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

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

REPLY COMMENTS OF AT&T CORP.

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AT&T Corp. ("AT&T") submits these reply comments in response to the comments filed in connection with the Commission's *Order & Notice of Proposed Rulemaking*. *See* 47 C.F.R. § 1.415.[1] As explained below, the Commission should decline to modify the default dial-around compensation rate for payphone calls.

INTRODUCTION AND SUMMARY

The comments confirm that there is no legitimate basis for the Commission to adopt the request of the American Public Communications Council ("APCC") and the RBOC Coalition (collectively, "Petitioners") and double the default rate for dial-around payphone calls from $0.24 per completed call to $.0484 or $0.49 per completed call.

First, as shown in Part I, there is no evidence that the current default rate is inadequate to ensure the widespread deployment of payphones necessary to meet current and future consumer demand. *Cf. Third Report & Order* ¶ 143.[2] There is no evidence to support the

[1] *Request to Update Default Comp. Rate for Dial-Around Calls from Payphones*, WC Docket No. 03-225, RM Docket No. 10568, Order and Notice of Proposed Rulemaking (rel. Oct. 31, 2003) ("*NPRM*").

[2] *Implementation of the Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of*

conclusion that consumers are unable to find or use payphones when they need them. Indeed, no state commission has suggested that current deployment levels are inadequate or that a rate increase would be an appropriate means to ensure the availability of payphones in locations where consumers' needs are not being met.

To be sure, there are fewer payphones now than there were when the Commission adopted the *Third Report & Order*. That is entirely unremarkable given the undisputed record evidence that demand for payphone services has fallen precipitously since 1999. The Commission, however, has made clear that the adequacy of deployment levels must be made with regard to consumer demand. *Third Report & Order* ¶ 143. Here, there has been no showing that payphone deployment is failing to satisfy what all acknowledge to be declining consumer demand.

The proposals advocated by the APCC and the RBOC Coalition would further exacerbate the decline in demand for payphone services. As the RBOC Coalition acknowledges, the IXCs are correct in arguing that "an increase in the per-call rate will depress demand for dial-around calls." RBOC at 8. Moreover, this increased burden would have to be borne by consumers without phones at home and who APCC claims cannot afford wireless alternatives. Indeed, there is no guarantee that this increased burden would be justified by a reintroduction of payphones to low-income areas because, as the RBOCs acknowledge, doubling the dial-around default rate will, at best, "perhaps stem somewhat the sharp drop in the number of payphones deployed nationwide." RBOC at 5.

1996, Third Report & Order, And Order On Reconsideration of the Second Report & Order, 14 FCC Rcd. 2545 (1999) ("*Third Report & Order*").

The appropriate response to the evidence presented by payphone service providers ("PSPs") is to rely upon state commissions to address any specific complaints of public need through public interest payphone programs authorized under 47 U.S.C. § 276(b)(2). Public interest payphone programs can be directed to specific areas of consumer need "where there would not otherwise be payphones as a result of the operation of the market." *First Report & Order* ¶ 277.[3] In this regard, the Commission has explained that "the states are better equipped than the Commission to respond to geographic and socio-economic factors affecting the need for such payphones that are too diverse to be effectively addressed on a national basis." *Id.* ¶ 278. What is more, a public interest payphone program would obligate states to address specific and concrete consumer needs – that are not being met by the operation of the marketplace – without granting a windfall to PSPs that would be borne by consumers with inadequate means to migrate from payphone service to another alternative such as wireless.

Second, as shown in Part II, the comments confirm that the proposals advanced by APCC and the RBOC Coalition also should be rejected because their cost studies and methodologies are not reliable and cannot be reconciled with the *Third Report & Order*. With regard to call volume, the numbers advanced by APCC and the RBOC Coalition do not seek to exclude payphones that fail to recoup their costs and therefore their estimates are based upon analyses that are wholly at odds with the marginal payphone methodology adopted by the Commission in the *Third Report & Order*. Their efforts to rehabilitate these estimates simply confirm that they have attempted to understate the number of calls as part of an effort to inflate their proposed per-call compensation rate.

[3] *Implementation of the Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of 1996*, Report & Order, 11 FCC Rcd. 20541 (1996) ("*First Report & Order*").

Similarly, with regard to costs, even if the methodologies employed by APCC and the RBOC Coalition were deemed reliable – and they are not – both APCC and the RBOC Coalition significantly overstate equipment costs by ignoring the vibrant market for second-hand payphone equipment. *E.g.*, WorldCom at 15, Table 2. There is no legitimate reason for ignoring that the decline in payphone deployment has created a ready market for inexpensive second-hand equipment that offers substantial cost savings for PSPs. Nor should such equipment be disregarded based upon assertions that reliance on second-hand equipment will degrade customer service. Such concerns are unsupportable because second-hand equipment regularly is employed without any negative impact on service to consumers.

Further, the comments confirm that estimates of bad debt and collection costs should be excluded from the Commission's calculations. The arguments of the PSPs simply ignore the import of the *Third Report & Order* as well as the impact of the Commission's recent *SBR Order* on the ability of PSPs to collect more efficiently and effectively the compensation to which they are entitled.[4]

Finally, the efforts by APCC to inflate the per-call compensation rate by excluding revenue from sources such as advertising and the internet should be rejected. APCC elsewhere boasts that advertising revenues provide a new and exciting revenue opportunity for payphone providers. Such revenue opportunities should be considered in determining whether and how the dial-around compensation rate should be modified.

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[4] *The Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of 1996*, CC Docket No. 96-128, Report & Order, ¶¶ 51-54 (rel. Oct. 3, 2003) ("*SBR Order*").

ARGUMENT

I. THERE IS NO BASIS FOR INCREASING THE DEFAULT DIAL-AROUND COMPENSATION RATE.

There is no evidence that current levels of deployment are inadequate to meet current or future levels of consumer demand or to justify a nationwide increase in the default compensation rate. To the extent that the Commission perceives a potential problem based upon geographic or socio-economic grounds, the proper solution, as envisioned by Congress, is enforcement of a public interest payphone program that enlists state commissions to assess and address directly any particularized public need without increasing the costs on payphone consumers across the country in general. *See* 47 U.S.C. § 276(b)(2).

A. There Has Been No Showing That Payphone Deployment Is Inadequate To Meet Consumer Need.

As the Commission explained in the *Third Report & Order*, "in order to calculate a 'fair' compensation amount," the Commission must first "deduce an appropriate level of payphone deployment." *Third Report & Order* ¶ 143. To make that determination, the Commission has relied upon "filings of several states that ha[d] studied the payphone markets in their respective jurisdictions and concluded that current deployment of payphones is *adequately meeting the needs of the public*." *Id.* Given that deployment must be viewed in relation to consumer demand, it follows that any modification of the current default rate must be supported by evidence that payphone deployment is inadequate to "meet[] the needs of the public." *Id.*

There has, however, been no evidence presented that the deployment of payphones throughout the country is, or will be, inadequate to meet the needs of the public. APCC, the RBOC Coalition and other PSPs ignore this threshold issue entirely and instead argue that because payphone deployment has decreased (and is decreasing), it follows that payphone deployment necessarily must be inadequate. *E.g.*, APCC at i, 7; RBOC at 4.

For example, APCC insists that the "Commission must act to stop the strong trend of declining payphones." APCC at 7. Similarly, the RBOC Coalition contends that doubling the default rate is necessary because it may "perhaps stem somewhat the sharp drop in the number of payphones deployed nationwide." RBOC at 5. Adopting the same assumption, the Florida Public Telecommunications Association ("FPTA") argues that a reduction in "the number of payphones . . . clearly is at odds with the stated intent underlying Congress' adoption of Section 276 of the Telecommunications Act of 1996 – the widespread deployment of payphones." FPTA at 3-4. For its part, the Illinois Public Telecommunications Association ("IPTA") appears to suggest that Section 276 requires the Commission to adopt regulations that ensure that every payphone remains profitable. IPTA at 4-5.

These arguments should be rejected. Section 276 requires the Commission to prescribe regulations "*to promote competition among payphone service providers* and promote the widespread deployment of payphone services *to the benefit of the general public*." 47 U.S.C. § 276(b)(1) (emphasis added). Section 276 does not guarantee the profitability of all deployed payphones without regard to falling consumer demand. Such an approach certainly would not "promote competition among payphone providers." *Id.* Indeed, the Commission expressly explained that its "approach is not designed to make every payphone profitable." *Third Report & Order* ¶ 79.[5] To the contrary, in the *Third Report & Order*, the Commission adopted a

[5] For the same reason, APCC's argument that "constitutional principles as well as the Commission's own market-oriented policies preclude the Commission from denying PSPs full recovery of cost for any reason" APCC at ii, should be rejected. APCC's position appears to be that PSPs may install payphones in locations without regard to consumer demand or cost and then insist upon a rate increase whenever demand is insufficient for the PSP to turn a profit.

methodology that fully recognized that "decreasing prices for cellular and PCS service, may reduce the number of payphones" and that "[s]uch a reduction in the number of payphones would be the result of a competitive marketplace." *Third Report & Order* ¶ 141 n.282.[6] At bottom, the Commission's methodology was predicated upon a threshold determination that the then-current levels of payphone deployment satisfied Congress's stated goal "of promoting widespread deployment of payphones to the benefit of the general public" because they were adequate "to meet[] the needs of the public." *Id.* ¶ 143.

In this proceeding, there is no dispute that the levels of payphone deployment in 1999 are no longer necessary to meet the needs of the public today. All acknowledge that consumer demand for payphone services has plummeted since 1999, and that consumers have adopted alternatives to payphone services. As FPTA explains, PSPs have "experienced significant erosion in every traditional revenue source because of 'migration' of payphone traffic

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Neither the Constitution nor Section 276 guarantee a risk-free investment. To the contrary, Section 276 is designed to "promote competition among payphone service providers." 47 U.S.C. § 276(b)(1). Indeed, the Commission has properly explained that "[p]ayphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount we establish." *Third Report & Order* ¶ 79.

[6] The Commission expressly recognized that "some LEC-owned payphones were not placed with profitability in mind, and may cease to exist even when provided with a reasonable compensation amount." *Id.* ¶ 58 n.100. As a result, the fact that certain market participants have chosen to exit the market, *e.g.*, FTPA at 2-3, IPTA at 10, simply reflects that there is now competition among payphone providers as Congress intended. 47 U.S.C. § 276(b). Indeed, even in areas where PSPs have decided to withdraw from the market, state commissions have been sensitive to ensure that payphones necessary to serve the public interest would remain available. *See* L. Brass, *BellSouth To Cut Cord on Pay Phones*, Knoxville News-Sentinel, Nov. 25, 2003 (noting that Tennessee Regulatory Authority was satisfied that "the need for payphone service would be met despite BellSouth's departure"); *BellSouth to Shut Down 3,400 State Pay Phones*, Assoc. Press, Jan. 1, 2004 (explaining that Kentucky Public Service Commission required BellSouth to "supply at least public coin phone in each of its exchanges" and considering implementation of "'public interest pay phone' program to bring phones to areas that haven't attracted a provider").

to dial-around calling methods and the displacement of payphone calling by wireless service." FPTA at 2. APCC quantifies this trend by acknowledging that "[i]n the last five years, the number of wireless customers has more than doubled, from about 60 million in mid-1998 to over 140 million as of December 2002." APCC 7 n.5. The Illinois Public Telecommunications Association ("IPTA") echoes these sentiments, explaining that "[p]ayphone services have suffered critical revenue erosion through the expansion of wireless services." IPTA at 9.

Given this decline in consumer demand, not even APCC proposes to "bring the level of payphone deployment back to that which existed in 1999." APCC at 8.[7] What is more, there is no evidence that current levels of deployment are not "adequately meeting the needs of the public." *Third Report & Order* ¶ 143. To the contrary, the record reflects that "PSPs have failed to remove redundant phones in sufficient numbers to reflect declining demand." Sprint at 8. Thus, a "compensation rate cannot reasonably be established based on inflated, and unsustainable, deployment levels" especially when insulation of PSPs "from declining demand for their services" would "directly undermine[] Congress's mandate to 'promote competition' in that industry." *Id.* at 5 (quoting 47 U.S.C. § 276(b)). In short, "there is no evidence that the decline in the numbers of payphones since 1998 has prevented a single person from making a payphone call." WorldCom at 2.

Unlike the *Third Report & Order*, no state commission has filed comments even suggesting that payphone deployment levels are inadequate to meet consumer demand. To the

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[7] IPTA's argument that "there has been a dramatic decrease in the general number of payphones available" simply ignores its own explanation for that decline and the Commission's recognition that increases in demand for wireless that caused a reduction in payphone lines were an expected result of a "competitive marketplace." *Third Report & Order* ¶ 141 n.282. Similarly, the fact that some PSPs may have exited the market, IPTA at 10, reflects nothing more than increased "competition among payphone service providers" as contemplated by Congress. 47 U.S.C. § 276(b).

contrary, the Texas Attorney General previously has stated that when a payphone disappears, "those customers without cellular phones or local service will simply find another payphone if they must make a call." Texas at 4 (filed Oct. 30, 2002). For its part, APCC, to this day, boasts that payphones are convenient because "payphones are everywhere," "[y]ou can locate a payphone just about anywhere," and "you always know where to find them."[8] Indeed, in responding to claims that "wireless phones have rendered payphones obsolete," APCC responds: "When a caller needs a payphone, he or she knows where to find one." *Supra* note 8, at 208 ("*The Payphone Industry: Myth or Fact*").

Nor is the need to "preserve the current level of payphone deployment . . . exemplified by the report submitted by West Virginia's Payphone Task Force." APCC at 8. The West Virginia Task Force report does not support the conclusion that current payphone deployment is (or will be) inadequate in West Virginia or nationally and does not justify the increase in the dial-around compensation rate proposed by APCC and the RBOC Coalition.[9] In particular, the West Virginia Task Force reviewed the state of the payphone market in West Virginia and explained that the "impact on particular counties" within West Virginia "varied widely." Task Force Report at 2. Although many counties lost payphones, others actually gained payphones; and, more specifically, the counties that experienced the greatest loss of payphones were "also the counties with the largest remaining number of payphones." *Id.* While APCC highlights the West Virginia Task Force's statement that "removal of even a single payphone can have a dramatic impact on rural areas," it omits the Task Force's conclusion that

[8] *See* APCC, *Consumer Frequently Asked Questions, at* http://www.apcc.net/public/pages/index.cfm?pageid=209 (last visited Jan. 22, 2004); *id.* at 212 ("*Benefits of Payphones: Convenience for Consumers*").

[9] West Virginia Consumer Advocate Division, *Sixth Interim Report Payphone Task Force*

"the majority of payphone removals over the past five years have occurred in urban areas" that "have the greatest cellular phone coverage and availability in the state." *Id.* at n.7.

More to the point, APCC wholly ignores the course of action recommended by the West Virginia Task Force, which decidedly was *not* to increase the costs of payphone services on low-income citizens who may rely on payphones. *Id.* at 5. To the contrary, the West Virginia Task Force acknowledged that it should continue to investigate "reports of payphone market failure by local officials or consumers" and that the West Virginia Public Service Commission should "consider institution of a public interest payphone program as part of an overall state telecommunications universal service fund" that would involve "subsidization of public interest payphones *in particular locations*." *Id.* (emphasis added).[10]

B. Doubling The Default Compensation Rate Will Accelerate The Decline in Demand For Payphones and Will Not Address "Concerns" Regarding Low-Income Consumers.

The comments further demonstrate that an increase in the dial-around payphone rate would neither increase the deployment of payphones nor address the concerns raised regarding low-income or rural payphone consumers. *See* 47 U.S.C. § 276(b).

1. The comments confirm that an increase in the default compensation rate would further depress demand for payphone services. Indeed, the RBOC Coalition

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(2003), *available at*:http://www.cad.state. wv.us/03pp%20Survey.htm.

[10] Additionally, the RBOC Coalition argues that "PSPs have been forced to recover an increasing share of common costs from local [coin] callers, with the market rate for such calls generally having increased from $0.35 to $0.50" and that an increase in the per-call rate therefore is necessary "to ensure that all payphone users bear a fair proportion of common costs." RBOC at 8. But that argument, if accepted, would require the Commission to recalculate the dial-around compensation rate whenever PSPs unilaterally modify the local coin call rate. Moreover, that argument ignores that local coin call rates have not uniformly been raised to $0.50, but instead vary throughout the country. *See* Supplemental Declaration of Hans Heymann ¶ 6 ("Supp. Heymann Decl.") (noting that some PSPs offer special $0.25 coin-call rates).

acknowledges as "true" the IXCs' concern that "an increase in the per-call rate will depress demand for dial-around calls." RBOC at 8. As AT&T has shown, doubling the dial-around rate "undoubtedly would accelerate the already existing decline in demand for payphone services." AT&T Comments 2, 8-11; *see also* Sprint at 2; WorldCom at 2; Global Crossing at 5. Even APCC does not truly dispute that a price increase would affect payphone consumer demand.

In this regard, a review of APCC's website is instructive because it reflects that independent PSPs are profoundly aware that consumers are concerned with payphone costs, especially when comparing payphone services to other potential alternatives. Thus, APCC's "Consumer FAQs" include, in carefully qualified language, the following:

> **Is it less expensive to use a payphone than wireless communication?**
>
> Yes, if you pay by coin at a payphone *it can be less expensive than wireless alternatives.*
>
> . . . .
>
> **Is it less expensive to use a prepaid phone card than paying by coin at a payphone?**
>
> No, many times it is much more expensive to use a prepaid phone card.
>
> . . . .
>
> **What is the payphone industry doing to compete with wireless technology?**
>
> The payphone industry competes with wireless in many ways. *The price of a payphone call is still a good value when compared to the capital investment, basic charge, usage charges and surcharges that wireless users incur. . . .*[11]

[11] *See* APCC, *Consumer FAQs, at* http://www.apcc.net/public/pages/index.cfm?/ pageid=209 (last visited Jan. 22, 2004) (emphasis added).

Of course, the rate increase proposed by APCC and the RBOC Coalition would directly affect the ability of PSPs to compete against wireless and other alternatives on the issue of cost.

APCC attempts to obscure the fact that a rate increase would depress consumer demand. It first argues that "when making a decision of whether or not to use a payphone, end users do not look at the dial-around rate, but rather at the final rate assessed by the IXC," APCC at 10, and that IXCs already "assess a 'markup' of up to 100% on their payphone compensation payments." *Id.* at 11. Second, APCC contends that any suppression in demand "is likely to result from high operator service surcharges and per-minute rates that are frequently assessed by IXCs, independently of whether the call is made from a payphone." *Id.* at 10. These arguments should be rejected.

First, an increase in the dial-around rate unquestionably would affect "the final rate charged by the IXC." *Id.* at 10. Any suggestion that IXCs should be obligated to internalize an increase in the dial-around compensation rate simply ignores market realities. IXCs such as AT&T operate in highly competitive markets with decreasing profit margins and significant competitive pressures. Indeed, the alleged "'markup' of up to 100%" of payphone-specific charges assessed by AT&T was designed to be a temporary measure to address increased payphone-specific refund obligations imposed by the Commission's *Fifth Report & Order*. *See* Supplemental Declaration of Hans Heymann ¶¶ 3-4 ("Heymann Supp. Decl.") (Attachment A). APCC proposal, in contrast, would further accelerate the decline in demand for payphone services by requiring AT&T (1) to increase its own payphone-specific charges by at least another $0.25, soon after AT&T already implemented a recent increase to cover adjustments in the payphone charges resulting from a recent Commission order, and (2) to maintain the payphone-specific charges at an artificially inflated level to secure recovery of a new dial-around compensation rate and associated administrative costs. *Id.* ¶ 5.

Second, APCC's reliance upon charges imposed by IXCs "independently of whether the call is made from a payphone" cannot undermine the fact that an increase in payphone-specific costs would inevitably cause a decline in demand for payphone services. At the outset, the costs charged by IXCs with regard to long-distance services are not at issue in this proceeding. Indeed, IXCs such as AT&T are non-dominant and lack market power that would allow them to artificially inflate their rates. As Sprint points out, "interLATA long distance revenues declined from $110 billion in 2000 to $99 billion in 2001, and that decline doubtless continued in 2002 and 2003." Sprint at 4 (footnote omitted).[12] In any event, even if APCC is correct that non-payphone-specific charges have affected consumer demand, it stands to reason that payphone specific-charges – here, a more than 100% increase in the dial-around default rate – will have a similar impact on consumer demand.

PSPs have acknowledged that relationship between demand and cost when confronted with similar increases. For example, when Ameritech announced that it intended "to increase the local coins rate at payphones throughout Michigan from 35 cents to 50 cents by September 2001," the Michigan Pay Telephone Association ("MPTA")—the trade association representing independent payphone service providers in Michigan—expressed disappointment because "'raising local coin rates at payphones is not the answer to maintain widespread deployment of pay telephones.'"[13] MPTA explained that "'[r]ate increases for local coin calls

[12] Further, the major independent IXCs are losing market share to "gains by RBOCs, whose affiliates own the vast majority of the nation's payphones." *Id.*

[13] Michigan Payphone Trade Group's Statement on Ameritech's Plan to Increase the Local Coin Rate, PR Newswire, July 12, 2001, *at* http://www.findarticles.com/cf_dls/m4PRN/

will not increase payphone usage,'" but "'will ultimately drive traffic patterns downward.'" *Id.* In doing so, MPTA stressed the importance of "'keeping local calling rates as affordable as possible to the thousands of residents who rely upon payphones.'" *Id.*

Recent experience in the prepaid phone card market reflects that consumers are keenly aware of payphone fees. Specifically, prepaid cards inform consumers that they will have less call time when placing calls from payphones than from other residential or business phones. Not surprisingly, the percentage of prepaid calling card calls made from payphones has declined from 41% in 1998, to 36% in 2000, to 27% in 2002.[14] Simply put, the proposals advanced by the RBOC Coalition and APCC will not ensure widespread deployment of payphones.

2. In the end, PSPs such as APCC argue that payphones remain the only alternative for low-income and/or rural consumers who will continue to depend upon payphone services even if the dial-around rate is doubled. *See* APCC at 5 (arguing that "[payphones] are perhaps most critical to those who cannot afford either a wireless phone or a home phone"); *id.* ("The availability of payphones is also critical for residents of rural areas, small towns, and Tribal Lands"); *see also id.* at 4 (payphones necessary for "[v]ictims of domestic violence and child abuse"). In effect, APCC and other PSPs seek to justify a nationwide doubling of the default compensation rate because they contend that such an increase is necessary to ensure that payphones remain available to a discrete group of low-income or rural consumers.

That argument should be rejected. As noted above, there has been no evidence that "the decline in the number of payphones since 1998 has prevented a single person from making a payphone call." WorldCom at 2. But even if such evidence had been presented,

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2001_July_12/76486488/p1/article.html.

[14] *See* Atlantic ACM, *Prepaid Cards: Market Dynamics & Forecasts 2001-2005* (2002).

Congress specifically created a mechanism for addressing such concerns when it provided that "the Commission shall determine whether public interest payphones, which are provided in the interest of public health, safety, and welfare, in locations where there would otherwise not be a payphone, should be maintained, and if so, ensure that such public interest payphones are supported fairly and equitably." 47 U.S.C. § 276(b)(2).

The Commission, in turn, has explained that "there is a need to ensure the maintenance of payphones that serve the public policy interests of health, safety, and welfare in locations where there would not otherwise be payphones as a result of the operation of the market." *First Report & Order* ¶ 277. In meeting this requirement, the Commission has recognized that "states are typically in a superior position to evaluate the need for payphones which serve community interests in health, safety and public welfare" and "are better equipped than the Commission to respond to geographic and socio-economic factors affecting the need for such payphones that are too diverse to be effectively addressed on a national basis." *Id.* ¶ 278. Indeed, the Commission ruled that "implementation of a public interest payphone program . . . may be a valuable tool in the states' efforts to achieve universal service." *Id.* ¶ 284. Finally, these obligations ultimately are enforceable by the Commission so that if a PSP believes that a state is not satisfying its obligations under Section 276(b)(2), then it may seek relief by filing "a petition with the Commission." *Id.* ¶ 286.

As WorldCom points out, if policy action is required, it should take the form of targeted "public interest payphone programs." WorldCom at 7. Reliance on public interest payphone programs will ensure that payphones remain available where there is a demonstrable public need but that such assistance is provided, for example, only where the payphone does not "generate revenues to cover the cost of installation or operation of the payphone" and "[n]o other payphones may be located at the same address."[15] This targeted approach is the "appropriate mechanism to ensure the widespread deployment of payphones in the public interest in the face of competition from wireless providers." WorldCom at 8.

Public interest programs, as the Commission has recognized, focus closely on real-world needs and do not impose the costs of securing payphone deployment in low-income or rural areas on the very low-income or rural consumers that APCC and the other PSPs contend have no other viable communications options. *First Report & Order* ¶ 283. Here, of course, there have been no submissions by the states indicating that payphone deployment is not meeting consumer needs or that the states lack the resources (or will) to develop targeted remedies that will address any such problems without further undermining demand for payphone services.

In contrast, doubling the dial-around compensation will not ensure that low-income consumers who allegedly lack access to a payphone necessarily would gain access to a payphone after the rate increase. After all, there is no requirement that PSPs would deploy payphones where demand has fallen. To the contrary, the Commission has acknowledged that "a payphone owner will never install a payphone unless it believes that the payphone will at least earn a normal rate of return." *Third Report & Order* ¶ 39.

Indeed, the RBOC Coalition does not contend that doubling the dial-around rate would increase the deployment of payphones but, at most, would "perhaps stem somewhat the sharp drop in the number of payphones deployed nationwide." RBOC at 5. As a result, doubling the default rate will not materially assist low-income consumers, but instead will result in an unjustified windfall to PSPs. Specifically, assuming that demand remains constant, "any

[15] *See* California Pub. Util. Comm'n, *Public Policy Payphone Program, available at* http://www.cpuc.ca.gov/static/industry/telco/public+programs/payphone.htm (last visited Jan. 22, 2004).

increase in the compensation amount will not only reduce the break-even number of calls and thus increase the number of payphones, *but also increase the profits generated by payphones that are already profitable*." *Third Report & Order* ¶ 39 (emphasis added).

In truth, doubling the dial-around rate would harm the low-income and rural consumers that APCC purports to champion. For example, payphone related charges would be passed along to consumers of prepaid cards, which are particularly appealing to those who have traditionally been excluded from equitable access to telecommunications services: lower income households, members of minority groups, students, members of the military, senior citizens, recent immigrants, and speakers of a language other than English.[16] These services are attractive for these and other consumer groups because they are so affordable. For those consumers who truly have no alternatives to payphones, increasing the dial-around rate for payphone calls would destroy the ability of such consumers to take advantage of prepaid card rates that are as low as three cents a minute.

Reliance upon the public interest payphone program is a far superior solution to any lingering concerns regarding unsatisfied consumer demand for payphone services. In contrast to a nationwide increase in the default compensation rate, state implementation of public interest payphone programs would target areas of actual consumer need and would not saddle low-income consumers with the burden of financing the proposed steep increase in the dial-around compensation rate.

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[16] Fully *half* of households with incomes below $20,000 and 70% of African-American households have used prepaid cards, and consumers 55 and older represent the fastest-growing segment of prepaid card users. See D. Wolfe, CPR Group, *Card Usage Climbs* (2002) *available at* http://www.intelcard.com/factsand figures/factsandfig.asp?A_ID=97; IDC, *Is There Room for Growth, U.S. Prepaid Calling Card Forecast and Analysis, 2002-2006* (Dec. 2002).

II. THE COMMISSION SHOULD REJECT THE PSPS' PROPOSALS BECAUSE THEY ARE BASED UPON IMPROPER ANALYSES AND UNRELIABLE DATA.

The comments confirm that the proposals of APCC and the RBOC Coalition also should be rejected because they depart in significant respects from the methodology adopted by the Commission in the *Third Report & Order*. Stated simply, the PSPs cannot both purport to rely upon the *Third Report & Order* while abandoning the central tenets of the Commission's analysis.

A. The PSP Call-Volume Estimates Depart From The Methodology Adopted In The *Third Report & Order*.

The comments confirm that the call volume estimates advanced by APCC and the RBOC Coalition are based upon methodologies that depart in significant respects from the approach adopted in the *Third Report & Order*. *See* AT&T at 3, 11-18; Sprint at 12-14. Both APCC and the RBOC Coalition have submitted call volume estimates that fail to abide by the Commission's definition of a "marginal payphone location." *Third Report & Order* ¶ 139.

As for APCC, its comments cannot correct the fact that its survey was rendered unreliable by self-selection. More fundamentally, APCC's survey was flawed because it included in the call volume estimate payphones that plainly were not located at marginal locations. APCC seeks to downplay this error by stating that its technique for estimating "call volumes at marginal payphones *differ slightly*," APCC at 18, but that suggestion severely understates APCC's departure from the *Third Report & Order*.

Although APCC contends that it applied *one* component of the Commission's definition of marginal payphone location, APCC quite plainly ignored that the Commission's definition of marginal payphone location *also* requires that "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset." *Third Report & Order* ¶

139. By doing so, APCC improperly failed to exclude unprofitable payphones from its calculation in direct contravention of the *Third Report & Order*.

Similarly, the RBOC Coalition includes in its calculation all payphones – including those for which the payphone operator is not recovering its costs or a normal rate of return on the asset. As a result, these RBOCs' call volume figures artificially depress the actual call volume at a true marginal payphone location by including low-volume payphones that plainly are unprofitable. AT&T at 16-18. The RBOC Coalition admits that it "has not used the same methodology in the current cost studies," but instead has relied upon "actual average call volumes" while "excluding those calls supporting payment of commissions to location owners at supra-marginal locations." RBOC at 4. That approach must be rejected because the RBOC Coalition admittedly makes no effort to exclude payphones that are not recouping their costs, including a normal rate of return. *Third Report & Order* ¶ 139. Simply put, the RBOC Coalition cannot purport to apply the *Third Report & Order* while fundamentally modifying the definition of "marginal payphone location."

B. The Cost Estimates Are Inflated And Are Based Upon An Analysis That Is Contrary To The *Third Report & Order*.

The comments further demonstrate that the cost estimates advanced by APCC and the RBOC Coalition are inflated in numerous respects. AT&T at 19-23; Sprint at 14-18; WorldCom at 11-22. As shown by WorldCom, the equipment costs identified by the PSPs ignore that second-hand payphone equipment is less costly and is readily available across the country. WorldCom at 11-15.

For its part, APCC argues *both* that the Commission should not use second-hand payphones to estimate equipment costs *and* that "the availability of used equipment is already factored into APCC's Cost Study." APCC at 28. Both arguments should be rejected. As to the former, the costs of second-hand equipment are significantly lower than the estimated equipment costs identified by the RBOC Coalition and the APCC, both of which relied upon new payphone equipment. Heymann Supp. Decl. ¶ 7. In this regard, the costs identified by WorldCom associated with used payphones are wholly consistent with AT&T's experiences and, on balance, reflect a far more accurate picture of market conditions than that advanced by APCC and the RBOC Coalition. *Id.* ¶¶ 7-8.[17] These reduced costs reflect that there is a glut of new or nearly new payphones sitting in inventory that are available at significantly less cost than was the case in 1999. *See* WorldCom at 11. The PSPs should not be permitted to avoid that market reality.

Moreover, it is entirely appropriate to rely upon the costs of such equipment without fear that consumers will suffer some degradation in service. AT&T has for years relied upon second-hand equipment in its own payphone operations. *See* Heymann Supp. Decl. ¶¶ 9-10. Nevertheless, AT&T has experienced no degradation in service associated with the use of these used payphones. *Id.* ¶ 9.

Second, the comments demonstrate that PSPs should not be permitted to include "bad debt" in the costs of a marginal payphone. AT&T at 20-22; Sprint at 17; WorldCom at 15-16. As AT&T and others pointed out, inclusion of "bad debt" is improper for multiple reasons under the *Third Report & Order* and the D.C. Circuit's decision affirming the *Third Report & Order*. AT&T at 20-22. Indeed, the "bad debt" identified by the PSPs appear to be all amounts about which there is a dispute regarding compensation, including any call which "had conversation time equal to or greater than 10 seconds." IPTA at 12. Reliance upon that data,

[17] Indeed, in a number of respects, WorldCom's cost estimates appear to be overly generous because they assume that all payphones will require programming and rate file, when, in fact, such costs would be applicable only for the subset of smart payphones. *See* Heymann Supp. Decl. ¶ 7. In addition, AT&T's experience reflects that the percentage of payphones with enclosures is markedly lower than the 74% reflected in WorldCom's estimate. *Id.*

even assuming it were legitimate "bad debt," would constitute an unreliable proxy for future bad debt estimates since the Commission recently acted to address PSP concerns regarding bad debt. *See SBR Order* ¶¶ 51-54.

Third, the comments further demonstrate that "collection costs" should not be included in the costs of a marginal payphone. AT&T at 22-23; WorldCom at 16. As WorldCom shows, the RBOCs "collections costs" are not appropriate because they include "the costs of validating calling cards, collect calls, and billed-to-third party calls in addition to identifying the IXC responsible for [dial-around compensation]." *Id.* These items are not necessary functions for PSPs. *Id.* With regard to APCC, there is no indication that the PSPs who responded to APCC's survey excluded such costs from their "sales, general, and administrative costs." *Id.* In all events, estimates of "collection costs" allegedly incurred in the past do not provide a reliable proxy for future collection costs given the Commission's recent action in the *SBR Order* which will assist PSPs in their efforts to ensure payment where authorized by statute. AT&T at 23 (citing *SBR Order*).

Finally, APCC is wrong in arguing that advertising revenues should be excluded from the assessment of the default compensation rate. APCC at 26. The RBOC Coalition apparently does not share APCC's view of the limits on the Commission's authority to consider such revenues. RBOC at 13. Indeed, for low-volume payphones located in places where the PSPs receive a location rent from the premises owner, the Commission has set the compensation rate so that these payphones would not be profitable without the location rent, *i.e.*, the Commission has refused to ignore these location rents, and it likewise should not ignore potentially substantial advertising revenues. *Third Report & Order* ¶ 147.

APCC further claims that "PSPs generate very little revenue from advertising." APCC at 27. APCC's website, however, informs its members that they can "[m]aximize [their] potential revenue today by joining APCC Services' exciting payphone advertising program,"[18] and that "[a]dvertising on payphones is a new and growing income source for payphone owners."[19] Indeed, APCC includes a sample contract that offers PSPs "Thirty-Five Dollars ($35.00) per month for every two outdoor panel displays posted," "Twenty Dollars ($20.00) per month for every indoor display posted," and additional revenue for "installation and maintenance" of such displays. *Advertising, supra* note 19 (providing link to "Advertising Contract"). In turn, APCC provides its members with a link to Prime Point Media, which facilitates payphone advertising programs and informs PSPs that "public telephone providers are poised to take advantage of new revenue-generating ideas."[20] Given these representations, there can be no justifiable reason to exclude this potential revenue stream from the Commission's determination of the appropriate dial-around compensation rate.

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[18] *See* APCC, *Payphone Advertising, at* http://www.apcc.net/public/pages/index.cfm? pageid=40 (last visited Jan. 22, 2004).

[19] APCC, *Welcome to the Advertising home page, at* http:/www.apccsideas.com/ pub/Advertising/myAdvertising.asp (last visited Jan. 22, 2004).

[20] Prime Point Media, *Our System, at* http://www.primepointmedia.com/oursystem.html (last visited Jan. 22, 2004).

CONCLUSION

For these reasons, the Commission should decline to modify the compensation for dial-around payphone calls, and should reject the proposed modifications to the current default rate proposed by APCC and the RBOC Coalition.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Reply Comments of AT&T Corp. was served, by the noted methods, the 22nd day of January, 2004, on the following:

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Attachment A

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

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

SUPPLEMENTAL DECLARATION OF HANS HEYMANN

1. **Qualifications.** My name is Hans Heymann. I am the District Manager in AT&T's Local Network Services Division supporting the National Public Markets business unit. My relevant qualifications are set forth in my original declaration, which was submitted with AT&T Corp.'s ("AT&T") opening comments in this proceeding, and which I incorporate here by reference.

2. In connection with this supplemental declaration, I have reviewed, among other things, the recently submitted comments of APCC and the RBOC Coalition as well as the comments of WorldCom.

3. **Effect of Increase in Dial-Around Rate on Payphone Consumers.** APCC's Comments appear to suggest that an increase in the dial-around rate may not affect consumer demand because any increase in price to the consumer would be predicated on AT&T passing this cost onto consumers. APCC implies that no such increase would be warranted (or

necessary) because IXCs such as AT&T already have implemented a "'markup' of up to 100%" of payphone-specific charges.

4. That assessment is mistaken. The "markup" referenced by APCC was adopted by AT&T as a temporary measure in response to payphone-specific refund obligations imposed on AT&T as a result of the Commission's *Fifth Order on Reconsideration*. AT&T simply cannot subsidize payphone service providers by absorbing additional payphone-specific increases in the dial-around default compensation rate.

5. Increases in the dial-around compensation rate such as the ones proposed by APCC and the RBOC Coalition would adversely effect payphone customers. Specifically, an increase in the dial-around compensation would result in a further substantial increase in the payphone-specific charges passed along to payphone consumers and would indefinitely delay a reduction of the current payphone-specific charges imposed on consumers to levels that pre-dated the *Fifth Order on Reconsideration.*

6. Contrary to APCC assertions, my experience has been that payphone consumers are very sensitive to price increases and will modify their conduct to avoid such increases, especially where alternatives such as wireless technology are available. Indeed, payphone service providers recognize the importance of price to payphone consumers and have adopted programs to increase demand by offering consumers, for example, an opportunity to pay as little as $0.25 for a three-minute local coin call.

7. **Equipment Costs.** The equipment costs identified by WorldCom far more accurately reflect the actual market conditions than the cost estimates of APCC and the RBOC Coalition. Indeed, some of the estimated costs identified by WorldCom appear to be

overstated because they assume that a specified cost will apply to all payphones. For example, WorldCom assumes that costs for "programming" ($45.00) and "rate file" ($23.67) will apply to *all* payphones, when in truth these costs will apply *only* to "smart payphones." Payphones designed to rely on the central office do not require "programming" or a "rate file." In addition, AT&T's experience reflects that the percentage of payphones with enclosures is markedly lower than the 74% reflected in WorldCom's estimate. *Id.* On balance, however, WorldCom's estimates of equipment better reflect the changes in the payphone equipment market than those of APCC or the RBOC Coalition.

8. The change in equipment costs is a result of changes in the payphone market in general. Reductions in demand have been met with reductions in payphone deployment. These reductions have created a glut of used equipment that is available on the open market at prices far below the costs of "new" equipment identified by APCC and the RBOC Coalition.

9. Deployment of "used" payphone equipment in no way harms consumers of payphone services. For years, AT&T has deployed "used" payphone equipment and, as a result, has reduced its equipment costs significantly without any degradation in service quality. APCC's suggestion that the Commission should ignore the actual market for payphone equipment because used equipment might jeopardize consumer service is inconsistent with my own experience managing AT&T's payphone equipment.

10. Moreover, APCC's suggestion that the costs of "used" equipment should be disregarded simply ignores that payphone service providers are, in fact, using such

warehoused inventory and second-hand equipment to meet their ongoing payphone equipment needs.

I, Hans Heymann, declare under penalty of perjury, that the foregoing is true and correct.

Hans Heymann

Executed on January 22, 2004