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August 26, 1998

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Ms. Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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

Dear Ms. Salas:

On August 25, 1998, BB Nugent and Dan Lanksbury of U S WEST and I met, on behalf of the RBOC/GTE/SNET Payphone Coalition, with Kathryn Brown, Larry Strickling, Glenn Reynolds, Greg Lipscomb, Milton Price and Craig Stroup.

Following a brief discussion of the history of this proceeding, we urged the Commission to retain its fundamental decision to deregulate the payphone industry and let competition determine the appropriate level of compensation for the various sorts of payphone calls. In the case of dial-around and 800 calls, where competition cannot work directly because of regulatory constraints, we urged the Commission to determine per-call compensation using a deregulatory, market-based approach, rather than a regulatory, cost-based one. Specifically, we argued in support of the Commission's avoided cost approach, starting from the deregulated, competitively determined local coin rate. As a number of noted economists have explained -- included Nobel Laureate Gary Becker, Alfred Kahn, and Jerry Hausman -- avoided cost analysis is a valid regulatory technique for determining the price that the market would set for a product where the market cannot function directly because of regulatory barriers. It mirrors the result that would obtain in a competitive market where a single facility is used to provide two services, provided, the price that is used as a starting point is itself competitively set.

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We explained that the local coin market and the coinless calling market are related in the relevant way -- on the supply side -- because all types of calls make use of the same payphone. Moreover, assuming the local coin market is competitive, that rate will reflect costs. Thus, subtracting costs from the rate does not involve subtracting apples from oranges. The resulting price is efficient in that it will reflect costs and the facility owner will earn the same economic return from each service. The result is also fair in that each call will make an equal contribution to the joint and common costs of the payphone, and the opportunity costs for the PSP will be same for each type of call. Finally, the result is conservative in that the local coin rate is the lowest market surrogate that might be used. IXCs currently pay up to $1 for 0+ calls, and using a blended commission rate for both 0+ and 800 calls would lead to a rate of from $.39 - $.63 per call.

The key premise of an avoided cost analysis, therefore, is that the local coin market is competitive. We pointed out that the Commission had already concluded that the local coin market would be competitive, based on low barriers to entry, in its First Report & Order. That conclusion was affirmed by the D.C. Circuit, which stated that: "it was not unreasonable for the Commission to conclude that market forces generally will keep prices at a reasonable level" (i.e., at the level of costs). It has also been borne out by experience since deregulation.

We also briefly discussed and dismissed three objections raised by some commenters to an avoided cost analysis, based on so-called "locational monopolies," based on the fact that payphone rates are rounded off to the nearest nickel, and based on the fact that subscriber 800 customers choose the phone but do not pay for the call. We explained that the bogeyman of "locational monopolies" has already been rejected by Commission, which was affirmed by the D.C. Circuit, in the context of deregulating the local coin rate. It is also empirically unsupported and logically implausible, for reasons we have explored fully in our comments and reply comments in this docket. As for "rounding off" we explained that many markets have prices that are rounded off. That doesn't mean they are not competitive, it simply means supply adjusts incrementally to incremental changes in price. In any event, no one can, or has even tried to, justify the claim that rounding to nearest nickel would, on average, be upward rather than downward. Finally, with respect to subscriber 800 calls, so long as the local coin market is effectively competitive, the local coin rate will remain reasonable and, hence, so will the per call rate. Moreover, 800 subscribers, to the extent that they do not want to pay for calls from payphones have the option not to accept such calls.

We briefly explained why calling party pays is not a viable approach, particularly at this late date. The Commission has already rejected it for good reasons, and was affirmed by the D.C. Circuit. Calling party pays is forbidden by TOCSIA for access code calls, see. 47 U.S.C. 226(e)(2) (calling for compensation "other than advance payment by consumers"), and because payphones cannot distinguish between 800 access codes and subscriber 800 numbers, this effectively prevents calling party pays for all coinless calls. In any event, calling party pays would inconvenience consumers and increase transaction costs.

Finally, we suggested certain adjustments to the Commission's avoided cost analysis to correct flaws in the Second Report & Order. These proposed adjustments are described in detail in our comments and reply comments in this docket. And we urged the Commission to deal as promptly as possible with the more than $300 million in unpaid interim competition.

One original and one copy of this letter are being submitted to you in compliance with 47 C.F.R. § 1.1206(a)(2) to be included in the record of this proceeding. If you have any questions concerning this matter, please contact me at (202) 326-7902.

Sincerely,

Michael K. Kellogg

cc: Kathryn Brown
Larry Strickling
Glenn Reynolds
Greg Lipscomb
Milton Price
Craig Stroup