

**FTI CONSULTING, INC.**  
**REPORT ON FINANCIAL IMPACT OF FCC SECOND REPORT AND ORDER**  
**ON BEHALF OF**  
**SECURUS TECHNOLOGIES, INC.**

**December 22, 2015**



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## I. EXECUTIVE SUMMARY

On November 5, 2015, the Federal Communications Commission (“FCC” or “Commission”) released its *Second Report and Order and Third Further Notice of Proposed Rulemaking In the Matter of Rates for Interstate Inmate Calling Services*,<sup>1</sup> adopting “comprehensive reforms of Inmate Calling Services, regardless of the technology used to provide service, to ensure just reasonable and fair rates as mandated by the Communications Act.”<sup>2</sup> In particular, the FCC’s *ICS Second Order* states:

For fees for single-call and related services and third-party financial transaction fees, we allow providers to pass through only the charges they incur without any additional markup. We limit automated payment fees to \$3.00.<sup>3</sup>

FTI has been asked to determine the impact that these two reductions will likely have on the business conducted by Securus and to determine if the conclusions reached by Mr. Geoffrey M. Boyd in his December 18, 2015 Affidavit are reasonable.<sup>4</sup> We have found that the impact identified in the Declaration of Mr. Boyd are within a reasonable range based on the exact same cost information that FTI relied on in responding to the FCC’s *Mandatory Data Collection*.<sup>5</sup>

## II. QUALIFICATIONS

FTI’s Network Industries Strategies group was formed to address the unique needs of infrastructure industries and, in particular, to assist clients in managing the regulatory framework often surrounding these industries. This FTI effort was led by Steven E. Turner and Brian F. Pitkin who authored the *FTI Cost Report*,<sup>6</sup> the *FTI Elasticity Report*,<sup>7</sup> and the *FTI Response*

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<sup>1</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, Second Report and Order and Third Further Notice of Proposed Rulemaking, Released: November 5, 2015 (“*ICS Second Order*”).

<sup>2</sup> *Federal Register*, Document 2015-21352, December 18, 2015.

<sup>3</sup> *ICS Second Order* at ¶ 147.

<sup>4</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, Affidavit of Geoff Boyd (Confidential Version), December 18, 2015 (“*Boyd Affidavit*”).

<sup>5</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, Public Notice, Commission Announces Inmate Calling Services Data Due Date, June 17, 2014 (“*Mandatory Data Collection*”).

<sup>6</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, FTI Consulting, Inc. Report Implementing the FCC Mandatory Data Collection on Behalf of Securus Technologies, Inc., July 17, 2014 (“*FTI Cost Report*”).

<sup>7</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, FTI Consulting, Inc. Report on Price Elasticity of Demand for Interstate Inmate Calling Services on Behalf of Securus Technologies, Inc., January 12, 2015 (“*FTI Elasticity Report*”).

*Report*<sup>8</sup> in this docket. As such, we are familiar with the cost characteristics and cost information of Securus’s business. Our qualifications, including copies of our curricula vitae are included in the *FTI Cost Report*.

### III. FCC ICS SECOND ORDER IMPACT ON SECURUS

Overall, FTI has determined that the overall impact of the *ICS Second Order* will cut the total revenue we identified in the *FTI Cost Report* by approximately █ (-█%). These levels of revenue reductions are so extensive that they will actually result in a █ return on equity.<sup>9</sup> The primary reasons for such extensive revenue loss are (1) the fact that the one-sided nature of the FCC’s rate application means that the per-minute rate reductions have a █% greater impact than implied by the FCC identified rates, and (2) the fact that the FCC has severely restricted the amount of ancillary services costs that Securus is able to recover. In this report, Securus has asked that we focus on the ancillary services cost restrictions.

#### A. Automated Payment Fees (Credit Card Processing)

Mr. Boyd identifies that “[t]he impact to Securus of implementing the new caps for online credit card funding transactions is an approximate \$█ million annual reduction in our EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization).”<sup>10</sup> We have reviewed Mr. Boyd’s analysis and determined that it is reasonable. In addition, we have taken the Ancillary Fees for 2013 as reported to the FCC in the *Mandatory Data Collection* (the last full year of information available as of that submission), and applied the price adjustment to each and every “Credit Card Processing Fee” identified in that filing.<sup>11</sup> This analysis resulted in a reduction of \$█ million in revenue for 2013 (from \$█ million to \$█ million).<sup>12</sup> Given that the number of funding activities grew at an annual rate of █% between 2012 and 2014, an

<sup>8</sup> *Rates for Interstate Inmate Calling Services*, WC Docket No. 12-375, FTI Consulting, Inc. Response to Second Further Notice Declaration of Coleman Bazelon and Expert Report of Don J. Wood on Behalf of Securus Technologies, Inc., January 27, 2015 (“*FTI Response Report*”).

<sup>9</sup> FTI has also determined that price elasticity of demand will not offset the revenue reductions as the FCC’s per-minute rate reductions are so extensive that they would require relatively elastic price elasticity of demand wherein the evidence suggests that ICS services are characterized by relatively inelastic price elasticity of demand.

<sup>10</sup> *Boyd Affidavit* at ¶ 5.

<sup>11</sup> Specifically, we have adjusted each fee tier (*i.e.*, each unique non-recurring charge in the *Mandatory Data Collection*) to the \$3.00 level set in the FCC order. We also separately adjusted these numbers for a mix of automated payment fees and live agent fees according to the order and found similar results.

<sup>12</sup> Revenue reductions equal reductions in EBITDA as there is no change in the costs associated with processing these credit card transactions.

estimate of \$[REDACTED] million actually appears to be a conservative estimate as our calculations would have resulted in an estimated reduction of \$[REDACTED] million for 2015.

## **B. Fees for Single-Call and Related Services**

Mr. Boyd identifies that “[t]he impact to Securus of implementing the new caps for single call services is an approximate \$[REDACTED] million annual reduction in our EBITDA.”<sup>13</sup> Again, we have reviewed Mr. Boyd’s analysis and determined that it is reasonable. In addition, we have taken the PayNow and Text2Connect calls for 2013 as reported to the FCC in the *Mandatory Data Collection* (the last full year of information available as of that submission), and re-rated these calls according to the FCC rate caps identified in the *ICS Second Order*.<sup>14</sup> We then added in the amounts paid directly to Securus’s third-party vendor of \$[REDACTED] million (with no markup). This analysis shows that revenue decreases by \$[REDACTED] million.

We then converted this revenue decrease to EBITDA using an average direct cost per call (excluding commissions) separately for PayNow and Text2Connect and the current mix of calls ([REDACTED]% PayNow and 38.9% Text2Connect). This analysis shows a total reduction in EBITDA of \$[REDACTED] million.<sup>15</sup> However, all charges and payments to the third party vendor for these calls are rated on a per-call basis, not a per-minute basis. Securus would need to invest significant amounts to change all of its systems for billing and payment from a per-call basis to a per-minute basis. As such, it is our understanding that Securus would likely stop providing the PayNow and Text2Connect services because the costs are likely to exceed the revenues. In other words, it is entirely reasonable to anticipate that the entire \$[REDACTED] million of Securus’s 2013 EBITDA would be lost as a result of the FCC’s order.

Moreover, FTI has reviewed the contracts by which Securus offers the PayNow and the Text2Connect services and verified Mr. Boyd’s claim that Securus has made an “investment of over \$[REDACTED] million to purchase the assets necessary to provide the PayNow and Text2Connect services, including the costs necessary to provide these services to connect with mobile phones.”<sup>16</sup>

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<sup>13</sup> *Boyd Affidavit* at ¶ 6.

<sup>14</sup> Specifically, we have adjusted the rates to reflect a maximum rate of \$0.11 for prisons, \$0.14 for jails with an average daily population (ADP) of 1,000 or more, \$0.16 for jails with an ADP of between 350 and 999, and \$0.22 for jails with an ADP of less than 350.

<sup>15</sup> Here, there are relatively minor differences in the volumes between 2012 and 2014 (approximately 2.1%, increasing slightly between 2012 and 2013 and decreasing slightly between 2013 and the partial year data for 2014), so we did not separately apply an adjustment factor.

<sup>16</sup> *Boyd Affidavit* at ¶ 7.

#### IV. CONCLUSION

Securus requested that FTI review the work of Mr. Boyd to ensure that the calculations he presents in the December 18, 2015 *Boyd Affidavit* reasonably represent the lost earnings that Securus will likely experience as a result of the FCC's *ICS Second Order*. FTI has reviewed the calculations performed by Mr. Boyd based on current (*i.e.*, 2015) data and we believe that his calculations are appropriate. FTI has also taken the additional step of using the information provided to the FCC in the *Mandatory Data Collection* (not a specific task requested by Securus) as a check on Mr. Boyd's calculations. This evaluation also suggests that the estimates presented in the *Boyd Affidavit* are reasonable.