Therefore, if our goal is to price dial-around calls such that they make a proportionate contribution to joint and common costs, we cannot do so by basing their price on the local coin calling price, because we do not know how individual PSPs price local coin calls in relation to the recovery of joint and common costs. Therefore, upon reconsideration, we find unreliable the assumption that PSPs set prices so that each call recovers an equal amount of joint and common costs.

c. *MCI v. FCC.*

71. Finally, in light of the Court's concerns regarding whether a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls, we find that a top-down approach is unsuitable at present for setting default compensation. By using a bottom-up approach, we resolve the Court's concerns, because we focus on the costs of a dial-around call, rather than attempting to compare the rate and costs of a local coin call to the cost of a dial-around call. The Court's concerns in *MCI v. FCC* and the other factors discussed in this section persuade us that, at this time, a bottom-up compensation methodology is more appropriate than a top-down methodology.[127]

5. Selection of a Bottom-Up Methodology.

72. In light of existing technological, statutory, and economic constraints, we find that the most appropriate mechanism for establishing fair compensation is a bottom-up approach. We recognize that such a compensation mechanism does not replicate the price that the market would set for each and every call from a payphone, which, in an ideal setting, would be our preferred outcome. Under the constraints detailed previously, however, we conclude that a bottom-up approach will best comply with the statutory directive of ensuring the widespread deployment of payphones in a manner that is consistent with our definition of fair compensation.

73. In establishing a bottom-up approach, we considered three standard economic

[127] In petitions for reconsideration, certain parties raise additional reasons why we should not use the top-down compensation methodology adopted in the *Second Report and Order*. Most of these commenters assert that the payphone market is not adequately competitive to allow the use of a top-down approach. *See, e.g.*, Consumer Business Coalition Recon. Pet. at 2, 4, 18-19; AT&T Recon. Pet. at 5, 6-7. As explained above, in response to the Court's concerns in *MCI v. FCC*, and in light of the technological, statutory, and economic constraints, we conclude that we should use a bottom-up default compensation mechanism at this time. *See* Section I above. As explained below, we believe the method adopted herein best responds to Congress's instruction concerning the widespread deployment of payphones. Because we are using a bottom-up methodology in this Order, we need not discuss the validity of the various additional arguments raised by petitioners challenging the top-down approach used in the *Second Report and Order*. Should we succeed in moving to a market-based system at some point in the future, we may address the validity of those arguments at that time.

approaches to setting prices, in addition to our review of the top-down methodology used in the *Second Report and Order:* (1) marginal cost pricing;[128] (2) the RBOC Coalition's Ramsey's-style pricing;[129] and (3) fully distributed cost coverage.[130] As explained in Section IV.B. below, we find that a fully distributed cost-coverage approach best fulfills our statutory directives within the economic, technological, and statutory constraints that currently exist. Specifically, we find that a fully distributed cost-coverage approach that determines cost by working from the bottom up will comport with statutory directives and satisfy the Court's concerns raised in *MCI v. FCC.* Furthermore, we find that, in keeping with Commission precedent arising from our implementation of the 1996 Act, payphone costs will be calculated on a forward-looking basis.[131] Thus, in setting a default compensation amount using a fully distributed cost-coverage approach (our "bottom-up" methodology), we examine the costs of a new payphone operation installing new payphones.

74. As explained above, we find that "fair compensation" means that the marginal cost of compensable calls, plus an appropriate amount of the joint and common costs of the payphone operation, will be recovered for each compensable call.[132] We conclude that a bottom-up methodology will provide fair compensation consistent with this standard. Thus, rather than focusing on the cost of adding one additional payphone to an operation, we

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[128] The marginal cost of a good is the additional cost from the production of one additional good. In the case of payphone calls, it is the cost of making one additional call using an existing payphone.

[129] The RBOC Coalition's Ramsey's-style pricing sets prices based on the related goods' marginal costs and price elasticities. The less elastic the demand for one good (in relation to others), the more fixed costs are assigned to that good.

[130] Fully distributed cost coverage allows the payphone owner an opportunity to recover the fixed costs associated with the payphone.

[131] *See, e.g., Local Competition Order*, 11 FCC Rcd at 15813, ¶ 620 ("In dynamic competitive markets, firms take action based not on embedded costs, but on the relationship between market-determined prices and forward-looking economic costs.") We previously stated that the "fairly compensated" standard in the payphone context was a different standard than the forward-looking, cost-based standard used in the context of interconnection and unbundled elements. *First Report and Order on Reconsideration*, 11 FCC Rcd at 21267, ¶ 68. Although we now adopt a forward-looking, cost-based method, we are not using the TELRIC pricing model from the Commission's *Local Competition Order.* Under that TELRIC approach, the Commission set a different price for each company. Here, we set a default compensation amount for all payphones. In addition, our approach differs from the *Local Competition Order*'s version of TELRIC because that version excludes certain SG&A costs that we include in our cost analysis. Because TELRIC sets prices for unbundled network elements, and because CLECs always perform their own billing and collection, billing and collection costs (which are considered parts of SG&A) were not covered by TELRIC. In this Order, we estimate the total costs of a payphone operation, so we must include all the SG&A costs when establishing the default compensation amount.

[132] *Second Report and Order*, 13 FCC Rcd at 1796, ¶ 42.

instead examine the total costs of a payphone operation and distribute those costs across all of the payphones in that operation. We find that this approach results in a compensation amount that is fair to both payphone owners and the beneficiaries of these calls. We also conclude that establishing a compensation amount that allows a PSP to recover its costs will promote the continued existence of the vast majority of payphones presently deployed, thereby satisfying what we consider to be Congress's primary directive that we ensure the widespread deployment of payphones.

75. In this Order, we consider a cost to be "joint and common" if the amount of the cost does not vary with respect to the mixture of calls at the payphone.[133] For example, the cost of a payphone's enclosure does not change due to an increase in the number of coin calls relative to coinless calls, or *vice versa*. We conclude, therefore, that the enclosure is a joint and common cost, and we attribute the enclosure costs to all types of calls. We attribute costs that are not joint and common to the type of call associated with that cost. For example, as the number of coin calls from a payphone increases, the coin collection costs also will rise due to the higher frequency of coin collection trips. We therefore attribute coin collection costs solely to coin calls.

76. As discussed above, we find that the use of a bottom-up approach also resolves the concern that PSPs do not necessarily price their various services such that each call recovers an equal share of joint and common costs.[134] In the *Second Report and Order*, the Commission's goal was to set a compensation amount that would allow each call to recover its share of joint and common costs.[135] The top-down approach, which subtracted the avoided costs of a compensable call from the price of the local coin call, assumed that each call would contribute equally to the joint and common cost. As explained above, we find that this assumption is not necessarily reliable, based on the manner in which PSPs price various calls.[136] Under our bottom-up approach, however, that problem no longer is at issue. Under the bottom-up approach, we use the total monthly joint and common costs of the payphone operation and divide these costs by the total monthly number of calls from a marginal payphone location. This results in a per-call share of the joint and common costs. Thus, a bottom-up approach alleviates the problem of how to ensure that each call has the opportunity to recover its share of joint and common costs.

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[133] *See* Section III.A. above, explaining joint and common costs in the context of payphone compensation. *Cf. Local Competition Order*, 11 FCC Rcd at 15845, ¶ 676 (defining joint costs and common costs).

[134] In this context, we define its "share" of the joint and common costs as that amount that is the monthly joint and common costs divided by the total number of calls in a month from a marginal payphone location.

[135] *Second Report and Order*, 13 FCC Rcd at 1796, ¶ 42.

[136] *See* Section IV.A.4. above.

77. Our bottom-up approach also avoids the impact of the technological restrictions discussed previously that undermine our previous approach of allowing the default rate to change with the deregulated coin rate of each payphone. As explained above, in the bottom-up system we adopt herein, we have set a single amount for compensation, which we find fair and compensatory. IXCs do not need the ability to block calls from payphones based on a varying compensation amount because all payphones will use the same compensation amount, absent an agreement between the parties for some different level of compensation. Finally, our bottom-up approach alleviates the Court's concerns in *MCI v. FCC* stemming from the Commission's use of the local coin price as the starting point of compensation for dial-around calls. Under the bottom-up approach, we do not use the local coin price to determine the costs associated with a compensable call. Thus, we do not run afoul of the Court's concern that the Commission was "subtracting apples from oranges."[137] Rather, we determine each of the costs of the dial-around call and add them together, from the bottom up, to determine the per-call compensation amount.

78. Our default compensation amount is calculated to allow the payphone owner the opportunity to recover a proportionate share of joint and common costs associated with dial-around calls. Payphone owners may, of course, determine that contracting with IXCs to receive a lower amount will attract more dial-around traffic and thus increase their profits. Payphone owners also have the opportunity to set their own prices for non-compensable calls, *e.g.*, coin calls and presubscribed calls, and may set the price for each type of call so that it covers the marginal cost plus a proportionate share of joint and common costs. This would allow a payphone in a marginal location the opportunity to recover all of its costs. Of course, a payphone owner may dismiss this pricing strategy in favor of an alternative strategy that may prove to be more profitable.

79. We note that our approach is not designed to make every payphone profitable. Payphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount we establish.[138] We discuss in Section III.B.3.b. below our selection of a marginal payphone location and our calculation of the number of calls from that location, important components of our calculation of the compensation amount.

80. Certain petitioners argue that we should use a marginal cost pricing approach, in which prices are set by considering the cost of producing one additional good. Others

[137] *MCI v. FCC*, 143 F.3d at 608 ("If costs and rates depend on different factors, as they sometimes do, then this procedure would resemble subtracting apples from oranges.").

[138] Even at an extremely high compensation rate, we would expect that so many IXCs would block calls that PSPs would receive minimal or no compensation for dial around calls.

argue that we should use a Ramsey's-style pricing approach.[139] We find, for the reasons stated below, that marginal cost pricing and the RBOC Coalition's Ramsey's-style pricing are ineffective in complying with our statutory goals. As explained elsewhere, however, we conclude that basing our determination of fair compensation on the marginal payphone is the approach most consistent with the statutory directive of ensuring widespread deployment of payphones.[140]

81. Specifically, we reject marginal cost pricing for the same reasons given by the Commission in the *First Report and Order* and alluded to in Section III above.[141] That is, a purely incremental cost standard for dial-around calls would undercompensate PSPs for dial-around calls, because it would prevent PSPs from recovering a reasonable share of joint and common costs from those calls. Thus, the revenue that would have been received from these calls would be subsidized by revenue from other types of calls, which, in and of itself, contradicts Congress's directive to eliminate subsidies and also distorts competition. Our bottom-up approach, however, adequately considers and accounts for the dial-around call's share of the joint and common costs.[142] In Section III.B.2.c. below, we reject the RBOC Coalition's version of Ramsey's-style pricing, in part, because the pricing methodology is extremely sensitive to small changes in input estimates. Furthermore, we find unreliable the input estimates provided by the RBOC Coalition.[143]

82. Several economists argue that a top-down approach like that used in previous orders is superior to a bottom-up approach. Dr. Becker argues that a bottom-up approach would approximate the actual pricing of payphone services only by chance and would result in an economically inefficient provision of payphone services.[144] Dr. Kahn states that the determination of costs from the bottom up inevitably is more contentious and subject to "political influence."[145] Dr. Hausman contends that a bottom-up approach cannot incorporate all of the market information, such as demand and cost conditions, and states that an average cost approach would result in the elimination of marginal payphones with below-average call

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[139] *See* RBOC Coalition Recon. Pet. at 4-6.

[140] *See* Section IV.B.3.b. below.

[141] *First Report and Order*, 11 FCC Rcd at 20576, ¶ 68.

[142] *See* IV.A.4. above.

[143] *See* Section IV.B.2.b. below.

[144] RBOC Coalition Recon. Opp., Declaration of Becker, at 13.

[145] RBOC Coalition Recon. Opp., Declaration of Kahn, at 7-8.

volumes or above-average costs.[146]

83. In response to Dr. Becker's critique, we recognize that a bottom-up method may not reflect the compensation amount that the market would set for a particular payphone. That is not our intention in this Order. Our goal is to provide a PSP with a payphone at a marginal location an opportunity to recoup all of that payphone's costs. In the alternative, PSPs are free to negotiate with IXCs to lower the compensation amount for dial-around calls, in an effort to attract more callers.[147] In adopting a bottom-up compensation methodology, we reconsider our conclusions in the *First Report and Order on Reconsideration* and *Second Report and Order* that reliance on cost studies to set the compensation rate may reduce the amount of revenue recovered by PSPs and therefore may reduce the number of payphones deployed.[148] As we state herein, however, because payphone operations incur very large fixed costs and very low marginal costs, allowing PSPs to recover only their marginal costs would be undercompensatory.[149]

84. In response to Dr. Kahn's concerns regarding the contentiousness of a bottom-up approach, we find that, when applied to dial-around calls, both top-down and bottom-up approaches are subject to differences of opinion. Although the top-down approach contains fewer cost estimates to consider compared to a bottom-up approach, other difficult elements are associated with top-down pricing. For example, as identified by the Court in *MCI v. FCC*, under a top-down approach, one must determine the correct starting price for the adjustments. Moreover, we believe that the number of disputable aspects of a particular approach is not a dispositive basis for choosing a pricing methodology. Finally, in response to Dr. Hausman's concerns, we agree that our bottom-up methodology does not consider the interactions of demand and cost. We explain in detail below our reasons for declining to adopt Dr. Hausman's recommendation that we use the RBOC Coalition's version of Ramsey's-style pricing.[150]

85. Although we could have attempted to price dial-around calls by equating the percentage markups over marginal cost for each type of call, we decline to do so for two

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[146] RBOC Coalition, Recon. Opp. at 7-9.

[147] Presumably, if the IXC contracted with the PSP for a compensation amount, the PSP would expect that the IXC would route callers to its payphones or that the IXC would not block calls from its payphones, once the IXC develops targeted call blocking.

[148] *First Report and Order on Reconsideration* 11 FCC Rcd at 21266, ¶ 66; *Second Report and Order*, 13 FCC Rcd at 1818, ¶ 93.

[149] *See* Section IV.A.5.

[150] *See* Section IV.B.2.b. below.

reasons. First, it would assume that payphone operators price their other calls, such as 0+ and 0- calls, in that manner.[151] We find no credible evidence to conclude that they do. Second, the resulting suggested price would be greatly affected by small changes in the marginal cost estimates. Under this approach, the default price would be determined by taking one fraction -- the markup of a local coin call divided by its marginal cost -- and setting it equal to another fraction -- the markup of a dial-around call divided by its marginal cost. Since three of the four factors are known quantities (*i.e.*, the marginal cost of a coin call, the marginal cost of a dial-around call, and the markup of a local coin call), the fourth factor (*i.e.*, the markup for dial-around calls) can be determined by selecting an amount that equalizes the two fractions. The price of the dial-around call would then be the sum of its marginal cost and its newly determined markup. Because the marginal costs of payphone calls are so small, however, if one of the marginal cost estimates (such as the marginal cost of a coin call) changed by only a few cents, the amount of the markup for dial-around calls equalizing the two fractions would change greatly. Because the price of a dial-around call would be the sum of its marginal cost and its markup, the resulting change in the markup would have a large effect on the price of a dial-around call.

86. In summary, we find that using a Ramsey's-style pricing mechanism leads to highly varied prices, depending on the estimate of marginal costs and elasticities. We do not believe that we can obtain sufficiently accurate marginal cost and elasticity estimates to use a Ramsey's-style pricing mechanism. We note that the RBOC Coalition believes that its Ramsey's-style pricing mechanism leads to a default compensation amount higher than $.35.[152] We show in Section IV.B.2.b. below, however, that in using estimates that we consider more reasonable, the RBOC Coalition's Ramsey's-style pricing mechanism leads to a default price that is less than the default price arrived at by using bottom-up approach we adopt in this Order. This underscores our concern about the large variance resulting from minor changes in assumptions.

87. We decline to use marginal cost/demand considerations as a reason to choose top-down pricing. There is no reason to believe that pricing compensable calls based on the market price of local coin calls is superior to bottom-up pricing, because the price of local coin calls is principally affected by the demand and marginal costs of coin calls, not coinless calls. This would result in what the Court in *MCI v. FCC* refers to as "comparing apples to oranges." Any attempt to modify the bottom-up default compensation amount in an effort to account for some measure of the marginal cost/demand analysis would amount to a purely arbitrary adjustment, because the size of an appropriate adjustment could not be quantified. Further, we find incorrect the RBOC Coalition's contention that the dial-around price should

[151] *See* para. 70 above, explaining how the evidence supports our belief that PSPs price dial-around calls differently from 0+ and 0- calls.

[152] *See* RBOC Coalition Second R&O Comments, Hausman at 17.

be at least $.35, because, as we show below in Section IV.B.2.b., reasonable marginal cost and elasticity estimates produce a price less than our default price.

6. Conclusions and Response to the Court.

88. We conclude, for the reasons stated above and elsewhere in this Order, that a bottom-up methodology is the most appropriate means for establishing a default compensation amount at this time. We also conclude that our selection of a bottom-up methodology reasonably resolves the Court's concerns, as expressed in *MCI v. FCC*. As the Court indicated, a market-based rate may be an appropriate method at some point in the future. When the time is appropriate, we will consider revisiting this issue.

C. Reconsideration Issues.

89. In this section, we address petitioners' arguments in support of, and in opposition to, various methodologies for determining the default compensation amount. In addition to the bottom-up methodology described above, we set the default compensation amount.

1. Overview.

90. In the *Second Report and Order*, the Commission established an interim default compensation amount for dial-around calls made from payphones by adjusting what the Commission determined to be the current deregulated coin price of $.35 to account for cost differences between coin calls and coinless calls. Thus, the Commission subtracted from $.35 costs directly attributable to coin calls and added costs directly attributable to dial-around or compensable calls.[153] In order to determine certain per-call costs, the Commission estimated the number of monthly calls made from a payphone in a marginal location.[154] Specifically, the Commission deducted the following costs associated with coin calls from the deregulated local coin price: avoided costs for the coin mechanism; local coin call termination charges; and coin collection and maintenance costs.[155] The Commission then added the following costs associated with dial-around or compensable calls: expenses for coding digits and interest on delayed receipts.[156] The Commission declined to make adjustments to the price for bad

[153] *Second Report and Order*, 13 FCC Rcd at 1796, 1807, and 1829-30, ¶¶ 42, 63, and 119.

[154] *Second Report and Order*, 13 FCC Rcd at 1797-1801, ¶¶ 46-50.

[155] *Second Report and Order*, 13 FCC Rcd at 1801-1803, ¶¶ 52-55.

[156] *Second Report and Order*, 13 FCC Rcd at 1804-1805, ¶¶ 57-60.

debt, collection costs relating to per-call compensation, opportunity costs, or location rents.[157] These calculations produced an adjusted market-based range for the cost of dial-around calls of $.277 to $.291.[158] The Commission established the interim default compensation amount at $.284, the midpoint of this range.[159] As explained previously, this was to be the fixed default compensation amount until October 1999, after which the default compensation amount would vary with the local coin price for each payphone, less avoided costs.

91. In response to the *Second Report and Order*, multiple parties filed petitions for reconsideration.[160] In addition to the record relating to these petitions, several parties filed comments in response to our *Public Notice*, released subsequent to the Court's remand in *MCI v. FCC*.[161] Our resolution of the petitions for reconsideration is based on the record arising from the reconsideration petitions, as well as the record created by the *Public Notice*.

92. The reconsideration petitions generally challenge two aspects of the *Second Report and Order*: (1) the Commission's overall methodology in setting the default compensation amount; and (2) the cost components underlying the Commission's calculation of the default compensation amount. In this Order, we have selected a bottom-up methodology to establish a default compensation amount for compensable calls.[162] This decision renders moot, in large part, petitioners' challenges to the *Second Report and Order*'s methodology.[163] Below, however, we address petitioners' remaining arguments supporting

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[157] *Second Report and Order*, 13 FCC Rcd at 1804, 1806-1807, ¶¶ 56, 61-62.

[158] *Second Report and Order*, 13 FCC Rcd at 1807, ¶ 63.

[159] *Id.*

[160] *See* Appendix B (listing parties filing petitions for reconsideration).

[161] *Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, Public Notice, CC Docket No. 96-128, DA 98-1198 (rel. June 19, 1998).

[162] *See* Section IV.A.4. above.

[163] For example, AT&T alleges that in making adjustments to the market coin rate in the *Second Report and Order*, the Commission failed to make adjustments for a PSP's profit that is included in every coin call. AT&T argues that the Commission deducted only $.066 for costs and nothing for the PSP's profit. AT&T also asserts that PSPs will profit twice from a coinless call because the adjusted coin market rate will include profit on a coin call as well as profit on a coinless call. AT&T Recon. Pet. at 17-18. Our move to a bottom-up default compensation methodology renders moot AT&T's challenge. As APCC notes, however, in the *Second Report and Order*, the Commission deducted the return on capital as well as the cost of the coin mechanism in making the adjustment to the coin rate. APCC Recon. Opp. at 21 (*citing Second Report and Order*, 13 FCC Rcd at 1801-1802 n.139). Thus, when the Commission deducted the cost of the coin mechanism, it also deducted the profit associated with it. We also note that in its bottom-up analysis in the *Second Report and Order*, the Commission similarly assumed all profit was associated with capital costs. *See Second Report and Order*, 13

and opposing various compensation approaches.

93. As explained in Section IV.B.3. below, we establish a per-call default compensation amount of $.24, using a bottom-up methodology that we adopt in this Order. We set the default compensation amount by evaluating the component costs of a dial-around call. Our evaluation incorporates our resolution of relevant arguments concerning the *Second Report and Order*'s cost components raised in petitions for reconsideration. In certain instances, our evaluation includes adjustments that were not explicitly requested by petitioners, but were raised by new evidence in the record.

2. Alternative Compensation Methodologies.

94. In this Section, we address alternative compensation mechanisms put forth by commenters that were not discussed above in connection with the Court's remand.

a. Duration Methodology.

95. Several commenters argue that the compensation amount for a toll-free call should be based on the duration of the call.[164] PageMart asserts that most paging calls last less than 30 seconds, while other dial-around calls last three to five minutes.[165] PageMart suggests that the cost of a toll-free call from a payphone varies according to duration, noting that "[s]ome of the factors leading to higher costs for longer calls include (i) the potential for increased line charges; (ii) wear and tear and added depreciation from extended use of payphone equipment; (iii) opportunity costs incurred with extended use; and (iv) increased commissions in connection with high usage payphones."[166] Pocket Science contends that consumers would be better off if dial-around compensation were based on the duration of the call, in part, because low-income consumers could more easily afford access to electronic mail by using Pocket Science's product.[167] Specifically, Pocket Science maintains that the compensation amount should be based on minutes of use and capped at $.285.[168] Although

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FCC Rcd at 1822-24, n.289.

[164] AirTouch Recon. Opp. at 3; Mtel Recon. Opp. at 6-7; Paging Network Comments at 10; PageMart Recon. Pet. at 3-5; Skytel Comments at 3-4. *See also* DMA Recon. Pet. at 1 and Source One Recon. Pet. at 5 (asserting that paging response calls be exempt from per call compensation).

[165] PageMart Recon. Pet. at 4.

[166] PageMart Recon. Pet. at 4.

[167] Pocket Science Comments at 1.

[168] Pocket Science Comments at 2.

the RBOC Coalition is not in favor of basing dial-around compensation on the call's duration, one of its economists suggests that doing so may be appropriate.[169]

96. In contrast, APCC argues that, although "measured compensation may have some theoretical appeal," it is impractical at this time, because payphone operators do not have the ability to monitor the length of the call.[170] Further, AT&T states that implementation of such a system would: (1) cost millions of dollars; (2) require 12-18 months so that it could update its systems; and (3) result in unnecessary administrative burdens.[171]

97. We are not convinced by the record evidence that the marginal costs of a relatively shorter dial-around call are significantly different than those of a longer call. Although the line charge for some coin calls may vary depending on the length of the call, dial-around calls do not incur any additional line charge, regardless of their length.[172] Indeed, as we have discussed, because most payphone costs are fixed, they do not vary with the length of the call.[173] Nor are we convinced that longer calls cause a significant amount of additional wear and tear on a payphone. Consistent with the Commission's determination in the *Second Report and Order*, we decline to make an adjustment for opportunity costs of a dial-around call because we conclude that it is unlikely that the revenue from another call will be lost. In the *Second Report and Order*, the Commission concluded that compensating PSPs for opportunity costs was not necessary because the evidence demonstrates that dial-around calls only occupy 1.8 percent of available payphone usage time.[174] In this Order, we decline to consider location rents as a cost of a dial-around call.[175] Even if we were to consider including compensating PSPs in connection with location rents, the amount of rent would not vary with the duration of a phone call because the amount of payphone revenue would not change.[176]

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[169] RBOC Coalition Comments, Analysis of Economist Gary S. Becker at 9, n.5 (stating that if coin calls and coinless calls are of different lengths, the proper policy would be to equate the margins per unit of time for each type of call).

[170] APCC August 21, 1998 *ex parte* letter to Magalie Roman Salas at 2.

[171] AT&T October 21, 1998 *ex parte* letter to Magalie Roman Salas.

[172] *See* Section IV.B.3.g(2) below, explaining that only local calls are assessed duration-based line termination charges.

[173] *See* Section III.A. above.

[174] *Second Report and Order*, 13 FCC Rcd at 1806, ¶ 61.

[175] *See* Section IV.B.3.c. below.

[176] *Id.*

98. Furthermore, we are persuaded by APCC and AT&T that a duration-based methodology would result in added expense, delay, and confusion. Several complaints have already been filed with the Commission regarding payment of payphone compensation. We believe the establishment of a duration-based methodology would result in the filing of even more complaints, thereby exacerbating, rather than resolving, the current situation.

99. Contrary to Pocket Science's suggestion,[177] even if we based the compensation amount on the duration of a call, we could not cap the compensation amount at $.285 or any other amount, because it would not fully compensate PSPs. Assuming the default amount were set at $.285, PSPs receiving less than $.285 for short calls must receive more than $.285 for longer calls in order for the PSP to be fully compensated. We therefore decline to alter the payphone compensation mechanism to reflect the duration of the call. We note, however, that IXCs and LECs are free to use measured service compensation in their contracts, if they so choose.

b. RBOC Coalition's Ramsey's-Style Pricing Methodology.

100. In setting per-call compensation in the *Second Report and Order*, the Commission declined to apply the RBOC Coalition's price-setting methodology using an analysis of the comparative elasticities of demand associated with coin and dial-around calls, as advocated by the RBOC Coalition.[178] The RBOC Coalition sought to demonstrate that, in addition to considering avoided costs in setting a market price, competitive firms consider a product's elasticity of demand.[179] The RBOC Coalition argued that elasticities in this case would result in a market price for access calls of the coin rate plus $.07 to $.08, or a total of $.42 to $.43.[180] The Commission observed that there were wide variations in the record regarding the assumed elasticities and concluded that the evidence was inadequate to determine the relative elasticities of coin and coinless calls.[181]

101. The RBOC Coalition argues that the Commission conceded in the *Second*

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[177] Pocket Science Comments at 2.

[178] *Second Report and Order*, 13 FCC Rcd at 1796, ¶ 41.

[179] A product's demand elasticity measures consumer response to price changes in the product. If the quantity a consumer demands remains approximately the same despite relatively large changes in price, the demand is said to be inelastic. The less elastic the demand for a good, the higher the price consumers will tolerate before the quantity they demand lowers significantly.

[180] *Second Report and Order*, 13 FCC Rcd at 1807-1808, ¶ 64; RBOC Coalition Recon. Pet., Analysis of Economist Dr. Hausman at 5.

[181] *Second Report and Order*, 13 FCC Rcd at 1809, ¶ 67.

Report and Order that competitive firms consider demand elasticities in setting prices, but failed to apply an elasticities analysis in this case.[182] The RBOC Coalition contends that its method of utilizing elasticities and marginal costs to set the price of toll-free and access-code calls from a payphone is based on conservative estimates and empirical data.[183] According to the RBOC Coalition, consumer demand for dial-around calls is less elastic than consumer demand for coin calls. Thus, APCC argues, if a PSP examined its elasticities and marginal costs, it would set the price of a dial-around call higher than the price of a coin call.[184] AT&T responds that there cannot be cross-elasticities of demand between two products, such as coin and coinless calls, that are in totally different markets.[185]

102. We again decline to adopt the RBOC Coalition's elasticities methodology.[186] Our objection is not that elasticities and marginal costs cannot be taken into account in setting product prices, especially in an industry with high fixed and common costs. Rather, we find that we do not have sufficiently accurate information in the record to use elasticities and marginal costs in this particular case. We also conclude that, for purposes of setting dial-around per-call compensation, the RBOC Coalition's proffered methodology results in prices that are unreliable. Specifically, the RBOC Coalition's methodology is highly sensitive to estimated values of elasticities and marginal costs. In conjunction with the RBOC Coalition's highly speculative estimates of the elasticities and marginal costs at issue, we find that the resulting "suggested price" is widely variant and thus of little practical value in establishing a reasonable compensation figure. Simply put, the RBOC Coalition's methodology gives wildly divergent answers when the inputs are changed even slightly, and we find such variance unacceptable given the unreliability of the information we have for input data.

103. The RBOC Coalition's proposal is a variation of a traditional economic theory known as Ramsey's pricing. In the classic version of the theory, a regulator setting prices for a hypothetical firm considers the elasticity of all of the products related by joint and common

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[182] RBOC Coalition Recon. Pet. at 4-6.

[183] RBOC Coalition Recon. Pet. at 6 (stating that PSPs already receive commissions for 0+ calls -- which have similar demand characteristics to dial-around calls and which are set in a highly competitive market -- well in excess of the local coin rate).

[184] RBOC Coalition Recon. Pet. at 6. Dr. Hausman further contends that as long as the price elasticity for long distance telephone service is less elastic than -1.24, the coinless rate should be higher than the coin rate. RBOC Coalition Recon. Pet., Analysis of Economist Dr. Hausman at 3.

[185] AT&T Recon. Pet. Reply at 9.

[186] *See Second Report and Order*, 13 FCC Rcd at 1809, ¶ 67.

costs and sets the prices simultaneously.[187] Thus, when pricing, the regulator would set the prices for all the related goods such that the markup ratio (markup divided by price) of the first good divided by that good's price elasticity is equalized to the markup ratio of the second good divided by the second good's price elasticity.[188] The regulator also would set the prices so that the firm earned only a normal rate of return.

104. The RBOC Coalition's methodology varies from the classic theory in several respects. The RBOC Coalition's theory assumes that the price of a local coin call is fixed at the price that was established before per-call compensation for dial-around calls was established. We believe that the RBOC Coalition's failure to set all payphone prices simultaneously undermines its application of the theory. In strictly applying Ramsey's pricing, payphone owners would not consider the local coin call price as fixed when deciding how much to charge for other types of calls.[189] The problem with the RBOC Coalition's improper use of a fixed starting price is compounded by the fact that the local coin call price is necessarily rounded to a nickel increment.[190]

105. Performed properly, moreover, Ramsey's pricing would price all types of payphone calls distinctly.[191] The RBOC Coalition's analysis, however, does not properly price 0+ calls distinctly. The RBOC Coalition implicitly assumes that 0+ calls have the same elasticity as dial-around calls. We believe that the demand for 0+ services is much less elastic than the demand for other coinless calling services.[192] We therefore believe that the resulting optimal price for dial-around calls would almost surely be lower than the price the

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[187] *See, e.g.*, Kenneth Train, Optimal Regulation, MIT Press, Cambridge, MA, at 116-145 (1992).

[188] Under this approach, a greater proportion of fixed costs will be assigned to (and therefore, a higher price will be charged for) the types of calls that are relatively less price elastic.

[189] *See, e.g.*, Kenneth Train, Optimal Regulation, MIT Press, Cambridge, MA, at 116-145 (1992).

[190] Payphones currently accept only silver coins.

[191] *See, e.g.*, Kenneth Train, Optimal Regulation, MIT Press, Cambridge, MA, at 116-145 (1992).

[192] The RBOC Coalition states that 0+ calls have similar demand characteristics to dial-around calls. RBOC Coalition Second R&O Comments, Hausman Declaration at 12. We disagree. At one time, all coinless payphone calls were essentially 0+ calls. Over time, alternative methods of making those same calls became available. Credit card calls became available, access-code calls could be made using 1-800 platforms, and now debit card calls can be made from a payphone. Most people that were making 0+ years ago have migrated to using these other methods of making coinless calls (and people who before did not make coinless calls now are). Those consumers that still make 0+ calls were not enticed by the inexpensive alternatives, which means that they are the least elastic consumers. The consumers that switched to making other types of coinless callers must be demanding coinless calls more elastically than the current 0+ callers.

RBOC Coalition suggests.[193] This is due to the RBOC Coalition's failure to take into account the excess profitability resulting from the high-priced 0+ calls. We believe that 0+ calls (perhaps the least price-elastic class of service provided by payphones) would have the highest markup.[194] With the increased revenue from dial-around and 0+ calls, payphones would become more profitable. Increased profitability would lead to more payphone installations, and the increased number of payphones would lead to a more elastic demand for the payphone in question. The payphone operation would then lower its calling prices. Accordingly, we find the RBOC Coalition's failure to treat 0+ calls distinctly, and its failure to account for the payphone's resulting profitability, leads to an overestimate for the price of dial-around calls.

106. The RBOC Coalition's methodology also relies on speculative estimates of elasticities and marginal costs for both coin calling and dial-around access. Although the RBOC Coalition presented casual empirical evidence of local coin call elasticity,[195] it did not present an empirical estimate of the elasticity associated with dial-around calls. Instead, the RBOC Coalition attempted to estimate the elasticity of dial-around calls by modifying the better-estimated elasticity of interstate long distance toll calls.[196] The RBOC Coalition states that this estimate is conservative because many long distance access-code callers have higher-than-average incomes, or are business callers, whose demand for access-code calls is less elastic than for standard interstate long distance calls.[197]

107. We find this reasoning speculative. We note that frequent users of dial-around access have the incentive to acquire the most information about prices, terms, and conditions. Their long-run demand, therefore, may be very elastic. Many payphone calls are international, and the demand for international calls is much more elastic than domestic toll calls.[198] The RBOC Coalition estimated the blended elasticity for toll-free and access-code

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[193] Even if we use the RBOC Coalition's estimates of marginal costs, which we believe to be flawed, we still arrive at the same conclusion. *See* para. 108 above.

[194] Ramsey's-style pricing would lead to a higher price for 0+ calls because the demand for 0+ calls is less elastic than the demand for dial-around calls.

[195] RBOC Coalition Second R&O Comments, Analysis of Dr. Hausman at 13.

[196] RBOC Coalition Second R&O Comments, Analysis of Dr. Hausman at 13-15.

[197] RBOC Coalition Recon. Pet., Analysis of Dr. Hausman at 2.

[198] For instance, in *Trends in the U.S. International Telecommunications Industry*, Common Carrier Bureau, Industry Analysis Division (1998) at 39, the international toll price elasticity stated to be close to -1, which is more elastic than the -.7 domestic toll price elasticity that Dr. Hausman assumed.

calls to be -.398.[199] Although the record does not contain any empirical estimates of the elasticity of dial-around calls, our experience in this area leads us to conclude that the blended elasticity could plausibly be as much as 50 percent higher, or -.6. We do not believe that -.6 is the correct value for the blended elasticity of a dial-around call. Rather, we find that -.6 creates the elastic bound of the true estimate. In other words, for the reasons stated above, we believe that the RBOC Coalition's elasticity estimate of -.398 is the inelastic bound of the actual blended dial-around elasticity and that -.6 is the elastic bound.

108. We also disagree with the marginal cost estimates provided by the RBOC Coalition. First, the RBOC Coalition relies on an Arthur Andersen estimate of $.04 for the marginal cost of a coin call,[200] but gives no basis for the Arthur Andersen estimate. We have estimated that, on average, the marginal cost of a coin call is $.053,[201] and in some areas it may be as high as $.127.[202]

109. Additionally, the RBOC Coalition estimates that the marginal cost of a dial-around call is $.05,[203] based solely on FLEX ANI costs.[204] We conclude that the per-call marginal cost is less than $.01.[205] First and foremost, FLEX ANI costs will not be marginal. Among the LECs that have tariffed the cost recovery element for FLEX ANI costs, the charge is a flat monthly rate element attached to all payphone lines. Because the charge does not vary with the number of dial-around calls or any other type of call, it will not affect the marginal cost of a dial-around call. Further, dial-around calls do not generate any additional line charges or coin collection costs. Other types of costs associated with a payphone, such as maintenance, SG&A, and capital costs, correlate to the number of payphones, but not to

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[199] RBOC Coalition Second R&O Comments, Analysis of Dr. Hausman at 15.

[200] RBOC Comments, Analysis of Dr. Hausman at 16.

[201] *Second Report and Order*, 13 FCC Rcd at 1800-1801, ¶ 50, n.129. As a result of information we have received, we determine that the marginal cost of a coin call is somewhat higher than $.053. We use the estimate from the *Second Report and Order* to be conservative in our examination of the RBOC Coalition's methodology. Were we to use the higher marginal cost of a coin call, the default price suggested by the RBOC Coalition's pricing methodology would be even lower.

[202] For instance, AT&T suggests that coin collection and rating costs could be $.047. *See Second Report and Order*, 13 FCC Rcd at 1803-1804, ¶ 55, n.145. The RBOC Coalition shows that, in some areas, the line charge alone for coin calls is $.08 per call. RBOC Coalition Comments, Andersen Affidavit at 4.

[203] RBOC Coalition Comments, Analysis of Dr. Hausman at 16.

[204] RBOC Coalition Comments, Analysis of Dr. Hausman at 16.

[205] The record indicates that the marginal cost of coinless calls is virtually zero.

the number of dial-around calls from a payphone.[206] The record does not contain any quantifiable marginal costs to support a specific estimate, and we conclude the marginal cost of these calls is less than $.01.

110. The most serious flaw in the RBOC Coalition's methodology is that it is highly sensitive to the estimates of the very parameters that we find to be improperly estimated: the elasticity of dial-around access, the marginal cost of a coin call, and the marginal cost of a coinless call. We illustrate the vagaries of the RBOC Coalition's methodology in the following table, which shows the "optimal" dial-around price suggested by the RBOC's pricing methodology and the suggested price for the various permutations of marginal cost and elasticity estimates. Although we conclude that the marginal cost of a dial-around call is virtually zero, for purposes of examining the suggested price resulting from the RBOC Coalition's methodology, we assume that the marginal cost of a dial-around call is $.01. Without this assumption, the RBOC Coalition's methodology would result in a price of zero for dial-around calls. When calculating the suggested dial-around price, we use the weighted average coin calling elasticity of -.663, as reported by the RBOC Coalition.

111. The following table shows that the RBOC Coalition's suggested pricing methodology results in dial-around calls being priced from $.07 to $1.59. The RBOC Coalition's variant of Ramsey's pricing results in a range of optimal prices so wide that we conclude that it cannot be used as a basis for selecting the default compensation amount for dial-around calls. Further, the table shows that when using a more accurate (yet still a conservatively low)[207] marginal cost estimate of a coin call and a more accurate (yet still a conservatively high)[208] marginal cost estimate of a dial-around call, the suggested price of a dial-around call ranges from $.07 to $.20. This demonstrates two points. First, when using the RBOC Coalition's Ramsey's-style pricing for payphone calls, uncertainty about even one of the inputs (in this case, the elasticity of dial-around calls) generates a range of prices that

[206] One possible exception to this statement may be the additional billing expense incurred because of an additional dial-around call. Theoretically, the additional call could be from a carrier that the PSP was not already billing, so the additional expense of billing this carrier would be a marginal cost. In this case, the additional expense associated with billing this carrier would be a marginal cost. This would be a rare event, however. Further, even in the rare event that the additional call caused the PSP to bill another carrier, the marginal cost of billing that carrier would itself be small, because most billing costs will be associated with the billing mechanism as a whole. Thus, the marginal SG&A cost associated with dial-around calls is virtually zero.

[207] We again note that we estimate that the marginal cost of a coin call is higher than $.053, but we use the conservative estimate of $.053 here because it leads to a higher suggested default price, which is still less than the default compensation amount we establish in this Order.

[208] We reiterate that we estimate that the marginal cost of a coinless call is $.00, but we employ here a conservative estimate of $.01, because it leads to a higher suggested default price, which is still less than the cost-based default compensation amount we establish in this Order.

is much too wide to use. It also demonstrates that taking into account demand and cost conditions leads to a lower price than our default price of $.231 (before adjustment for interest). We therefore conclude that the RBOC Coalition's Ramsey's-style pricing should not be used to set the default compensation amount, and that the RBOC Coalition's methodology does not demonstrate that our methodology is undercompensatory.

OPTIMAL (DEFAULT) PRICE FOR A DIAL-AROUND CALL USING THE RBOC COALITION'S RAMSEY'S-STYLE PRICING METHODOLOGY

	The Marginal Cost of a Dial-Around Call	
	$.01	$.05
If the marginal cost of a coin call is $.04 and the elasticity of the access charge is	The Resulting Default Price	The Resulting Default Price
-.398	$.32	$1.59
-.600	$.10	$.50
If the marginal cost of a coin call is $.053 and the elasticity of the access charge is	The Resulting Default Price	The Resulting Default Price
-.398	$.20	$1.02
-.600	$.07	$.37

c. Bellwether Compensation.

112. Sprint argues that we should identify the most efficient carrier and base the dial-around compensation amount on that carrier's costs, *i.e.*, the so-called "bellwether" approach.[209] Sprint contends that we have "no duty to ensure that each provider will earn a fair return on its investment, and that even using industry average costs would reward less efficient or less competent operators and would thus deprive the public the benefit of competition."[210] Dr. Baumol agrees, stating that the default price should be set to allow the "maximally efficient" payphone provider to recover its costs.[211]

113. We decline to adopt a bellwether approach because there is insufficient information on the record to conclude that the cost differences among PSPs with data on the record are due to differences in efficiency. All of the parties that submitted data on the record operate payphones in multiple areas and in multiple states.[212] Each region of the country experiences different costs. For example, payphones in dry climates require less protection from rain than payphones in wetter climates. Therefore, a PSP in a more arid region could install a less protective and thus cheaper enclosure than a PSP in a wetter region. Clearly, a PSP in the wetter region should not be deemed less efficient because it needs to invest in a more expensive enclosure. Similarly, we find that regional differences in labor costs and telephone line expenses would affect the cost of a payphone operation.[213] Sprint did not provide any justification showing that any party was more efficient than another.[214]

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[209] Sprint Comments at 15.

[210] Sprint Comments at 16.

[211] AT&T Reply, Analysis of William J. Baumol at 16.

[212] *See* Davel 1998 10K at 2; Peoples Telephone 1998 10K at 4. Furthermore, the RBOC Coalition, which represents companies doing business in all 50 states, submitted data.

[213] The problems with the search for the bellwether approach "most efficient" carrier extend into many different aspects of providing payphones. For example, when comparing the relative costs of maintenance on payphone enclosures, a PSP located predominantly in a densely populated urban area will have very different costs from a PSP in a rural, more sparsely populated area. The difference in costs, however, cannot be translated in a normative determination about which provider is more efficient. In short, this methodology implicates concerns similar to those expressed by the court in *MCI v. FCC* about comparing apples to oranges.

[214] Sprint may believe that LECs are more efficient than PSPs in providing payphones, but as we discuss in Section IV.B.3.a, we do not believe that LEC payphone units are more efficient than PSP payphone units.

d. Caller-Pays Methodology.

114. Under a caller-pays compensation methodology, the calling party would pay for dial-around calls by depositing coins or using a credit card. The caller-pays compensation mechanism is a variation of the set use fee compensation mechanism. Under the set use fee compensation mechanism, the IXC imposes a charge on the caller, collects payment from the caller, and remits that money to the PSP.[215] In the *First Report and Order*, the Commission rejected the caller-pays approach and the set use fee approach on similar grounds.[216] Despite some parties' requests, we decline to adopt a caller-pays compensation methodology at this time.[217]

115. We expect IXCs to develop the technology necessary to employ targeted call blocking, which will allow them to block calls from PSPs that they find to be excessively priced. With the bargaining power afforded to them by the ability to block calls, we are hopeful that IXCs will negotiate privately with PSPs for fair and mutually agreeable compensation amounts.[218] Our preference is for IXCs and PSPs ultimately to enter into privately negotiated agreements establishing compensation amounts for dial-around calls. Although some economists would argue that a caller-pays methodology forms the basis for the purest market-based approach, we find that the statutory language and legislative history indicate Congress's disapproval of a caller-pays methodology.[219] We therefore conclude that

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[215] *See First Report and Order*, 11 FCC Rcd at 20584-85, ¶ 84.

[216] *First Report and Order*, 11 FCC Rcd at 20584-85, ¶¶ 84-85. The Commission concluded that a particular set use fee would lead to greater transaction costs than what would be experienced under a carrier-pays compensation plan. The Commission also found that a caller-pays compensation plan could burden transient callers by requiring them to deposit coins and thus could conflict with section 226(e)(2). *Id.*

[217] *See, e.g.*, PageMart Recon. Pet. at 6; ATP Comments at 2-4; AT&T Comments at 13. *See also* Allen Lund Company Comments at 1-2 (estimating that 25-30 percent of their toll-free calls originate from payphones, leaving them defenseless against potential fraud, and advocating mandatory caller pays method to protect against this type of fraud). APCC counters that any compensation system will have potential for fraud, but that with vigilance, the authorities can "detect, and quickly address actual fraud." APCC Reply Comments at 48. We agree with APCC. The potential for fraud, in and of itself, does not persuade us to choose one compensation system over another. Rather, the valid concerns about fraud allow us to reiterate that we will deal aggressively with any payphone owners found to be abusing the dial-around compensation process. *First Report and Order*, 11 FCC Rcd at 21265, ¶ 63.

[218] *See* Section IV.A.3.a. (discussing the role of targeted call blocking in any move to a deregulatory solution to dial-around compensation).

[219] Specifically, the relevant portions of the Senate Report provide that section 226(e)(2) bars the Commission from concluding that compensation for compensable calls must be paid by the caller. *See* S. Rep. No. 101-439 at 20 (1990). *See also* 47 U.S.C. § 226(e) ("The Commission shall consider the need to prescribe

we should monitor the advancement of call blocking technology and any accompanying marketplace developments before reconsidering a caller-pays compensation approach.

116. We also note that some parties urge us to adopt a "modified caller-pays plan." Under a modified caller-pays plan, entities subscribing to a toll-free number would have three options for handling calls made from payphones. First, the subscriber could elect to accept calls from payphones and pay the charges associated with those calls that are passed through to it by the IXC. Second, the subscriber could block all calls from payphones, eliminating the need for compensation to the PSP. Third, the subscriber could elect to use a special "area code" (*i.e.*, 8XX, instead of "800" or "877" codes) that would enable it to block incoming payphone calls that callers chose not to pay for with coins or a credit card. For the reasons provided above for not instituting a mandatory caller-pays system, we also decline in this proceeding to impose the modified caller-pays or 8XX plan. We note that a modified caller-pays plan is the subject of a petition for rulemaking filed by AirTouch and that the Commission may examine the issue further if that petition is granted.[220]

e. Requests for Exemptions from Compensation.

117. Several petitioners assert that certain types of calls, such as "help line" or paging calls, should be exempt from per-call compensation charges.[221] Other petitioners urge us to exempt from compensation requirements payphone calls to 800 hotlines and Electronic Benefit Transfer ("EBT") services.[222] Specifically, these parties request that we either waive the per-call compensation amount or establish an 8XX number for non-profit organizations.[223] The petitioners supporting an EBT exemption claim that state contracts currently compensate EBT service providers on a fixed price basis. Because the contracts were signed before the

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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.").

[220] *See AirTouch Paging Petition for Rulemaking to Establish a Dedicated 8XX Code for Toll-Free Calls Placed from Pay Telephones*, Public Notice, RM-9273, Report No. 2274 (rel. May 6, 1998).

[221] DMA Recon. Pet. at 1; Source One Recon. Pet. at 5.

[222] *See, e.g.*, Citicorp Comments at 3, 6. EBT is an automated payment process for government assistance programs, such as Food Stamps. EBT uses debit cards and banking technology to provide monetary assistance to recipients of these programs.

[223] *See* CitiCorp Services Comments at 1-3, 5; Colorado Department of Human Services Reply Comments at 2; Kentucky Cabinet for Families & Children Reply Comments at 2; New Hampshire Department of Health & Human Services Reply Comments at 2; Pennsylvania Department of Public Welfare Reply Comments at 1; Washington Department of Social Services Reply Comments at 1.

implementation of per-call compensation charges, EBT service providers did not factor payphone access costs into the contract terms.[224] As an alternative method of compensating PSPs for EBT and 800 hotline calls, these petitioners advocate increasing the cost of coin calls.[225] Several of these commenters encourage us to maintain jurisdiction over the regulation of payphones rates.[226]

118. We find that Congress clearly instructed us in Section 276 to ensure compensation for "each and every" call from a payphone. Congress explicitly exempted only two types of calls: emergency calls (911) and TRS calls. Because Congress did not provide for any other exceptions, we cannot grant an exception for these types of calls. Even if Congress permitted us to grant an exception for EBT calls, we are unconvinced that we should do so. We understand that when a caller is placing an EBT call, the buyer of that call will be the government. This is insufficient justification, however, to deny payphone owners compensation for the use of their payphone. We are confident that our default compensation amount is fair to all parties involved. In receiving compensation, payphone owners will benefit from their decision to place their payphone where consumers benefit from using it. In addition, carriers will pay no more than a proportionate share of the payphone's joint and common costs.

119. We agree with APCC that EBT callers benefit greatly from the placement of payphones in areas with EBT traffic.[227] The people who use payphones to complete EBT calls likely have no phone service in their home and are therefore likely to derive significant benefits from conveniently located payphones. Payphone owners that receive fair compensation for EBT calls are more likely to locate their payphones in areas where EBT calls are made, thus providing service for people who rely on payphones as a phone of last resort. Payphones will thus be placed where the amount of traffic warrants the payphone's existence, which is one of the benefits of a deregulatory approach.

120. We also decline requests to artificially raise the local coin calling rate or to re-regulate payphone prices so that calls like EBT calls can be made for free or at a reduced price. We understand that because of our default compensation amount, government agencies will ultimately spend more money to disburse benefits. Under Citicorp's proposal to raise the

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[224] *See, e.g.*, Citicorp Comments at 2-3, 6.

[225] *See, e.g.*, CitiCorp Comments at 5.

[226] Oklahoma Department of Human Services Reply Comments at 1; Rhode Island Comments at 2; Vermont Department of Social Welfare Reply Comments at 2.

[227] APCC Reply Comments at 48-49.

local coin calling price, however, consumers will still pay for those calls, albeit in a different form. Under Citicorp's proposal for free or reduced-price EBT calls, PSPs would not receive the extra compensation from EBT traffic and therefore would have no economic incentive to locate payphones according to the needs of EBT callers. Any such scheme also would involve creating a subsidy, an option that Congress specifically eliminated in the 1996 Act.[228]

121. We note that APCC states that some PSPs would be willing to reduce the amount of per-call compensation if they find evidence that IXCs do the same. We encourage those parties with budgetary concerns to meet with the IXCs and PSPs to reach a voluntary agreement regarding per-call compensation.

3. Cost Calculation.

122. In this section, we address challenges to three aspects of the Commission's calculation in the *Second Report and Order* of the cost of a dial-around call. Petitioners challenge the accuracy of the various sources of cost data on which we relied in determining the cost of a dial-around call. Petitioners challenge our choice of a marginal payphone location in establishing certain per-call costs. Finally, petitioners argue that various components of our cost calculation were either improperly allowed, improperly disallowed, or improperly calculated.

a. Source of Cost Data.

123. In this section, we address issues raised concerning the cost data discussed in the *Second Report and Order*. We also examine the cost data submitted in response to our *Public Notice* and in petitions for reconsideration. Petitioners raise concerns regarding five sources of cost data. First, petitioners argue that, in the *Second Report and Order*, the Commission relied too heavily on data from independent PSPs. Second, parties claim that NYNEX's cost studies show that NYNEX's average cost of a coin call is less than $.25, implying that the compensation amount also should be less than $.25. Third, parties claim that, in the *Second Report and Order*, the Commission ignored Sprint's cost data. Fourth, AT&T submitted data from SBC that purportedly shows that, in using a LEC's costs, the per-call compensation amount should be less than $.25. Fifth, MCI submitted a cost study purporting that the average cost of a dial-around call is significantly less than the Commission estimated. We address each of these issues separately.

[228] 47 U.S.C. § 276. For the same reasons stated above, we decline to create a special 8XX code that could be used by non-profit companies.

124. *Reliance on APCC and Independent PSP data.* When calculating the average cost of a dial-around call in the *Second Report and Order*, the Commission relied on data that it concluded was reliable.[229] In its petition for reconsideration, AT&T asserts that the *Second Report and Order* generally overstates the costs of payphone calls, because the Commission relied too heavily on cost data submitted by APCC and other independent payphone providers.[230] AT&T further states that most payphones are operated by LECs, not independent payphone owners.[231] In the *Second Report and Order*, the Commission relied solely on APCC data only when determining the number of calls made from a payphone in a marginal location.[232] In this Order, however, we do not rely on that calculation. We therefore need not address AT&T's arguments regarding the use of APCC data.

125. *NYNEX cost studies for Massachusetts and New York State.* Before the Commission issued the *Second Report and Order*, Sprint petitioned the Commission to require NYNEX to distribute to all parties of record a copy of the confidential Massachusetts DPUC study, which concludes that the cost of a coin call is $.167. The Commission denied Sprint's petition.[233] AT&T contends that the Massachusetts DPUC study supports a per-call dial-around price of less than $.167. AT&T suggests that the LECs failed to supply cost data because such data would militate in favor of establishing a compensation amount that is less than an amount that would benefit the LECs.[234]

126. On July 10, 1998, the New York Public Service Commission (PSC) filed comments showing that, in a study conducted in New York, Bell Atlantic's average cost of a coin call is less than $.25.[235] Several parties cite this study in support of AT&T's contention that, due to lower costs experienced by LECs, the default, per-call compensation amount

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[229] *Second Report and Order*, 13 FCC Rcd at 1820-24, ¶¶ 99-107.

[230] AT&T Recon. Pet. at 12-16 (stating that the Commission should not have relied only on independent PSP data when determining the average cost of a dial-around call, because independent PSPs have higher costs than LEC-owned PSPs).

[231] AT&T Recon. Pet. at 13 ("IPPs . . . operate only about 20 to 25 percent of all payphones."). *See also* AirTouch Recon. Opp. at 8; Arch Recon. Reply at 3.

[232] *Second Report and Order*, 13 FCC Rcd at 1798-99, ¶¶ 46-50.

[233] *Second Report and Order*, 13 FCC Rcd at 1825, ¶ 110. The Commission denied Sprint's petition, in part, based on Bell Atlantic's claim that the study was proprietary.

[234] AT&T Recon. Pet. at 14.

[235] State of New York Department of Public Service Comments at 1.

should be less than $.25.[236]

127. The RBOC Coalition asserts that the Massachusetts DPUC and New York cost studies are not fully distributed cost studies, maintaining that several costs were omitted. The RBOC Coalition further states that the line costs in Massachusetts were less than line costs in other states served by Bell Atlantic.[237] Arthur Andersen, on behalf of the RBOC Coalition, states that the New York study reported the provision of access lines at cost, rather than at tariffed rates. Arthur Andersen further states that the New York cost study excludes many fixed costs associated with providing payphone service.[238]

128. For the reasons provided by the RBOC Coalition, we decline to rely on the New York study in determining the costs of a stand-alone payphone provider. We believe that, when taking into account all the appropriate costs, the average cost of making a coin call in New York is likely to be higher than the $.25 that the New York PSC reported.

129. *Sprint data.* In the *Second Report and Order*, the Commission did not rely heavily on Sprint cost data.[239] AT&T alleges that the Commission failed to adequately consider Sprint's cost data. AT&T believes that Sprint's data demonstrates that LEC-owned payphone operations are more efficient than independent PSP operations. AT&T avers that, because most payphones are owned by LECs, the dial-around default price should be less than the amount established in the *Second Report and Order.*[240]

130. We conclude that the Sprint data are unreliable. First, Sprint's return and depreciation estimates appear to be based on embedded costs, not forward-looking costs. This is significant in assessing the reliability of Sprint's data, because embedded costs do not necessarily reflect the economic cost of establishing a current operation. Specifically, Sprint's cost study suggests that it can recoup the value of a payphone by recovering $6.98 each month for five years.[241] Thus, based on Sprint's data, a Sprint payphone, including pedestal,

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[236] *See, e.g.*, Sprint Comments at 18.

[237] RBOC Coalition Second R&O Reply, Andersen at 2-3; RBOC Reply, Andersen at 6-7.

[238] RBOC Reply, Andersen at 6, 7.

[239] *Second Report and Order*, 13 FCC Rcd at 1820-24, ¶¶ 99-108.

[240] AT&T Recon. Pet. at 13-14 (*citing Second Report and Order*, 13 FCC Rcd at 1821, ¶ 101 n.267).

[241] Sprint Second R&O Reply, Exhibit 1 at 2 (asserting that monthly depreciation for payphone assets is $6.98).

enclosure, and installation, costs $418.80.[242] The evidence on the record, however, demonstrates that a newly installed coin payphone unit costs more than $2,300.[243] Clearly, Sprint's asset return requirement is too low.

131. We assume that Sprint's $6.98 monthly depreciation amount results from its particular accounting procedures, in which, as a normal course of business, Sprint has been depreciating its payphone assets over a five-year-period. We find, however, that the evidence supports a conclusion that payphones last longer than five years.[244] Thus, it appears that, when Sprint transferred the payphones to its unregulated payphone operation, the payphone operation received those payphones at less than full market value.[245] We note that payphones that were older than five years at the time of transfer would have effectively been transferred at a book value of zero. Sprint would have completely depreciated those payphones, leaving them with a book value of zero. Thus, these payphones were transferred to Sprint's payphone operation at a value of zero.[246] This non-economic accounting methodology alone justifies setting prices on a going-forward basis. More importantly, because the marketplace sets prices on a forward-looking basis, we do not use embedded costs in this Order.

132. Second, we find appropriate our decision in the *Second Report and Order* to not rely on Sprint's estimate for Sales, General and Administration (SG&A) costs (*i.e.*, overhead costs).[247] Sprint reported that its SG&A costs are only $8.51 per payphone per month. This is almost 70 percent less than a large PSP's SG&A cost[248] and nearly 50 percent

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[242] We arrive at $418.80 by multiplying the monthly payphone recovery cost of $6.98 by 60 months.

[243] *See* IV.B.3.g(1).

[244] The record evidence demonstrates that payphones should be depreciated over 10 years. *See, e.g.*, Peoples Telephone 1997 SEC form 10-K, page 31; MCI Comments, Exhibit 2 at 3.

[245] The Commission required BOCs or other incumbent LECs subject to our joint cost rules to classify their payphone operations as nonregulated for our Part 32 accounting purposes, pursuant to our regulations implementing section 276. *See First Report and Order*, 11 FCC Rcd at 20621, ¶ 157.

[246] We realize that not all LECs depreciate their payphones over a five-year schedule, but this does not obviate our conclusion that embedded costs do not necessarily correlate to economic value.

[247] *Second Report and Order*, 13 FCC Rcd at 1822, ¶ 103.

[248] *Compare* Sprint R&O Reply, Exhibit 1 at 2 (estimating monthly SG&A at $8.51) *to* CCI Second R&O Comments at 10 (monthly SG&A of $28.80, derived by multiply CCI's $.04 per call estimate times CCI's 720 average number of calls).

less than SBC's SG&A estimate of $16.52.[249] In light of the contrary record evidence, and given our experience regulating telecommunications companies, including payphone operators, we find that Sprint's SG&A estimate does not reasonably represent the costs of a stand-alone payphone company. For this reason, we find that the Commission properly exercised its discretion and did not rely on Sprint's estimate of SG&A costs. We note that, although the Commission did not fully explain its reasoning in the *Second Report and Order*, we believe the Commission's decision was nonetheless correct. Furthermore, for these same reasons, we conclude that we should not rely on Sprint's costs in this Order.

133. *SBC data (as submitted by AT&T).* In its petition for reconsideration, AT&T submits a new cost study, called Project Quintet, that SBC performed to facilitate the possible sale of its payphone operations.[250] AT&T argues that the Project Quintet data demonstrate that the average cost of a coin call is $.195.[251] SBC states that the costs enumerated in Project Quintet were incomplete and did not account for several costs of a payphone operation, including legal support and rent.[252] The RBOC Coalition submitted supplemental information regarding maintenance and SG&A costs.[253] AT&T believes that the Project Quintet data are sufficient to estimate SBC's payphone costs and do not require modification.[254]

134. We note that the Project Quintet data that AT&T submitted does not include line items for legal support, rent, advertising, or other similar costs. We therefore concur with SBC that those costs were not included in the data submitted by AT&T. We find, however, that the Project Quintet data, as supplemented by SBC,[255] provides some assistance to our determination of a fair default compensation amount. Although the capital costs

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[249] RBOC Coalition Nov. 12, 1998 *ex parte* letter from M. Kellogg to Craig Stroup. The amount of $16.52 includes $10.38 reflected in the Project Quintet data that AT&T submitted, plus $6.14 of monthly costs originally omitted in the Project Quintet study.

[250] AT&T Recon. Pet., Attachments I-III.

[251] *Id.* at 15. *See also* Consumer-Business Coalition Recon. Opp. at 5 (arguing that SBC data proves LEC payphone operators have lower costs).

[252] RBOC Coalition Nov. 12, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

[253] RBOC Coalition Nov. 12, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

[254] AT&T Nov. 19, 1998 *ex parte* letter from J. Spurlock to Magalie Roman Salas at 1.

[255] RBOC Coalition Nov. 10, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

derived from the Project Quintet data are unusable because they are based on embedded costs,[256] we conclude that the SG&A and maintenance costs, as supplied by SBC, are reliable.

135. *MCI data.* In response to our *Public Notice*, MCI submitted a payphone cost study suggesting that the average cost of a coin call is $.16, and the average cost of a coinless call is $.12. Upon review, we conclude that MCI's cost study is unreliable for four reasons. First, the cost study is based on a hypothetical business model.[257] Because payphones serve a wide variety of locations, including outdoor locations, we find that the capital cost data from actual payphone operations will better reflect a PSPs actual costs. Second, MCI's SG&A estimate is based on multiplying the capital investment by 10.4 percent.[258] This 10.4 percentage was arrived at by examining AT&T's overhead costs.[259] AT&T is primarily a long distance company, not a payphone operator. We find that MCI failed to adequately explain why a payphone operator's overhead costs should bear the same relationship to capital as AT&T's. We thus find unreliable MCI's percentage of 10.4 for estimating overhead costs. Furthermore, MCI multiplies its overhead factor by an amount of capital that we find to be too low, resulting in an SG&A estimate that consequently is too low.[260] We thus conclude that MCI's SG&A cost estimate is unreliable.

136. Third, we find that MCI's cost study is incomplete. For example, MCI did not include any cost estimates for trucks, replacement parts, and other items.[261] We find that these costs are required, however, for a payphone operation. Also, MCI estimated the monthly telephone expenses, in part, by using the 1996 ARMIS reports, using line items USOA 2315 and 6315 (public telephone equipment), but did not account for the payphone

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[256] AT&T Recon. Pet., Attachments I-III.

[257] MCI operates its own payphones, but its cost study is not based on its own experience. We have no evidence on the record from actual payphone operations. For instance, APCC submitted payphone capital cost data from two large payphone operations. *See* APCC Aug. 21, 1998 *ex parte* letter to Magalie Roman Salas; APCC Sept. 16, 1998 *ex parte* letter from R. Aldrich to Magalie Roman Salas. We also used maintenance and SG&A data from SBC. *See* SBC Nov. 10, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

[258] MCI Comments, Exhibit 2 at 4.

[259] MCI Sept. 11, 1998 *ex parte* letter from L. Sawicki to Magalie Roman Salas at 2.

[260] MCI assumes that a newly installed payphone costs less than $1700 (*see* MCI Comments, Exhibit 2 at 7), but we find that the average payphone costs more than that. *See, e.g.*, APCC Aug. 21, 1998 *ex parte* letter from R. Aldrich to Magalie Roman Salas (stating that a newly installed payphone costs $2523).

[261] Although some parties may argue that these costs are included in the overhead figure that MCI used, we conclude in para. 135 that MCI's calculation of overhead is unreliable.

costs included in accounts 6533 and 6534.[262] For these reasons, we conclude that MCI's cost study is unreliable.[263]

137. *LEC payphone data versus non-LEC payphone data.* Several parties contend that LEC payphones are more efficient than non-LEC payphones.[264] Parties point to NYNEX cost studies that allegedly show that NYNEX experienced lower costs than non-LEC PSPs. As we state above, we are unable to verify the validity of some of this third-party information.[265] Also, some of the third-party data appears to be unreliable on its face. For example, SBC states that the SG&A estimates that may be derived from the Project Quintet data are too low because several SG&A costs are omitted.[266] Also, the RBOC Coalition states that the NYNEX studies do not include all payphone costs.[267] Thus, we find that, before using third-party information, such information must be verified.

138. We conclude, however, that much of the data submitted by the independent PSPs reliably reflect the costs of a stand-alone payphone operation. First, as the Commission noted in the *Second Report and Order*, the independent PSPs' data are consistent with their Securities and Exchange Commission (SEC) forms 10K, which must be certified to by an officer of the company.[268] Further, these data are based on their own, actual payphone operations. In certain instances, where we could not use a particular cost element because it did not accurately measure the cost we were examining, the RBOC Coalition and PSPs

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[262] In an RBOC Sept. 14, 1998 *ex parte* letter from M. Kellogg to Craig Stroup, the RBOC Coalition states that additional payphone costs are reported in accounts 6533 and 6534.

[263] In addition to their cost study, MCI also submitted an *ex parte* letter analyzing an RBOC PSP's costs, in which MCI concluded, after adjusting for coin related costs, that the cost of a payphone operation is $109.543 per phone per month. MCI Aug. 26, 1998 *ex parte* letter from L. Sawicki to Magalie Roman Salas. Interestingly, MCI's estimate is actually higher than our estimate of $101.29 per month (*see* line 6 in the table in Section IV.B.3.g(8). below). MCI divides its cost estimate by 700 calls for a per-call compensation estimate of $.156. Dividing MCI's estimate of $109.543 by 439 calls at a marginal payphone location results in per call compensation amount of $.233 per call, which is comparable to our estimate in this Order before interest is allowed. *See* line 7 in the table in Section IV.B.3.g(8) below.

[264] For instance, AT&T suggests that SBC payphone operations have lower SG&A and maintenance costs than non-LEC PSPs. AT&T Recon. Pet. Attachments I-III.

[265] *See* Section IV.B.3.a. above (discussing NYNEX's New York and Massachusetts data). In the case of the BellSouth data that AT&T filed, the information was not sufficiently detailed to use.

[266] RBOC Coalition Nov. 12, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

[267] RBOC Coalition Second R&O Reply, Andersen at 2, 3; RBOC Replies, Andersen at 6, 7.

[268] *Second Report and Order*, 13 FCC Rcd at 1823, ¶ 106.

submitted supplemental data that convinced us of the data's reliability. For example, because the cost of installing a new payphone cannot accurately be determined by examining the capital costs reported on a PSP's SEC form 10K, two large PSPs submitted information that specifically addressed the costs associated with installing a new payphone.[269] In addition, in response to our request, the RBOC Coalition supplied data for payphone line costs and FLEX ANI cost recovery tariffs.[270] We find the payphone line cost data and FLEX ANI data to be reliable, because the cost estimates were largely taken from tariffs, with the remaining figures provided with sufficient documentation to convince us they are correct.

b. Use of Marginal Payphone Location.

139. To establish a per-call default compensation amount based on the costs of a payphone operation, the cost of that operation must be divided by a particular number of calls. In the *Second Report and Order*, we concluded that we should use the number of calls at the marginal payphone location. A marginal payphone location is a location where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner. The Commission determined that when the 1996 Act was passed and payphones were receiving dial-around compensation on a per-phone basis, the marginal payphone location experienced 542 calls per month.[271]

140. Some parties disagreed with the Commission's use of a marginal payphone location in establishing the default compensation amount for dial-around calls. For example, when MCI calculated the cost of a coin call, it assumed that 700 calls per month were made from a particular location.[272] CWI argues that, in the *Second Report and Order*, the cost of making a coin call was inflated by using a hypothetical payphone that experiences a relatively low volume of calls.[273] Alternatively, Dr. Hausman states that the "Commission should set prices so that a marginal payphone will still be able to recover its costs,"[274] and that using average call volumes will cause payphones with low call volumes or relatively high costs to

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[269] In the APCC Aug. 21, 1998 *ex parte* letter to Magalie Roman Salas, Peoples Telephone reported the costs of a new payphone, with installation and pedestal/enclosure. In the APCC Sept. 16, 1998 *ex parte* letter from R. Aldrich to Magalie Roman Salas, Davel also reported the costs of a newly installed payphone.

[270] RBOC Coalition Sept. 3, 1998 *ex parte* letter from M. Kellogg to Craig Stroup.

[271] *Second Report and Order*, 13 FCC Rcd at 1797-1801, ¶¶ 46-50.

[272] MCI Comments, Exhibit 2 at 7.

[273] CWI Comments at 10.

[274] RBOC Coalition Second R&O Comments, Hausman Declaration at 23.

exit the industry.[275] Similarly, APCC contends that the use of an average call volume would lead to call volumes continually increasing, because payphones with submarginal call volumes would be forced to exit the industry due to lower compensation amounts that are based on the average call volumes.[276] Additionally, parties have submitted information showing that the 542 calls at a marginal location, which we relied on in the *Second Report and Order*, was too high. The RBOC Coalition submitted data showing that the average RBOC Coalition payphone handles 478 calls per month.[277] APCC stated that call volumes at independent payphones fell sharply.[278] APCC attributes the decrease in call volume to the drop in cellular and PCS prices and the increase in the number of payphones, and notes that the decreasing call volumes occurred largely before the coin prices increased.[279]

141. We reaffirm that use of the marginal payphone location is necessary to fairly compensate PSPs and ensure the widespread deployment of payphones in compliance with the mandates of section 276. We find that basing the default compensation amount on an average payphone location would cause many payphones with less-than-average call volumes to become unprofitable. We note that many states examining the payphone market have concluded that there are a sufficient number of payphones and thus a public interest payphone program[280] is unnecessary at this time.[281] We conclude that, if we were to base the default

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[275] RBOC Coalition Comments, Hausman Declaration at 7.

[276] APCC Reply at 26-27.

[277] RBOC Coalition Sept. 3, 1998 *ex parte* letter to Magalie Roman Salas at 2. *Cf.* APCC Sept. 28 *ex parte* letter from R. Aldrich to Magalie Roman Salas.

[278] APCC Sept. 25, 1998 *ex parte* letter to Magalie Roman Salas.

[279] *Id.*

[280] In the *First Report and Order*, the Commission -- finding that primary responsibility for administering and funding public interest payphones should rest with the states -- set forth basic guidelines that the states should follow in establishing a funding mechanism and directed the states to review whether they have adequately provided for public interest payphones. *First Report and Order*, 11 FCC Rcd at 20677-86, ¶¶ 277-286. As the Commission defined them in the *First Report and Order*, public interest payphones are payphones that: (1) fulfill a public policy objective in health, safety, or public welfare; (2) are not provided for a location provider with an existing contract for the provision of a payphone; and (3) would not otherwise exist as a result of the operation of the competitive marketplace. *First Report and Order*, 11 FCC Rcd at 20680, ¶ 282.

[281] *See, e.g.*, North Carolina Utilities Commission, *In Re Payphone Service*, Docket No. P-100, Sub 84a, (May 13, 1998) (noting that the restructuring and deregulation of the payphone industry will expand the availability of payphone service to the public and that the increased subscription to cellular services lessens the need for a public interest payphone program; concluding that a public interest payphone program in North Carolina would be premature and inappropriate); Maine Public Utilities Commission, *In Re Provision of Payphone Service*, Docket No. 98-356, (August 25, 1998) (finding that a public interest payphone program is

compensation amount on the average payphone location, many payphones would become unprofitable and exit the industry. We therefore conclude that we should use the marginal payphone location when establishing the default compensation amount. Because it assures fair compensation for the overwhelming majority of payphones, we conclude that the methodology we adopt in this Order will not negatively affect the current deployment of payphones and thus is consistent with Congress's goal of widespread deployment of payphones.[282]

142. MCI asserts that use of a marginal payphone location suffers from a "circularity" problem because the number of calls at a marginal payphone location is affected by the compensation amount.[283] Thus, an increase in the per call compensation amount means that a payphone needs fewer calls to break even. The "circle" thus consists of call volume

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unnecessary due to the wide availability of payphones in Maine); Pennsylvania Public Utility Commission, *In Re Rescind Obsolete Regulations Regarding Telephone and Residential Telephone Service*, L-00960113 (April 10, 1998) (noting the wide availability of payphones in Pennsylvania); Colorado Public Utilities Commission, *In the Matter of Proposed Amendments to the Rules Regulating Telecommunications Service Providers and Telephone Utilities*, 4 CCR 723-2; and the Rules Regulating Operator Service Providers, 4 CCR 723-18 (Sept. 15, 1997) (concluding that the market should ensure the availability of public interest payphones and that regulators should intervene only where necessary); Montana Public Service Commission, *In the Matter of the Commission's Inquiry into Payphone Issues Arising out of the Telecommunications Act of 1996 and Subsequent Federal Communications Commission Order to Implement the Payphone Provisions of the Act*, Docket No. D97.2.33, Order No. 6050 (Feb. 26, 1998) (finding that there is no evidence indicating that the payphone market is failing to serve the public interest); New York Public Service Commission, *Proceeding on Motion of the Commission to Review Regulation of Coin Telephone Services under Revised Federal Regulations Adopted Pursuant to the Telecommunications Act of 1996*, Case 96-C-1174 (July 15, 1998) (stating that the number of payphones available for public use appears to be increasing in New York and therefore declining to establish a public interest payphone program); Public Utility Commission of Oregon, *In the Matter of an Investigation Concerning Public Interest Payphones Pursuant to Federal Communications Commission Dockets CC 96-128 and 91-35*, Order No. 98-435 (Oct. 26, 1998) (concluding that formal proceedings are unnecessary because Oregon has no state regulatory impediments to entry or exit in the payphone market and there is no need for a public interest payphone program at this time); Public Service Commission of Delaware, *In the Matter of the Investigation and Adoption of Rules to Govern Payphone Services within the State of Delaware*, Order No. 4885 (August 25, 1998) (finding no identifiable need for a public interest payphone program in Delaware at the time); Public Service Commission of West Virginia, *In Re General Investigation into the Payphone Market in West Virginia*, Case No. 98-0430-T-GI (Jan. 4, 1999) (concluding that there is no need to take any additional regulatory actions to address "market failures" in the deregulated payphone market in West Virginia at this time).

[282] We believe, however, that other factors, such as the decreasing prices for cellular and PCS service, may reduce the number of payphones. Such a reduction in the number of payphones would be the result of a competitive marketplace. That does not mean that state commissions should not take action regarding payphones if they believe market forces are causing the removal of payphones in locations where they continue to be needed.

[283] *See* MCI January 19, 1999 *ex parte* letter from G. Ford to Magalie Roman Salas at 2-4 (discussing the circularity associated with the use of a marginal payphone location).

being a function of compensation, and compensation being a function of call volume. Although MCI argues that this circularity undermines the use of a marginal location, this same concern applies equally to the use of an average location, or for that matter any volume level the Commission could choose as a rational starting point for its analysis.[284] This is true because the problem does not arise from the selection of average versus marginal payphone locations, but rather is inherent in the use of a per-call compensation scheme, as mandated by the statute.[285] As the default amount increases, more low volume payphones become profitable; as default amount decreases, more payphones become unprofitable and are likely to be taken out of service.[286]

143. The concern identified by MCI requires us first to deduce an appropriate level of payphone deployment, in order to calculate a "fair" compensation amount. Based on the evidence in the record, we have concluded that the current approximate level of deployment most appropriately satisfies Congress's stated goal of promoting widespread deployment of payphones to the benefit of the general public.[287] This conclusion is supported by the filings of several states that have studied the payphone markets in their respective jurisdictions and concluded that the current deployment of payphones is adequately meeting the needs of the

[284] Indeed, MCI readily admits that an "average-payphone approach" (which it supports) also suffers from this circularity problem, *unless* the Commission were to use "average call volumes prior to implementation of the per-call compensation approach." MCI Jan. 19, 1999 *ex parte* letter from G. Ford to Magalie Roman Salas at 5. First, we note that MCI's condition would apply equally to the circularity concerns of a marginal-payphone approach. Second, MCI's assertion that this resolves the circularity concerns is misplaced because using pre-compensation volumes would still reflect the effects of a particular compensation amount, albeit one where the compensation level was little or zero. More generally, we reject MCI's approach because, before per-call compensation, payphone owners were not receiving fair compensation for a large segment of their total call volume -- dial-around calls. We recognize that before per-call compensation, some payphone owners were receiving $6.00 per month for dial-around compensation which compensated them solely for access code calls and not for toll free calls. Thus, in order for a payphone to break even in the period prior to per call compensation, that payphone required a higher number of local, 0+, and 0- calls as compared to payphones under the current per call compensation plan. This would result in a compensation amount that would not adequately compensate payphone owners for dial-around calls. We thus conclude that basing the default compensation amount on the number of calls at the current marginal payphone location is reasonable and appropriate.

[285] *See* 47 U.S.C. § 276(b)(1)(A).

[286] We also note that the use of a top-down methodology likewise would suffer from a similar problem. To set the per-call default compensation amount using a top-down methodology, we would subtract the cost of the coin mechanism (a cost associated solely with coin calls) on a per-call basis. We would thus be required to determine the appropriate number of calls to use when calculating the per-call costs associated with the coin mechanism. As with the bottom-up approach, we would have to select either the average or marginal payphone location when determining call volume, both of which are dependent on the default compensation amount.

[287] 47 U.S.C. § 276(b)(1).