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KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.

SUMNER SQUARE
1615 M STREET, N.W.
SUITE 400
WASHINGTON, D.C. 20036-3209

(202) 326-7900
FACSIMILE:
(202) 326-7999

September 4, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

By Hand

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Room TW-B204
Washington, D.C. 20554

Re: *Petition for Rulemaking To Establish Revised Per-Call Payphone Compensation Rate*

Dear Ms. Dortch:

Please find enclosed for filing the original and nine copies of the RBOC Payphone Coalition's Petition for Rulemaking in the above-captioned matter. Also enclosed is one extra copy of the petition. Please date-stamp and return the extra copy.

Thank you for your assistance. If you have any questions, please call me at 202-326-7921.

Sincerely,

Aaron M. Panner

cc: Qualex International

Enclosures

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

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of Petition for Rulemaking To Establish Revised Per-Call Payphone Compensation Rate	R.M. – To: The Commission

PETITION FOR RULEMAKING

MICHAEL K. KELLOGG
AARON M. PANNER
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
1615 M Street, NW
Suite 400
Washington, DC 20036
(202) 326-7900

Counsel for the RBOC Payphone Coalition

September 4, 2002

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PETITION FOR RULEMAKING

SUMMARY AND INTRODUCTION

Pursuant to section 1.401 of the Commission's rules, 47 C.F.R. § 1.401, BellSouth Public Communications, Inc., SBC Communications Inc., and the Verizon telephone companies (collectively, the "RBOC Payphone Coalition" or "Coalition") hereby petition the Commission to establish a new per-call payphone compensation rate of $0.49 per call.

Commission action is urgently needed. In adopting the existing $0.24 rate, the FCC relied on cost data and call volume data collected in 1996-1998. Since 1998, RBOC payphone service providers ("PSPs") have cut their costs, but such cost reductions have not kept pace with the extraordinary decline in the volume of payphone calls due to the proliferation of wireless telephones. Indeed, call volumes across the country have fallen by *more than 50%* since 1998. As a result, payphone deployment has fallen sharply – more than 20% over the same time period. Moreover, and despite this sharp drop in the number of deployed payphones, RBOC PSPs have actually cut *per-payphone* costs. Despite this retrenchment, with the sharp drop in call volume, *per-call* costs have increased; PSPs have no choice but to recover their costs from an ever-decreasing number of callers. As a result, unregulated prices for payphone calls have risen since 1998. In most of the country, the price of a local coin call was typically $0.35 in 1998. That market price has risen to $0.50.

In light of these market realities, the existing $0.24 rate does not satisfy the legislative requirement that PSPs be "fairly compensated for each and every completed intrastate and interstate call," as that requirement is defined in the Commission's own orders.[1] In its *Third Report and Order*,[2] the Commission determined that "the default per-call compensation amount . . . should ensure that each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone."[3] The current $0.24 rate does not meet that standard.

The Commission should immediately issue a Notice of Proposed Rulemaking to adopt a revised per-call compensation rate.[4] In so doing, the Commission should apply the methodology from the *Third Report and Order* – a methodology already accepted by the D.C. Circuit – with small modifications that will enable the Commission to rely on available data in a more straightforward way.

[1] 47 U.S.C. § 276(b)(1)(A).

[2] Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 2545 (1999).

[3] *Id.* at 2571, ¶ 59 (footnote omitted).

[4] The Commission should not seek comment on this petition for rulemaking, but should immediately issue an NPRM on its own motion. Any arguments that parties may wish to offer against changing the per-call rate can be offered once the rulemaking is commenced, and time is of the essence.

I. THE COMMISSION SHOULD RECALCULATE THE DEFAULT COMPENSATION RATE BASED ON THE METHODOLOGY FROM THE *THIRD REPORT AND ORDER*

In the *Third Report and Order*, the Commission employed a cost-based calculation to determine the default rate for per-call compensation. The Commission's methodology was affirmed on review.[5] Accordingly, there can be no obstacle to the Commission employing the same methodology and recalculating the default rate based on current market and cost data.

It is not practical for the Commission to move to a pure "market-based resolution" of the per-call compensation issue. In theory, a market rate for dial-around calls would be the most efficient and "fairest" solution to the per-call compensation problem.[6] But, as a result of the operation of the Telephone Operator Consumer Services Improvement Act ("TOCSIA"), PSPs are not at liberty to block dial-around calls. Accordingly, all such calls amount to a "forced sale" of payphone services. By contrast, IXCs are free to block calls from payphones; if they believe the default rate is "too high," they can negotiate a lower rate; indeed, under the FCC's rules, the default rate applies only where the parties do not agree to another rate. But because IXCs have no incentive to pay *more* than the default rate, it is vital that the Commission revise the default rate to reflect current costs more accurately. Otherwise, PSPs will continue to be deprived of fair compensation, in violation of the congressional command.

This Commission should modify the methodology set forth in the *Third Report and Order* only slightly. In particular, the Commission should use a different approach to determine the call volume at a marginal payphone. The Commission's stated purpose behind adopting the

[5] *See American Pub. Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000).

[6] *See Third Report and Order*, 14 FCC at 2570, ¶ 57 ("'fair compensation' [is] the amount to which a willing seller (*i.e.*, PSP) and a willing buyer (*i.e.*, customer, or [interexchange carrier ("IXC")]) would agree to pay for the completion of a payphone call").

marginal payphone as the basis for its per-call compensation calculation was that, by relying on the costs of a marginal phone, rather than on those of an average phone, it would "promote the continued existence of the vast majority of payphones."[7] In the *Third Report and Order*, the Commission based its calculation of the marginal payphone call volume on revenue requirements reported by the RBOC Payphone Coalition.[8] The Coalition had used revenue requirements for a marginal location reported by Coalition members to derive a call volume for that marginal location.[9]

The Coalition has not used the same methodology here, because whether a payphone is marginal depends on the rate of compensation paid for all of the calls made from the payphone. In a market with sharply declining call volumes, whether a marginal payphone will remain marginal depends on whether and by how much the per-call compensation rate is increased.

Market facts illustrate the point. Although the Commission intended to set a per-call rate that would "ensure the widespread deployment of payphones in compliance with the mandates of section 276,"[10] the number of RBOC phones has fallen by more than 20% – from 1.35 million to 1.06 million – since the *Third Report and Order*. As the Commission feared, and despite the Commission's effort to determine the call volume at a marginal phone, "many payphones [have] become unprofitable and [have] exit[ed] the industry."[11] They have become unprofitable –

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[7] *Id.* at 2571, ¶ 59.

[8] *Id.* at 2612, ¶ 147.

[9] *Id.* The Coalition reported a marginal call volume of 414 calls. The Commission increased that volume by averaging the call volume at a marginal location with the call volume at new locations where RBOC PSPs would agree to pay commissions. *See id.* The Commission never explained the reason for this adjustment.

[10] *Id.* at 2608, ¶ 141.

[11] *Id.* at 2608-09, ¶ 141.

despite the fact that PSPs have raised local call rates in an attempt to offset falling call volumes – in large measure because PSPs have not had the benefit of any increase in the per-call compensation rate. Thus, to determine an appropriate default rate, the Commission should look at current actual call volumes in order to determine the per-call revenue requirement for payphones that are still deployed.

The Commission should, however, continue to calculate the dial-around rate by calculating the call volume at the "marginal payphone location," because "basing the default compensation amount on an average payphone location would cause many payphones with less-than-average call volumes to become unprofitable."[12] The Commission has defined the marginal payphone as one that "earns just enough revenue to warrant its placement, but not enough to pay anything to the premises owner."[13] The number of calls at a marginal location, according to the Commission's definition, is thus equal to the number of calls at the average location minus the number of calls required to pay the average location rent.[14] The Commission followed a similar approach to calculate the call volume at a marginal payphone location in the *Second Report and Order*[15]; that methodology was never challenged.

By calculating the marginal payphone call volume in this way, the Commission can ensure that dial-around and toll-free calls are making the appropriate pro rata contribution to

[12] *Id.* at 2608, ¶ 141.

[13] *Id.* at 2615-16, ¶ 156.

[14] To use a simple example, if the average payphone generates 250 calls per month, the total cost of the payphone (including commissions) is $125, and the average commissions are $25, then 20% of the payphone calls – 50 calls in this example – are devoted to commissions. The *marginal* payphone location would therefore be expected to generate 200 calls – that is, 80% of the average.

[15] Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 13 FCC Rcd 1778 (1997).

recovery of payphone costs under current (or, at least, recent) market conditions, as the Commission intended. While continuing declines in the number of payphone calls indicate that a default rate set in 2002 based on 2001 data will no longer be fairly compensatory in a couple of years, quick action on the Coalition's petition will at least ameliorate the current shortfall in compensation, and perhaps stem somewhat the sharp drop in the number of payphones deployed nationwide – a drop that is directly contrary to the congressional desire for "widespread deployment of payphone services."[16]

II. CURRENT COST AND MARKET DATA SUPPORT A DEFAULT RATE OF $0.49

The RBOC Payphone Coalition retained KPMG LLP to perform a cost study (attached hereto) to determine per-call costs, based on the methodology the Commission used in its *Third Report and Order*. Working directly with personnel from each of the RBOC Payphone Coalition members, as well as with personnel from Qwest Communications International, Inc. ("Qwest"), KPMG gathered financial and operational data associated with each of the RBOC Payphone Coalition member's payphone businesses, as well as with Qwest's payphone business. The purpose of the study was to duplicate as closely as possible the requirements and mechanisms set forth in the *Third Report and Order*. In those few instances where KPMG deviated slightly from the Commission's methodology to simplify certain calculations, KPMG did so conservatively.

1. Components of the Cost Calculation

Payphone Capital Expense. In the *Third Report and Order*, the Commission calculated this cost by estimating the cost of an AT&T 11A coinless payphone and the remaining costs of the payphone unit, such as the enclosure, pedestal, associated spare parts, and installation, and then calculating monthly payments that would cover these costs over a 10-year period, including

[16] 47 U.S.C. § 276(b)(1).

taxes calculated at a composite rate of 39.25%, and interest computed using the FCC's authorized after-tax rate of return of 11.25%.[17]

KPMG worked with the RBOC Payphone Coalition to determine if these costs had changed significantly since the Commission issued the *Third Report and Order*. Except for the fact that the cost of a new AT&T 11A payphone was no longer identifiable, these costs had not changed.[18] Thus, the KPMG cost study used the $28.04 per month figure arrived at by the Commission in the *Third Report and Order*.[19]

Line Charge Costs. In the *Third Report and Order*, the Commission set forth criteria for calculating the joint and common line costs associated with payphones.[20] Using these criteria and the data available at the time, the Commission adopted a national average joint and common line cost of $33.65.[21]

KPMG employed this methodology, using data collected from the RBOC Payphone Coalition members. KPMG segregated the line costs based on pricing options: unlimited service, consisting of a flat monthly fee, regardless of usage; measured service, which consists of a lower monthly flat fee plus a usage-based pricing component (per-call or per-minute); and a

[17] *Third Report and Order*, 14 FCC Rcd at 2621-23, ¶¶ 166-169; KPMG Report at 3-4.

[18] KPMG Report at 3. A similar unit, the AT&T 11B coinless payphone, costs $250, $25 more than the $225 cost used in the *Third Report and Order*. *Id.*; *Third Report and Order*, 14 FCC Rcd at 2622, ¶ 169.

[19] *Third Report and Order*, 14 FCC Rcd at 2623, ¶ 169; KPMG Report at 3-4. Because the added cost of the AT&T 11B payphone only would have increased the monthly cost to $28.49, KPMG chose to stay with the $28.04 figure. KPMG Report at 4.

[20] *Third Report and Order*, 14 FCC Rcd at 2623-25, ¶¶ 170-174.

[21] *Id.* at 2625, ¶ 174.

choice between unlimited and measured service.[22] KPMG aggregated the costs associated solely with the monthly recurring charges for unlimited and measured services, and excluded any usage-based costs. Based on the data collected, KPMG calculated the average joint and common line costs to be $37.86 per payphone per month.[23]

Maintenance Costs. In the *Third Report and Order*, this Commission treated maintenance as a joint and common cost, and accepted data submitted by SBC and the RBOC Payphone Coalition and averaged it with higher cost data submitted by Peoples Telephone.[24] Excluding the portion of maintenance costs that were strictly related to coin calls, the Commission arrived at a maintenance cost of $18.90 per payphone per month.[25]

In performing its cost study, KPMG adjusted the maintenance costs collected from the RBOC Payphone Coalition to exclude coin-related costs.[26] The resulting average joint and common maintenance costs were calculated to be $13.81 per payphone per month, 26.9% less than the $18.90 calculated by the FCC.[27]

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[22] KPMG Report at 4-5.

[23] *Id.* at 5. KPMG calculated this line cost based on data from the RBOC Payphone Coalition that was current through August 2001. The Coalition believes that payphone line rates have been reduced in some states and may be reduced in others in the future. The Coalition has not quantified that decreased cost but can update this component of the cost calculation relatively easily once this proceeding is underway.

[24] *Third Report and Order*, 14 FCC Rcd at 2625-26, ¶¶ 175-176.

[25] *Id.* at 2626, ¶ 177.

[26] KPMG Report at 5-6. These costs included relevant salaries, wages and benefits, coin collection activities, coin collection centers, counting centers, shipping of coins, and coin-only related maintenance visits. *Id.* at 6.

[27] *Id.*

Sales, General, and Administrative Costs. The Commission found no credible evidence that total Sales, General, and Administrative ("SG&A") costs change as the coin/coinless ration of calls changes, and hence concluded that SG&A costs were joint and common.[28] Using a weighted average of data provided by the RBOC Payphone Coalition and Peoples Telephone (to represent data for non-LEC payphone providers), the Commission calculated SG&A costs to be $19.62 per payphone per month.[29]

In its calculation of SG&A costs, KPMG excluded certain items that were identified as strictly related to coin calls; KPMG also excluded certain allocations of corporate personnel and other costs from the SG&A amounts which would have been allowable under the *Third Report and Order* but were immaterial.[30] As a result, KPMG calculated SG&A costs to be $15.30 per payphone per month, 22% less than the Commission's calculation.[31]

Semi-Public and Incidental Revenues. In performing its cost study, KPMG included cost and call volume data from semi-public phones, that is, phones for which the premises owner had a particular need. Call volumes from such semi-public phones tend to be lower than for public phones, but premises owners also may make payments to the PSP to offset a portion of the PSP's costs. For that reason, it was important to include semi-public revenues in the cost calculation. In addition, PSPs have a small amount of other incidental revenue, including station advertising.

KPMG calculated per-payphone semi-public revenues by dividing all such revenues by the total number of payphones (public and semi-public) in the study and determined that such

[28] *Third Report and Order*, 14 FCC Rcd at 2626-27, ¶¶ 178-179.

[29] *Id.* at 2627, ¶ 179. The Commission excluded bad debt from the calculation of SG&A costs. *Id.*

[30] KPMG Report at 6.

[31] *Id.*

revenues amounted to $13.82 per payphone per month.[32] Consistent with the Commission's marginal-payphone methodology, KPMG treated semi-public revenues as negative commissions, that is, payments from location owners reflecting the fact that the payphones were inframarginal, that is, not self-supporting.[33] This treatment is consistent with the Commission's definition of a marginal payphone as one that earns just enough revenues to support itself.[34] The remaining incidental revenues were payments for advertising space on payphones, amounting to $0.34 per payphone per month. These revenues were treated as an offset to the payphone costs.[35]

Bad Debt. The Commission declined to include bad debt in its cost calculations, because there was insufficient information regarding these costs.[36] Since the *Third Report and Order*, however, PSPs have collected much more reliable data relating to bad debt; as a result, KPMG included the bad-debt element in its cost calculation. According to the cost study, bad debt resulted in a cost of $0.028 per call.[37]

Dial-Around Carrier Identification Costs. PSPs incur these marginal costs when they validate calling card, collect, and billed-to-third-party calls to prevent fraud and identify who is

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[32] *Id.* at 8 & n.5.

[33] *Id.* at 8.

[34] Treating the semi-public and incidental revenues as an offset to costs, rather than as negative commissions, does not affect the result of the per-call cost calculation at the marginal payphones. *See id.* at 8 n.4.

[35] *Id.* at 8-9.

[36] *Third Report and Order*, 14 FCC Rcd at 2618-20, ¶¶ 160-162. The Commission noted that some of what the payphone providers were deeming "bad debt" were actually payments withheld due to legitimate billing disputes and billing errors by the payphone operators. *Id.* at 2619, ¶¶ 161-162.

[37] KPMG Report at 9. This figure was quantified by dividing the total amount of actual bad-debt write-offs by the total number of completed per-call payphone compensation ("PCC") calls. *Id.*

liable for a PCC charge. KPMG calculated a cost of $0.012 per PCC call by dividing the total amount of dial-around carrier identification costs by the total number of PCC calls.[38]

Interest. The Commission determined that payphone operators were entitled to four months of interest calculated at 11.25% annually, built into the cost of each call, to account for the fact that payments generally are not made for several months after the dial-around or toll-free call is made.[39] KPMG incorporated this interest component, which resulted in an addition of $0.02 to the cost of each call, into its calculation.[40]

2. Costs Excluded from the Cost Calculation

Coding Digit (FLEX ANI) Costs. The Commission determined the costs that PSPs must pay LECs for the implementation of FLEX ANI to be joint and common and, as such, attributable to all types of calls.[41] The Commission thus calculated that the average payphone owner would pay $1.08 per payphone line per month for 36 months.[42] KPMG excluded FLEX ANI costs from its study because the three-year cost-recovery period has already elapsed.[43]

Commission Costs and Location Rents. In accordance with the *Third Report and Order*, KPMG excluded these costs from its calculations because the model is based upon a marginal payphone location.[44]

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[38] *Id.* at 10.

[39] *Third Report and Order*, 14 FCC Rcd at 2630-31, ¶¶ 187-189.

[40] KPMG Report at 14.

[41] *Third Report and Order*, 14 FCC Rcd at 2627-30, ¶¶ 180-186.

[42] *Id.* at 2629-30, ¶ 186.

[43] KPMG Report at 7. It should be noted that the recent substantial decrease in payphone call volume may have impacted PSPs' ability to fully recover these costs. *Id.*

[44] *Id.*; *see Third Report and Order*, 14 FCC Rcd at 2607-15, ¶¶ 139-153.

3. Calculating the Per-Station and Per-Call Cost

To calculate the monthly cost per station, KPMG needed to determine the number of stations deployed by each PSP and the number of calls per marginal station. KPMG used data provided by the members of the RBOC Payphone Coalition, which showed a decrease in stations from about 1.35 million in 1998 (the year which the Commission used to make the calculations in the *Third Report and Order*) to an aggregate total of 1,061,370 stations as of the end of August 2001.[45]

Another component of KMPG's cost calculation was call volumes. Using data reported by the RBOC Payphone Coalition, KPMG calculated that, on average, 253 calls were made per month per station, a decrease of 47.1% from the previous 478 average calls used by the Commission.[46] There were 219 calls per marginal station in August 2001; as a percentage of average calls, this figure is consistent with previous years.[47]

Using the elements described above, KPMG calculated the total recoverable monthly cost per station (before dial-around carrier identification costs, bad debt, and interest, which are all calculated on a per-call basis) to be $94.67, 5.5% less than the $100.21 used by the Commission in the *Third Report and Order*.[48] Dividing this monthly cost by 219 calls per month at a marginal station, and adding the per-call costs of dial-around carrier identification, bad debt, and

[45] KPMG Report at 10. This decrease is due to the largely to wireless substitution. *Id.* KPMG used August 2001 as a representative month in its cost study because payphone call volumes in August reflect the average traffic for a payphone operator during a year, when the busy summer season has ended and the slower fall and winter seasons have not yet commenced. *Id.* at 2. Moreover, KPMG encountered no evidence indicating that costs incurred in August 2001 are significantly different from costs in other months. *Id.*

[46] *Id.* at 11. Again, this decrease was due to the availability of wireless alternatives. *Id.*

[47] *Id.* at 11-13.

[48] *Id.* at 14, 16. These total monthly costs exclude FLEX ANI costs. *Id.* at 16.

interest in accordance with this Commission's methodology, results in a cost of $0.49 per call.[49] KPMG attributed this increase to the decline in payphone call volumes, which more than offset the savings in equipment, line, maintenance, and SG&A costs.[50]

CONCLUSION

The Commission should issue a Notice of Proposed Rulemaking proposing an increase in the per-call compensation default rate to $0.49.

Respectfully submitted,

MICHAEL K. KELLOGG
AARON M. PANNER
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
1615 M Street, NW
Suite 400
Washington, DC 20036
(202) 326-7900

Counsel for the RBOC Payphone Coalition

September 4, 2002

[49] *Id.* at 14.

[50] *Id.* at 15.

ATTACHMENT

Calculation of Per-Call Compensation

KPMG LLP ("KPMG") was asked to perform a cost-study for the RBOC Payphone Coalition, which includes BellSouth Public Communications, Inc., SBC Communications Inc., and the Verizon telephone companies, in order to determine a proposed per-call payphone compensation ("PCC") rate based on the cost calculation methodology outlined in the Federal Communications Commission's ("FCC") Third Report and Order in CC Docket No. 96-128[1] and affirmed on review in American Public Communications Council v. FCC, 215 F.3d 51 (D.C. Cir. 2000). We have been informed that the RBOC Payphone Coalition intends to petition the FCC to establish a new per-call compensation rate.

Working directly with personnel from each of the RBOC Payphone Coalition members, as well as with personnel from Qwest Communications International Inc. ("Qwest"), we gathered financial and operational data associated with each of the RBOC Payphone Coalition member's payphone businesses, as well as with Qwest's payphone business. The type of data we gathered included:

- Equipment Costs – AT&T 11B Coinless Payphone and Corresponding Installation Costs
- Line Costs
- Maintenance Costs
- Selling, General & Administrative ("SG&A") Costs
- Net Commissions (Location Rents and Semi-Public Revenues)
- Incidental Revenues (Payphone Booth Advertising)
- Bad Debt

[1] Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 2545 (1999) ("3rd R&O").

- Dial-Around Carrier Identification Costs
- Number of Stations (Payphones)
- Number of Payphone and PCC Calls
- Number of Calls from a Marginal Payphone Location

For purposes of this cost-study, we utilized data for the month of August 2001 to calculate the PCC amount. Payphone call volumes in August are reflective of the average traffic for a payphone operator during a year, as the busy summer season has ended, and the slower fall and winter seasons have not yet commenced. Based on our review of the data, the average number of calls per station per month was not significantly different for the eight months ended August 2001 when compared to the month ended August 2001 on a stand alone basis. Therefore, we concluded that call volumes during August 2001 were representative of the average call volumes for the payphone business units of the RBOC Payphone Coalition and Qwest. In addition, we did not encounter any evidence that would lead us to believe that the costs associated with operating the payphone business units during the month of August 2001 were not reflective of the costs incurred from month to month, based on payphone call volumes.

A. Components of Cost Based Per-Call Compensation

Equipment Costs

The costs associated with a working payphone include the costs of the payphone unit and the enclosure, pedestal and associated spare parts, as well as other capital costs, including installation (adjusted for coin mechanism installation costs), as outlined in the 3rd R&O. In the 3rd R&O, the FCC calculated the capital cost of a payphone unit using three steps:

- Estimating the cost of an AT&T 11A coinless payphone,
- Estimating the remaining costs of the payphone unit, including those documented above, and
- Calculating the monthly payments that would cover the payphone and remaining costs over a 10-year period, including taxes calculated at a composite rate of 39.25% and interest computed using the FCC's authorized after-tax rate of return of 11.25%.

For purposes of our cost-study, we worked with the RBOC Payphone Coalition and Qwest to determine if these payphone costs had changed significantly from the amounts detailed in the 3rd R&O. Our review indicated that they had not. While the cost of a new AT&T 11A payphone was no longer identifiable, we were able to determine that a similar unit, the AT&T 11B coinless payphone, cost $250, $25 more than the $225 cost used in the 3rd R&O. In addition, RBOC Payphone Coalition members and Qwest indicated that the remaining equipment-related costs had not changed significantly since the 3rd R&O. As such, we used the $28.04 monthly payment amount from the 3rd R&O in our cost-study.

Including the additional $25 for the payphone unit would have increased the monthly payment amount by $.45 to $28.49, as calculated on a present-value basis below:

	Current Cost Study	3rd R&O
Cost of Coinless Payphone Unit	$250.00	$225.00
Remaining Cost	$1,362.50	$1,362.50
Less: Coin Mechanism Install Costs	($60.00)	($60.00)
Total Costs	$1,552.50	$1,527.50
Number of Payment Years	10	10
Interest	11.25%	11.25%
Taxes (Federal, State and Local)	39.25%	39.25%
Monthly Payment	$28.49	$28.04

Line Costs

In order to calculate the joint and common line costs associated with payphones, we employed the methodology outlined by the FCC in the 3rd R&O. In order to do so, it was necessary to segregate the line costs based on pricing options. The pricing of payphone lines falls under one of three categories:

- Unlimited service, consisting of a flat monthly fee, regardless of usage,
- Measured service, which consists of a lower monthly flat fee plus a usage-based pricing component (per-call or per-minute), or
- A choice between unlimited and measured service.

Based on the type of service selected and the pricing options provided by the local exchange carrier ("LEC") servicing the applicable common line, line costs are considered joint and common as follows:

- When unlimited service is the only option provided by the LEC, the entire line cost amount is considered joint and common.
- When measured service is the only option provided by the LEC, only the monthly recurring flat fee is considered joint and common.
- When the LEC provides a choice between unlimited and measured service, only the monthly recurring flat fee associated with the measured service option is considered joint and common.

Based on the data collected from the RBOC Payphone Coalition members and Qwest, we aggregated the costs associated solely with the monthly recurring charges for unlimited and measured services, and excluded any usage-based costs. As a result, the average joint and common line costs were calculated to be $37.86 per payphone per month. This amount is 12.5% more than the $33.65 calculated by the FCC in the 3rd R&O.

Maintenance Costs

In determining the joint and common maintenance costs associated with payphones, the FCC, in the 3rd R&O, found that the change in maintenance costs varies insignificantly with the number of coin calls and that maintenance is usually performed during regularly scheduled visits, and are therefore considered joint and common. However, the FCC noted that coin collection costs and maintenance related strictly to the coin function are not considered joint and common, and should be excluded from maintenance costs.

The maintenance costs collected from the RBOC Payphone Coalition and Qwest for the cost-study were adjusted to exclude coin-related costs, including relevant salaries, wages and benefits, coin collection activities, coin collection centers, counting centers, shipping of coins and coin-only related maintenance visits. Using that data, the average joint and common maintenance costs were calculated to be $13.81 per payphone per month. This amount is 26.9% less than the $18.90 calculated by the FCC in the 3rd R&O.

SG&A Costs

In the 3rd R&O, the FCC found that total SG&A costs were considered joint and common, as there was no credible evidence that these costs change materially based on the mix of coin and coinless calls.

The SG&A costs we collected from the RBOC Payphone Coalition and Qwest for the cost-study were adjusted, however, to exclude certain items identifiable as related solely to coin calls. In addition, we excluded certain allocations of corporate personnel and other costs from the SG&A amounts, as they were immaterial (though allowable under the 3rd R&O). The average joint and common SG&A costs were calculated to be $15.30 per payphone per month. This amount is 22.0% less than the $19.62 calculated by the FCC in the 3rd R&O.

FLEX ANI Costs

Although FLEX ANI costs were considered joint and common, they were not included in the current cost-study. In the 3rd R&O, the FCC found that the average payphone owner would pay $1.08 per payphone per month for 36 months, due to the FLEX ANI. Under this scenario, these costs would have been recovered by payphone owners under the current $.24 PCC rate, applied retroactively to October 7, 1997. Although we did not attempt to calculate the impact of FLEX ANI costs on the PCC rate, it should be noted that the substantial decrease in the number of payphone calls over the past few years would suggest that the RBOC Payphone Coalition members and Qwest were unable to fully recover FLEX ANI costs.

Net Commissions: Commission Costs / Location Rents and Semi-Public Revenues

As outlined in the 3rd R&O, we have excluded commission costs and location rents from the cost study, based solely on the FCC's determination that the PCC rate should be calculated using a marginal payphone location. The FCC has ruled that 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."[2] The FCC further defines a marginal payphone location as a location where "the payphone earns just enough revenue to warrant its placement, but not enough to pay anything to the premises owner,"[3] thus justifying the exclusion of commissions from the cost base. The RBOC Payphone Coalition and Qwest reported average location rents and commissions of $28.68 per payphone per month.

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[2] 3rd R&O, 14 FCC Rcd at 2616, ¶139.

[3] 3rd R&O, ¶156.

To be consistent with the FCC's definition of a marginal payphone location, it was necessary to exclude from the cost base a reduction related to semi-public revenues.[4] Semi-public revenues are payments from premises owners or operators to the members of the RBOC Payphone Coalition and Qwest for the installation and operation of payphones. These payments may be required in locations where the payphones do not generate enough traffic to support payphone deployment, and essentially represent "negative" commissions. The RBOC Payphone Coalition members and Qwest reported average semi-public revenues of $13.82 per payphone per month.[5]

In order to calculate the net commissions, we aggregated the commission costs / location rents and the semi-public revenues, resulting in the following net commissions:

Commission Costs / Location Rents per Payphone Per Month	$28.68
Semi-Public Revenues per Payphone Per Month	$(13.82)
Net Commissions per Payphone Per Month	$14.86

Incidental Revenues

After quantifying the equipment, line, maintenance and SG&A costs and net commissions associated with payphone calls, we adjusted the cost base for identifiable incidental revenues associated with payphone booth advertising. RBOC Payphone Coalition members earn revenues by providing advertising space in payphone booths or on their payphones. These revenues were treated as reductions to the cost base in the cost-study. The reduction to the

[4] However, if semi-public revenues would have been treated as a direct reduction to the cost base in the cost-study and not as "negative" commissions, the resulting PCC would remain at $.49.

[5] This number was calculated by dividing total payments by location owners by the total number of payphones in the cost-study.

cost base for payphone booth advertising was $.34 per payphone per month. Although this amount is insignificant in comparison to the costs and net commissions, it was necessary to include it in order to properly reflect the cost base. The RBOC Payphone Coalition members and Qwest noted that in some cases payphone booth advertising revenues were non-existent.

Bad Debt

In the 3rd R&O, the FCC elected not to establish a cost element related to bad debt. The main reasons given by the FCC were as follows:

- Insufficient information on the record to account for the costs relating to bad debt,
- Assertion by interexchange carriers ("IXCs") that some alleged uncollectibles were legitimate billing disputes that arose during the PCC interim period, and
- Knowledge that a certain percentage of the uncollected PCC charge is due to billing errors by the payphone operators, as opposed to non-payment by IXCs.

Since the 3rd R&O, the RBOC Payphone Coalition members and Qwest have developed more reliable bad debt information related to PCC calls during the effective period of the $.24 PCC charge. Utilizing the bad debt amounts related only to actual write-offs, and excluding reserved amounts, we calculated bad debt to be $.028 per call. This figure was quantified by dividing the total amount of actual bad debt write-offs by the total number of completed PCC calls.

Dial-Around Carrier Identification Costs

These charges are typically classified by the RBOC Payphone Coalition members and Qwest as LIDB (line information database) or call-detail record ("CDR") charges. These charges result from the validation of calling card, collect and billed-to-third-party calls. This information is used to prevent fraud and determine the carrier that owns the calling card or 800/888 number, so the RBOC Payphone Coalition members and Qwest can identify who is liable for a PCC charge.

Dial-around carrier identification costs are incurred as a result of PCC calls and are marginal costs to the RBOC Payphone Coalition members and Qwest. These costs amount to $.012 per PCC call. This figure was quantified by dividing the total amount of dial-around carrier identification costs by the total number of PCC calls.

Number of Stations (Payphones)

After the total payphone costs were identified, it was necessary to determine the number of stations or payphones deployed by each RBOC Payphone Coalition member and Qwest in order to calculate a monthly cost per station. For the month ended August 31, 2001, an aggregate total of 1,061,370 stations were reported to us by RBOC Payphone Coalition members and Qwest. As expected, the number of stations has decreased from prior years, due largely to wireless penetration and affordability ("wireless substitution"), and other changes in the payphone business environment.

Number of Payphone and PCC Calls

In addition to collecting station information, we requested that each RBOC Payphone Coalition member and Qwest provide us with call counts. Total calls were used to determine per-call costs for Equipment, Line, Maintenance and SG&A costs, and Incidental Revenues. Total PCC calls were used to determine a per call cost for Bad Debt and Dial-Around Carrier Identification costs.

The total number of calls included calls originating from both public and semi-public stations. Based on the information provided, we calculated a weighted average number of calls per month per station to be 253. This is a per-station decrease of 47.1% from the previous 478 average calls reported by the RBOC Payphone Coalition, attributable largely to the deployment and affordability of wireless services.

Number of Calls from a Marginal Payphone Location

As outlined in the 3rd R&O, and discussed above, in order to determine a PCC charge, the FCC stipulated that the calculation should be based on a marginal payphone location. For the RBOC Payphone Coalition and Qwest, the average number of calls per month per marginal payphone amounted to 219 calls, and the average number of total calls amounted to 253 for the August 2001 period. Based on these figures, calls from a marginal payphone represented 86.56% of total average calls. This is not inconsistent with data received in previous years (see below). The average marginal call volume of 219 was calculated assuming that a marginal payphone location would neither pay any location rents or commissions, nor earn any semi-public revenues. The calculation of the 219 calls is as follows:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$37.86
Maintenance Costs	$13.81
SG&A Costs	$15.30
Incidental Revenues	($ .34)
Subtotal of Recoverable Costs* (A)	$94.67
Net Commissions (B)	$14.86
Total (A) +(B) = (C)	$109.53
Net Commissions as a % of Total (B) / (C) = (D)	13.57%
Number of Average Calls per Station (E)	253
Number of Calls per Marginal Station (E) x (1 – (D))	219

* - Excludes Bad Debt, Dial-Around Carrier Identification Costs and Interest

In the 3rd R&O, the FCC used an average of 439 calls for a marginal payphone location in its determination of the PCC rate. This was the midpoint of 414 (the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC payphone service providers for the payphone) and 464 (the number of payphone calls that must be placed in order for the LEC payphone service providers to begin paying a location payment to the premises owner) as previously reported by the RBOC Payphone Coalition.

Based on information provided by the RBOC Payphone Coalition in previous years, the average number of total calls from an RBOC Payphone Coalition member payphone was 478. Based on the figures provided by the RBOC Payphone Coalition members, and accepting the

FCC's midpoint of 439 calls for a marginal payphone location, calls from the marginal location represented 91.84% of total average calls Utilizing the RBOC Payphone Coalition submitted number of 414 calls, calls from the marginal location represented 86.61% of total average calls. This relationship is essentially unchanged at 86.56% based on the current cost-study data.

B. Calculation of Cost-Based PCC Rate

Employing the cost-based methodology in the 3rd R&O, we used the financial and operational data discussed above to calculate the current PCC charge at a marginal payphone location as follows:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$37.86
Maintenance Costs	$13.81
SG&A Costs	$15.30
Incidental Revenues	($ .34)
Sub-Total of Recoverable Costs	$94.67
Divide By: Number of Calls per Marginal Station	219
PCC before Dial-Around Carrier Identification Costs, Bad Debt and Interest	$.432
Dial-Around Carrier Identification Costs per PCC Call	$.012
Bad Debt Costs per PCC Call	$.028
Interest for 4 Months	$.018
PCC Charge	$.49

As noted, the calculation above excludes net commissions and uses calls from a marginal location. However, the PCC charge calculation is almost identical, should the decision be made that net commissions are includible and total average calls (as opposed to calls from a marginal location) are used. This calculation is:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$37.86
Maintenance Costs	$13.81
SG&A Costs	$15.30
Net Commissions	$14.86
Incidental Revenues	($ .34)
Sub-Total of Recoverable Costs	$109.53
Divide By: Weighted Average Number of Calls per Station	253
PCC before Dial-Around Carrier Identification Costs, Bad Debt and Interest	$.433
Dial-Around Carrier Identification Costs per PCC Call	$.012
Bad Debt Costs per PCC Call	$.028
Interest for 4 Months	$.018
PCC Charge	$.49

The difference between the $.24 PCC charge calculated in the 3rd R&O and the $.49 PCC charge in our cost-study is attributable mainly to the decrease in payphone call volumes, which more than offsets the decline in Equipment, Line, Maintenance and SG&A costs over time. Reviewing the first scenario above, which excludes commissions and uses call volumes from a marginal location, the total recoverable costs, net of incidental revenues and before dial-around carrier identification costs, bad debt and interest of $94.67 is actually 5.5% less than the recoverable cost amount of $100.21, after excluding FLEX ANI costs, calculated by the FCC in the 3rd R&O.

Attached as Exhibit A is my curriculum vitae.

KPMG LLP

By

Carl Geppert

Carl Geppert

August 30, 2002

Exhibit A

CARL R. GEPPERT
Partner, Industry Director
Americas Communications Practice

RELEVANT SKILLS AND EXPERIENCE

Carl is a Partner and Industry Director in KPMG LLP's Americas Communications Practice. He has 22 years of experience in assisting communications companies address significant financial, regulatory, information technology and business issues. Carl is a member of KPMG's Global Communications Industry Steering Committee, responsible for overseeing the delivery of services to KPMG communications industry clients on a global basis. Carl is also the Global Partner in Charge of KPMG's Margin Enhancement practice. Products offered through the Margin Enhancement practice are designed to help communications companies effectively manage their revenue-related business risks to enhance revenue, manage costs and positively impact profitability.

- Serves as KPMG's primary interface with the FCC in addressing accounting, cost allocation, affiliate transaction, costing and pricing issues and was a member of the Telecommunications Subcommittee of the AICPA's Public Utilities Committee. Consults regularly with communications clients, the FCC and state public utility commissions (PUCs) regarding regulatory matters, including issues involving the proper application of the Part 32 accounting and the Part 64 cost allocation rules.

- Has served as the overall engagement partner for the financial statement and Part 64 cost allocation audits at two Regional Bell Operating Companies (RBOCs), Qwest Communications International Inc. (formerly U S WEST) and Ameritech Corporation. He has directed numerous attest engagements and advisory projects related to regulatory matters, including examinations of merger/Section 271 terms and conditions imposed by the FCC, billing and cost allocation examinations required by various state PUCs, and access charge billing and cost reconciliations required by the FCC. Has served as the concurring review partner for several large communications companies, including GTE Corporation, ALLTEL Corporation, SNET Communications and NECA.

- Directed work for the RBOC Payphone Coalition from May 1996 to the present. Has filed several affidavits and participated in ex parte meetings with the FCC, addressing per call compensation costing and pricing issues and asset reclassification/cost accounting safeguard issues in response to Section 276 of the Telecommunications Act of 1996.

- Authored position papers entitled "Accounting Simplification in the Telecommunications Industry," filed with the FCC on July 15, 1998, and the "Supplement to July 15, 1998 Position Paper - Accounting Simplification in the Telecommunications Industry," filed with the FCC on November 10, 1998, in connection with the FCC's 1998 Biennial Regulatory Review pursuant to Section 11 of the Communications Act, as amended, and its Notice of Proposed Rulemaking in CC Docket No. 98-81. Participated in ex parte meetings with the Accounting Safeguards Division, Common Carrier Bureau and each FCC Commissioner's office to review the recommendations contained in the position paper.

- Has served as an accounting and consulting expert in several regulatory proceedings and has provided expert affidavits and testimony. Recent engagements include:

  - Testified in State of California in conjunction with Roseville Telephone Company regulatory proceeding regarding cost allocation, affiliate transaction and other matters.

  - Filed expert affidavits and other correspondence with the FCC in relation to the Commission's RBOC continuing property record audits and met extensively with each FCC Commissioner's office as well as representatives from both the U.S. Senate and House of Representatives to review the issues surrounding such audits.

  - Filed an expert affidavit and participated in ex parte meetings with the FCC in conjunction with the United States Telephone Association's Petition for Reconsideration of the FCC's Second Report and Order in CC Docket No. 96-149.

  - Filed an expert affidavit in conjunction with a U S WEST Communications state of Washington rate proceeding regarding regulatory policies and rate levels.

  - Prepared and filed an expert report addressing the nature and proper accounting treatment of access charge billings, specifically the pre-subscribed interexchange carrier charge (PICC) and universal service fund charge (USF).

  - Directed a project to assess the profitability of inside wire installation and maintenance services and provided testimony and expert affidavits in proceedings for Ameritech's telephone operating companies in Illinois, Indiana, Michigan, Ohio and Wisconsin.

  - Authored comments in several FCC proceedings, most recently the proceeding to implement the Section 272 biennial audit requirements pursuant to CC Docket No. 96-150.

  - Directed U.S. project teams participating in studies performed in China, Spain, France and Germany to assist in the development of interconnection prices and regulatory models by analyzing regulatory models, regulatory accounting and cost allocation rules and regulations, interconnection costing and pricing methods and cost of capital methodologies used in various countries.

  - Served as subject matter expert in U.S. regulatory and costing matters in connection with a project to examine accounting separations processes for the European Commission and develop interconnection policies and procedures.

- Directed projects to analyze the fair market value of services provided between local exchange carriers and their nonregulated affiliates in accordance with the FCC's affiliate transaction rules as modified in CC Docket No. 96-150. Has consulted with numerous clients on the application of the FCC's affiliate transaction rules.

- Assisted in rate filings by reviewing forecasted data, analyzing historical data and developing and reviewing expert testimony on a variety of complex accounting and tax issues. Developed a P.C.-based Pricing Analysis Tool to assist companies evaluate alternative regulatory strategies at the Federal and state levels.

- Developed and conducted training seminars on the telecommunications regulatory accounting process, accounting for income taxes, the rate case process and service cost concepts for communications industry personnel. Has instructed over 100 training seminars in the communications industry.

- Directed numerous projects to analyze the operating effectiveness and internal control structure over key revenue processes and implement effective solutions to enable clients to more effectively manage their revenue business risks. He has extensive consulting experience in working with both incumbent and competitive carriers in addressing risks related to retail, wholesale, interconnection/access and miscellaneous (regulated and nonregulated) revenues. Engagements have addressed the areas of service pricing and costing, customer care/service order processing, provisioning, customer and carrier access billing, accounts receivable management, billing and collections, and separations and settlements. He has authored articles on Margin Enhancement and revenue assurance in *Telephony, Billing World, teledotcom and Telecommunications* magazines as well as several industry white papers. He is a frequent speaker at industry conferences and seminars addressing margin enhancement, billing and revenue assurance topics.

REPRESENTATIVE CLIENTS

Qwest/U S WEST	ATU Telecommunications
Ameritech	ALLTEL
BellSouth	Citizens Utilities
SBC Communications	Global Crossing
Verizon	Level 3 Communications
Cable & Wireless	Roseville Communications
GTE	Sprint
NECA	U. S. Telecom Association

EDUCATIONAL AND PROFESSIONAL BACKGROUND

Carl holds Bachelor and Master of Science degrees in accounting from the University of Illinois. He is a CPA in the states of Colorado and Illinois and is a member of the American Institute of Certified Public Accountants, Colorado CPA Society, Illinois CPA Society and the Institute of Internal Auditors.