NEW YORK LAW SCHOOL

DigitalCommons@NYLS

Media Law and Policy

Media Center

Winter 1996

PAYPHONE DEREGULATION UNDER THE TELECOMMUNICATIONS ACT OF 1996

Benjamin Lipschitz

Follow this and additional works at: https://digitalcommons.nyls.edu/media_center

Part of the Communications Law Commons

PAYPHONE DEREGULATION UNDER THE TELECOMMUNICATIONS ACT OF 1996

Benjamin Lipschitz[1]

Introduction

In passing § 276 of the Telecommunications Act of 1996 (the "1996 Act"), Congress sought to end one of the remaining vestiges of the 1984 AT&T breakup by denying the Bell operating companies ("BOCs") their bottleneck control over the telephone network for payphones. The 1996 Act promised to erect a "pro-competitive de-regulatory national framework designed to accelerate rapid private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[1] To this end, the Federal Communications Commission (the "Commission"), in its pay telephone rulemaking proceeding (the "Rulemaking"),[2] sought to advance the twin goals of § 276 to "promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public.[3]" The Commission defined a payphone as "any telephone made available to the public on a fee-per-call basis, independent of any other commercial transaction, for the purpose of making telephone calls, whether the telephone is coin-operated or is activated either by calling collect or using a calling card.[4]"

Background

Traditionally, payphones have been regulated primarily by the states as part of the local exchange company's ("LECs") network-based service.[5] The Commission has focused on payphones primarily in the context of its regulation of carriers that provide operator-assisted long-distance service, ("OSPs"), and in particular, its implementation of the Telephone Operator Consumer Services Improvement Act (TOCSIA).[6] As discussed below, for purposes of regulation, the definition of the LEC network will no longer include payphones because such telephones can now perform most of the control and supervision functions previously performed by the LEC network. Moreover, TOCSIA is the basis for the per-call compensation mechanism and for the information and disclosure requirements adopted in the Rulemaking.

TOCSIA, enacted in response to widespread dissatisfaction with varying OSP rates after the AT&T breakup,[7] requires that all OSPs identify themselves to consumers and quote their rates upon request; TOCSIA also requires payphones to unblock access to other carriers and post certain disclosures on or near each telephone.[8] Under TOCSIA, the Commission concluded that a per-call compensation mechanism was preferable because such compensation method would create greater incentives for all payphone service providers ("PSPs"), both LECs (BOCs and non-BOC LECs) and independent payphone operators ("PPOs"), to place their payphones in locations that generate the most traffic.[9] At the time TOCSIA was enacted, however, the Commission determined that a per-call compensation mechanism was not technically feasible to implement.[10]

Under an earlier rulemaking, the Commission had concluded that customer premises equipment ("CPE"), such as the telephones used by end users, should be competitively provided and not offered as part of a carrier's regulated transmission service.[11] Deregulating CPE would increase the consumer's freedom of choice, increase marketplace competition, and avoid the potential for anti-

---

[1] J.D., New York Law School; blipschi@aol.com; presently working as an Agency Attorney at the New York City Department of Information, Technology and Telecommunications (DoITT).

[1] S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996).

[2] 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) ("*Notice*"); *Report and Order*, FCC 96-388 (rel. Sept. 20, 1996) ("*Report and Order*"); *Order on Reconsideration*, FCC 96-439 (rel. Nov. 8, 1996) ("*Recon Order*").

[3] 47 U.S.C. § 276(b)(1).

[4] *Recon Order, supra* note 2 at para. 13.

[5] *Notice, supra* note 2 at para. 2; see, e.g., 16 NYCRR § 650, et al.

[6] Pub. L. No. 101-435, 104 Stat. 986 (1990) (codified at 47 U.S.C. § 226).

[7] Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, *Report and Order*, 6 FCC Rcd 4736, 4737 (1991) ("*First Report and Order*"); see also, *Second Report and Order*, 7 FCC Rcd 3251 (1992).

[8] See, generally, 47 U.S.C. § 226.

[9] *Second Report and Order, supra* note 7 at 3252-53.

[10] *Id.*

[11] See, Amendment of 47 C.F.R. § 64.702 (Second Computer Inquiry), 77 FCC 2d 384 (1980) ("Computer II"), modified on recon., 84 FCC 2d 50 (1981), modified on further recon., 88 FCC 2d 512 (1981), aff'd sub. nom. Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

competitive activities by carriers.[12] Such activities included subsidizing services facing competition with revenues from regulated, monopolistic services or shifting costs from a service in a competitive industry to a service that the carrier operates as a regulated monopolist.[13] The Commission, however, specifically excluded coin-operated payphones from the definition of CPE because, unlike other customer premises equipment that could be "unbundled" from basic exchange service, coin-operated payphones were still integrated with the LECs' network.[14]

With the advent of "smart" payphones -- payphones with sufficient computer intelligence to perform most of the control and supervision functions previously performed by a LEC's network -- the Commission could find that BOC payphone CPE were no longer integrated with the LEC network, as smart payphones would allow BOC payphones to operate separately from local exchange service.[15] The Commission reaffirmed, however, that LEC payphones would continue to be classified as network elements rather than CPE, but recognized the right of non-LEC providers to interconnect these payphones to the interstate public switched network.[16] Because of the development of smart payphones, PPOs had begun to seriously compete with the LECs for payphone service. Currently, there are nearly 1.5 million LEC payphones[17] and nearly 350,000 competitively provided payphones.[18] Neither PPOs nor LECs, however, own the premises where a particular payphone is located; location providers select the PSP who will provide payphone services on their premises.

PPOs and LECs are compensated differently for interexchange carrier ("IXC") operator services based upon their relationship to the location provider.[19] PPOs may negotiate an agreement with a presubscribed IXC, pursuant to which the IXC pays a percentage of its revenues from the payphone to the PPO. The PPO, in turn, pays a commission to the location provider based on the revenues generated by the payphone. Pursuant to the Modification of Final Judgement, however, BOCs were required to permit location providers to select the IXC to which the payphone would be presubscribed for interstate, interLATA traffic.[20] Accordingly, the location provider makes its own contract with an IXC to share in the interLATA revenues generated by the phone. Therefore, while the non-BOC LECs, like the PPOs, may receive a portion of the IXC commissions on interLATA operator-service calls using the presubscribed carrier, the BOCs do not receive any revenue directly from these calls. On the other hand, unlike the PPOs, all LECs, including the BOCs, receive, as a part of the carrier common line ("CCL") charges paid by IXCs, compensation for LEC provision of the facilities, including the payphone, necessary to deliver interexchange traffic to the IXCs. Moreover, the payphone element of the CCL is charged to all interexchange customers, not just to traffic originating or terminating at a payphone.

Payphone Reform

Under § 276 of the 1996 Act, the Commission seeks to establish regulatory parity for all PSPs and to overcome existing barriers to market-based payphones. The Commission seeks: (1) to ensure fair compensation for all completed intrastate and interstate calls using a payphone; (2) to discontinue incumbent local exchange carrier subsidies; (3) to prescribe nonstructural safeguards for BOC payphones; (4) to permit BOCs to negotiate with payphone location providers for presubscribed interLATA service; (5) to permit all PSPs to negotiate with payphone location providers for presubscribed intraLATA service; and (6) to adopt guidelines for states to establish public interest payphones.[21]

Payphone reform is aided by the potential competition in the payphone market that is characterized by ease of entry. It is relatively easy for a potential PSP to purchase a payphone, secure a location contract, and obtain a payphone line from the LEC and maintain the phone. In addition, payphones can be easily removed and used at another location and there are no apparent economies of scale to impede entry.

Payphone reform is hampered, however, by existing barriers to market-based payphones. In the present environment, there are regulatory, structural, and technological barriers to the development of a market-based payphone industry. Regulatory barriers include placement of phones and payphone subsidies. Structural barriers include: (1) LECs own payphones and also provide the tariffed payphone services to PPOs;[22] (2)

[12] *Id.* at 446.

[13] *Id.* at 443.

[14] Computer II.

[15] *Notice, supra* note 2 at para. 5.

[16] See, Memorandum Opinion and Order, Registration of Coin Operated Telephones, 49 Fed. Reg. 27763 (1984).

[17] Statistics of Communications Common Carriers, 1994/95 edition, Common Carrier Bureau, FCC at 159, Table 2.10 (1995).

[18] *Notice,, supra* note 2 at para. 6.

[19] *Notice, supra* note 2 at paras. 7-8.

[20] United States v. Western Elec. Co., 698 F. Supp. 348, 365 (D.D.C. 1988).

[21] See, generally, 47 U.S.C. § 276(b).

[22] *Report and Order, supra* note 7 at para. 14.

certain areas, because of their size, location or the caller's lack of time to identify substitute payphones will support a PSP monopoly charging supra-competitive prices;[23] and (3) consumers need full information regarding prices and choices for competitive markets to succeed. [24] Technological barriers include the lack of an effective per-call tracking mechanism for per-call compensation.

To overcome existing market barriers and to establish regulatory parity, the Commission has established a two-phase approach to implement payphone reform under § 276. The first phase began on October 7, 1996. The second phase will begin one year later, October 7, 1997, and last until October 7, 1998. During the first phase, states will continue to set the local coin rates but may also move to market-based local coin rates. States are responsible for balancing the need to fairly compensate the owners of payphones with the need to protect consumers from excessive rates. As of December 16, 1996, states must revoke payphone regulations that impose market entry or exit requirements. Those regulations that remain in place must, on a competitively neutral basis, provide information and price disclosure and must also ensure that payphones provide free access to dialtone, emergency, and telecommunications relay service calls for the hearing impaired ("TRS").[25]

During the first phase, IXCs with annual toll revenues in excess of $100 million will pay PSPs a monthly flat-rate of $45.85 per phone. This flat-rate compensation will apply proportionally to individual IXCs, based on their respective annual toll revenues.[26] Flat-rate compensation was determined using a $.35 local coin rate, the rate in the majority of states that have allowed the market to determine the local coin rate,[27] and an average of 131 access code calls and subscriber 800 calls.[28] LECs, however, will not be eligible for flat-rate compensation until the first day of the month following their reclassification and transfer of payphone equipment along with the termination of subsidies, as discussed below.[29]

Regarding 411 or other directory assistance calls, to ensure fair compensation for these calls, the PSP may charge a market-based rate for this service. Moreover, to ensure that a LEC does not discriminate in favor of its own payphones, the LEC must impute to its own payphones any fee it imposes on PSPs for 411 calls.

At the start of phase two, IXCs are required to track payphone calls and pay PSPs a per-call rate of $.35, unless the IXC and PSP otherwise agree. While the market will set the price for local coin rates, states may get an exception to market rates upon a specific showing of market failure. To correct monopoly rates of locational monopolies, the states may mandate additional PSPs at a location, or require that the PSP secure its contract through a competitive bidding process to ensure the lowest possible rates. If market failure persists, upon request of the state, the Commission may intervene. In addition, during the second phase, the Commission may review the deregulation of local coin rates nationwide and determine whether marketplace dysfunctions exist. Absent such a finding, at the conclusion of the second phase, the market-based local coin rate will be the default compensation rate for all payphone compensable calls in the absence of an agreement. The market will account for inflation or technological advancements.[30] Notwithstanding market-based payphones, the Commission will take affirmative steps to overcome specific market dysfunctions, such as requirements under TOCSIA. The Commission already requires that, as of December 16, 1996, PSPs must clearly indicate local coin rates on payphone placards.[31] LECs, however, will not be eligible for per-call compensation until all its payphone subsidies are terminated, as discussed below.

LECs will be eligible for per-call compensation when they discontinue their payphone subsidies and payphone access charge payments by April 15, 1997. To discontinue payphone subsidies, the LECs must reclassify their payphones as detariffed and deregulated CPE and transfer their payphone assets to unregulated accounts or affiliates. To discontinue access charge payments, the LECs must file an effective interstate CCL tariff reflecting a reduction for deregulated payphone costs and reflecting additional multiline subscriber line charge ("SLC") revenue. The CCL charge now includes LEC payphone costs, though the charge is applied to interstate switched access service that is unrelated to payphone service costs. The SLC charge is not attributed to LEC payphones because the LECs recover their payphone costs through the CCL charge.[32]

LECs must also offer PSPs individual central office coin transmission services, and certain other services that

[23] *Id.* at para. 15.

[24] *Id.* at para. 16.

[25] *Id.* at para. 50; 47 C.F.R. § 64.1330. See, related TRS reform issues in CC Docket No. 90-571.

[26] 47 C.F.R. 64.1301; a list of annual toll revenues for IXCs is listed in appendix F of the *Report and Order.*

[27] *Report and Order, supra* note 7 at para. 56.

[28] Based on call volume data provided to the Commission by PSPs; *Id.* at para. 125.

[29] *Id.*

[30] *Id.* at para. 73.

[31] 47 C.F.R. § 64.1340.

[32] *Recon Order, supra* note 7 at para. 180.

LECs provide to their own payphones under nondiscriminatory, public, tariffed offerings.[33] Coin service will allow competitive payphone providers to offer payphone services using either instrument-implemented "smart payphones" or "dumb" payphones that utilize central office coin services. These services must be made available by the LEC or its affiliate to other payphone providers on a comparable basis to ensure that other payphone providers can compete with LEC payphone operations. Specifically, LECs must provide fraud protection, special number assignments, installation and maintenance, billing and collection, validation, and per-call tracking.[34]

In addition to the above requirements for all other LECs, BOCs must have approved comparably efficient interconnection ("CEI") plans for basic payphone services and unbundled functionalities prior to receiving compensation. Such CEI plans must describe how the BOCs will comply with certain accounting requirements and nonstructural safeguards to provide an appropriate regulatory framework that will ensure that BOCs do not discriminate or cross-subsidize their payphone service. These safeguards include: (1) nondiscriminatory access to network features and functionalities; (2) CPNI requirements as modified by § 222 of the Act;[35] (3) network information disclosure rules; (4) installation, maintenance, and quality nondiscrimination requirements; and (5) cost accounting safeguards.[36] Similarly, BOC CEI plans must be in place before the BOCs are allowed to participate in interLATA presubscription for their payphones because the CEI nonstructural and accounting safeguards are necessary to deter anticompetitive conduct that may arise when BOCs are allowed to choose their interLATA carrier.[37]

Regarding the choice of intraLATA carrier, the Commission provides all PSPs with the right to participate in the selection of the intraLATA carriers presubscribed to their payphones.[38] In implementing this right, the Commission seeks to eliminate existing barriers upon any PSP's ability to compete on this basis. However, intraLATA carriers presubscribed to payphones must meet minimum Commission standards for routing and handling emergency calls[39] because payphones serve a critical role in emergencies, as discussed below regarding public interest payphones ("PIPs").

PIPs are payphones that: (1) fulfill a public policy objective in health, safety, or public welfare; (2) are not provided for by a location provider with an existing contract for the provision of a payphone; and (3) would not otherwise exist as a result of the operation of the competitive marketplace.[40] To address potential market failure, the Commission established guidelines for the states to administer and fund PIPs. The Commission recognized that the states are typically in a superior position to respond to geographic and socio-economic factors affecting the need for PIPs that are too diverse to effectively address on a national basis.[41] Consistent with the Rulemaking's primary reliance on the competitive marketplace, however, these guidelines require that the states administer and fund PIPs in a manner which is competitively neutral, and which fairly and equitably compensates PIP providers.

Moreover, states must evaluate and review their PIP programs by September 20, 1998, to determine whether they need to take measures to ensure that payphones serving important public interests will continue to exist after the elimination of subsidies and other competitive provisions established in the Rulemaking. By this date, states must also ensure that any existing programs are administered and funded consistent with the Rulemaking.[42] This review may be conducted in conjunction with the states' study of the payphone marketplace, mentioned above, which is required in connection with the transition to market-based payphone compensation.

Conclusion

In the past, the payphone industry has operated with entry and exit restrictions and subsidies. As the payphone industry becomes more competitive, purely market driven price and supply outcomes may diverge from public policy. Accordingly, government and interested parties must continue to monitor the industry to ensure that the rules adopted by the Commission will result in competitive payphone prices and an adequate number of payphones to meet consumer demand.

---

[33] Computer II at 387-9; 47 U.S.C. §§ 201, 202, and 276; *BOC CPE Relief Order*, 2 FCC Rcd 143 (1986).

[34] *Id.* at para. 149.

[35] See, Implementation of the Telecommunications Act of 1996: Accounting Safeguards under the Telecommunications Act of 1996, *Notice of Proposed Rulemaking*, 11 FCC Rcd 9054 (1996).

[36] *Id.* at para. 200.

[37] *Id.* at para. 237.

[38] 47 U.S.C. § 276(b)(1)(E).

[39] *Supra* note 35 at para. 260.

[40] *Id.* at para. 282.

[41] *Id.* at para. 278.

[42] *Id.* at para. 285; 47 C.F.R. § 64.1330.