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September 25, 2003

Ex Parte Filing

Marlene Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
12th Street Lobby, Room TW-A325
Washington, D.C. 20554

Re: *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket 96-128; *RBOC/GTE/SNET Payphone Coalition Petition for Clarification*, NSD File No. L-99-34

Dear Ms. Dortch:

On September 25, 2003, on behalf of the RBOC Payphone Coalition, Marie Breslin of Verizon, Paul Francischetti of Verizon, Michael Alarcon of SBC, and I met with Scott Bergmann of Commissioner Adelstein's office. The substance of our presentation is reflected in the attached ex parte letter, filed September 22, 2003. In addition, we provided Mr. Bergmann with a copy of a portion of an FCC brief, which is also attached.

One original and two copies of this letter are being submitted to you in compliance with 47 C.F.R. § 1.1206(a)(2) to be included in the record of these proceedings. If you have any questions concerning this matter, please contact me at (202) 326-7921.

Sincerely,

Aaron M. Panner

cc: Mr. Bergmann

We stressed that there is no legal obstacle to re-establishing the first-switch carrier pays rule. Contrary to the arguments that some long-distance carriers have made, such a rule does *not* require IXCs to act as "guarantors" of another carrier's obligation. Instead, IXCs themselves benefit from *all* of the payphone-originated calls that they carry: they bill SBRs for them and they need not carry them if they do not wish to do so. If reselling carriage of payphone-originated calls is beneficial to the IXC – and it is, or they wouldn't be in the business – then there is no obstacle to requiring IXCs to compensate PSPs for the services that the PSP is providing.

Relatedly, it is simply not true that a first-switch carrier pays rule relieves PSPs of all business risk. To the contrary, there have been major bankruptcies among facilities-based carriers, costing PSPs many tens of millions of dollars for which they have never been compensated. More fundamentally, unlike IXCs, which have a choice about whether to accept payphone-originated calls and whether to enter into business arrangements with particular SBRs, PSPs have no choice about whether or to whom their traffic will be routed. PSPs are forced into the transaction; IXCs are not. And IXCs can fairly allocate any business risk with their SBR customers; again, PSPs have no such ability.

Indeed, the basic flaw of the original rule, under which SBRs were largely responsible for tracking and paying compensation, is that PSPs are at an enormous disadvantage when it comes to enforcing their compensation rights against SBRs. RBOC PSPs lost tens, if not hundreds, of millions of dollars under the old rule. This is true for several reasons: PSPs do not know how many calls are routed to resellers or who the resellers are; many of the resellers are small companies that may receive relatively few calls; resellers commonly go out of business and resume operations under different names. Attempting to bring enforcement actions against small resellers is a practical impossibility, but because there are many hundreds of such carriers, their unpaid obligations add up to significant losses for which PSPs have received no compensation.

The basic strength of the "first-switch carrier pays" rule is that it depends on market mechanisms to ensure that IXCs and SBRs share information and allocate costs efficiently. Notably, all parties insist that the long-distance market is competitive. If so, then IXCs should be free to offer whatever terms they wish to ensure that resellers reimburse IXCs for payphone-originated calls that SBRs complete. If an SBR does not find the terms acceptable, it can go elsewhere for service. Accordingly, there is no justification for adopting regulations to govern the flow of information and compensation from SBRs to IXCs. As long as the market is functioning, it should resolve the issue more efficiently than regulation can.

Indeed, the very availability of market mechanisms is a significant advantage of the first-switch rule over the last-switch rule. All of the elaborate safeguards that the Commission would have to put in place to give SBRs the right to compensate PSPs directly would be unnecessary. And whatever safeguards the Commission adopts will almost inevitably impose significant inefficiencies – either needless costs or insufficient protection. By contrast, if the market is allowed to work, IXCs and SBRs can negotiate arrangements that are efficient and that will ensure that all business risks are fairly allocated.

We emphasized, however, that adopting a "first-switch" solution is far preferable to adopting elaborate regulatory requirements to attempt to plug the many holes in an SBR-pays regime. Indeed, even if the FCC adopts detailed regulatory requirements, it will be difficult if not impossible to anticipate all of the enforcement issues that may arise. For example:

- Who will be responsible if an IXC reports that it handed off more call attempts to an SBR than the SBR reports receiving from the for the same toll-free number for the same period? That is what happened under the old rules – order-of-magnitude discrepancies between the number of calls IXCs claimed to be routing to SBRs and the number of calls SBRs claimed to be receiving. Who will be responsible for sorting out any discrepancy?

- What happens when an SBR hands off a call to a second SBR?

- What will happen if SBR simply refuses to pay? An IXC can stop providing service, but a PSP cannot. Or, as commonly happens, an SBR goes out of business? Uncollectible risk will be significant, and the FCC will have to build that risk into the new per-call compensation rate.

One original and two copies of this letter are being submitted to you in compliance with 47 C.F.R. § 1.1206(a)(2) to be included in the record of these proceedings. If you have any questions concerning this matter, please contact me at (202) 326-7921.

Sincerely,

Aaron M. Panner

cc: Mr. Cooke
Mr. Thaggart
Mr. Cooper
Mr. Yachbes

BRIEF FOR RESPONDENTS

ORAL ARGUMENT SCHEDULED
DECEMBER 5, 2002

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 01-1266

SPRINT CORPORATION, et al.,

PETITIONERS,

v.

FEDERAL COMMUNICATIONS COMMISSION
and UNITED STATES OF AMERICA,

RESPONDENTS.

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL COMMUNICATIONS COMMISSION

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B. The Commission Reasonably Chose To Place The Initial Payment Responsibility On The Facilities-Based IXC.

Petitioners contend (Br. 35) that placing the initial responsibility for per-call compensation upon the facilities-based IXCs is "facially arbitrary," but there is nothing arbitrary about it. Quite to the contrary, in response to a genuine problem that petitioners themselves acknowledge, the Commission has implemented a solution that relies on a realistic assessment of the market forces and access to information that prevail in the payphone industry.

The Commission faced a substantial regulatory problem: several years' experience had shown that the existing per-call compensation system adopted in the *Second Payphone Order* was not working. The rules -- including the requirement that an IXC identify to the PSP the SBRs to which it handed off calls -- "have not had the intended effect of ensuring that PSPs receive compensation" under the statute. *Second Order On Reconsideration* ¶10 (JA 6). Petitioners concede as much. *E.g.*, Br. 42 ("The record shows that ... PSPs have had trouble collecting from SBRs"). Because the statute requires the FCC to ensure that PSPs are compensated for "each and every completed intrastate and interstate call using their payphone," 47 U.S.C. § 276(b)(1)(A), it was imperative that the agency take remedial action.

The Commission traced a major part of the problem to the behavior of the IXCs themselves: "IXCs unilaterally determine that they are not responsible for paying compensation for calls routed to switch-based resellers, but at the same time the IXCs do not identify which resellers are responsible for compensation, even when the PSP requests this information." *Second Order On Reconsideration* at ¶8 (JA 5). Thus, "the failure in the compensation regime results from insufficient information about the reseller being made available to the PSP." *Id.* ¶15 (JA 8). In the absence of information, the PSP could not know the party responsible for compensation, and in the absence of any business relationship with SBRs, even if the PSP knew

who owed it money, collection was often impossible or impracticable. *See* RBOC Coalition Reply Comments at 6 (JA 847); APCC Reply Comments at 6 (JA 834). Moreover, because they are unable to block coinless calls from being made from their payphones, 47 U.S.C. § 226(c)(1)(B), PSPs also lack any business leverage over SBRs and IXCs. Nothing in the petitioners' brief disputes the Commission's analysis of the market failure that led to the problem.

In contrast to the PSPs' lack of information and leverage, "the first underlying interexchange carrier is reasonably certain to have access to the information necessary for per call tracking or to be able to arrange for per call tracking in its arrangements with switch-based resellers that complete the calls." *Second Order On Reconsideration* ¶16 (JA 9). That is because "underlying facilities-based carriers, who have a customer relationship with resellers, are in a far better position to track the calls and provide adequate information to PSPs to ensure that they are compensated for every compensable call." *Ibid.* (JA 8).

The Commission sensibly remedied the failure of information flow by utilizing the position held by the IXC, the party with the greatest access to information and with direct business relationships on both sides of the line. Unlike the PSP, the IXC knows exactly which SBR to seek reimbursement from for any given call; and because the IXC provides the input central to the SBR's entire business, the IXC holds considerable leverage over the SBR that the PSP lacks entirely. By making the IXC initially responsible for payment to the PSP, the FCC gave the IXC a strong incentive to use its leverage to derive all of the necessary call data from the SBR. That same leverage enables the IXC to obtain reimbursement from the SBR. Under that arrangement, the PSP will be fully compensated in a way that fulfills the Commission's policy that the primary economic beneficiary of the call bears its cost. In short, the agency

identified the existence and source of a problem and crafted a solution that solves the problem at its root -- the essence of rational decision making. This Court upheld just such a recognition of the market forces at work in the payphone industry in *Illinois*, 117 F.3d at 566-567.

As this case amply demonstrates, experience can prove that an agency's approach to a policy problem will not always work. Agencies need room to experiment in crafting solutions to complex issues, and the law does not require an agency to guarantee that any given answer will work. Rather, rules need only be reasonable on the basis of the record before the agency. In this case, the FCC's first attempt at a per-call compensation regime proved unworkable, so it changed the regime to account for the realities of the payphone business. Should the IXCs demonstrate, after sufficient time for further experience, that the new approach has failed as well, there is no reason to believe that the FCC will not be willing to consider further modifications. On the current record, however, the Commission reasonably concluded that the new rules will significantly improve the situation.

Petitioners' arguments do not undermine the reasonableness of the Commission's decision. Their claims rest mainly on the false premise that IXCs are in the same position as PSPs with respect to access to SBR call data. For example, their very first contention is that making the IXCs responsible for initial payment will not lead to proper compensation because "it is technologically impossible for first facilities-based carriers to determine which calls are completed by a SBR," and the new approach "simply inject[s] a third party ... into the disputes between PSPs and SBRs." Br. 35-37. In other words, they claim, the new system will change nothing because the IXC is in no better a position to secure compensation from the appropriate party than a PSP would be.

As explained above, however, the Commission found that IXCs occupy a position fundamentally different from that of PSPs: the IXCs have customer relationships with SBRs and access to the data that the IXCs themselves were denying the PSPs. The old system failed because the PSPs did not know who owed them compensation; only the IXCs had that information, and they refused to turn it over. The new system will work because the party that must pay compensation in the first instance knows exactly whom to look to for reimbursement and has the direct business relationship and the leverage necessary to obtain full information on call completion. It makes no difference that the IXC itself cannot directly track an SBR call, because the IXC can require the SBR to provide the requisite data (in the requisite format) as a condition of service contained in the resale contract.[5] *See Second Order On Reconsideration* ¶18 (IXCs can "negotiat[e] reimbursement terms in future contract provisions") (JA 9). SBRs obviously have such data, for they bill their own customers only when a call is answered by its recipient. *See* Comments of The International Prepaid Communications Association at 13 ("Just as IXCs track their own payphone-originated calls, so do SBRs.") (JA 1044); Comments of the Ad Hoc Resellers Coalition at 3 ("ARC members are able and willing to report call completion to the underlying carriers.") (JA 967).

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[5] Petitioners are thus wrong to argue that "SBRs are free to submit call completion data on paper, computer disk, or other format" that will require "immense" efforts to track by hand millions of calls. Br. 40. In fact, an IXC need only require its SBR customers to provide the data in a format that will best fit the IXC's needs. Petitioners' own affiant recognizes as much. Bryde Dec. at 7 ¶19 (JA 928) ("Sprint would have to amend ... its existing contractual arrangements to include ... a provision obligating the [SBR] to provide [call completion] data to Sprint."). The law does not require the Commission to promulgate rules governing matters that are easily worked out by private contract. Thus, petitioners are also wrong that the FCC improperly "failed ... to adopt a rule requiring SBRs to provide [call data] information." Br. 36. As one large provider of prepaid and access code services advised the Commission, the IXC "has the power of the contract that could require SBR signatories to provide accurate data in a specified format as a condition of service." Comments of Intellicall Operator Services, Inc. at 4 (JA 1025).

Thus, the Commission correctly concluded that even if IXCs cannot themselves track calls they hand off to SBRs, "there are other options available to these IXCs to track *or arrange for the tracking* of coinless payphone calls." *Third Order On Reconsideration* ¶10 (emphasis added) (JA 18-19); *see also Second Order On Reconsideration* ¶16 ("only the first underlying interexchange carrier is reasonably certain to have access to the information necessary for per call tracking *or to be able to arrange for per call tracking in its arrangements with switch-based resellers that complete the calls*") (emphasis added) (JA 9).

The rest of petitioners' arguments likewise depend on the flawed theory that PSPs and IXCs hold the same position with respect to SBRs. Petitioners contend that the FCC "failed utterly to explain why SBRs will be any more likely to 'work with' first facilities-based carriers" than with PSPs, Br. 37, but the customer relationship between the IXC and the SBR supplies the very incentive to cooperate that was missing from the original rule. Likewise, petitioners are wrong that "the Commission failed to explain why funneling [call completion] data through first facilities-based carriers will somehow make the information more accurate or acceptable to PSPs." Br. 38. In fact, under the old rules, PSPs often received no data at all and had no power to negotiate any other arrangement, whereas now IXCs can insist as a condition of service that SBRs provide not only complete data but also any necessary indicators of its reliability. For that reason, petitioners are wrong in contending that "like PSPs, first facilities-based carriers have no means of independently verifying [SBRs'] call completion records" and that all parties will challenge the accuracy of SBR call data. Br. 38. IXCs need only require an agreed-upon verification system, such as a periodic audit.

The same reasoning defeats petitioners' similar contention that the FCC improperly failed "to allow first facilities-based carriers *any* option when SBRs simply fail to provide the requested

call completion data." Br. 39. One option is for the IXC to suspend service if the SBR fails to comply with its contractual obligation to provide the data, thereby depriving the SBR of an input necessary to its business.[6] That scenario by itself shows why SBRs are likely to provide data to IXCs (the exact inverse of why they refused to cooperate with PSPs, who had no such leverage) and why the Commission properly assigned to the IXC the role of initial payor. The petitioners are thus flatly wrong when they assert that the FCC has done "nothing to cure ... systemic problems" in the payphone compensation regime, Br. 42; that the agency has "place[d] all of the regulatory costs and obligations on the first facilities-based carriers, based only on the bare expectation that they will be able to address the risks of non-collection by 'private contract,'" Br. 42; that "SBRs will refuse to reimburse first facilities-based carriers ... and first facilities-based carriers will be left holding the bag for the disputed calls,"[7] Br. 38; and that "the agency simply shifted the exact same problems with the existing scheme onto the backs of first facilities-based carriers," Br. 35. In fact, the FCC has fashioned a reasonable method of addressing the problems

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[6] Petitioners claim that IXCs "are legally obligated to provide resale services," thereby implying that they are powerless to impose conditions on resale. Br. 42. The FCC order on which they rely for that proposition held only that it was an unreasonable practice for AT&T, then an integrated company, to forbid resale entirely. *Resale and Shared Use of Common Carrier Services and Facilities*, 60 FCC 2d 261, 264 (1976), *aff'd*, *AT&T v. FCC*, 572 F.2d 17 (2d Cir.), *cert. denied*, 439 US. 875 (1978). The order indicates that an IXC may impose reasonable restrictions on resale service. *Id.* at 263 ¶4; *see also Public Services Enterprises of Pennsylvania v. AT&T Corp.*, 10 FCC Rcd 8390, 8398 ¶19 (1995). Conditions such as provision of necessary call completion data are surely reasonable.

[7] Petitioners rely (Br. 38, 42) on the Court's holding in *Illinois* that the Commission may not impose costs on one company that should be borne by another. 117 F.3d at 565. The Court there rejected the Commission's decision to excuse small IXCs altogether from paying compensation and required the largest IXCs to make up the shortfall. That holding is not implicated here because the rules do not impose on IXCs costs that are properly borne by an SBR. Moreover, the Commission has expressly authorized IXCs to "recover from their reseller customers the expense of per-call compensation," *Second Order On Reconsideration* ¶18 (JA 9), which could reasonably include a bad debt expense.

with the existing payphone compensation system that harnesses the realities of information and leverage in the payphone market.

Petitioners appear to argue that the Commission has arbitrarily required that IXC per-call compensation be perfect: IXCs, they assert, "theoretically violate the New Rules unless they pay compensation for the exact number of completed calls, even when they are unable to obtain the information necessary to make that determination." Br. 39. In support of that claim, they rely on the Commission's rejection of AT&T's practice of compensating the PSP and billing the SBR for every call without having tried to determine whether it was completed. *Third Order On Reconsideration* ¶¶ 2, 8 (JA 16, 18). The Commission has adopted no standard of exactitude. It has certainly placed upon the IXC the duty to make an effort to obtain completion data. But the Commission has not addressed the matter beyond that, and we would expect that, should it be called on to address a particular situation, the Commission would endorse reasonable practices by IXCs in furtherance of the per-call compensation requirements even if the ultimate numbers were not exact.[8] Any such practice would be a great improvement over the existing regime of systematic undercompensation.

C. The Commission Has Properly Allowed PSPs And SBRs To Enter Into Direct Contracts.

Petitioners attack the Commission's allowing PSPs and SBRs to enter into direct contracts on two fronts. First they assert that such contracts will in fact never be entered into and that the FCC's belief to the contrary is "pure folly." Br. 44. Then they claim that if there were

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[8] Indeed, one group of SBRs suggested in its comments that "[u]nless the switch-based reseller cooperates in providing call completion reports, it will be in no position to criticize the facilities-based IXC for paying the PSP for both completed and uncompleted calls and passing on that charge." Comments of CommuniGroup of K.C., Inc. *et al.* at 13 (JA 1017).