BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
Request to Update Default Compensation Rate for	)	WC Docket No. 03-225
Dial-Around Calls from Payphones	)	RM No. 10568

RBOC PAYPHONE COALITION'S REPLY COMMENTS ON NOTICE OF PROPOSED RULEMAKING

INTRODUCTION AND SUMMARY

Sprint Corp. ("Sprint"), AT&T Corp. ("AT&T"), Global Crossing North America, Inc. ("Global Crossing"), and WorldCom, Inc. ("WorldCom") have opposed an increase in the per-call compensation rates, even though these same carriers – unconstrained by regulation – have dramatically increased the rates *they* charge for long-distance calls from payphones since the $0.24 rate was established in 1999. *See, e.g.*, Sprint Comments at 5; AT&T Comments at 9; American Public Communications Council ("APCC") Comments at 10-11. Their comments, however, cast no doubt on the urgent need to increase the per-call default rate. Nor do their comments provide any rational alternative to the marginal payphone methodology established in the *Third Report and Order*.[1] Finally, their comments fail to call into question the validity of the costs study conducted by the RBOC Payphone Coalition (the "Coalition"), which establishes that current per-call costs of dial-around calls vastly exceed the current default rate. Accordingly, the Commission should promptly adopt a revised per-call compensation rate of $0.49 per call.

I. **A.** The IXCs argue that the Commission should leave the default rate unchanged because there is no evidence that payphone deployment is inadequate to meet current

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[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) (subsequent history omitted) ("*Third Report and Order*").

demand. In fact, APCC's Comments contain substantial evidence that reduction in payphone deployment is a significant public policy issue, with implication for public safety and for individuals with limited access to alternative communications resources. More fundamentally, the argument ignores the terms of the statute and the Commission's reasoning in the *Third Report and Order*. Section 276 of the Act requires that the Commission establish a fair per-call compensation rate to promote widespread payphone deployment; the Commission has determined that the most equitable way to establish that rate and to meet congressional goals is to include a proportionate share of joint and common costs of a marginal payphone in the per-call default rate. The IXCs do not and cannot argue that the current default rate accurately reflects current per-call costs, and they provide no alternative methodology that the Commission could follow that would be consistent with the statute or established Commission precedent.

B. The IXCs' suggestion that an increase in the per-call rate would accelerate the reduction in the number of payphones deployed is baseless. There is no evidence in the record that an increase in the per-call default rate would accelerate declining payphone revenues; PSPs would not be seeking an increase in the per-call compensation rate if they did not believe it was in their interest. In any event, because the per-call rate is a *default* rate, PSPs and IXCs are free to negotiate a lower rate; by contrast, the default rate sets an absolute ceiling on the amount PSPs can charge for the services they are required to provide to IXCs.

C. Sprint's proposal for a caller-pays compensation system should be rejected for all of the reasons that the Commission has recognized in the past.

II. Sprint, WorldCom, and AT&T offer isolated criticisms of the Coalition cost study submitted with its petition for rulemaking in 2001. None has merit. Indeed, the Coalition's most recent study demonstrates that the $0.49 figure likely understates current per-call costs.

A. The Coalition's method for estimating call volumes at a marginal payphone location is sound. The Coalition adjusted its marginal call calculation both for phones that pay commissions (by excluding calls attributable to payment of commissions) and for phones that are deployed only because the location owner pays the PSP (by including semi-public payphone revenues in the cost calculation). The Coalition's methodology is thus designed to identify the call volume at payphones that pay no commission. Moreover, because current levels of payphone deployment reflect payphones maintained in place at a per-call compensation rate of $0.24, the Coalition's marginal payphone call volume calculation likely *overestimates* the number of calls required to cover the costs of such a phone and therefore leads to an *underestimate* of per-call costs.

B. The IXCs do not question most of the cost elements in the Coalition's study. The Coalition has re-examined its calculation with regard to the few points that the IXCs challenge and made certain adjustments. Because these balance out, the Coalition's overall estimate of per-call costs is essentially unchanged.

1. The Coalition has thoroughly documented bad debt costs. IXCs' claim that allowing recovery of bad debt is legally barred because it would force one IXC to pay the obligations of another is incorrect. Rather, the bad debt element compensates PSPs for the *risk* of non-payment they incur by providing service to all IXCs; regulators routinely and necessarily permit recovery of such costs of doing business. Although, the IXCs do not seriously challenge the Coalition's *estimate* of bad debt expense, the Coalition has reevaluated the data collected from all RBOC payphone providers and determined that the estimate included in its cost study is actually too low and should be increased to reflect predicted bad debt expense under a new, higher per-call rate.

Likewise, the Coalition's cost study establishes that the Coalition incurs costs specifically for the purpose of identifying the carrier responsible for payment of per-call compensation; such costs are marginal costs specifically associated with those compensable calls and must be included in the per-call rate.

2. In light of IXCs' claims that payphone capital costs have decreased significantly since the *Third Report and Order* was released, the Coalition has prepared a new estimate of such costs, based on data in the record and additional data collected from one RBOC payphone operation. This study shows that payphone capital costs have decreased somewhat, but not by as much as WorldCom estimates.

C. The D.C. Circuit has rejected the "top-down" methodology that the Commission applied in the *Second Report and Order*,[2] and the Commission then refused to re-adopt it; accordingly, AT&T's arguments based on that methodology should be accorded no weight. In any event, a proper top-down estimate of per-call costs yields a per-call rate of $0.467, providing further confirmation of the validity of the Coalition's requested rate.

DISCUSSION

I. THE COMMISSION SHOULD SUBSTANTIALLY INCREASE THE PER-CALL COMPENSATION DEFAULT RATE

The comments filed in this proceeding confirm that the current default rate is not fairly compensatory. They likewise confirm that, in the absence of an adjustment to the per-call rate to reflect current market conditions, payphone deployment will continue to decrease dramatically, contrary to the express intent of Congress and with serious public policy implications. The Commission must act as quickly as possible to adopt a new per-call default rate of $0.49 per call.

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

A. The IXCs Provide No Justification for Abandoning the *Third Report and Order* Methodology

There is no dispute that increased wireless telephone penetration and usage has caused the number of payphone calls to decrease dramatically since the Commission established the per-call compensation default rate in 1999. As a result, and despite a sharp reduction in the number of payphones deployed, the number of calls per payphone has also dropped dramatically. Accordingly, and despite cost-cutting by PSPs, there is no dispute that the per-call costs of payphone calls has increased.

In light of those undisputed facts an increase in the per-call rate is required under the statute and the Commission's *Third Report and Order*. Section 276(b)(1)(A) explicitly requires the Commission to "establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for *each and every completed intrastate and interstate call using their payphone*." 47 U.S.C. § 276(b)(1)(A) (emphasis added). The purpose of these regulations is "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public." *Id.* § 276(b)(1). Thus, the Commission must ensure that per-call compensation serves to *preserve* payphone deployment, not to hasten the removal of payphones that would be viable if regulation did not impose a cap on the rate that PSPs can charge for compensable calls. The Commission recognized the importance of this statutory directive in the *Third Report and Order*, holding that it would "place great weight on Congress's directive to ensure that payphones remain widely deployed and available to the public at large." 14 FCC Rcd at 2550, ¶ 10.

The IXCs nonetheless argue that the Commission need not act because there is no evidence "that payphone deployment is now or will be insufficient to meet declining consumer demand." AT&T Comments at 7; *see* Sprint Comments at 6-8 (arguing that the Commission need not promote payphone deployment). Their arguments are wrong on the law and on the facts. First, the congressional command "to promote the widespread deployment of payphone services for the benefit of the general public" establishes the legislative judgment that widespread deployment is an important regulatory goal. As APCC explains in its Comments, that judgment reflects the unique attributes of public payphones. They provide a service that is accessible to users on demand and without initial investment in equipment or monthly services charges. They ensure privacy and serve important public safety functions. And they can be of critical importance to those who subscribe to wireless service as well. APCC Comments at 3-4. Moreover, as the Commission recognized in the *Third Report and Order*, payphone services are most critical to those with few other communication service options – including the poor, the elderly, and residents of rural areas. *Third Report and Order*, 14 FCC Rcd at 2550-51, ¶ 10.

The factual record also belies IXCs' claims that declining payphone deployment has had no effect on consumers. APCC cites several articles that establish the inconvenience and even the threat to public safety that declining payphone deployment has caused for payphone users. APCC Comments at 4-6. Indeed, as APCC notes, during last summer's blackout in the Northeast, payphones provided a critical communications resource, as was widely reported in the media. And despite significant declines, users make nearly 200 million calls from Coalition payphones every month; overall payphone usage likely exceeds 300 million calls. For tens of millions of users, access to payphones is an important communications resource.

Some IXCs argue that governments should use explicit subsidies to maintain payphones in place. *See* WorldCom Comments at 5-8. But at least one reason that payphone deployment is declining is that PSPs' compensation for a substantial number of calls is artificially capped at a rate that does not permit PSPs to recover their costs of providing service. The per-call compensation rate is unquestionably depressing payphone deployment *below* what it would be in a well functioning market. Whether or not subsidy programs make sense in particular instances, they cannot ensure widespread deployment, and they should not be used where market forces – and a fairly compensatory rate for per-call compensation – are capable of ensuring that demand is satisfied.

As a matter of basic fairness among various classes of payphone users, the IXCs' arguments are no more defensible. As the Coalition noted in its Comments, the Commission held in its *Third Report and Order* 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." 14 FCC Rcd at 2571, ¶ 59 (footnote omitted). This was based on a determination that "*fair compensation* require[s] that dial-around calls contribute a proportionate share of the common costs of payphone service" because "any other approach would unfairly require one segment of payphone users to disproportionately support the availability of payphones to the benefit of another segment of payphone users." *Id.* at 2570, ¶ 57 (emphasis added).

The IXCs necessarily ignore this determination because they cannot argue that, with the current per-call default rate, each class of payphone user bears a proportionate share of common costs. To the contrary, in light of declining payphone call volumes, PSPs have been forced to increase the local coin rate to slow the decline in revenue. As a result, local coin callers are bearing an increasing share of payphone costs, and IXCs (and their customers) are getting a reduced-fare ride. The IXCs themselves illustrate this point in their comments. *See* Global Crossing Comments at 5.

Accordingly, there is and can be no dispute that if the Commission maintains the methodology it adopted in the *Third Report and Order* – as it said it was inclined to do – that the per-call default rate must increase significantly because it no longer provides recovery of a fair proportion of payphone costs. Yet in arguing that the Commission should leave the current rate in place, the IXCs offer *no* alternative rate-setting methodology that would justify that result.[3] To accede to that request, in the absence of legal justification, would be wholly arbitrary. As a matter of law and simple fairness, the Commission must increase the per-call default rate.

B. An Increase in the Per-Call Rate Will Have a Positive Effect on Revenues

The IXCs argue that any increase in the dial-around compensation rate will cause such a steep reduction in demand that even more payphones will exit the market. *See* Global Crossing Comments at 2-7; Sprint Comments at 2, 8-11; AT&T Comments at 2-3, 7-11; WorldCom Comments at 10. Their suggestion seems to be that demand for dial-around calling is so elastic that an increase in the per-call rate would lead to a decrease in revenues. This claim is legally unpersuasive and factually unsupported.

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[3] Sprint alone argues that the Commission should abandon its determination that the per-call compensation rate should be set based on per-call costs at a marginal payphone. In its view, the methodology "does nothing to promote deployment" and leads to "subsidy [for] higher-volume payphones that do not need it." Sprint Comments at 11. This argument is without merit. First, the Commission has already determined that by designing its per-call compensation system to ensure that a marginal payphone would just recover its costs, the Commission could "promote the continued existence of the vast majority of payphones." *Third Report and Order*, 14 FCC Rcd at 2571, ¶ 59. "[B]asing the default compensation amount on an average payphone location would cause many payphones with less-than-average call volumes to become unprofitable." *Id.* at 2608, ¶ 141. The fact that higher-volume phones will likely take in revenues above cost simply reflects the greater value of the payphone location; indeed, the location owner, not the PSP, will take in the bulk of any profit in the form of commissions or location rents. *See id.* at 2562, ¶ 37. Those location rents are themselves critical to payphone deployment because, at many high volume locations, the location owner would find another use for the space if the PSP did not pay rent. In any event, Sprint offers no alternative rate-setting methodology.

First, as a legal matter, the IXCs uniformly ignore the fact that the per-call compensation rate is a *default* rate. *See Third Report and Order*, 14 FCC Rcd at 2580, ¶ 78 ("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."). PSPs are of course attentive to the revenue effects of changing prices, and if an increase in the per-call rate led to a decrease in revenues, PSPs would quickly negotiate a reduction.

As a factual matter, however, there is absolutely no evidence to support the IXCs' claim. Not one of the commenters attempts to demonstrate that the price-elasticity of demand for compensable calls is greater in magnitude than -1, and the only evidence in the record from prior proceedings demonstrates that, in fact, the effect on demand from an increase in the per-call rate is likely to be relatively insignificant, particularly because the per-call compensation rate is just a fraction of the overall cost of many types of long-distance calls from payphones. *See generally* Comments of the RBOC/GTE/SNET Payphone Coalition, CC Docket No. 96-128 (filed Aug. 26, 1997).[4]

Notably, the IXCs themselves have dramatically increased their own rates for many types of payphone-originated calls – and have dramatically marked up the per-call compensation charge they impose on their customers. MCI has more than doubled the charge for a four-minute interstate collect call since 1997; AT&T has also increased its charges substantially. They have done so despite what Sprint (Comments at 4-5) characterizes as decreasing demand, and presumably they have done so in an effort to preserve revenues – not to accelerate their decline.

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[4] Nor does WorldCom justify the assumption that prepaid card providers would increase the surcharge they choose to impose for payphone-originated calls by any more than the increase in the per-call compensation rate: to the contrary, if prepaid card providers already charge their customers $.50 per call for payphone-originated calls, as WorldCom states, then they would have little, if any, need to raise the surcharge to accommodate a $.49 rate.

The Commission can confidently conclude that an increase in the per-call rate will have a positive effect on payphone revenues, and therefore a positive effect on payphone deployment.

C. Sprint's Request for a Caller Pays System Should Be Rejected

Sprint offers no arguments in support of its proposal that the Commission adopt a caller-pays system for per-call compensation that the Commission has not already rejected repeatedly. Such a system would violate the language and purpose of section 226(e). *See* Coalition Comments at 9. The Commission is not free to ignore the statute simply because Sprint argues that it is "entirely inapplicable to the post-section 276 world." Sprint Comments at 25. Sprint has not sought forbearance. And a caller-pays systems would be a mistake as a matter of policy. *See* Coalition Comments at 9-10. The Commission accordingly should confirm its prior holdings in this regard.

II. THE COALITION'S COST STUDY SUPPORTS AN INCREASE IN THE PER-CALL DEFAULT RATE TO $0.49 PER CALL

The Comments filed on the Coalition's cost study are notable for what they do not contain. Even though Sprint and AT&T – at least – have data concerning payphone costs from their own payphone operations, they have not submitted that data. The Commission should take their silence as an admission that their own per-call costs likely exceed those established by the cost studies submitted by the Coalition and by APCC.

In any event, none of the criticisms of the Coalition's study has merit. First, the challenge to the Coalition's method for determining marginal payphone call volumes is without merit. Second, the challenges to the Coalition's calculation of payphone capital costs, bad debt cost, and carrier identification expenses are unfounded. Third, a top-down calculation – though the Commission cannot rely on it in setting the per-call rate – confirms that the proposed $0.49 rate is reasonable.

A. The Coalition's Marginal Payphone Call Volume Calculation Is Sound

The Coalition has amply explained both its methodology for determining call volumes at a marginal Coalition payphone and the reasons for applying that methodology. *See* Coalition Comments at 3-5. AT&T criticizes the Coalition's approach, but its criticisms are without merit. (Notably, no one challenges the *data* upon which the calculation is based.)

As an initial matter, the Coalition has already explained why it cannot apply the precise methodology form the *Third Report and Order* to determine marginal call volumes. *See* Coalition Comments at 4. In the *Third Report and Order*, the Commission based its calculation of the marginal payphone call volumes on revenue requirements reported by RBOC payphone providers. *Id.* at 2612, ¶ 147. But the Coalition cannot calculate marginal call volumes based on revenue requirements in an environment where the per-call compensation rate is expected to increase significantly. The Coalition *can* determine the cost of operating a payphone, excluding all commissions, and allocate those costs based on current call volumes at such a payphone. This will ensure that compensable calls make a proportionate contribution to payphone costs.

AT&T first argues that the Coalition has failed to "exclude call volumes for locations where premises owners pay or receive rents" and therefore does not "reflect . . . call volume at 'a location where the payphone operator is able to just recoup its costs.'" AT&T Comments at 17 (emphasis omitted) (quoting *Third Report and Order*, 14 FCC Rcd at 2607, ¶ 139). But this comment ignores that the Coalition's methodology *does* exclude call volumes attributable to commissions paid by PSPs, as well as any revenues received on account of semi-public payphones. *See* Coalition Comments at 5 & Ex. 1 ("KPMG Study") at 9. In this way, the only call volumes included in the marginal call calculation are those that contribute to the costs of payphone operations, not including commissions. This is consistent with the Commission's definition of the marginal payphone. The Commission itself has relied on this methodology in the *Second Report and Order*, and neither the Commission nor the D.C. Circuit ever called it into question. *Cf.* AT&T Comments at 18.

AT&T also argues that the Coalition "has skewed the analysis by including in its analysis payphones that . . . do not recover their costs." *Id.*; *see also* WorldCom Comments at 17. But the Coalition study does not "skew" results in any direction, because it simply reflects the costs of currently installed payphones. Such a study necessarily represents a snapshot in time, and as call volumes decrease, a phone that is marginal in one year may be losing money the next. Indeed, the Coalition's recent study shows that call volumes at marginal payphones have continued to decline (and would support a significantly higher per-call rate than the $0.49 rate the Coalition has proposed). But there is no reason to believe that a significant number of payphones included in the Coalition's study were unprofitable at the time the study was carried out.

Moreover, AT&T ignores the fact that the Commission's failure to increase the per-call compensation rate since 1999 means that payphone revenues have been artificially depressed, leading to a faster-than-warranted rate of payphone removal. That is, if the per-call compensation rate had increased steadily with increasing per-call costs, PSPs' revenues also would have increased, and more payphones would have remained profitable. Because the number of payphones is *lower* than it would have been if regulation had kept up with changing market conditions, *per-payphone* call volumes under the Coalition's study are likely *higher*, not lower, than they would be at the ideal marginal phone, defined with reference to an updated per-call compensation rate, based on current per-call costs.

In sum, the call volume calculation included in the Coalition's study provides a sound basis for estimating the per-call costs at a marginal payphone.

B. Each Component of the Coalition's Cost Study Is Justified

Several components of the Coalition's study are simply uncontested. Thus, no one challenges the Coalition's reported line costs, SG&A costs, or maintenance costs.[5] The Commission therefore can rely on this data as an accurate reflection of costs for the payphone industry. Instead, the IXCs' criticisms are directed at three cost components: payphone capital costs, bad debt expenses, and carrier identification costs. Those criticisms are without merit.

1. Bad Debt and Carrier Identification Cost Must Be Included

The Coalition has urged the use of two new cost factors: bad debt and carrier identification costs. Both are reasonable, and the IXCs have no valid objection to including those costs.

First, the IXCs complain that the Coalition's inclusion of bad debt cost is inappropriate because it "forces" some carriers to bear the obligations incurred by other carriers. *See*, *e.g.*, AT&T Comments at 22; WorldCom Comments at 16. That argument fails as a matter of law and fact. A cost component for bad debt is not intended to compensate PSPs for past losses, but instead to compensate them for the *risk* that they will not be compensated for the services they provide. That risk is an ordinary cost of doing business with *all* IXCs. *See* Memorandum Opinion and Order, *Petition of WorldCom, Inc. for Preemption Pursuant to Section 252(e)(5) of*

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[5] Sprint claims that the Coalition's data are based on isolated samplings. Sprint Comments at 12. The claim is false; the data are collected for RBOCs' actual accounting data. And while Sprint argues that the data are based on a single month, the current Coalition study was based on nine months of data from 2003.

In addition, Sprint suggests that the Coalition has "ignor[ed] new and growing revenue opportunities." Sprint Comments at 18. This is likewise incorrect. The Coalition's study included incidental revenues in its calculations. *See* RBOC Coalition Petition for Rulemaking at 8 (filed Sept. 4, 2002); RBOC Coalition, Calculation of Per-Call Compensation Rate at 10.

the Communications Act of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc. and for Expedited Arbitration, 18 FCC Rcd 17722, 17783, ¶ 148 (2003) ("In establishing UNE prices, it is appropriate to increase the amount of cost to be recovered by a factor that reflects the fact that some portion of charges will not be paid by Verizon's competitive LEC customers."); *id.* at 17956, ¶ 598 (holding that "Verizon's 'uncollectibles' markup to its UNE prices is a better way" of addressing the "risk of non-collection"). As the Coalition already demonstrated (*see* Coalition Comments at 12 n.4), bad debt or uncollectibles are regularly included in cost calculations for universal service plans, international call compensation, interstate access tariffs, and UNE rates. And there is no dispute that if PSPs could set prices in a free market, they would include bad debt risk in their calculations.

The IXCs also argue that including bad debt in the dial-around compensation rate might allow PSPs to collect twice, once from the debtors and once from the dial-around compensation rate. *See, e.g.*, AT&T Comments at 21. But the Coalition study estimated bad debt by looking at *actual* write-offs – *i.e.*, bad debt that was never collected. *See* KPMG Study at 11. By using a historic average, the Coalition was able to estimate future levels of *actual* write-offs due to bad debt. There is no double recovery.

The IXCs do not seriously challenge the magnitude of the predicted bad debt in the Coalition's study, and for good reason – that prediction was significantly *understated.* The Coalition study calculated bad debt as a cent-per-call figure, rather than a percentage figure. That approach was incorrect, because, with an increase in the per-call *rate*, one would expect that bad debt as a *percentage* of collectibles to remain about the same but the *amount* of bad debt to rise. Making the appropriate calculation indicates that, under the reseller-pays regime comparable to the one that the Commission has just instituted, Coalition members experienced bad debt of approximately 12 percent of collectibles. *See* KPMG, Calculation of Per Call Compensation – Supplemental Report, RBOC Payphone Coalition at 10-11 ("KPMG Reply Report") (Attached as Ex. 1). This is quite comparable to the experience reported by Sprint, which informed the Commission that it had experience bad debt expense in the collection of per-call compensation from reseller customers of from eight to more than ten percent (despite the existence of contractual relationships with those customers). *See* Comments of Sprint Corp., CC Docket No. 96-128, NSD File No. L-99-34, at 8 (filed June 23, 2003) ("Sprint has typically incurred bad debt expense accounting for 8% of payphone compensation from switchless resellers"); *id.* at 12 (bad debt of more than ten percent for switch-based resellers). This would add 2.3 cents to the final rate.[6]

Second, the IXCs complain that the Coalition improperly included "collection costs." Sprint Comments at 15; AT&T Comments at 23; WorldCom Comments at 16. But the IXCs misunderstand the Coalition's use of the term. What the Coalition has on occasion referred to as "collection costs" includes only carrier identification costs – that is, the cost of identifying which IXC should be billed for any particular call. *See* KPMG Study at 12.[7] Contrary to the IXCs' quotation of the *Third Report and* Order, *see*, *e.g.*, AT&T Comments at 23, this cost factor does not attempt to measure any "increase" in costs due to a greater proportion of coinless calls.

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[6] This figure also reflects adjusted payphone capital costs.

[7] WorldCom argues that the Coalition's cost category includes "the costs of validating calling cards, collect calls, and billed-to-third party calls in addition to identifying the IXC responsible for DAC." WorldCom Comments at 16. In fact, one of the RBOC erroneously included some of these costs in its reporting for the 2001 study. The Coalition discovered the error and determined that it had a negligible impact ($.001) on the final rate reported in the 2001 study. The error was corrected in the 2003 study

Rather, it merely attempts to measure a cost that is directly associated with dial-around calls. As a marginal cost, it is properly includable in the dial-around compensation rate.

2. *The Capital Cost of Payphones Should Be Adjusted Slightly*

In response to data submitted by WorldCom and others, the Coalition has re-examined its determination that the payphone capital cost estimate contained in the *Third Report and Order* represents an accurate estimate of current capital costs. Based on WorldCom's data and additional data collected from one RBOC payphone operation, the Coalition has determined that a proper estimate of payphone capital costs is $997.78, as compared to $ 1527.50 used in the *Third Report and Order*. However, the Coalition has also determined (as noted in its Comments) that the 10-year depreciation period applied by the Commission is not consistent with the depreciation period applied by Coalition members for financial reporting purposes. The depreciation period varies between five and eight years, and KPMG has used a mid-point estimate of 6.5 years. The Coalition has also adjusted some of WorldCom's inputs to reflect the actual costs incurred by the Coalition member, though the Coalition simply accepted some of WorldCom's estimates given time constraints. The result is a monthly cost of $22.09 as compared to $28.04 used in the *Third Report and Order*. *See* KPMG Reply Report at 8. The net effect of this adjustment is to reduce the per-call cost estimate under the 2001 study by $.024. *Id.* This adjustment is offset by the adjustment to the Coalition's bad debt estimate described above and therefore has little effect on the bottom-line cost estimate of $.49 per call, reducing it by $.003 to $.487.[8]

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[8] Using 2003 call volume information, the reduction in estimated capital costs would reduce the estimated $0.59 per-call cost by $.033 *Id.* Again, this amount must be offset by an increase in estimated bad debt.

C. A Proper "Top-Down" Calculation Confirms That the Coalition's Requested Rate Is Reasonable

The IXCs claim that a "top-down" calculation shows that the Coalition's suggested rate is unjustified. *See, e.g.*, Sprint Comments at 16; AT&T Comments at 23-25. Their claim is wrong as a matter of law and as a matter of fact.

As a matter of law, the Commission's previous effort to rely on a top-down calculation of the per-call rate, in the *Second Report and Order*, was reversed by the D.C. Circuit. *See MCI Telecomms. Corp. v. FCC*, 143 F.3d 606 (D.C. Cir. 1998). There, the Court held that the Commission did not explain "why a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls." *Id.* at 608. The Court found that if "costs and rates depend on different factors, as they sometimes do, then [the Commission's] procedure would resemble subtracting apples from oranges." *Id.*

In the *Third Report and Order*, "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," the Commission found "that a top-down approach is unsuitable at present for setting default compensation." 14 FCC Rcd at 2577, ¶ 71. The Commission concluded that "[b]y 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." *Id.* AT&T has not even attempted to justify reconsidering that conclusion. Indeed, because AT&T has consistently urged the Commission to set the per-call default rate using a bottom-up cost approach, it can hardly object to its application here.

In any event, even if the Commission were to conduct a top-down calculation to "validate" the result of its bottom-up calculation (*id.* at 2632-33, ¶ 192), a proper top-down calculation would confirm that the requested $0.49 rate is reasonable.[9] The current local coin rate is $.50. Subtracting from that rate a realistic estimate of the costs specific to coin calls – that is, the costs of a coin mechanism,[10] local usage charges, coin collection and coin-specific maintenance – and adding marginal costs specifically associated with compensable calls – including bad debt, carrier identification costs, and interest expense – yields a result of $.467 per call. *See* KPMG Reply Report at 3.

[9] AT&T makes no good faith attempt to carry out this calculation. Most significant, it estimates capital costs associated with the coin mechanism at a figure that far exceeds WorldCom's estimate of *overall* payphone capital costs, which is absurd. In addition, AT&T has made no effort to confirm that the Commission's earlier estimate of coin collection costs remains accurate (in fact, such costs have fallen with decreasing call volumes, as one would expect). *See* KPMG Reply Report at 3-6. As a result, its calculation is completely unreliable.

[10] In fact, coin mechanism costs should not be considered marginal costs of coin calling but joint and common costs. But the Coalition has deducted them nevertheless in performing its calculation. *See* KPMG Reply Report at 3-4.

CONCLUSION

The Commission should adhere to the methodology of the *Third Report and Order* and set a new dial-around compensation rate of $0.49 per call.

Respectfully submitted,

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