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
	)	

REPORT AND ORDER

Adopted: July 27, 2004 **Released: August 12, 2004**

By the Commission:

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I. INTRODUCTION AND SUMMARY

1. In this order, we modify the default rate of payphone compensation for "dial-around" calls set forth in section 64.1300(c) of our rules.[1] This action reflects our continued efforts to implement the requirements of section 276 of the Communications Act of 1934, as amended ("Act"), which directs the Commission to "promote the widespread deployment of payphone services to the benefit of the general public."[2] In pursuit of this mandate, section 276(b)(1) also directs the Commission to establish "a per call compensation plan to ensure that all payphone service providers (PSPs) are fairly compensated for each and every completed call."[3] More than five years ago, the Commission set a default compensation rate of $.24 per call for "dial-around" calls made from payphones.[4] The Commission did, however, say that it would reexamine this rate should conditions warrant.[5] Since then, the industry has changed from a growing industry to a shrinking industry, leading to a substantial increase in the local coin rate. Because the dial-around compensation rate is derived by spreading the largely fixed costs of payphones over a measure of the number of calls, the decline in call volumes also requires us to reexamine the dial-around rate. Thus, we initiated this proceeding to ensure that this rate continues to provide "fair[] compensat[ion]" for each and every payphone call. As we explain more fully below, we conclude that changes in the payphone market warrant increasing this rate to $.494 per call.

II. BACKGROUND

2. In a series of orders starting in 1996, the Commission promulgated pay telephone service regulations to implement section 276 of the Act, as amended by the Telecommunications Act of 1996 ("the 1996 Act").[6] Among the provisions of section 276 addressed in these orders is section 276(b)(1)(A),

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[1] 47 C.F.R. § 64.1300 (c).

[2] 47 U.S.C. § 276 (b) (1).

[3] 47 U.S.C. § 276 (b)(1)(A).

[4] *See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-128, Third Report and Order and Order on Reconsideration of the Second Report and Order, 14 FCC 2545 (1999).

[5] *Id.* at 2658, para. 230.

[6] *See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Notice of Proposed Rulemaking, 11 FCC Rcd 6716 (1996) (hereinafter *First Payphone NPRM*); Report and Order, 11 FCC Rcd 20541 (1996) (hereinafter *First Report and Order*); Order on Reconsideration, 11 FCC Rcd 21233 (1996) (hereinafter *First Reconsideration Order*), *aff'd in part and remanded in part sub nom. Illinois Pub. Telecomm. Ass'n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997), *clarified on reh'g,* 123 F.3d 693 (D.C. Cir. 1997), *cert. denied sub nom. Virginia State Corp. Comm'n v. FCC*, 523 U.S. 1046 (1998) (hereinafter *IPTA)*; Second Report and Order, 13 FCC Rcd 1778 (1997), *aff'd in part and remanded in part sub nom. MCI v. FCC*, 143 F.3d 606 (D.C. Cir. 1998) (hereinafter *MCI*); Third Report and Order and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545 (1999) (hereinafter *Third Report and Order*), *aff'd sub nom. American Pub. Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000) (hereinafter *American*); Second Order on Reconsideration, 16 FCC Rcd 8098 (2001) (hereinafter *Second Reconsideration Order*); Third Order on Reconsideration and Order on Clarification, 16 FCC Rcd 20922 (2001) (hereinafter *Third Reconsideration Order*),
(footnote continued on next page)

which specifically directs the Commission to establish a plan to ensure that PSPs are "fairly compensated" for every completed interstate and intrastate call.[7] The statute does not prescribe a particular method for accomplishing this task, other than to specify that such action shall "promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public[.]"[8]

3. In implementing section 276(b)(1)(A), the Commission has relied whenever feasible on a market-based, deregulatory mechanism for payphone compensation, as required by both section 276 and the generally pro-competitive goals of the 1996 Act. In the case of certain types of calls broadly referred to as "dial-around" calls,[9] however, the Commission recognized that various statutory, technological, and economic factors inhibited the development of a fully deregulated means of providing fair compensation. For example, the Commission determined that, because section 226 of the Act prohibits PSPs from blocking access code calls to interexchange carriers (IXCs),[10] PSPs were deprived of market leverage to negotiate fair compensation for the delivery of such calls to IXCs.[11] Unlike other aspects of payphone service, such as the local coin rate, the Commission found it necessary to adopt a more regulatory approach to ensure that PSPs are fairly compensated for these types of calls. The Commission, therefore,

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remanded sub nom. Sprint Corp. v. FCC, 315 F.3d 369 (D.C. Cir. 2003); Fourth Order on Reconsideration and Order on Remand, 17 FCC Rcd 2020 (2002); Fifth Order on Reconsideration and Order on Remand, 17 FCC RCd 21274 (2002)(hereinafter *Fifth Reconsideration Order*), *aff'd sub nom. AT&T v. FCC,* __ F.3d __ (D.C. Cir. 2004); Report and Order, 18 FCC Rcd 19975 (2003)(hereinafter *Tollgate Remand Order*), *pets. for reconsideration pending*.

[7] *See* 47 U.S.C. § 276(b)(1)(A). The statute directs 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, except that emergency calls and telecommunications relay service calls for hearing disabled individuals shall not be subject to such compensation." *Id.*

[8] 47 U.S.C. § 276(b)(1). *See First Report and Order*, 11 FCC Rcd at 20566, para. 48; *Second Report and Order*, 13 FCC Rcd at 1789, para. 24.

[9] There are typically three types of calls made from payphones: coin calls; coinless calls using the long distance carrier selected by the payphone owner (referred to as the "presubscribed carrier"); and so-called "dial-around" calls, where the caller makes a coinless call using a carrier other than the payphone's presubscribed long distance carrier. Generally, there are two types of dial-around calls. The first type is where a caller uses a code to access his or her preferred long distance carrier to make a long distance call, e.g., "1/800/CALL-ATT" or "10-10-321." The second type of dial-around calls are known as "toll-free" calls, such as 1/800/Flowers. In this type of call, the flower company will pay (or "subscribes" to) a long distance carrier for a toll-free number that its customers can use to make long distance calls to the company without incurring toll charges. Similar to the caller who uses 1/800/CALL-ATT, the flower customer calling from a payphone is making a long distance call using a carrier other than the payphone's presubscribed long distance carrier.

[10] *See* Telephone Operator Consumer Services Improvement Act (TOCSIA), Pub. L. No. 101-435, 104 Stat. 986 (1990) (codified at 47 U.S.C. § 226). The effect of this statutory provision is to preclude PSPs from blocking outgoing 800 and other 8XX calls, including toll-free subscriber calls.

[11] *First Report and Order*, 11 FCC Rcd at 20567, para. 49.

established a default per-call compensation amount to be paid by IXCs[12] to PSPs for each and every completed intrastate and interstate dial-around call, in the absence of individual agreements.[13]

4. Based upon its determination that the payphone market has low entry and exit barriers and likely would become increasingly competitive, the Commission in the *First Report and Order* chose a market-based, rather than a cost-based, default compensation amount.[14] Because a purely market-based approach was not then feasible, the Commission decided that compensation should be based on a market surrogate. Concluding that the costs of coin calls and dial-around calls were "similar,"[15] the Commission set a PSP's default dial-around compensation rate (to be paid in the absence of a negotiated agreement) equal to the amount the particular PSP charges for local coin calls.[16] Because it found that fully competitive conditions for coin calling did not yet exist, the Commission established a uniform interim rate of dial-around compensation of $.35 per call, which was the local coin call price in several states where payphone coin calling rates had been deregulated.[17] The Commission also concluded in the *First Report and Order* that use of a purely incremental or marginal cost standard for all calls would be inadequate because PSPs would be unable to recover a reasonable share of the joint and common costs of the payphone.[18]

5. On review, the court of appeals concluded, *inter alia*, that the Commission had not adequately justified its conclusion that the costs of local coin calls are similar to those of toll-free and access-code calls, and it remanded the matter to the Commission.[19]

6. The Commission responded to the court's remand in the *Second Report and Order*. The Commission affirmed its decision in the *First Report and Order* to use a market-based, interim compensation amount for compensable calls.[20] Responding to the court's findings that it had failed to address information in the record regarding cost disparities between coin calls and dial-around calls, the Commission concluded that the appropriate per-call compensation amount for dial-around calls was the market-based local coin price, adjusted for the differences in the costs of providing coin calls and dial-around calls.[21] The Commission examined the underlying cost components and found that the cost to PSPs of providing dial-around calls from a "marginal," or low traffic, payphone location[22] was $.066 less

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[12] The Commission determined in the *First Report and Order* that the primary economic beneficiaries of access-code and toll-free subscriber calls, the IXCs, should be responsible for compensating the PSPs. *Id.* at 20584, para. 83. For purposes of this *Report and Order*, the term "IXC" also includes a LEC when the LEC provides a toll-free subscriber service or a service accessed by access codes, *see id.* at 20584 n.293, and switched-based resellers that are the primary economic beneficiaries of coinless payphone calls transferred to their switches. *See Tollgate Remand Order*, 18 FCC Rcd at 19988, para. 27 (rel. Oct. 3, 2003); Errata (WCB, rel. Oct. 23, 2003).

[13] *See First Report and Order,* 11 FCC Rcd at 20567-68, paras. 50-51.

[14] *Id*. at 20541, para. 70; *id.* at 20568, para. 52.

[15] *Id.* at 20577, para. 70.

[16] *Id.* at 20577-578, paras. 70-71.

[17] *Id.* at 20577-578, paras. 70-72.

[18] *Id.* at 20576, para. 68.

[19] *Illinois*, 117 F.3d at 564.

[20] *Second Report and Order*, 13 FCC Rcd at 1789, para. 24.

[21] *Id.* at 1796, para. 41.

[22] *Id*. at 1797-1801, para. 42.

than the cost of providing coin calls.[23] The Commission therefore reduced the market coin call price of $.35 by $.066 to arrive at a default per-call compensation amount of $.284.[24] The Commission also concluded that this default amount would be in effect for two years, until October 6, 1999.[25] After two years, the per-call default amount would be the market-based local coin price, less $.066, representing the net avoided costs of a dial-around call.[26]

7. On review, the court remanded portions of the *Second Report and Order* on the grounds that the Commission had not adequately justified the derivation of a compensation amount for coinless payphone calls. In particular, the court held that the Commission had failed to explain why a market-based compensation amount for coinless calls could be derived by subtracting avoided costs from a market price charged for coin calls.[27]

8. In response to this remand, the Commission set a default compensation rate of $0.24 per call for a three-year period beginning April 21, 1999. In the *Third Report and Order,* the Commission switched from the top-down "market-based" methodology reflected in its prior orders to a "bottom-up" methodology to establish the default per-call compensation rate.[28] Pursuant to the bottom-up methodology, the Commission calculated an average fully distributed cost for each type of call such that the default price for each type of call is set equal to the fully distributed cost of that type of call.[29]

9. The Commission determined that the joint and common costs of payphone operations should be recovered equally from each and every call.[30] Joint and common costs are those that do not vary with the relative number of coin and coinless calls at the payphone. Thus, for example, coin collection costs are not joint and common costs because they vary depending on the number of coin calls placed at the payphone. The Commission identified five categories of joint and common costs for payphones: capital expenditures; line charge costs; maintenance costs; sales, general and administrative ("SG&A") costs; and FLEX ANI[31] costs. The Commission determined that the sum of those costs was $101.29 per payphone per month.[32]

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[23] *Id.* at 1828, para. 117.

[24] *Id.* at 1830, para. 121.

[25] *Id.* at 1828, para. 117.

[26] *Id.* at 1828, para. 117.

[27] *MCI*, 143 F.3d at 608.

[28] *Third Report and Order*, 14 FCC Rcd at 2545.

[29] *Id*. at 2545, para. 72. This is a "bottom-up" methodology because the price of dial-around or compensable calls is calculated by "building-up" the costs of these calls from a starting point of zero using costs, instead of "building-down" from a starting point of the price of coin calls using avoided costs.

[30] While the compensation rate should also recover the marginal cost of placing a dial-around call, the Commission concluded that no such costs existed or that such costs were so small as to be insignificant. *Id.* at 2631, para. 190.

[31] FLEX ANI is a coding digit technology that allows IXCs to identify payphone-originated calls for per-call compensation purposes. *See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, TDS Telecommunications Corporation Petition for Waiver of Coding Digit Requirement, International Telecard Association Petition for Reconsideration of Payphone Compensation Obligation,* CC Docket No. 96-128, Memorandum Opinion and Order, 13 FCC Rcd 4998, 5000, para. 2 and n.8.

[32] *Third Report and Order,* 14 FCC Rcd at 2632, para. 191

10. To translate the total monthly cost of $101.29 per payphone into a per call rate, the Commission affirmed its finding in the *Second Report and Order* that monthly costs should be divided by the total number of calls made from a "marginal payphone," which the Commission defined as one "where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location provider."[33] The Commission concluded that the use of a marginal payphone, as opposed to an "average payphone," was "necessary to fairly compensate PSPs and ensure the widespread deployment of payphones."[34] It found that "basing the default compensation amount on an average payphone location would cause many payphones with less-than-average call volumes to become unprofitable," which in turn would lead to the removal of existing payphones in contravention of the statutory mandate to ensure their "widespread deployment."[35] Because the bottom-up methodology would assure fair compensation for the overwhelming majority of payphones, the Commission concluded that the per-call compensation methodology adopted in the *Third Report and Order* would not negatively affect the current deployment of payphones and thus would promote Congress's goal of widespread deployment of payphones.

11. Relying on data submitted by the RBOC Payphone Coalition, the Commission determined that the typical "marginal" payphone at the time of the *Third Report and Order* had a call volume of 439 calls per month.[36] Dividing $101.29 by 439 calls yields a per call figure of $0.231. The Commission added $0.009 to this figure to provide interest to PSPs to compensate them for the four-month time delay inherent in the dial-around compensation process, for a total of $.24 per call.[37]

12. The Commission therefore prescribed a default dial-around compensation rate of $.24 per call to remain in effect until at least January 31, 2002. The Commission stated its belief that, in the future, targeted call blocking would play a significant role in bridging the gap between Congress's and the Commission's goal of a deregulatory solution and the need to ensure fair compensation. The Commission also stated, however, that if, by January 31, 2002, parties have not invested the time, capital, and effort necessary to remove the technological and other impediments to a market-based resolution, parties could petition the Commission regarding the default compensation amount.[38]

13. On June 16, 2000, the court affirmed the default rate of $0.24, concluding that the Commission's bottom-up calculation of the default payphone compensation rate was a reasonable exercise of its jurisdiction.[39]

14. On August 29, 2002, the American Public Communications Council ("APCC") filed a Request that the Commission Issue a Notice of Proposed Rulemaking (or in the alternative, Petition for

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[33] *Id*. at 2607, para. 139. The location provider is the entity that owns or leases the space where the payphone is placed. *See First Payphone NPRM*, 11 FCC Rcd at 6721-22. In some cases, the PSP will pay commissions to the location provider. In other instances, the location provider will make payments to the PSP.

[34] *Id.* at 2608, para. 141.

[35] *Id.* at 2608-09, para. 141.

[36] *Id.* at 2614, para. 151 n.202.

[37] *Id.* at 2615, para. 153.

[38] *Id.* at 2658, para. 230.

[39] *American*, 215 F.3d at 51.

Rulemaking) to consider a new default compensation rate for dial-around calls from payphones.[40] On September 4, 2002, the RBOC Payphone Coalition (BellSouth Public Communications, Inc., SBC Communications, Inc., and the Verizon telephone companies) filed a petition also requesting that the Commission establish a new dial-around compensation rate.[41] On October 31, 2003, we granted the petitions for rulemaking filed by the PSPs and requested comment on whether to modify the default rate of payphone compensation for "dial-around" calls set forth in section 64.1300(c) of our rules.[42]

III. DISCUSSION

15. There appears to be no dispute among the commenting parties that industry conditions have changed significantly.[43] Payphone usage is decreasing as the use of wireless services increases.[44] As a result, payphones in growing numbers are being removed from many locations because they no longer have sufficient call volumes to remain economically viable.[45] The number of RBOC payphones has fallen by about 40 percent -- from 1.38 million in February 1997 to fewer than 900,000 as of March 31, 2003.[46] APCC, on behalf of its independent payphone service provider membership, also reports a significant decline in the number of deployed payphones. For the overall period from 1998 to March 31, 2003, APCC reports a total decline in payphones of more than 30 percent.[47] There is also wide agreement that the local coin rate continues to increase, most recently to $.50 at most payphones.[48] The point of disagreement concerns the implications of these changes for the dial-around compensation rate--the PSPs favor a substantial increase in the compensation rate, while the IXCs argue that there is no need to increase the rate. As set forth in the *Third Report and Order* and affirmed by the court of appeals,[49] the Commission's method of calculating the dial-around compensation rate spreads the costs of payphones, which are largely fixed, over a measure of the number of payphone calls. Thus, the dial-around rate is affected by the volume of payphone calls, which has indisputably declined since the Commission set the current rate, necessitating the reexamination we undertake here.

A. Level of Payphone Deployment

16. PSPs contend that the lower level of payphone deployment is inadequate to serve the public interest.[50] Many individuals,[51] local governments,[52] and community organizations[53] have viewed

[40] Request that the Commission Issue a Notice of Proposed Rulemaking (Or, in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate (filed Aug. 29, 2002) ("APCC Petition"). On August 30, 2002, APCC filed a corrected copy of its petition.

[41] Petition for Rulemaking to Establish Revised Per-Call Payphone Compensation Rate (filed Sept. 4, 2002) ("RBOC Coalition Petition").

[42] *Request to Update Default Compensation Rate for Dial-Around Calls From Payphones,* Order and Notice of Proposed Rulemaking, WC Docket No. 03-225, 18 FCC 22811 (2003) (hereinafter *NPRM).*

[43] *See, e.g.*, AT&T Comments at 6; MCI Comments at 2; Sprint Comments at 6; APCC Comments at 2.

[44] *See, e.g.*, AT&T Comments at 2; Illinois Public Telecommunications Association Comments at 9.

[45] *See, e.g.,* APCC Comments at 6-7; RBOC Coalition Comments at 4-5; Sprint Comments at 8.

[46] RBOC Coalition Comments at 4.

[47] APCC Comments at 2.

[48] *See, e.g.,* APCC Comments at 9; IDT Comments on Petitions for Rulemaking at 12; Global Crossing Comments on Petitions for Rulemaking at 4; MCI Comments at 9; RBOC Coalition Comments at 7.

[49] *See supra* paras. 8-13.

[50] APCC Petition at 6-8; APCC Reply Comments at 2-9; RBOC Coalition Reply Comments at 5-7.

with alarm the declining number of payphones. State public service commissions have similarly expressed concern with the declining number of payphones, as demonstrated by their interest in public interest payphone ("PIP") programs.[54] Predicting that payphone deployment is likely to drop even further in future years, the PSPs urge the Commission to raise the dial-around compensation rate in order to prevent, or at least slow, further erosion of the payphone base.[55]

17. The IXCs argue that the problem is too many payphones, not too few. They contend that the Commission should leave the compensation rate unchanged and allow market forces to determine the number of payphones in the marketplace.[56] To the extent that public policy action is needed, the IXCs contend, it should take the form of state PIP programs.[57]

18. In considering these issues, we must first acknowledge that, as we noted in the NPRM, the current per-call compensation rate is itself the result of government intervention in the payphone market.[58] First, the Act requires PSPs to let callers access any carrier from payphones; this prohibition on call blocking impedes PSPs from negotiating market-based compensation.[59] Second, concerns about direct payments for services using toll-free numbers at payphones resulted in various statutory limitations on direct payments at the payphone instrument.[60] Moreover, the IXCs do not assert that they are currently able to implement targeted call blocking, a development which the Commission previously found could justify shifting from a prescribed compensation rate to a negotiated compensation rate.[61]

19. For all these reasons, it was necessary for the Commission to intervene in the market by prescribing per-call compensation for "dial-around" calls. Although we attempted to set a cost-based compensation rate that would minimize regulatory distortion of the market, we acknowledged that we would have to periodically review that rate in order to ensure that it continues to "fairly compensate" PSPs and promote payphone competition and widespread deployment of payphones. Especially when market conditions have changed significantly, it is incumbent upon us to reexamine whether the conditions resulting in the present Commission-prescribed rate still apply.

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[51] *See, e.g*., APCC Petition, Atts. 4, 11.

[52] *See, e.g*., APCC Reply Comments, Exhs. 2, 4.

[53] *See, e.g*., APCC Reply Comments, Exhs. 2, 3.

[54] APCC Comments at 6, 8-9; APCC Reply Comments at 5-6.

[55] APCC Comments at 7; RBOC Coalition Comments at 5.

[56] *See, e.g.*, AT&T Comments at 7.

[57] AT&T Reply Comments at 15; MCI Reply Comments at 7-10; Global Crossing Reply Comments at 3.

[58] *NPRM* , 18 FCC Rcd at 22818, para. 20.

[59] *See* 47 U.S.C. § 226(c)(1)(B), which requires PSPs to ensure access to the operator services provider desired by the consumer.

[60] 47 U.S.C. §§ 226 (c)(1)(C), (e)(2).

[61] In the *Third Report and Order,* the Commission noted that, while PSPs are prohibited from blocking dial-around calling, it appears that IXCs may legally decline to accept dial-around calls for which they are unable to negotiate a satisfactory price. The deployment of targeted call-blocking technology seemed to offer a means of transitioning to a negotiated, market-based rate. *Third Report and Order,* 14 FCC Rcd at 2647-48, para. 230. The Commission requested the industry to inform it in the event that technology was developed to allow economical deployment of targeted call blocking. *Id.*

20. The IXCs contend that we need not act because there is no evidence "that payphone deployment is now or will be insufficient to meet declining consumer demand."[62] Even if the decline in payphone deployment were not outstripping the decline in consumer demand, payphones do not exist solely to meet a given level of economic demand. We acknowledge, as did Congress in passing section 276, that payphones are accessible on demand to consumers without initial investment or monthly charges, and provide a unique back-up communications option when subscription services – whether wireline or wireless – are unaffordable or unavailable.[63] Payphone services are particularly critical to those with few other communications service options – including low-income customers, the elderly, and residents of rural areas.[64] Payphones also enhance access to emergency (public health and safety) services.[65]

21. Further, in arguing that the decline in payphone deployment results from legitimate market forces, i.e., lower demand for payphone calls, the IXCs ignore the fact that PSPs' ability to respond to such market forces is restricted by the Commission's prescription of a maximum dial-around compensation rate. Given these factors, we cannot presume that the marketplace will automatically ensure that payphone deployment is sufficient; rather, section 276 makes it our responsibility to ensure that inadequate compensation does not cause deployment to drop to levels insufficient to serve the public interest. The evidence in the record shows that there has been a significant, accelerating decline in the number of payphones deployed.[66] In the *Third Report and Order*, the Commission found that deployment was satisfactory because no grass roots concern with the deployment level had surfaced.[67] Today, as the PSPs point out, declining deployment is causing inconvenience to consumers and may even be starting to pose a public safety issue.[68] The public, community organizations, and government officials view the decline in deployment as a negative development.[69]

22. While the IXCs claim that current deployment is sufficient despite the substantial and accelerating decline in the number of payphones deployed, they offer little support for this claim. AT&T points out that the West Virginia Payphone Task Force found that the impact of payphone declines on particular counties in West Virginia varied widely, and that urban counties, which have the most payphones and comparatively more expansive cellular coverage and availability, experienced the greatest decline in payphones.[70] In other words, the counties that start out with more payphones lose more

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[62] AT&T Comments at 7; *see also* Sprint Comments at 6-8.

[63] APCC Comments at 3-4.

[64] *Third Report and Order*, 14 FCC Rcd at 2550-51, para. 10.

[65] Payphones were vital in maintaining the communications network during the recent power outage and related blackout that stretched from Ohio to New York. *See* APCC Comments at 4.

[66] APCC Comments at 7; RBOC Coalition Comments at 4 & Exh. 1 at 11. Sprint argues that the decline in payphone deployment reflects primarily the removal of redundant payphones, i.e., the reduction in the number of payphones in banks of two or more payphones. Sprint Comments at 8. Sprint adds that the decline in per-payphone volume reflects PSPs' failure to remove all redundant payphones. APCC's cost study survey results indicate, however, that more than three quarters of independent payphones are the only payphone at their locations. APCC Reply Comments at 3, Exh. 1, para. 33.

[67] *Third Report and Order*, 14 FCC Rcd at 2608, para. 141.

[68] APCC Comments at 4-6 and documents cited therein; APCC Reply Comments at 3-5 and documents cited therein.

[69] *See* para. 16, *supra.*

[70] AT&T Reply Comments at 9-10.

payphones because they have more payphones to lose. This predictable pattern hardly supports any inference that the remaining payphones are sufficient to serve the public interest.

23. As for cellular coverage, the West Virginia Payphone Task Force found that: "Although cell phones offer a convenient alternative to payphones for many customers, they provide little assistance to low-income citizens who may rely on payphones as a primary method of conducting business."[71] Further, the Task Force's report also states that "because of the topography of West Virginia, there are many areas where cellular phone service simply isn't available."[72] The Task Force concludes that "many areas, especially rural areas, are now on the edge of market failure."[73] Although such a finding that areas "are now on the edge of market failure" is not necessary in order for us to conclude that current levels of deployment are insufficient, it strongly reinforces our conclusion to that effect.

24. If deployment is inadequate, section 276 requires us to take action to affect deployment, if possible, by adjusting the dial-around compensation rate. Although PIP programs may be useful in filling gaps in payphone availability, they typically require case-by-case determinations by regulators about whether payphones are needed in particular locations. For example, a recent PIP determination by the New Hampshire Public Utilities Commission required a seven-month proceeding and resulted in the placement of only one payphone.[74] Such case-by-case determinations cannot possibly address the deployment issues caused by the removal of hundreds of thousands of payphones nationwide.

25. Unlike the West Virginia Commission in deciding whether to institute a PIP program, we find that it is not appropriate for us to wait until there is a manifest "market failure"[75] in the payphone market before taking necessary action to ensure fair compensation for the deployment of payphone service. The predominant cause of the decrease in the deployment of payphones appears to be increasing use of wireless services. But, this trend does not absolve us of the need to follow the intent of the Act. As noted above, the payphone market does not function in isolation from a particular prescribed default dial-around compensation rate; rather, it is affected by that rate, whatever it may be. The purpose of that rate prescription is not to remedy "market failure" by subsidizing[76] payphones, but to support, to the extent possible, a functioning market and promote payphone deployment by ensuring that dial-around calls bear an appropriate share of the costs of operating payphones.

B. Cost Methodology

26. According to the cost studies submitted by the PSPs, although per-payphone costs have not changed dramatically, falling call volumes have caused a major increase -- to between $.48 and $.59 -

[71] West Virginia Payphone Task Force, Sixth Interim Report, available on the internet at http://www.cad.state.wv.us/03pp%20Survey.htm (West Virginia Payphone Report).

[72] *Id*.

[73] *Id.*

[74] *See* New Hampshire Public Utilities Commission, Petition for Designation of Acworth Payphone as a Public Interest Payphone (PIP), DT 02-250, Order No. 24,008 (rel. July 9, 2002) (APCC Reply Comments, Exhibit 5).

[75] *See* West Virginia Payphone Report.

[76] The issue of whether there is a need to provide universal service support for payphones in a particular area was recently raised in *In The Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order and Order on Reconsideration, 18 FCC Rcd 15090, 15099, para. 21 (2003).

- in per-call costs at marginal payphones.[77] As a result, the PSPs contend, the current dial-around compensation rate of $.24 no longer provides cost recovery for PSPs and is therefore no longer adequate to ensure the widespread deployment of payphones.[78]

27. In the *NPRM,* we tentatively concluded that the methodology the Commission adopted in the *Third Report and Order* is the appropriate methodology to use in reevaluating the default dial-around compensation rate.[79] As noted above, the Commission found in the *Third Report and Order* that a bottom-up methodology based on fully distributed costs and the average monthly call volume at a marginal payphone would assure fair compensation for the overwhelming majority of payphones and would promote Congress's goal of widespread deployment of payphones.[80] That methodology was affirmed by the United States Court of Appeals for the D.C. Circuit.[81]

28. Some of the commenting parties oppose continued use of a rate methodology based on the costs of maintaining marginal payphones. The International Prepaid Communications Association, Inc., and MCI contend that marginal payphones are payphones that cannot be maintained without a subsidy, and that subsidies are more appropriately administered by state PIP programs or through the Universal Service Fund.[82] Sprint argues that the Commission should abandon the marginal payphone methodology because it is inherently circular, discourages PSPs from removing unprofitable payphones, and overcompensates high-volume payphones.[83] Sprint advocates replacement of the marginal payphone methodology with a caller-pays approach.[84] Caller-pays is a compensation plan that requires the caller to deposit coins or other forms of advance payment before making a dial-around call.[85]

29. These comments appear to exaggerate the defects of the marginal payphone methodology. As the *Third Report and Order* made clear, marginal payphones are not "unprofitable" by definition; rather, they are at the edge of profitability.[86] Moreover, the IXCs appear to assume that the dial-around compensation rate is a subsidy. It is not -- it is a cost-based compensation rate. Thus, whether payphones can remain profitable depends, in part, on the rate of dial-around compensation that we prescribe. If the rate is cost-based, it cannot be a "subsidy."

30. While some high-volume payphones may be "overcompensated" by a rate set according to the marginal payphone methodology, the result of such "overcompensation" will be to stimulate the

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[77] APCC Petition, Att. 1 (calculating rate of $.484); APCC Reply Comments at 33 (adjusting rate to $.476); RBOC Coalition Petition, KPMG Study (calculating rate of $.49); RBOC Coalition Comments, Exh. 1 (calculating updated rate of $.59); RBOC Coalition Ex Parte Filing, May 21, 2004) (adjusting updated rate to $.552).

[78] APCC Comments at 2-3.

[79] *NPRM*, 18 FCC Rcd at 22820, para. 27.

[80] Call volumes are determined on a monthly basis. *See Third Report and Order*, 14 FCC Rcd at 2613-14, para. 151.

[81] *American,* 215 F.3d 51, 57.

[82] IPCA Comments at 2-3; MCI Comments at 5-8. *But see* MCI Comments at 7 (supporting rationale for denying Universal Service Fund payments to PSPs).

[83] Sprint Comments at 9-11.

[84] *Id.* at 19-26.

[85] *NPRM,* 18 FCC Rcd at 22821-22, para. 32.

[86] *Third Report and Order*, 14 FCC Rcd at 2607, para. 139.

installation of additional payphones until overcompensation disappears. Only in true "locational monopolies" could such overcompensation be sustained. Although some such monopolies may exist, no party has accepted our invitation, issued at the beginning of this proceeding, to identify and request this Commission to regulate or otherwise remedy such locational monopolies.[87] Therefore, we have no reason to believe that a serious overcompensation problem results from the use of the marginal payphone methodology.

31. The IXCs do not offer any persuasive alternative to the marginal payphone methodology. A caller-pays program is less satisfactory than this methodology for the reasons discussed in Section III.H below. Further, as discussed in Section III.A above, PIP programs provide no remedy for widespread declines in payphone deployment. The IXCs also seem to argue that the compensation rate should not be increased because the payphone industry is doomed to a terminal decline no matter what action the Commission takes.[88] Even if this somewhat self-serving assertion turned out to be true, we cannot evade the statutory directive 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[s]."[89] In carrying out this task, we must attempt to "promote the widespread deployment of payphone services to the benefit of the general public." The possibility that no policy under the current statutory framework will succeed in increasing widespread payphone deployment does not relieve us of our statutory obligation to try to do so using a methodology that has been affirmed on review, and in any event, to ensure that PSPs are fairly compensated.[90]

C. Elasticity

32. We invited comment on whether the methodology should be modified in any way due to changes in the payphone industry since its adoption.[91] For example, in the *Third Report and Order*, the Commission considered the issue of demand elasticity in determining the appropriate allocation of overhead expenses between dial-around calls and other calls, but it was unable to reach a firm conclusion.[92] In addition to the question of allocation of overhead, we asked for comment on whether elasticity of demand for dial-around calling could be so high that an increase in the dial-around rate would cause severe demand suppression resulting in lower overall revenues for PSPs.[93] We sought comment on the impact of recent increases in the coin calling rate and the cross-elasticity of demand between payphones and wireless telephone service. We invited the submission of any further data that may have become available on these questions.[94]

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[87] *See First Report and Order,* 11 FCC Rcd at 20572-73, para. 61 (suggesting that states might address payphone locations that charge monopoly rates, by, e.g., mandating that additional PSPs be allowed to provide payphones, and, if market failure persists, urging states to recommend the matter to the Commission for investigation).

[88] AT&T Comments at 6-7.

[89] 47 U.S.C. §276(b)(1)(A).

[90] *See Third Report and Order,* 14 FCC Rcd at 2550, para. 10 (in setting compensation, the Commission places "great weight on Congress's directive to ensure that payphones remain widely deployed and available to the public at large").

[91] *NPRM*, 18 FCC Rcd at 22820-21, para. 28.

[92] *Third Report and Order*, 14 FCC Rcd at 2588, para. 102.

[93] *NPRM*, 18 FCC Rcd at 22820-21, para. 28.

[94] *Id.*

33. The PSPs argue that there is insufficient information to determine the elasticity of demand for purposes of cost allocation, and no reason to believe that dial-around calling is so price-elastic that a rate increase in the amount they propose would cause a reduction in revenues.[95] APCC argues further that the Commission cannot legally deny PSPs a rate increase based on alleged elasticity effects.[96]

34. Some IXCs argue that, due to the elasticity of the demand for dial-around calling, an increase in the dial-around rate would suppress demand,[97] and some claim that demand suppression would be severe enough to cause increased removal of payphones.[98] In support of this claim, the IXCs rely on information suggesting that (1) the decline in payphone deployment has corresponded to an increase in payphone rates and/or the ratio of payphone rates to cell phone rates,[99] and (2) the demand for calling card calls is price sensitive.[100]

35. The information provided by the IXCs does not justify an inference that demand for dial-around calls is so elastic that an increase in dial-around rates in the amount proposed would suppress demand to the point of decreasing revenues. First, data on local coin calling elasticities, even if persuasive, cannot, without more, justify the inference that the demand for dial-around calling is highly elastic.[101] Second, data on the impact of increases in retail rates for coinless calls are of limited usefulness.[102] The fact that, as AT&T alleges, a certain percentage increase in a calling card rate corresponded with a certain percentage decline in demand for card calling does not mean that the same percentage increase in the compensation rate would have the same effect.[103] In fact, logic suggests that the impact of the same percentage increase in the compensation rate, which represents only a portion of calling card rates, would be far less.[104] Third, the IXCs do not attempt to determine actual causation as opposed to correspondence, which is especially troubling given the likely impact of other factors. Specifically, they do not attempt to separate the impact of increased wireless use from the impact of payphone rate increases. It is likely that wireless service market developments, including the

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[95] *See* RBOC Coalition Comments at 6-9; APCC Comments at 10-14.

[96] APCC Comments at 12-13.

[97] Global Crossing Comments at 2-7; AT&T Comments at 2-3, 7-11; MCI Comments at 9-10; Sprint Comments at 2, 8-11.

[98] Global Crossing Comments at 4-6; MCI Comments at 9-11.

[99] Global Crossing Comments at 2-7; MCI Comments at 9-11

[100] AT&T Comments at 7-11.

[101] In any event, the record provides no reason to believe that even local coin calling is so elastic that increasing the rate to $.50 has caused a reduction in overall local coin revenues.

[102] The IXCs do not provide any data on the impact on subscriber toll-free calling, which seems less likely than card calling to be affected by compensation rate increases, since the caller does not pay directly for the call.

[103] In any event, AT&T does not show that calling card rate increases have led to a reduction in total revenues. Presumably, if that were the case, IXCs would have returned their calling card rates to prior levels. *See* RBOC Coalition Reply Comments at 9. In fact, the PSPs provide evidence that IXCs often impose considerable surcharges on their customers for access code calls. APCC Comments at 10-11 (citing collect calling service charges of $3.99 for AT&T and $4.99 for MCI, plus usage charges of $.99 per minute for both carriers); San Diego Payphone Owners Association Comments at 2-3 (citing AT&T charges ranging from $6.18 to $7.96 for calling card calls ranging from one to three minutes).

[104] For example, if AT&T charges $4.14 for an average access code call, as APCC estimates based on AT&T's data, then a 100% increase in the dial-around compensation rate (from $.24 to $.48) would increase AT&T's average charges by only 5.8%. *See* APCC Reply Comments at 18.

introduction of flat-rate plans[105] and the major increases in demand for wireless service, have done far more than payphone rate increases to trigger and accelerate the decline in payphone deployment.

36. In summary, the Commission did not find sufficient evidence to determine elasticities in the *Third Report and Order*, and the IXCs' submissions in this proceeding do not remedy that insufficiency. Therefore, we lack a sufficient or persuasive evidentiary basis either to allocate joint and common costs between coin calls and dial-around calls on a basis other than equal per-call shares, or to predict that an increase in the compensation rate will accelerate the decline in payphone revenues and deployment.

37. We acknowledge the possibility that setting the "default" dial-around rate at increasingly high levels could cause a reduction in overall revenues, but we have no reason to believe that the currently proposed increases would produce that effect. Further, as some PSPs point out, they are not required to charge the default dial-around rate.[106] In the event that a reduction in overall revenues occurs or is threatened, PSPs could protect themselves from adverse revenue effects by accepting a lower rate.[107]

D. Cost Study Methodology

38. In the *NPRM*, we sought comment on the PSPs' cost studies, and we invited commenting parties to submit additional studies that support or refute the information presented in the APCC and RBOC Coalition studies.[108] We also asked whether the methodologies reflected in those studies are consistent with the rate methodology the Commission adopted in the *Third Report and Order*.[109] We specifically sought comment on the methods used and inputs developed to estimate the marginal payphone monthly call volume, a key driver in determining the per-call compensation rate.[110]

39. In the *Third Report and Order,* the Commission defined a marginal payphone as a location where "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the premises owner."[111] The call volume at a marginal payphone was estimated based on call volumes reported by the RBOC Coalition, which were derived from estimated revenue requirements for a marginal location, average call distributions at RBOC payphones, and prevailing per-call compensation rates.[112]

40. APCC and the RBOC Coalition argue that, with minor modifications, their methodologies for determining the call volumes from marginal payphones are consistent with the *Third Report and Order*. APCC's cost study surveys actual call volumes from a random sample of payphones

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[105] *See Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Fourth Report, 14 FCC Rcd 10145, 10155-56 (1999)(discussing impact of flat-rate plans on demand for wireless service). *See also* APCC Reply Comments at 22.

[106] *See* RBOC Coalition Reply Comments at 2.

[107] *See id.* at 9.

[108] *NPRM*, 18 FCC Rcd at 22820, para. 26.

[109] *Id.*

[110] *Id.*, para. 28.

[111] *Third Report and Order*, 14 FCC Rcd at 2607, para. 139.

[112] *Third Report and Order* 14 FCC Rcd at 2612, para. 147.

that do not pay the premises owner or receive commissions from the premises owner.[113] APCC calculated a marginal payphone call volume of 233.9 calls per payphone per month.[114] The RBOC cost study estimates call volumes from marginal payphones by averaging call volumes from all RBOC payphones and adjusting the average call volume for the number of calls necessary to recover commission payments.[115] The RBOC Coalition initially calculated a marginal payphone call volume of 219 calls per payphone per month.[116] In its comments, the RBOC Coalition updated its cost study to reflect call volumes experienced in 2003. The RBOC Coalition's revised marginal call volume is 166 calls per payphone per month.[117]

41. The IXCs argue that the PSPs' methodologies for estimating call volumes from marginal payphones are inconsistent with the *Third Report and Order* because the PSPs did not limit their study samples to payphones that exactly recoup their costs. Specifically, AT&T argues that the studies fail to exclude "semi-public" payphones for which the PSP receives a payment from the premises owner.[118] AT&T also contends that, even if the studies did not include "semi-public" payphones, the studies are still flawed because they fail to exclude payphones that "'will not be profitable, regardless of the compensation amount [the Commission] establish[es].'"[119] The IXCs also claim that the RBOC cost study methodology is inconsistent with the *Third Report and Order* because it does not use actual marginal payphones.[120]

42. The PSPs reject the IXCs' claims and also argue that minor differences between their study methodologies and the *Third Report and Order* methodology are justified by changed circumstances. APCC points out that its survey specifically requested respondents to state whether they received payments from the premises owner.[121] Don Wood, the consultant who conducted the study, states that payphones for which the owners answered this question in the affirmative were excluded from the study.[122] Further, APCC argues that AT&T incorrectly contends that the Commission's methodology requires the use of call volumes only at payphones that exactly "break even." According to APCC, in the real world, few if any payphones exactly break even.[123] APCC states that most payphones that neither

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[113] APCC Comments at 17-18.

[114] APCC Petition, Att. 1.

[115] RBOC Coalition Petition, KPMG Study at 11-13.

[116] *Id.*

[117] RBOC Coalition Comments, Exh. 1 at 14.

[118] AT&T Comments at 14 n.9, 17.

[119] AT&T Comments at 14 (quoting *Third Report and Order,* 14 FCC Rcd at 2580, para. 79), 17. AT&T objects to other aspects of APCC's study as well. AT&T complains that the study did not indicate the size of sampling variability, and that the response rate to APCC's survey was less than 50 percent. This non-response rate, AT&T contends, may have biased the results given the respondents' interest in the outcome. AT&T Comments at 15, n.10, Att. B at paras. 13-15. APCC responds that the rate of response exceeds typical survey response rates, and that there is no evidence that the respondents were aware of how their responses might influence the outcome. APCC Reply Comments at 34, Wood Dec. at paras. 29-33. We find APCC's methodology reasonable under the circumstances, particularly given the IXCs' failure to offer any alternative data.

[120] AT&T Reply Comments at 18; MCI Reply Comments at 14-15; Sprint Reply Comments at 10.

[121] APCC Comments at 17-18.

[122] APCC Reply Comments, Exh. 1, Wood Dec. at para. 28.

[123] APCC Reply Comments at 9, n.8.

make payments to nor receive payments from the premises owner will not generate exactly the amount of revenue needed to recoup all costs plus a specified rate of return.[124] Rather, such payphones will generate somewhat more or less than the amount needed to break even exactly.[125] Since the PSP has decided that it will not demand or pay a commission payment for such payphones, APCC contends that it is reasonable to conclude that those payphones, on average, will come close to breaking even.[126]

43. The RBOC Coalition points out that its study does exclude call volumes necessary to recover commission payments and any revenues received on account of semi-public payphones.[127] The RBOC study began by determining the average per-payphone call volume from its members' payphones, and then adjusted that average by determining the average net commission (total monthly commissions minus total monthly "semi-public" payments, divided by total payphones), and subtracting from the average call volume the number of calls necessary to generate the revenue for an average net commission.[128] As a result, the RBOCs contend, "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."[129]

44. The RBOC Coalition acknowledges that it modified the *Third Report and Order* methodology by basing its estimate of marginal call volumes on an adjustment of actual average call volumes rather than on a hypothetical calculation of calls needed to meet a revenue requirement. The Coalition contends, however, that this modification was appropriate to take account of the changed circumstance that the compensation rate must be set for a market with sharply declining call volumes, and to avoid the circularity that would otherwise result from applying the *Third Report and Order* methodology in such a market.[130] Where payphone call volumes are sharply declining, the RBOC Coalition contends, "whether a marginal payphone will remain marginal depends on whether and by how much the per-call compensation rate is increased."[131] If the Commission treats as marginal only those payphones that continue to recoup their costs despite declining call volumes, then the existing dial-around rate will automatically justify itself, because the prevailing dial-around rate is by definition sufficient to support a payphone that can recover its costs at prevailing rates. Under such a circular approach, however, the evident disparity between the contribution to common costs made by the current $.50 local coin rate and the $.24 dial-around compensation rate would remain unremedied.[132] In addition, currently "marginal payphones would soon become sub-marginal as payphone call volumes continue to decline, necessitating either a further increase in the local coin rate (and in the disparity between coin and coinless calling rates) or the removal of even more payphones."[133]

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[124] *Id.*

[125] *Id.*

[126] *Id*. at 25-28, Wood Dec. at paras. 16-27.

[127] RBOC Coalition Reply Comments at 11. Semi-public payphones are payphones that a LEC typically provides in exchange for both the coin revenue generated and a monthly fee, paid by the location provider. Semi-public payphones tend to be located, at the request of the location provider, where public access is limited and an insignificant amount of calls are made. *See First Report and Order*, 11 FCC Rcd at 20562, n.142.

[128] RBOC Coalition Petition, KPMG Study at 11-12; RBOC Comments at 5, Exh. 1 at 15-16.

[129] RBOC Coalition Reply Comments at 12.

[130] RBOC Coalition Comments at 3-5.

[131] *Id.* at 4.

[132] *Id.* at 7-8.

[133] *Id.* at 4-5.

45. We find that the call volume estimates proffered by the PSPs with respect to marginal payphones are reasonable and that we may rely on them in setting a new compensation rate. The IXC objections regarding "semi-public" payphones ignore the fact that both the APCC and RBOC Coalition studies took steps either to exclude or to adjust for "semi-public" payphones that utilize payments from the premises owner in order to meet their costs. Further, we cannot conclude that the studies included a significant number of unprofitable payphones. Both APCC and the RBOC Coalition took a reasonable approach to limiting the data they used to calculate volume, and the IXCs do not provide any persuasive reasons to fault this approach, apart from their own very strict interpretation of the *Third Report and Order*. The PSPs' cost studies show that the steps they took ensure that their methodology is consistent with the *Third Report and Order* methodology.

46. We further find that it was not unreasonable for the RBOC Coalition to adjust the *Third Report and Order* methodology in order to take account of changed circumstances, in particular the sharp and continuing decline in payphone call volumes. In the *Third Report and Order*, the Commission noted a potential circularity in the methodology. It avoided such circularity by determining an appropriate level of payphone deployment – the then-existing level – and setting the compensation rate at the level necessary to recoup the costs of then-existing marginal payphones.[134]

47. Under current circumstances, by contrast, it does not appear that the current deployment level is adequate, and even if it were, the sharp ongoing decline in call volumes suggests that maintaining the current compensation rate will *not* preserve even the current deployment level. Therefore, it is reasonable to modify the *Third Report and Order* methodology to include in the definition of "marginal payphones" all payphones that currently do not pay commissions to premises owners or receive payments from premises owners, even if some of those payphones may not currently recoup all their costs. This adjustment increases the likelihood that the compensation rate will either preserve the current level of payphone deployment or at least slow the decline in the deployment level.

48. Moreover, we note that the IXCs have failed to provide any marginal payphone call volume estimate of their own, even though they could have done so.[135] Given the available evidence in the record, therefore, we find reasonable the call volume estimates proffered by the PSPs with respect to marginal payphones.

49. Finally, we note that as of March 31, 2003, there were about 854,295 RBOC payphones and about 464,479 independent payphones.[136] Thus, we estimate that RBOC payphones represent about 65 percent and independent payphones about 35 percent of the total of about 1,318,774 RBOC and independent payphones. In order to calculate a fair "default" per-call compensation rate, where feasible, we reflect this weighted average in calculating the various per-call compensation (PCC) costs claimed by the RBOC Coalition and APCC.

E. Cost Categories and Inputs

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[134] *Third Report and Order,* 14 FCC Rcd at 2609-11, paras. 142-43.

[135] MCI, Sprint, and AT&T all have significant payphone operations of their own. *See, e.g.,* AT&T Comments at 20.

[136] Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telephone Service*, Table 7.5 (May, 2004). Independent telephone company payphones were not represented in either study and therefore are not represented in the weighted average we employ.

50. In the *NPRM*, we sought comment on whether the particular inputs the Commission adopted in the *Third Report and Order* for various cost categories continue to be appropriate or whether there are changed conditions that warrant modifications to the particular inputs used.[137] We also sought comment on whether the cost categories identified in the *Third Report and Order* should be modified or new ones added.[138]

1. Equipment Costs

51. APCC's cost study uses vendor price quotes and survey data on PSP equipment types and configuration to calculate equipment costs of $27.66 per payphone per month, slightly lower than the $28.04 amount calculated in the *Third Report and Order*.[139] The RBOC Coalition's initial study concludes that equipment costs had not changed significantly since the *Third Report and Order* and therefore uses the $28.04 amount from the *Third Report and Order* without change.[140] Both APCC and the RBOC Coalition observe that a depreciation period shorter than the ten-year period used in the *Third Report and Order* could be appropriate. Nevertheless, both of the studies use the ten-year period in order to be consistent with the *Third Report and Order*. APCC also contends that return on investment should be higher than the 11.25 percent return used in the *Third Report and Order*, but it again uses the 11.25 percent number in order to be consistent with the *Third Report and Order*.[141]

52. The IXCs contend that the PSP studies overstate equipment costs because, given the declining payphone base, estimates of capital costs should be based on the price of second-hand payphones.[142] AT&T asserts that equipment costs associated with its 12,000 military base payphones are significantly lower than the costs estimated by the PSPs, but does not provide any actual estimate of its own equipment costs.[143] Sprint does not provide any data on equipment costs from its own payphone operations. MCI reviews price quotes collected from various payphone equipment vendor web sites, and on that basis estimates that nearly new payphones can be purchased for $222.50.[144] MCI contends that use of payphones available at these prices would not cause a decline in service quality.[145]

53. APCC responds that it considered used equipment in its cost determinations if the equipment had been fully restored to like-new condition.[146] APCC argues that the quality of service would diminish if PSPs must maintain marginal payphone locations only by recycling unrestored used equipment.[147] APCC also argues that new equipment prices already reflect the widespread availability of

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[137] *NPRM*, 18 FCC Rcd at 22821, para. 29.

[138] *Id.*, para. 30.

[139] APCC Petition, Att. 1, §§ D.2.2.1, D.5.1, D.5.4. APCC's study adjusts the price of the equipment reviewed to exclude the cost of the coin mechanism. *Id.,* §§ D.2.2.1, D.5.4.

[140] RBOC Petition, KPMG Study at 3.

[141] APCC Petition, Att. 1, § D.2.2.3.

[142] AT&T Comments at 19-20, Heymann Dec. at paras. 23-24; MCI Comments at 16.

[143] AT&T Comments, Att. A, Heymann Dec., para. 25.

[144] MCI Comments at 12-15.

[145] MCI Reply Comments at 17; *see also* Global Crossing Reply Comments at 13.

[146] APCC Reply Comments at 36.

[147] APCC Comments at 28.

used payphone equipment at depressed prices, because the price of new goods reflects the availability and price of used goods.[148]

54. APCC also notes that MCI's survey relies on website advertisements for "dumb" sets, liquidation items of unknown origin, items posted on auction boards, and novelty items.[149] The advertisements do not include complete information about the equipment to be provided, and thus APCC challenges the credibility of the price information proffered by MCI and questions the service quality of payphones available at the quoted prices.[150] APCC also points out that maintenance cost calculations, which it based on equipment installed in new or like-new condition, would have to be reexamined if the Commission adopts an equipment cost input based on lower-quality equipment.[151]

55. In its reply comments, the RBOC Coalition adjusts its estimate of capital costs to reflect MCI's estimate of the average price of used payphones, but it rejects MCI's other claims regarding the viability of used versions of other equipment, such as pedestals and enclosures, reasoning that those items must be purchased new even when a used payphone is installed.[152] The RBOC Coalition also factored in estimates of the probability that various items such as pedestals and enclosures would be needed for a location.[153] The RBOC Coalition's revised capital cost estimate is $22.09 per payphone per month.[154]

56. The IXCs also argue that the equipment investment values reflected in the PSP cost studies fail to reflect accumulated depreciation of the embedded base of assets.[155] The PSPs reply that the Commission has consistently defined the cost basis for a bottom-up methodology to be forward-looking.[156] They point out that rational economic decisions are based on the replacement cost, not booked cost, of assets. If payphone providers are permitted to recover only booked investment minus accumulated depreciation, the PSPs contend, they will be unable to invest in replacement assets when the existing assets reach the end of their useful life.[157]

57. We conclude that it is appropriate for cost studies to reflect the availability of used equipment. Although APCC states that its cost study considered the price of used equipment restored to like-new condition, APCC does not provide any detail as to the inputs it used to determine used equipment prices. Therefore, we will not rely on APCC's equipment cost estimate of $27.66. We find that WorldCom's estimates of the cost of payphone equipment and programming, which are accepted by the RBOC Coalition, are reasonably representative of the actual cost of equipment incurred in today's market. We agree with the RBOC Coalition, however, that other components, such as pedestals and enclosures, are purchased new. We therefore accept the RBOC Coalition's recalculation of the cost of each component of an average payphone, based on MCI's estimates for items that are purchased used and

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[148] *Id.;* APCC Reply Comments, Exh. 1, Wood Dec. at para. 37.

[149] APCC Reply Comments at 36 & Exh. 1, Wood Dec. at para. 36.

[150] *Id.*

[151] *Id.*, Exh. 1, Wood Dec. at paras. 37-38.

[152] RBOC Coalition Reply Comments, KPMG Supplemental Report at 7.

[153] *Id.*

[154] *Id.*

[155] AT&T Comments at 19-20; Sprint Comments at 15.

[156] APCC Reply Comments at 35 (citing *Third Report and Order*, 14 FCC Rcd at 2603, para. 131).

[157] APCC Reply Comments at 35-36, Wood Dec. at para. 35.

the RBOC Coalition's estimates for items that are purchased new. This revised cost is $997.78.[158] In converting this cost estimate to a monthly figure, however, the RBOC Coalition advocated utilizing a 6.5-year depreciation period.[159] APCC, by contrast, used a 10-year depreciation period, as was used in the *Third Report and Order*.[160] In response, the RBOC Coalition also offered its own calculation using a 10-year depreciation period.[161] We find no basis for departing from our previous ruling that a 10-year period is appropriate, particularly given that both APCC and the RBOC Coalition used a ten-year depreciation period in their cost studies submitted in this proceeding. Therefore, we rely upon the alternative calculation submitted by the RBOC Coalition, based on a 10-year period, which computes a monthly equipment cost of $17.66.[162]

58. We reject the IXCs' arguments that equipment costs should be based on embedded equipment. As the PSPs point out, decisions are based on the replacement cost, not booked cost of assets.

2. Line Costs

59. The PSPs' cost studies determined line costs by applying the *Third Report and Order* methodology to current data on line rates collected from PSPs.[163] The APCC study uses the LEC line rates in effect for each location studied as of the second quarter of 2002.[164] The RBOC Coalition study initially used older data, from August 2001.[165] The RBOC Coalition supplemented its study, however, with data from 2003.[166]

60. Sprint argues that the inputs to the APCC study related to LEC line charges are overstated because "payphones have enjoyed significant reductions in their line costs, as a result of state implementation of the new services test."[167] The Commission adopted the requirement that LECs price payphone lines under the new services test in its 1996 payphone orders.[168] Thus, the Commission's order requiring application of the new services test to line rates had been in effect for five or six years when the final line cost estimates were made. In a subsequent order, which required certain Wisconsin LECs to submit cost justification for their payphone line rates directly to the Commission, the Common Carrier Bureau issued guidance clarifying application of the new services test for the benefit of state public service commissions.[169] These guidelines had been available for two to three years when the final line

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[158] RBOC Coalition Reply Comments, KPMG Supplemental Report at 8.

[159] *Id.*

[160] APCC Petition, Att. 1, D.5.5.

[161] RBOC Coalition ex parte (May 21, 2004) at 2.

[162] *Id.*

[163] APCC Petition, Att. 1, Tab D; RBOC Coalition Petition, KPMG Study at 4-5.

[164] APCC Reply Comments at 36, Exh. 1, Wood Dec. at para. 40.

[165] RBOC Coalition Petition, KPMG Study at 2.

[166] RBOC Coalition Comments, Exh.1, at 6-7.

[167] Sprint Comments at 17.

[168] *First Report and Order*, 11 FCC Rcd at 20614, para. 146; *First Reconsideration Order*, 11 FCC Rcd at 21308, para. 163.

[169] *Wisconsin Public Service Commission*, *Order Directing Filings*, 15 FCC Rcd 9978 (Com. Car. Bur., March 2, 2000).

cost estimates were made. In an order released January 31, 2002, we modified the Bureau's order, but generally affirmed application of the new services test.[170] The final line cost estimates post-date this order as well. Accordingly, Sprint's argument is not convincing: line cost estimates most likely account for at least some reduction attributable to application of the new services test given that it has been applied by state commissions over time periods prior to or concurrent with the data provided by the PSPs. Moreover, even if we grant that some payphone line rates may have declined since that time, neither Sprint nor any other IXC has offered any competing data or estimates.

61. Given the available record evidence, therefore, we find that the most current data offered by APCC and the RBOC Coalition provide a reasonable basis for estimating line costs. Again, we take a weighted average of the APCC and RBOC Coalition study results. The weighted average of the RBOC Coalition's revised line cost of $34.84 and the APCC study's line cost of $38.77 is $36.22.[171]

3. Maintenance Costs

62. The RBOC Coalition study initially calculated maintenance costs of $13.81 per payphone per month.[172] In the supplemental study, maintenance costs were determined to be $9.67 per payphone per month.[173] APCC's cost study found maintenance costs of $17.45 per payphone per month.[174] Each of these estimates is less than the $18.90 the Commission calculated in the *Third Report and Order*.[175] No party challenges these determinations or supplies alternative data. We therefore find the most current APCC and RBOC calculations of maintenance costs reasonable and use those amounts. The weighted average of the RBOC Coalition's revised maintenance cost of $9.67 and the APCC study's maintenance cost of $17.45 is $12.41.[176]

4. SG&A Costs

63. The RBOC Coalition study initially calculated SG&A[177] costs of $15.30 per payphone per month.[178] Its supplemental study calculated costs of $18.20 per payphone per month.[179] This adjustment reflects the use of financial data from a more recent nine-month period, as opposed to the earlier one-month period used in the initial RBOC study. APCC's cost study found SG&A costs to be $23.43 per payphone per month.[180] These amounts are comparable to the $19.62 amount the Commission

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170 *Wisconsin Public Service Commission*, *Order Directing Filings*, 17 FCC Rcd 2051 (January 31, 2002), *aff'd sub nom. New England Pub. Comms. Council v. FCC*, 334 F.3d 69 (D.C. Cir. 2003).

171 $34.84*.65 + $38.77*.35 = $36.22.

172 RBOC Coalition Petition, KPMG Study at 5-6.

173 RBOC Coalition Comments, Exh. 1 at 7.

174 APCC Petition, Att. 1, Tab E.

175 *Third Report and Order,* 14 FCC Rcd at 2626, para. 177.

176 $9.67*.65 + $17.45*.35 = $12.41.

177 SG&A (sales, general and administrative) costs include all overhead costs. *See Third Report and Order,* 14 FCC Rcd at 2559, para. 31.

178 RBOC Coalition Petition, KPMG Study at 6.

179 RBOC Coalition Comments, Exh. 1 at 8.

180 APCC Petition, Att. 1, Tab E.

calculated in the *Third Report and Order*.[181] No party challenges these determinations or supplies alternative data. We therefore find the most current APCC and RBOC calculations of maintenance costs to be reasonable and utilize those amounts. The weighted average of the RBOC Coalition's revised SG&A cost of $18.20 and the APCC study's SG&A cost of $23.43 is $20.04.[182]

5. Collection Expenses

64. Both the APCC and the RBOC Coalition cost studies add an element for collection costs, or, in the RBOC study, "carrier identification costs" that are specific to dial-around compensation.[183] In the *Third Report and Order,* the Commission declined to include an element for such costs in setting the dial-around rate, finding that the record contained insufficient information to determine the extent to which administration costs vary when the number of coinless calls increases relative to coin calls. We invited comment on whether there is now an adequate record to justify such an element, and the appropriate amount of such an element.[184]

65. The PSPs argue that there should be a separate cost element for dial-around collection expenses such as fees paid to dial-around aggregators and litigation expenses incurred for the purpose of collecting compensation from delinquent IXCs. APCC's cost study estimates collection costs of $.007 per call.[185] The RBOC Coalition study estimates carrier identification costs of $.011 per call.[186]

66. The IXCs point out that, in the *Third Report and Order*, the Commission found that collection expenses were included in SG&A, and they argue that there is insufficient information to justify a different finding here.[187] They also contend that the PSPs' estimate of collection expenses is inflated, arguing that such expenses will decrease in the future as a result of the Commission's switch-based reseller order.[188] They do not, however, provide any specific estimates of their own. The PSPs respond that the collection costs included in their studies are not general expenses attributable to SG&A, but specific expenses attributable solely to dial-around compensation.[189]

67. We agree with the PSPs that the collection costs they have identified are specific to dial-around compensation and are not reflected in SG&A costs. In the RBOC Coalition's study, SG&A costs and carrier identification costs were determined separately based on the same review of RBOCs' financial and operational data.[190] There is no evidence that the cost data in the two categories were duplicative. As

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[181] *Third Report and Order*, 14 FCC Rcd at 2626-27, para. 179.

[182] $18.20*.65 + $23.43*.35 = $20.04.

[183] RBOC Coalition Petition at 10; APCC Petition at 13-15.

[184] *NPRM,* 18 FCC Rcd at 11, para. 30.

[185] APCC Petition, Att. 1.

[186] RBOC Coalition Comments, Exh. 1 at 12.

[187] AT&T Comments at 23; MCI Comments at 16.

[188] AT&T Comments at 23 (citing *Tollgate Remand Order*). MCI contends that the RBOC Coalition cost study improperly includes calling card validation costs as collection costs. MCI Comments at 16. The RBOC Coalition states that it corrected its study for this error, with a *de minimis* impact on the rate. RBOC Coalition Reply Comments at 15 n.7.

[189] APCC Reply Comments at 29; RBOC Payphone Coalition Reply Comments at 15-16.

[190] RBOC Coalition Petition, KPMG Study at 1.

for APCC's cost study, we think it unlikely that a typical respondent to APCC's survey would assume that charges imposed by third parties for specific collection activities would be included in SG&A. In any event, APCC's estimate of collection costs is significantly lower than the RBOC Coalition's estimate. Therefore, again lacking any other record evidence, we accept the PSPs' estimates of collection expenses as reasonable; RBOC Coalition collection cost of .011 per-call, and the APCC study's collection cost of $.007.[191]

6. Bad Debt

68. The PSPs argue that bad debt has been reasonably estimated or factored into their cost studies and must be reflected in the dial-around compensation rate to ensure fair compensation. The RBOCs provide a direct estimate of their bad debt,[192] while APCC's cost study accounts for bad debt by including in marginal payphone call volumes only those dial-around calls for which PSPs were actually paid.[193]

69. The IXCs contend that it is unlawful to include bad debt in the dial-around compensation rate. Citing the *Fifth Reconsideration Order*, the IXCs state that an allowance for bad debt impermissibly would require carriers that pay their compensation obligations to bear the expenses of non-paying carriers.[194] As the RBOC Coalition explains, however, 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.[195] Thus, we routinely approve cost elements for bad debt in, for example, access tariffs and UNE rates.[196] Moreover, rates should factor in bad debt; virtually all businesses factor it into their pricing, and there is no persuasive argument that we should prevent PSPs from doing the same.[197]

70. The IXCs also object that the PSPs' data are unreliable, because they include currently uncollected compensation that may yet be collected in the future, resulting in double recovery.[198] The RBOC Coalition, however, states that its study includes only amounts that had been determined to be

[191] We individually add the RBOC Coalition's submissions for collection costs, bad debt and compensation for the four-month delay and the APCC's submissions for its collection costs, bad debt and compensation for the four-month delay and then take a weighted average of the individual totals.

[192] RBOC Coalition Petition at 10.

[193] APCC Reply Comments at 32.

[194] AT&T Comments at 22; MCI Comments at 16; Sprint Comments at 14. *See Fifth Reconsideration Order*, 17 FCC Rcd at 21303, para. 83.

[195] RBOC Coalition Reply Comments at 13. *IPTA*, cited by the IXCs, is also inapposite. That decision held that "administrative convenience cannot possibly justify an interim [compensation] plan that exempts all but large IXCs from paying for the costs of services received." 117 F. 3d at 565. A cost component for bad debt would not "exempt" any carrier from compensation, but would simply ensure that PSPs are fully compensated even though they are not able to collect from all carriers that owe compensation.

[196] RBOC Coalition Comments at 12, n.4; RBOC Coalition Reply Comments at 13-14.

[197] In *APCC v. FCC*, 215 F.3d 51 (D.C. Cir. 2000), where the court of appeals upheld the determination in the *Third Report and Order* not to include an element for bad debt in the $.24 rate, the court did not hold that bad debt allowances are improper *per se*. The court merely upheld the determination that the record was insufficient to enable the Commission to establish a cost element for bad debt "at this time." *Id.* at 55-56.

[198] AT&T Comments at 21.

uncollectible and removed from the accounts receivable and bad debt reserve balances.[199] APCC's approach of including only paid dial-around calls in call volumes could, however, result in double recovery if additional payments were subsequently collected for the payphones and periods included in the study. In its reply comments, however, APCC states that it reviewed the subsequent history of payments for the study period and adjusted the estimated call volumes to reflect a relatively small amount of additional payments received after the study data were collected.[200] Therefore, we will accept APCC's adjusted figure.

71. The IXCs also contend that past bad debt is not a reliable predictor of future bad debt.[201] This is potentially true of components of any cost study. To the extent determination of any of these components requires the Commission to exercise predictive judgment, the standard is not whether the Commission can predict future conditions perfectly, as the IXCs appear to argue, but instead whether the data provided to the Commission give it a sufficient basis to make a reasonable estimate. In 1999, the Commission declined to include a cost element for bad debt because the record reflected insufficient experience with the compensation regime to develop such a reasonable estimate.[202] Now that five additional years have elapsed, such experience is available and is reflected in the data made available by the PSPs.

72. According to the RBOC Coalition, the data in its original study were collected at a time when an older version of a reseller-pays rule, which it views as similar to the rule we recently adopted, was in place.[203] Therefore, the RBOC Coalition argues that those data provide an accurate estimate of future levels of bad debt. By contrast, AT&T points out that the Commission's new reseller-pays rule is intended to and should succeed in reducing the amount of bad debt compared with experience under the old reseller-pays rule.[204]

73. We agree with AT&T that our new reseller-pays rule will most likely reduce the amount of bad debt to a lower level than experienced under the pre-2001 reseller-pays rule. We have carefully crafted our new rule to ensure that resellers establish accurate call tracking systems and to provide PSPs with the tools they need to verify compensation payments. For this reason, we do not expect that bad debt percentages will exceed those experienced under the current rule. Therefore, we will apply the RBOC Coalition's alternative estimate of a 5.4 percent bad debt percentage, which is based on its experience during the first nine months of 2003.[205]

74. We note that APCC is conservative in its approach to accounting for bad debt, because it does not provide an actual bad-debt allowance, but only factors unpaid dial-around calls into the call

[199] RBOC Coalition Comments, Exh. 1 at 11.

[200] APCC Reply Comments at 18.

[201] AT&T Comments at 21.

[202] *Third Report and Order*, 14 FCC Rcd at 2619-20, para. 162.

[203] RBOC Coalition Comments at 12. Our original reseller-pays rule was in place from October 7, 1997 through November 22, 2001. The rule currently applicable is a first-facilities-based-IXC-pays rule, which took effect November 23, 2001, and is to remain in effect until the first day of the first calendar quarter following approval by the Office of Management and Budget of the switch-based-reseller-pays rule adopted in the *Tollgate Remand Order*. 18 FCC Rcd at 20014, para. 84. *See* OMB Approval No. 3060-1046 (May 5, 2004).

[204] AT&T Comments at 21.

[205] RBOC Coalition Ex Parte (May 21, 2004) at 2.

volumes estimate for purposes of calculating the per-call rate.[206] Therefore, it is reasonable to accept this conservative approach to bad debt, notwithstanding that we hope and expect that bad debt will decline under our new reseller-pays rule.

75. Because the APCC and RBOC Coalition studies use different methodologies to reflect bad debt (the RBOC Coalition provides a specific estimate, while APCC reflects bad debt by counting only paid dial-around calls), we do not use a weighted average to estimate bad debt. Instead, we complete the bad debt and call volume calculations separately for the APCC and RBOC Coalition approaches, and take a weighted average of the resulting rates.

7. Incidental Revenues

76. In the *NPRM*, we sought comment on whether and how we should consider the revenues and costs associated with the provision of additional services and activities in conjunction with payphones, such as Internet access or rental of advertising space.[207] The RBOC Coalition included in its study an offset for incidental revenues, including advertising.[208] APCC did not include such an offset. APCC argues that revenues from activities such as advertising cannot legally be considered because they are derived from non-telecommunications activities that are not subject to regulation.[209] Citing the Commission's Computer III decision,[210] APCC claims that "the Commission can no more consider PSPs' advertising revenues in setting the dial-around rate that it can consider a local exchange carrier's non-telecommunications revenue in a rate-of-return proceeding."[211] APCC also argues, that, in any event, advertising revenues are available for only a fraction of all payphones -- those with relatively large amounts of pedestrian traffic -- and that marginal payphones in particular are unlikely to produce any incidental revenue.[212] The IXCs claim that advertising revenue should be included and point to information on APCC's website suggesting that revenue from advertising is significant.[213]

77. We do not believe that we are legally required to disregard any incidental revenues such as advertising revenues, and we find that the RBOC Coalition's approach to this issue is more reasonable than that of APCC. To the extent that Computer Inquiry classifications of "regulated" and "non-regulated" are relevant to this proceeding, we have previously ruled that payphone service falls squarely

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[206] APCC Comments at 25. Thus, if there were 150 coin calls, 90 paid dial-around calls and 10 unpaid dial-around calls at a marginal payphone, then the bad debt ratio for dial-around is 1:9, and the cost-based rate should be multiplied by 1.11 to provide an appropriate allowance for bad debt. Under APCC's method, however, the 10 unpaid dial-around calls are excluded from the total estimated call volume (which includes coin calls) that is used in calculating the dial-around rate. As a result of the 10 unpaid calls, the call volume becomes 240 instead of 250, increasing the dial-around rate by a factor of 250/240, or only 1.04 instead of 1.11.

[207] *NPRM*, 18 FCC Rcd at 22821, para. 31.

[208] RBOC Coalition Comments at 13.

[209] APCC Comments at 26.

[210] Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), Report and Order, 104 FCC 2d 958, 1086 (1986).

[211] APCC Comments at 26.

[212] APCC Comments at 27.

[213] AT&T Reply Comments at 21-22. Sprint argues for the inclusion of revenues from Internet access, but provides no supporting information. Sprint Comments at 18. We agree with APCC that Internet terminals are unlikely to be installed at marginal locations.

on the "non-regulated" side.[214] Computer III does not require the separation of non-regulated payphone costs from non-regulated advertising costs otherwise related to those payphone costs. Moreover, the advertising is related to the payphone operation. It makes use of the very same enclosure used to house the payphone. To the extent that regulated accounting classifications are at all relevant here,[215] advertising revenues appear to be analogous to "non-operating" revenues under section 32.7300 of our regulations, which can be addressed by simply subtracting such revenues from the overall payphone "revenue requirement."

78. The RBOC Coalition's initial study found average incidental revenue of $.34 per payphone per month, and its supplemental study estimated average incidental revenue of $.74 per payphone per month. The IXCs do not develop any competing estimate of average incidental revenue. We find reasonable the PSPs' assertions that advertising revenue is available only at a fraction of payphones and is much less likely to be available at marginal payphone locations. Accordingly, we accept the RBOC Coalition's determination of average incidental revenue. Since APCC's cost study did not request information on incidental revenue, we will not accept APCC's determination of zero incidental revenue. Instead, we will subtract the RBOC Coalition's estimate of $.74 per payphone per month from APCC's cost study.

8. Compensation for the Four-Month Payment Delay

79. For purposes of compensating PSPs for the four-month average delay between the placing of a dial-around call and payment of compensation, Sprint argues that the 11.25 percent number used by the PSPs is not reasonable and that "IRS overpayment rates" should be utilized as a proxy for the "time value of money."[216] The Commission has twice upheld the 11.25 percent figure for application to payphone compensation, and, each time, explained why it is reasonable to use this figure in this context.[217] Sprint has provided no persuasive reason to overrule those precedents, and we decline to do so here. Therefore, we accept the RBOC Coalition's and APCC's estimates of $.021 and $.018, respectively.

F. Calculation of a Modified Dial-Around Compensation Rate

80. We calculate the modified dial-around compensation rate according to the following table:

Equipment cost	$17.66
Line cost	$36.22
Maintenance cost	$12.41
SG&A cost	$20.04

[214] *First Report and Order*, 11 FCC Rcd 20541, para. 142 (1996)(payphones should be treated as "deregulated and detariffed (customer premises equipment)").

[215] As noted above, there is no direct relevance because both payphone service and advertising are "non-regulated" activities from a carrier accounting perspective.

[216] Sprint Comments at 15.

[217] *Third Payphone Order*, 14 FCC Rcd at 2630-31, paras. 187-89; *Fifth Reconsideration Order*, 17 FCC Rcd at 21284-85, paras. 30-31. Further, we note that PSPs have previously argued that the 11.25 percent rate of return applied to determine capital costs and compensation for the four-month delay is too low and should be increased to account for the high level of risk incurred by investors in the payphone industry. *Fifth Reconsideration Order*, para. 28. While the PSPs do not press this issue here, we find that the concerns raised previously are not without significance, and further confirm that it would not be appropriate for us to reduce the applicable rate below the 11.25 percent level.

Incidental revenues	($.74)
Total monthly joint and common costs	$85.60
Divide by: marginal payphone call volume	191[218]
Per-call joint and common costs	$.450
Collection costs	$.011/.007
Bad debt costs	$.026[219]/0
Compensation for 4 months delay	$.021/.018
Subtotal: Collection, Bad debt and Compensation for 4 months delay	$.058/.025
Weighted average: Collection, Bad debt, Compensation For 4 month delay	$.044[220]
Weighted average per-call compensation rate	$0.494[221]

G. Use of a "Top-Down" Test of Validity

81. Commenters argue that the Commission's previous top-down approach should be used to assess the reasonableness of the results of any bottom-up analysis.[222] According to AT&T, a top-down analysis yields a rate of $.278 per call, considerably less than the $.48-59 rate advocated by the PSPs.[223]

82. The PSPs dispute that the results of a top-down analysis should be accorded any significance.[224] In addition, the RBOC Coalition conducts its own top-down analysis, which yields a rate of $.467 per call, close to the $.49 rate advocated by the Coalition.[225]

83. The *Third Report and Order* does not require top-down "validation." Indeed, the top-down approach was rejected by the court of appeals in *MCI Telecomms. Corp. v. FCC*.[226] In the *Third Report and Order*, the Commission held that "a top-down approach is unsuitable at present for setting

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[218] Although the APCC and RBOC Coalition studies used different methodologies to determine call volume, with the APCC reflecting bad debt by counting only paid dial-around calls and the RBOC Coalition counting all completed calls and providing a specific estimate of bad debt, we take a weighted average of the estimates of call volume. We calculate the call volume as follows: 166*.65 + 238*.35 = 191.

[219] .054*($.45 + $.011)/(1-.054) = $.026.

[220] $.058*.65 + $.025*.35 = $.044.

[221] Per-call joint and common costs $.450 + add-ons $.044 = $.494.

[222] AT&T Comments at 24; Sprint Comments at 16.

[223] AT&T Comments at 25.

[224] APCC Reply Comments at 37-39, Exh. 1, Wood Dec. at paras. 43-45; RBOC Coalition Reply Comments at 17-18.

[225] RBOC Coalition Reply Comments, Supplemental KPMG Report at 2-7.

[226] 143 F.3d 606 (D.C. Cir. 1998).

default compensation."[227] Furthermore, the Commission acknowledged that its use of the top-down methodology in the *Third Report and Order* was merely for purposes of validation,[228] and that an application of it has been found to have no legal significance.[229]

84. As noted above, the record contains conflicting evidence as to whether a top-down calculation would "validate" the rate increase requested by the PSPs. While AT&T's top-down analysis yields a rate of $.278, the RBOC Coalition analysis yields a rate of $.467. AT&T's analysis omits any dial-around specific costs. As discussed above, however, we find that it is appropriate to include dial-around compensation specific elements for four months interest, bad debt, and collection costs. Adding these elements to AT&T's analysis would increase the resulting rate substantially. Further, AT&T's calculation may overestimate coin mechanism costs, coin collection costs, and local usage charges,[230] which would result in overstating avoided costs and, consequently, understating the dial-around rate.

85. Therefore, we find that no top-down analysis is necessary or warranted under the circumstances. Such an analysis does not permit us to draw any conclusions regarding the validity of any particular rate.

H. Caller Pays

86. In the NPRM, we tentatively concluded that we should not adopt a "caller-pays" compensation plan, in which the caller would deposit coins or other forms of advance payment before making a dial-around call,[231] based on our previous findings that the Act disapproves of the methodology.[232] Nevertheless, we sought comment on whether circumstances have changed such that it is now appropriate to reconsider a caller-pays approach to payphone compensation. Noting that interexchange carrier payphone surcharges may impose a high price on the convenience of coinless calling, we sought comment on our authority to allow advance consumer payment for use of payphones and on how we should analyze the costs and benefits of carrier-pays and caller-pays systems.[233]

1. Statutory Authority and Congressional Intent Regarding Caller Pays

87. Some IXCs challenge our tentative conclusion and previous findings that Congress, through the Act, disapproves of a caller-pays methodology. Sprint argues that section 226(e) of the Act[234]

[227] *Third Report and Order*, 14 FCC Rcd at 2577, para. 71.

[228] *Id.* at 2632, para. 192.

[229] *Z-Tel Communications, Inc. v. FCC*, 333 F.3d 262, 270-72 (D.C. Cir. 2003) (holding that the Commission did not "rely" on data that the Commission used only to obtain further assurance that its conclusion was correct); *AT&T Corp. v. FCC*, 220 F.3d 607, 625 (D.C. Cir. 2000).

[230] RBOC Coalition Reply Comments, KPMG Supp. Report at 2-7; APCC Reply Comments, Exh. 1, Wood Dec. at para. 44 n. 11.

[231] *NPRM*, 18 FCC Rcd at 22821-22, para. 32.

[232] *See Third Report and Order*, 14 FCC Rcd at 2597, para. 115.

[233] *NPRM*, 18 FCC Rcd at 22822, para. 33.

[234] Section 226(e) of the Act, which was enacted prior to section 276, requires the Commission to "consider the need to prescribe compensation (other than advance payment by consumers) for owners of competitive public pay telephones for calls routed to providers of operator services that are other than the presubscribed provider of operator services for such telephones." 47 U.S.C. § 226(e)(2).

does not bar the Commission from *allowing* PSPs to require advance payment from callers for dial-around calls, but only bars the Commission from *prescribing* caller-pays compensation.[235] Sprint adds that in any event section 226(e) has been "superseded" by section 276, which contains no indication of Congressional approval or disapproval of a caller-pays plan.[236]

88. The PSP commenters, on the other hand, contend that section 226 "for all practical purposes" prohibits a caller-pays approach.[237] Not only does section 226 prohibit the Commission from prescribing advance-payment compensation,[238] but it also requires PSPs to allow callers to dial access codes to reach their preferred operator service provider[239] and prohibits PSPs from requiring an "advance deposit" for access code calling unless they also require "advance deposits" for 0+ calls.[240] The PSPs point out that these restrictions cannot be ignored merely because Sprint contends they are no longer applicable.[241]

89. The provisions cited by the PSPs, taken together, indicate to us a statutory policy not to hinder consumers from using payphones to access their operator service providers of choice. Conceivably, we could fashion a caller-pays system that does not literally violate any of the restrictions of section 226. Nonetheless, in our judgment, to increase the inconvenience to consumers of dial-around calling would conflict with the clear statutory and Congressional intent to make access code calling more, not less, convenient for consumers. We see nothing in section 276 that "supersedes" this Congressional intent.

90. Even if Congress had not disapproved, moreover, we are not persuaded that the benefits of caller pays outweigh its costs. To make such a determination, we would have to assign values to a number of unquantified factors. For example, the conclusion that caller pays is more efficient rests on the unproven assumption that coins are the most efficient means of payment for payphone service.[242] Yet, the prevalence of coinless "operator assisted" calling illustrates that a large percentage of callers prefer *not* to use coins – even though they may end up paying more for the convenience. Despite our invitation, no party has proffered a reasonable means to evaluate this trade-off. Further, a caller-pays system would result in callers having to pay, for the first time, for "toll-free" service – a seeming contradiction in terms.[243] The record is unclear on the costs that may result from introducing a new inhibition to toll free calling, or on the costs associated with the elimination of coinless calling from payphones.[244] For all these reasons, we decline at this time to adopt a caller-pays system.

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[235] Sprint Comments at 24-26. *See also* MCI Reply Comments at 11.

[236] Sprint Comments at 24-26. .

[237] RBOC Coalition Comments at 9.

[238] 47 U.S.C. § 226(e)(2).

[239] 47 U.S.C. § 226(c)(1)(B).

[240] 47 U.S.C. § 226(c)(1)(C). *See* APCC Reply Comments at 42.

[241] RBOC Coalition Reply Comments at 10.

[242] Sprint provides no factual basis for its claim that the inconvenience of coins could be substantially mitigated by installing credit-card swipe equipment. As APCC notes, even if such equipment could be universally installed at reasonable cost, the lower-income and immigrant groups that rely most on payphones are least likely to have credit cards. APCC Reply Comments at 42 n.25.

[243] APCC Reply Comments at 41.

[244] APCC Comments at 15; APCC Reply Comments at 41-42.

2. Per-Payphone Compensation Rate

91. On May 5, 2004, AT&T filed an ex parte in this proceeding, asking the Commission to adopt a new, lower per-payphone compensation rate.[245] The per payphone rate applies only to those payphones that are not supported by Flex ANI technology.[246] In response to AT&T's filing, the RBOC Coalition and APCC filed ex parte letters on May 17, 2004[247] and May 18, 2004,[248] respectively. The RBOC Coalition states that fewer than five percent of its payphones qualify for per-payphone compensation.[249] APCC indicates that approximately four percent of its payphones qualify for per-payphone compensation.[250] APCC also states that AT&T has been on notice for six months that it should request a modification of the per-phone rate, and that it "has also had access for at least two years to information that would enable it to propose a new rate."[251] The prescription of the new per-call compensation rate that we adopt in this order will not prejudice any reexamination of the per-payphone compensation rate. Indeed, the per-call compensation rate is one element of the per-payphone rate. Thus, in order to conclude this proceeding expeditiously, we decline to delay our decision in order to re-visit per phone compensation, as AT&T requests. Instead, we will release shortly a Further Notice of Proposed Rulemaking in this proceeding to develop a complete record on which to determine whether to set a new rate for per-payphone compensation.

IV. CONCLUSION

92. In our proceedings implementing section 276, our overarching objectives have been to promote payphone competition and "the widespread deployment of payphone services to the benefit of the general public." Conditions in the payphone industry have changed dramatically since we last prescribed the per-call payphone compensation rate. With the growth of wireless communications, payphone usage has declined substantially, resulting in the removal of more and more payphones. The record in this proceeding convinces us that a continued decline in payphone deployment risks leaving an insufficient number of payphones to meet the needs of the public, including, public safety requirements. The payphone market has reacted by increasing the local coin rate to $.50 in most areas, creating a mismatch between an increasing market-based for local coin calls and a static, regulated compensation rate for access code and subscriber toll-free calls. Based on the substantial evidence in the record regarding per-call costs, we find that, to ensure that coinless calls bear a fair share of payphone costs, and to provide additional revenues to prevent or slow continuing declines, it is appropriate to prescribe an increased default dial-around compensation rate of $.494 per call.

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[245] AT&T Notice of Ex Parte Communication, May 5, 2004.

[246] *See* para. 9, *supra.*

[247] RBOC Payphone Coalition Ex Parte Filing, May 17, 2004.

[248] APCC Ex Parte Communication, May 18, 2004.

[249] RBOC Coalition Ex Parte at 1.

[250] APCC Ex Parte at 2.

[251] *Id*. at 3.

V. PROCEDURAL MATTERS

A. Final Paperwork Reduction Act Analysis

93. This action contained herein contains no new or modified information collections subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13. The Regulatory Flexibility Act analysis is contained in Appendix B, attached to this Order.

VI. ORDERING CLAUSES

94. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 1, 4(i)-4(j), 201, 226, and 276 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i)-(j), 201, 226, 276, this Report and Order IS ADOPTED.

95. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Report and Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

96. IT IS FURTHER ORDERED that section 64.1301 of the Commission's Rules, 47 C.F.R. 64.1301 IS AMENDED as set forth in Appendix A of this Report and Order, and SHALL BE effective 30 days after Federal Register publication.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX A

The Federal Communications Commission amends 47 C.F.R. Part 64 as follows:

§ 64.1301 Per-payphone compensation obligation.

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(c) In the absence of an agreement as required by paragraph (a) of this section, the carrier is obligated to compensate the payphone service provider at a per-call rate of $.494.

APPENDIX B

FINAL REGULATORY FLEXIBILITY ANALYSIS

1. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),[252] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the 2003 Order and *Notice of Proposed Rulemaking* (*Notice*) in WC Docket No. 03-225.[253] The Commission sought written public comment on the proposals in that *Notice*, including comment on the IRFA. This present Final Regulatory Flexibility Analysis conforms to the RFA.[254] To the extent that any statement in this FRFA is perceived as creating ambiguity with respect to Commission rules or statements made in this present order, the order is controlling.

A. Need for, and Objectives of, the Rules

2. In the *Order and Notice of Proposed Rulemaking*, the Commission invited comments on whether the existing dial-around default rate applicable to calls made from payphones needed to be revisited. Among other things, the Commission noted that the existing rate had been in effect for nearly four years and that conditions in the payphone industry had change dramatically. In now adopting a revised default rate, the Commission sought to ensure that the new rate accurately reflected the current economic conditions in the payphone industry. The Commission also sought to ensure that the new rate would promote competition and provide for the widespread deployment of payphones. With this order, the Commission adopts a revised payphone dial-around default rate of $.494.

B. Summary of Significant Issues Raised by Public Comments in Response to the IRFA

3. No comments were received directly in response to the IRFA. However, we have summarized some of the following significant issues: (1) level of payphone deployment; (2) cost methodology used to evaluate the default dial-around compensation rate; (3) impact of elasticity of demand on cost allocation; (4) methodologies for estimating call volumes; (5) particular inputs related to cost categories; and (6) methodology for validation of a rate increase.

4. Level of Payphone Deployment: The PSPs argue that payphone deployment is inadequate to serve the public interest, and that the Commission should raise the dial-around compensation rate to prevent, or at least slow, further erosion of the payphone base.[255] IXCs contend that there are too many payphones, and that the Commission should leave the compensation rate unchanged.[256] The Commission concluded that payphone deployment is inadequate, and concluded that it should adjust the dial-around compensation rate to affect deployment.[257]

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[252] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601-612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

[253] Order and Notice of Proposed Rulemaking, WC Docket No. 03-225, 18 FCC Rcd 22811, 22822 (2003).

[254] *See* 5 U.S.C. § 604.

[255] *See, e.g.,* APCC Petition at 6-8; RBOC Coalition Reply Comments at 5-7. *See also* Report and Order at para. 16.

[256] *See, e.g.,* AT&T Comments at 7. *See also* Report and Order at para. 17.

[257] *See* Report and Order at paras. 18-25.

5. Cost Methodology to Evaluate Dial-Around Rate: The PSPs argue that the Commission should use a marginal payphone methodology to reevaluate and increase the dial-around compensation rate.[258] Some parties oppose the Commission's use of a rate methodology based on the costs of maintaining a marginal payphone.[259] The Commission concluded that there is no persuasive alternative to the marginal payphone methodology.[260]

6. Elasticity of Demand and Cost Allocation: The PSPs argue that there is insufficient information to determine the elasticity of demand for purposes of cost allocation, and no reason to believe that dial-around calling is so price-elastic that a rate increase in the amount they propose would cause a reduction in revenues.[261] Some IXCs argue that, due to the elasticity of the demand for dial-around calling, an increase in the dial-around rate would suppress demand,[262] and some claim that demand suppression would be severe enough to cause increased removal of payphones.[263] The Commission concluded that the proposed increase in the compensation rate would not accelerate the decline in payphone revenues and deployment.[264]

7. Methodology for Call Volumes: The IXCs argue that the PSPs' methodologies for estimating call volumes from marginal payphones are incorrect because the PSPs did not limit their study samples to payphones that exactly recoup their costs, and because they do not use actual marginal payphones.[265] The PSPs contend that any changes to the prescribed cost study methodology are justified by changed circumstances, and that the Commission's methodology does not require limiting study samples only to payphones that exactly "break even."[266] The Commission found that the cost study methodologies used by the PSPs were reasonable, and that the Commission could rely on them in setting new compensation rates.[267]

8. Cost Category Inputs: The IXCs argue that certain costs and expenses are overstated, and raise issues related to the treatment of bad debt and advertising revenue. Specifically, the IXCs contend that PSP studies overstate equipment costs by failing to account for used equipment, overestimate line costs by failing to account for changed circumstances, and double count collection expenses because they are already included in SG&A costs.[268] Some PSPs argue that it is inappropriate to adopt an equipment cost input based on used equipment, while others contend that it is possible to factor used payphones into

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[258] *See* APCC Petition, Att. 1, and RBOC Coalition Comments, Exh. 1. *See also* Report and Order at para. 26.

[259] *See* IPCA Comments at 2-3; MCI Comments at 5-8. *See also* Report and Order at para. 28.

[260] *See* Report and Order at paras. 27, 29-31.

[261] *See* RBOC Coalition Comments at 6-9; APCC Comments at 10-14. *See also* Report and Order at para. 33.

[262] Global Crossing Comments at 2-7; AT&T Comments at 2-3, 7-11; MCI Comments at 9-10; Sprint Comments at 2, 8-11.

[263] Global Crossing Comments at 4-6; MCI Comments at 9-11. *See also* Report and Order at para. 34.

[264] *See* Report and Order at paras. 35-37.

[265] *See* AT&T Comments at 14; AT&T Reply Comments at 18; MCI Reply Comments at 14-15; Sprint Reply Comments at 10. *See also* Report and Order at para. 41.

[266] *See* APCC Comments at 17-18; APCC Reply Comments at 9, 25-28; RBOC Coalition Comments at 3-5. *See also* Report and Order at paras. 40, 43-44.

[267] *See* Report and Order at paras. 45-49.

[268] *See generally* Report and Order at paras. 52, 56, 60, and 66.

cost calculations, but not other used equipment.[269] The Commission agreed with the IXCs that it is appropriate for cost studies to reflect the availability of used equipment.[270] The Commission disagreed with the IXCs with respect to line costs, and found that the PSPs provided a reasonable basis for estimating line costs.[271] Finally, the Commission disagreed that collection expenses were double-counted, finding the PSPs were correct in arguing that there are certain collection costs that are specific to dial-around compensation which are not reflected in SG&A costs.[272]

9. The IXCs further contend that it is unlawful for PSPs to include bad debt in the dial-around compensation rate.[273] The Commission disagreed wit the IXCs, agreeing with the PSPs that rates should factor in bad debt.[274] Finally, the IXCs argue that advertising revenue from marginal payphones should be included in cost studies as an offset.[275] Some PSPs include advertising revenue as an offset, while others argue that they should not be considered.[276] The Commission agreed with the IXCs, finding it is more reasonable to include advertising revenue as an offset.[277]

10. Rate Validation Methodology: Some IXCs argue that a top-down approach should be used to assess the reasonableness of the results of any bottom-up analysis.[278] The Commission disagreed with the IXCs, noting that the PSPs were correct in their contention that a top-down validation is neither necessary not warranted.[279]

C. Description and Estimate of the Number of Small Entities to which the Rules Will Apply

11. The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the rules adopted herein.[280] The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[281] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[282] A small business

[269] *See* Report and Order at paras. 54-55.

[270] *See* Report and Order at para. 56.

[271] *See* Report and Order at paras. 59 and 61.

[272] *See* Report and Order at paras. 64-65 and 67.

[273] *See* Report and Order at paras. 69-71.

[274] *See* Report and Order at para. 69.

[275] *See* Report and Order at para. 76.

[276] *See* Report and Order at para. 76.

[277] *See* Report and Order at para. 77.

[278] AT&T Comments at 24; Sprint Comments at 16. *See also* Report and Order at para. 81.

[279] *See* Report and Order at paras. 82-85.

[280] 5 U.S.C. §§ 603(b)(3), 604(a)(3).

[281] *Id*. § 601(6).

concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[283]

12. Below, we describe and estimate the number of small entity licensees and regulatees that may be affected by rules adopted pursuant to this *Order*. The most reliable source of information regarding the total numbers of certain common carrier and related providers nationwide, as well as the number of commercial wireless entities, appears to be the data that the Commission publishes in its *Trends in Telephone Service* report.[284] The SBA has developed small business size standards for wireline and wireless small businesses within the three commercial census categories of Wired Telecommunications Carriers,[285] Paging,[286] and Cellular and Other Wireless Telecommunications.[287] Under these categories, a business is small if it has 1,500 or fewer employees. Below, using the above size standards and others, we discuss the total estimated numbers of small businesses that might be affected by our actions.

13. We have included small incumbent LECs in this present RFA analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g.*, a wired telecommunications carrier having 1,500 or fewer employees), and "is not dominant in its field of operation."[288] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not "national" in scope.[289] We have therefore included small incumbent LECs in this RFA analysis, although we emphasize that this RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

14. *Wired Telecommunications Carriers*. The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees.[290] According to Census Bureau data for 1997, there were 2,225 firms in this category,

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[282] *Id*. § 601(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such terms which are appropriate to the activities of the agency and publishes such definitions(s) in the Federal Register."

[283] 15 U.S.C. § 632.

[284] FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service*, Table 5.3 (August 2003) (*Trends in Telephone Service*).

[285] 13 C.F.R. § 121.201, North American Industry Classification System (NAICS) code 513310 (changed to 517110 in October 2002).

[286] *Id*. § 121.201, NAICS code 513321 (changed to 517211 in October 2002).

[287] *Id*. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

[288] 5 U.S.C. § 601(3).

[289] Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." *See* 15 U.S.C. § 632(a); 5 U.S.C. § 601(3). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b).

[290] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

total, that operated for the entire year.[291] Of this total, 2,201 firms had employment of 999 or fewer employees, and an additional 24 firms had employment of 1,000 employees or more.[292] Thus, under this size standard, the majority of firms can be considered small.

15. *Incumbent Local Exchange Carriers (LECs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to incumbent local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[293] According to Commission data,[294] 1,337 carriers reported that they were engaged in the provision of local exchange services. Of these 1,337 carriers, an estimated 1,032 have 1,500 or fewer employees and 305 have more than 1,500 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by the rules and policies adopted herein.

16. *Competitive Local Exchange Carriers (CLECs), Competitive Access Providers (CAPs), and "Other Local Exchange Carriers."* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to providers of competitive exchange services or to competitive access providers or to "Other Local Exchange Carriers," all of which are discrete categories under which TRS data are collected. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[295] According to Commission data,[296] 609 companies reported that they were engaged in the provision of either competitive access provider services or competitive local exchange carrier services. Of these 609 companies, an estimated 458 have 1,500 or fewer employees and 151 have more than 1,500 employees.[297] In addition, 35 carriers reported that they were "Other Local Service Providers." Of the 35 "Other Local Service Providers," an estimated 34 have 1,500 or fewer employees and one has more than 1,500 employees.[298] Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, and "Other Local Exchange Carriers" are small entities that may be affected by the rules and policies adopted herein.

17. *Interexchange Carriers (IXCs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to interexchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[299] According to Commission

[291] U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, "Establishment and Firm Size (Including Legal Form of Organization)," Table 5, NAICS code 513310 (issued October 2000).

[292] *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is "Firms with 1,000 employees or more."

[293] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

[294] *Trends in Telephone Service* at Table 5.3.

[295] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

[296] *Trends in Telephone Service* at Table 5.3.

[297] *Id.*

[298] *Id.*

[299] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

data,[300] 261 companies reported that their primary telecommunications service activity was the provision of interexchange services. Of these 261 companies, an estimated 223 have 1,500 or fewer employees and 38 have more than 1,500 employees.[301] Consequently, the Commission estimates that the majority of interexchange service providers are small entities that may be affected by the rules and policies adopted herein.

18. *Operator Service Providers (OSPs).* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to operator service providers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[302] According to Commission data,[303] 23 companies reported that they were engaged in the provision of operator services. Of these 23 companies, an estimated 22 have 1,500 or fewer employees and one has more than 1,500 employees.[304] Consequently, the Commission estimates that the majority of operator service providers are small entities that may be affected by the rules and policies adopted herein.

19. *Payphone Service Providers (PSPs).* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to payphone service providers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[305] According to Commission data,[306] 761 companies reported that they were engaged in the provision of payphone services. Of these 761 companies, an estimated 757 have 1,500 or fewer employees and four have more than 1,500 employees.[307] Consequently, the Commission estimates that the majority of payphone service providers are small entities that may be affected by the rules and policies adopted herein.

20. *Prepaid Calling Card Providers.* The SBA has developed a size standard for a small business within the category of Telecommunications Resellers. Under that SBA size standard, such a business is small if it has 1,500 or fewer employees.[308] According to Commission data,[309] 37 companies reported that they were engaged in the provision of prepaid calling cards. Of these 37 companies, an estimated 36 have 1,500 or fewer employees and one has more than 1,500 employees.[310] Consequently, the Commission estimates that the majority of prepaid calling card providers are small entities that may be affected by the rules and policies adopted herein.

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[300] *Trends in Telephone Service* at Table 5.3.

[301] *Id.*

[302] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

[303] *Trends in Telephone Service* at Table 5.3.

[304] *Id.*

[305] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

[306] *Trends in Telephone Service* at Table 5.3.

[307] *Id*.

[308] 13 C.F.R. § 121.201, NAICS code 513330 (changed to 517310 in October 2002).

[309] *Trends in Telephone Service* at Table 5.3.

[310] *Id.*

21. *Other Toll Carriers.* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to "Other Toll Carriers." This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[311] According to Commission's data,[312] 92 companies reported that their primary telecommunications service activity was the provision of other toll carriage. Of these 92 companies, an estimated 82 have 1,500 or fewer employees and ten have more than 1,500 employees.[313] Consequently, the Commission estimates that most "Other Toll Carriers" are small entities that may be affected by the rules and policies adopted herein.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

22. With this order, the Commission finds that the revised default rate will not increase existing reporting, recordkeeping or other compliance requirements. The rate has been increased from $.24 to $.494. This increase creates no change in the way that directly affected parties operate.

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

23. The RFA requires an agency to describe any significant, specifically small business, alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.[314]

24. In the IRFA, we stated, "[T]he overall objective of this proceeding is to evaluate whether changes are necessary in the current default rate of compensation for dial-around calls originating at payphones, in order to ensure that payphone service providers are fairly compensation, promote payphone competition, and promote the widespread deployment of payphone services. The *Notice* seeks comment on specific issues related solely to the level of dial-around compensation."[315] In considering all of the comments filed in this proceeding, there has not been any identification of any alternative that would have further limited the impact on entities while remaining consistent with Congress' pro-competitive objectives set out in the Act.

25. Report to Congress. The Commission will send a copy of this order, including this FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.[316] In addition, the

[311] 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

[312] *Trends in Telephone Service* at Table 5.3.

[313] *Id*.

[314] 5 U.S.C. § 603(c).

[315] 18 FCC Rcd 22832, para. 58.

[316] *See* 5 U.S.C. § 801(a)(1)(A).

Commission will send a copy of this orders, including the FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this order and FRFA (or summaries thereof) will also be published in the Federal Register.[317]

[317] *See* 5 U.S.C. § 604(b).