to access code callers to calling card calling -- all such providers also permit collect calling, third party billing, and other services. For this reason they are OSPs and are covered by the anti-blocking provisions of the Act, as well as the provision prohibiting the requirement of advance payment for access to OPSs.[17]

PCIA also argues that the advance payment provision merely refers to other provisions of TOCSIA that require OSPs to "permit the consumer to terminate the telephone call at no charge before the call is connected" and prohibit OSPs from "bill[ing] for unanswered telephone calls in areas where equal access is available." PCIA Comments at 11, quoting 47 U.S.C.

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[17]PSPs are also subject to the provisions of section 64.704 of the Commission's rules, which includes an anti-blocking provision at least as broad as that contained in section 226(e)(1) of the Act.

§ 226(b)(1)(B), (F). But this reading of the advance payment provision makes no sense: as an initial matter, the provisions of section 226(b)(1) apply to charges applied by OSPs, not aggregators. Furthermore, this would read the reference to advance payment in section 226(e)(2) as mere surplusage. Finally, the patent absurdity of reading the advance payment provision as permitting advance coin deposits is underlined by Frontier's comical claim that section 226(e)(2) "appears to prohibit advance payments, not payments made simultaneously with the transaction." Frontier Comments at 9-10.[18] With respect to coins, it is hard to imagine when a caller would make the "advance payment," if not at the time of the call.[19] Nor does any party suggest why Congress would have bothered to direct the Commission to consider the need for compensation for access code calls, if PSPs were free to require coin deposits for such calls.

It is thus clear that current law prohibits PSPs from requiring advance coin deposits for access to OSPs. As a practical matter, this forecloses the Commission from adopting calling party pays for subscriber 800 calls as well, for many access codes -- such as the heavily advertised[20] 1-800-CALLATT, and 1-800-COLLECT -- are indistinguishable, from the PSPs point of view, from a subscriber 800 number. None of the parties advocating calling party pays has suggested a way around this problem.

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[18]Frontier's alternative suggestion that section 276 repealed section 226 by implication is unsupported and unsupportable.

[19]It is even harder to imagine that Congress passed TOCSIA simply in order to discourage pre-paid calling cards.

[20]Such advertising invariably features a payphone.

B. Calling Party Pays Would Inconvenience Consumers

The Commission's refusal to consider requiring advance coin deposits for 800 calls and access code calls was based on sound policy considerations as well:

> The Commission has long held that callers should not be required to deposit coins when making a call that i[s] otherwise billed to an account. We note that coinless calling, including use of coinless payphones, has proliferated in recent years. We conclude that when transient callers have an expectation that they may avoid carrying coins to make payphone calls, because they will be making only calls billed to a calling card or to a subscriber 800 end-user, it would be burdensome and increase transaction costs to impose a compensation approach that would require callers to acquire coins to make such calls. We conclude further that the ability to make coinless calls from payphones is a convenience that transient callers value.

Order on Recon., 11 FCC Rcd at 21275, ¶ 88. Moreover, the FCC's conclusion that "Congress intended to ensure access to 800 number subscribers without the calling party incurring a charge" seems irrefutable. Id. at 21275-76, ¶ 89.

There is little question that the reaction of consumers to a new requirement that they deposit coins for access code and subscriber 800 calls would be one of sheer outrage. Indeed, AT&T itself has explained why a calling party pays system would be a mistake:

> AT&T supports the Commission's conclusion . . . that the least burdensome and most cost efficient compensation mechanism is a "carrier pays" system for all types of payphone calls. A "set use" payphone fee charged directly to end users through a coin-deposit approach would inconvenience callers and discourage payphone use, or even prevent such use altogether. Consumers have become accustomed to the ability to make cash-free calls from payphones through the use of calling cards, credit cards, debit cards, collect calls and billed to third number calls. Consumers have also become accustomed to making toll free 800 and 888 calls from payphones. A coin deposit-based "set use" fee would seriously undermine the value and perception of these calls as "toll free."
>
> A coin-deposit system would make payphone calling more confusing and difficult . . . . Moreover, a coin deposit requirement would completely preclude calls by persons who do not have the necessary change available. Thus, such a

> requirement would be a major step backward in making telephone services accessible to the transient public . . . .

AT&T Comments (FCC filed July 1, 1996).[21]

While commenters may be right that the costs of administering a calling party pays system would be lower than the costs of administering a carrier pays system, see, e.g., Excel Comments at 7, there is little doubt that the overall transaction costs of calling party pays would be far higher. This is because every time a caller lacked correct change, the caller would be obligated to obtain the change or to forego the call. This would be repeated literally millions of times each day. While these costs may be diffuse, they would be real, and they would be enormous. The Commission was absolutely right to reject such an approach.

The court of appeals has endorsed the Commission's reasoning. Noting that "the Commission elected to adopt a 'carrier pays' system in order to maintain the convenience of coinless calling upon which the public has come to rely," the court held that "[t]he Commission's balancing of the competing concerns of administrative efficiency and consumer convenience was not arbitrary." Illinois Public Telecommunications Ass'n v. FCC, 117 F.3d 555, 567 (D.C. Cir. 1997), cert. denied, 118 S. Ct. 1361 (1998).

Notably, the Consumer-Business Coalition, the only group that purports to represent subscriber 800 end-users, does not advocate calling party pays; to the contrary, they admit that "most 800 subscribers are reliant on being accessible from all phones, including payphones." CBC Comments at 4.

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[21] AT&T conveniently forgot these points when it realized that the Commission had rejected its unrealistically low TELRIC approach to payphone compensation, but it has never been able to explain them away. See AT&T Petition for Reconsideration at 4-5 (FCC filed Oct. 21, 1996).

Finally, there is simply no truth to the claim that only calling party pays can effectively impose market discipline on PSPs. To the contrary, the Commission's avoided-cost default rate ensures that the per-call rate will be subject to market discipline in two ways. First, because the per-call rate is derived from the competitive local coin rate, and because point-of-sale competition for local coin callers will constrain local coin prices, competition in the local coin market will constrain the default per-call compensation rate. See supra at 4-5. Second, because the rate is a default rate, to be applied only in the absence of negotiated agreement, and because IXCs can block calls from payphones, IXCs and their subscribers have significant leverage to negotiate rates.[22]

This last point is important, because if the Commission's default rate were unreasonable, IXCs and their customers would presumably have declined to continue to pay for payphone services. Per-call compensation charges have been in place for over nine months, and IXCs have been passing through charges to their subscribers, in many cases, for far longer, yet there is no evidence on the record that IXCs have seen any decline in the demand for access code calling or

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[22]Already the vast majority of payphones are coding-digit capable; by the end of the transition period, implementation will be virtually universal. While Flex ANI was originally required on the ground that IXCs required it for tracking purposes, see Order on Recon., 11 FCC Rcd at 21265-66, ¶ 64, subsequent events have suggested that it was unnecessary for this purpose. However, IXCs have since argued that tracking is important to permit targeted call blocking. See Brief of MCI et al., at 30, MCI v. FCC, No. 97-1675 (D.C. Cir. filed Mar. 31, 1998). The IXCs should not therefore be heard to claim now that call blocking is too expensive to provide an effective check on the market. See, e.g., AT&T Comments at 10-11, a proposition, in any event, for which there is no evidence in the record.

WorldCom claims that Flex ANI deployment is "far from complete." WorldCom Comments at 6. The fact is that WorldCom has never requested Flex ANI from any member of the Coalition, and therefore has no basis for its contention.

for subscriber 800 calling from payphones. This is, then, a third "dog that didn't bark," strong market evidence that the per-call default rate is certainly not too high.[23]

Moreover, the lack of blocking (and the related fact that there has been no decrease in dial-around and 800 calling) gives the lie to claims that payphone services lack value to IXCs or to 800 subscribers.[24] See WorldCom Comments at 3-4 (claiming that payphones confer no economic benefit on IXCs or 800 subscribers). Now that such services are priced at a market-based level, the precise value of such services -- to IXCs and their subscribers -- is all the more clear. Indeed, the CBC candidly admits that payphone services are extremely valuable -- apparently indispensable. See CBC Comments at 4 ("[M]ost 800 subscribers are reliant on being accessible from all phones, including payphones, thereby rendering call blocking an invalid business option."). It is hard to see how CBC can consistently argue that foregoing payphone services at current prices is unthinkable, and that such services are overpriced.

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[23]No one has argued that wholesale blocking of payphone calls is expensive, and some paging services evidently have chosen to implement it for at least some of their subscribers.

[24]Citicorp claims that "toll-free access is often necessary for [governmental and non-profit institutions] for them to carry out their purposes, but there is no available mechanism for them to easily offset the increased cost of access." Citicorp Comments at 3. Citicorp's suggestion that the Commission should therefore relieve such organizations of the cost of payphone access is remarkably hypocritical. Presumably, Citicorp does not offer its services to not-for-profit institutions for free, but instead intends to earn a fair market return on its consulting business. Just as governmental and non-profit institutions pay market-based rates for computers, consultants, and other necessary inputs, they should pay market-based rates for payphone services.

What makes the Citicorp comments even more difficult to tolerate is the argument that the burden of providing toll-free access should be recovered by "increasing . . . coin rates." Citicorp Comments at 5. Requiring local callers -- including poor people who may lack access to private phones of their own -- to pay higher local coin rates to support others' toll-free calling is hardly a progressive response to public needs.

Frontier's statement that it is an "involuntary participant[]" in the market for payphone services, Frontier Comments at 2, is patently false. Unlike PSPs, who have no choice but to route calls to Frontier, Frontier could block calls from payphones if it chose to do so.[25] Yet Frontier wants to accept the calls, and decline to pay for them. See Complaint, Bell Atlantic-Delaware, Inc. v. Frontier Corp. (FCC filed July 15, 1998). Such lawless conduct is impossible to justify.

CONCLUSION

For the foregoing reasons, the Commission should reaffirm its commitment to set a market-based default rate for per-call compensation, by adjusting the local coin rate for the net avoided costs of coinless calling.

Respectfully submitted,

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July 27, 1998

[25]Frontier's claim that an IXC cannot selectively block subscriber 800 calls, as opposed to calls to its own access code, see Frontier Comments at 4, is another obvious falsehood.

A

DECLARATION OF ALFRED E. KAHN

I, **Alfred E. Kahn**, do hereby declare as follows:

I have been asked to comment on the article by Beard, Ekelund and Subea, "A Study of Payphone Market Organization and Compensation," which was filed by MCI along with its comments in the payphone proceeding.

Its general thesis is that the deregulation of payphone rates has set off intensified competition among payphone operators for the right to place their equipment at desirable locations, resulting in very large "monopoly rents" earned by the owners of those locations, while producing no significant increase in the deployment of those facilities, as was the intention of the Telecommunications Reform Act; and that the FCC's proposed linkage of the regulatorily-prescribed charges for non-coin calls to those coin rates will merely aggravate the consequent injury to the consuming public.

Their exposition raises two distinct kinds of questions—one, conceptual; the other, factual.

CONCEPTUAL ISSUES

At the conceptual level, the authors' argument is dismayingly muddled. This confusion—which is far from merely terminological—is reflected in their constant attachment of the adjectival "monopoly" to the rents earned by owners of desirable locations—as well as, in their analogy, to such items as a Picasso painting—a logical stretch that they themselves implicitly recognize, in the latter instance, by putting quotation marks around the word "monopoly" (p. 1). Their analogy to "monopoly cable television franchises," immediately following, epitomizes the conceptual confusion of their argument.

In strict economic terms, rent is the return (or price) received by the owner of a non-reproducible good or resource—a Picasso painting, land at a particular location or of a particular inherent fertility. While such payments may be explicit costs to the purchaser or renter of those goods or facilities, as the authors themselves recognize in a moment of lucidity,

> they are *not* an *economic* cost, but a *rent,* i.e., a *transfer* arising from differential "qualities" of a resource in fixed supply. (p. 13)

Such economic rents *do not determine market price* but are *determined by* the market price, whether competitive or monopolistic. Even though in a sense a Picasso painting is unique, the differential (to use the authors' correct characterization) between the price it commands in an auction and the prices of paintings by less popular painters is determined by the valuation that the successful bidder places upon it; and that valuation is determined by its superiority (as judged by the market) over other, less prized paintings available to purchasers.

So, similarly, as market demand for wheat grows, cultivators may have to have access to progressively less fertile or more distant land or to more intensive methods of cultivating existing land, at diminishing marginal product (from, for example, successive applications of fertilizer) and correspondingly increasing marginal costs. The rental value of such land (or of a retail location on Madison Avenue) is determined by its superiority or superior productivity over the more marginal inputs drawn into supply function by increasing demand, as the authors explicitly recognize. At the margin, where marginal costs are set, there are no such rents.

The fact, therefore, that, as the authors state,

> Cost differences between phones will arise primarily from variations in locations rents, with high traffic sites earning greater payments for the rightholder (p. 12)

does not mean, in itself, that the charges for use of the phones are monopolistic or reflect monopoly power. The costs of engaging in white-collar business may vary as between Wall Street and downtown Yonkers largely because of the differences in the respective rental charges for office space, as may the costs of retailing on Fifth Avenue and upper Second Avenue; but that does not mean that the prices charged by those enterprises to purchasers of their services are monopolistic or contain any monopoly element: the rental payments to owners of the properties merely reflect the differences in profitability of operations at the favorable locations, on the one side, and at the marginal ones, on the other; but those charges need contain no *monopoly profits*, even though the rents at the more favorable locations reflect the scarcity of such favorable sites.

True, the less elastic the supply of favorable sites (or fertile land)—the less their supply or availability increases in response to higher rentals—the less elastic will also be the supply of the services in whose production they are an input, in response to increased demand or higher prices; and the more rents will rise as demand—for example for placement of coin phones at those locations—increases: the inelastic supply of Van Gogh paintings ensures that their prices will rise more rapidly over time than the product of still-living and still-producing artists, as demands of art collectors increase; but that absolutely does *not* mean that the market for Van Gogh paintings is in any sense non-competitive or "monopolistic."

This is a situation totally and fundamentally different from the bidding for exclusive cable television franchises, which the authors posit at the outset of their paper (p. 2). In that case possession of the franchise confers an authentic monopoly in the supply of an economic product—cable services in a given locality. The analogy between the two that the authors draw is incorrect, as a matter of principle. They simply blur the difference between a true monopoly price and the ability of the owner of a superior resource (superior by virtue of its quality, as perceived by buyers, or its location) for the supply of a product that is supplied also by others, under a regime of free entry, to extract economic rents.

The simple economic proposition, to which they do not explicitly respond, is that social welfare, considered in the aggregate, is maximized by letting prices rise to marginal cost, bearing in mind always that there are no rents at that margin.

Moreover, the fact that payphone charges went up once they were deregulated and the local exchange companies and independent payphone providers began, in consequence, to compete more intensely for convenient locations offers no basis whatever for the inference that the higher prices are monopoly prices. The simple historical fact is that payphone charges were until that time explicitly subsidized; in addition, state commissions forced LECs to provide and maintain such facilities at unprofitable locations, where they were often subject to periodic vandalism. Small wonder that the simultaneous deregulation and withdrawal of subsidies then led to increased charges. The 40 percent increase in price that the authors cite (p. 10) could well in these circumstances have had nothing whatever to do with monopoly exploitation, even though it may have occasioned an increase in rental payments, which may in turn have appeared from the standpoint of service providers to have caused or necessitated that price increase.

FACTUAL ISSUES

There is another strain in the authors' argument, however, that is economically sound, in principle, and is truly directed at the possibility of monopoly exploitation of consumers. Whether it supports the conclusions they draw depends not on economic principles but on whether the facts are as they describe them. I refer to their contention that the markets for payphone services, properly defined—applying, for example, the criteria of the merger guidelines—are, either generally or in specific circumstances, truly local.

Whether this is an apt description, as I say, is a factual question—and, as I will point out presently, it does not seem to be supported by the evidence. It is at least a plausible assertion, however, that—in contrast with, let us say, downtown commercial districts, where there is a plenitude of possible sites for the installation of competing payphones—there may well be a sufficient break in the chain of substitutes between payphones at an airport and elsewhere to permit genuinely monopolistic exploitation of patrons of the former services. The latter "markets" might nevertheless be large enough to support a sufficient number of separate providers of those services to offer patrons the protections of effective competition; but, as the authors point out, if the airport operator were to attempt to maximize revenues, it might well behave just as a municipality that auctions off the *exclusive* right to provide cable television services. The result in both cases could well be genuinely monopolistic profits.

In light of this reasoning, however, I find the authors' exposition astoundingly incomplete, to put it politely, and unconvincing:

- First of all, they by no means confine their argument to situations, such as at airports, in which it might be plausibly argued that there could be a sufficient break in the geographic chain of substitutes to give rise to the possibility of genuine monopoly profits. So far as their argument is concerned, *every* payphone location is a potential monopoly. But that is surely absurd: while travelers passing through an airport may have no feasible alternative sufficient to deter them in sufficient numbers from using phones whose charges are 10 percent or more above rates prevailing elsewhere, that can certainly not be true of payphone users in almost all other conceivable circumstances, as I have already suggested in referring to downtown business areas. It is my understanding that a significant percentage of payphones are actually within sight of other payphones, and consumers even more often are presumably aware that another one is nearby. In these situations, there could be no basis for the claim that the ordinary laws of competitive supply and demand cease to be effective in the market for payphone services.

- In these circumstances, one would have thought the authors would have tested their hypothesis by studying payphone charges in both potentially monopolizable and competitive situations. Not only have they failed to do so; as I understand it, other witnesses—including AT&T and the Competitive Telecommunications Association!—are testifying that no such differences are observable.

- In explaining this apparent uniformity—had they chosen to look for it—the authors might have taken into account the fact that the airports are typically run by public authorities, which might be subject to restraints about using their potential monopoly positions to exploit travelers. The findings of the Competitive Telecommunications Association that payphone prices are in effect essentially uniform, location by location, is consistent with each location, even isolated ones such as airports, being constrained by effective competition (perhaps because of the availability of substitutes such as wireless calling, or the possibility that callers will defer calls in response to price increases). Alternatively, because consumers are generally habituated to the competitive market price, it is possible that the exploitation of a hypothetical monopoly position—by an airport or a sports stadium—would breed more ill-will than it was worth.

- Finally, the FCC did, in recognition of the possibility of a genuine locational monopoly, set up complaint procedures, under which the states could petition to regulate rates in such cases: as I understand it, no one has evoked that provision.

The Competitive Telecommunications Association, surprisingly, cites the uniform thirty-five-cent charge by all major PSPs as a refutation of the proposition that the market is competitive: it means, they say, that the rates do not reflect cost differences, and "If costs and rates converged,...one would expect evidence of that through variations for cost differences such as these." (p. 1)

The answers are simple:

(1) Uniform prices are certainly *not* incompatible with a finding of competition; the essence of competitive markets is to force the same price on all suppliers within that market, regardless of differences in their costs. Of course, price uniformity *could* be reflective also of perfect monopoly or collusion; but the wide multiplicity and geographic dispersion of offerers of these services, along with the ease of entry, make that alternative interpretation totally implausible.

(2) If, as I suspect, the major asserted differences in these costs are in rental payments, then, as I have already pointed out, such rents are not price-determining in competitive markets; they would be the consequence and reflection, instead, of the differences in the net profits that can be earned at various locations, at the *uniform, competitively-determined* market price.

As I understand it, several parties have advocated "calling party pays" as an effective mechanism for setting prices for payphone services used by callers making access code and subscriber 800 calls. This proposal, however, necessarily implies acceptance of the proposition that competition among payphone providers for callers will effectively constrain prices. If that is true in the market for access code and subscriber 800 calling, there is no reason to doubt that it is true also in the market for local coin calling. In short, the "calling party pays" proposal effectively undermines the opposition to the FCC's decision.

I hereby swear and affirm that the statements contained in the attached Declaration are true and correct to the best of my knowledge and belief.

Alfred E. Kahn

Alfred E. Kahn

Subscribed and sworn to me this 24th day of July, 1998.

Delores S. Haring

Notary Public

My commission expires 6/30/2000

DELORES S HARING
Notary Public, State of New York
No. 4766345
Qualified in Tompkins County
Commission Expires June 30, ~~19~~ 2000

B

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Critique of Incremental Payphone Cost Studies

Carl R. Geppert

July 27, 1998

Critique of Incremental Payphone Cost Studies

Arthur Andersen LLP ("Arthur Andersen") was asked by the RBOC/GTE/SNET Payphone Coalition ("the Coalition") to determine whether the "Payphone Cost Study" prepared by MCI ("the MCI study") and New York Telephone Company's incremental cost study for the state of New York are representative of the fully embedded cost of operating all payphones. We believe that both significantly understate the fully embedded cost of operating payphones.

SECTION I: CRITIQUE OF THE MCI STUDY

The following table adjusts the MCI study to incorporate all costs of providing payphone service and to better reflect the experience of the Coalition.

Cost Category	MCI Smart Set Payphone Cost Study[1]	Revised Calculation
Capital Costs	$26.72	$46.93
Volume Sensitive Costs	18.950	13.542
Station Sensitive Costs	58.790	59.449
Other Costs	10.860	58.730
Total Station Costs	$115.320	$178.651
Average Number of Calls	700	478
Average Cost Per Call (all calls)	$0.165	$0.374

The following explanations provide insight into why we believe that MCI's figures understate the total cost of providing payphone service:

- Incremental Costs are Not Representative of Total Payphone Costs: The MCI study includes only costs "to provide an additional payphone"[2] (commonly referred to as "incremental costs") and inappropriately excludes many fixed costs associated with

[1] We did not provide an alternative calculation of MCI's semi-smart payphone cost figures due to the fact that these type of payphones are not representative of those used by the Coalition.
[2] See, MCI Payphone Cost Study, Exhibit 2 (7/13/98), page 1 [hereinafter "MCI Study"].