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2024-10-26 buy payphones and retire

> PAYPHONES at High Volume
>
> Existing sites! Earn BIG $$. Money Back Guarantee!

Dropshipping AliExpress watches, AI-generated SEO spam websites... marginally legal and ethical passive income schemes, that serve to generate that income mostly for their promoters, can feel like a modern phenomenon. The promise of big money for little work is one of the fundamental human weaknesses, though, and it has been exploited by "business coaches" and "investment promoters" for about as long as the concept of invesstment has existed. We used to refer mostly to the "get rich quick" scheme, but fashions change with the time, and at the moment "passive income" is the watchword of business YouTubers and Instagram advertising.

And what income is more passive than vending machine coin revenue? Automated vending has had a bit of a renaissance, with social media influencers buying old machines and turning them into a business. The split of their revenue between vending machine income and social media sponsorship is questionable, but it's definitely brought some younger eyes to an industry that is as rife with passive income scams as your average spam folder. Perhaps it's the enforcement efforts of the SEC, or perhaps today's youth just need a little more time to advance their art, but I haven't so far seen a vending machine hustle quite as financialized as the post-divestiture payphone industry.

For much of the history of the telephone system, payphones were owned and operated by telephone carriers. As with the broader telephone monopoly, there were technical reasons for this integration. Payphones, more specifically called coin operated telephones, were "dumb" devices that relied on the telephone exchange for control. In the case of a manual exchange, you would pick up a payphone and ask the operator for your party---and they would advise you of the price and tell you to insert coins. The coin acceptor in the payphone used a simple electrical signaling scheme to notify the operator of which and how many coins you had inserted, and it was up to the operator to check that it was correct and connect the call. If coins needed to be returned after the call, the operator would signal the phone to do so.

With the introduction of electromechanical and then digital exchanges, coin control became automated, but payphones continued to use specialized signaling schemes to communicate with the coin control system. They had to be connected to special loops, usually called "coin lines," with the equipment to receive and send these signals. The payphone itself was a direct extension of the telephone system, under remote control of the exchange, much like later devices like line concentrators. It was only natural that they would be operated by the same company that operated the control system they relied on.

Well, a lot of things have changed about the payphone industry. The 1968 Carterfone decision revolutionized the telephone industry by allowing the customer to connect their own device. Coin operated telephones in the traditional sense were unaffected, but Carterfone opened the door to a whole new kind of payphone.

In 1970, burglar alarm manufacturer Robotguard blazed the trail into a new telephone business. They imported a Japanese payphone that was a little different from the American models of the time: it implemented coin payment internally. Robotguard connected the payphone through one of their burglar alarm autodialers, a device that was already fully compliant with telephone industry regulations, and then hooked it up to a Southwestern Bell telephone line in a department store in in St. Louis. By inserting a dime, the phone was enabled and you could make a local call (the autodialer was used, in part, to limit dialing to 7 digits to ensure that only local calls were made).

Robotguard had done their homework, consulting the same law firm that represented Carterfone in the 1968 case. They believed the scheme to be legal, since the modified Japanese payphone behaved, to the telephone company, just like any other customer-owned phone. The New York Times quotes Southwestern Bell, whose attitude is perhaps best described as resignation:

> Spokesmen for the Southwestern Bell Telephone Company, the operating company in that area, acknowledge that the equipment is in the store, that it is working as described and that it appears completely legal. There is nothing they can do about it at this time, they say.

There was, indeed, nothing that they could do about it. Robotguard had introduced the Customer-Owned Coin-Operated Telephone, or COCOT, to the United States. Payphones were now a competitive business.

Despite a certain air of inevitability, COCOTs had a slow start. First, there would indeed be an effort by telephone companies to legally restrict COCOTs. This was never entirely successful, but did result in a set of state regulations (and to a lesser extent, federal regulations related to long-distance calls) that made the payphone business harder to get into. More importantly, though, the technical capabilities of COCOTs were limited. The Robotguard design could charge only a fixed fee per call, which made it a practical necessity to limit the payphone to local calls. Telephone company payphones, which allowed long-distance calls at a higher rate, had an advantage. Long-distance calls were also typically billed by minute, which made it important for a payphone to impose a time limit before charging more. These capabilities were difficult to implement in a reasonably compact, robust device in the 1970s.

A number of articles will tell you that COCOTs became far more common as a result of payphone deregulation stemming from the 1984 breakup of AT&T. I would love to hear evidence to the contrary, but from my research I believe this is a misconception, or at least not the entire story. In fact, payphones were deregulated by the Telecommunications Act of 1996, but that was done in large part because COCOTs were already common and telephone companies were unhappy that conventional payphones were subject to rate regulation while COCOTs were not [1].

Divestiture did definitely open the floodgates of COCOTs, although I think that the advances in electronics around that time were also a significant factor in their proliferation. In any case, several manufacturers introduced COCOTs in 1984 and 1985.

These later-generation COCOTs were significantly more sophisticated than the mechanical system used by Robotguard. To the user, they were pretty much indistinguishable from carrier-operated payphones, charging varying rates based on call duration and local or long distance. This local simulation of the telephone exchange's charging decisions required that each COCOT have, in internal memory, a prefix and rate table to determine charges. Early examples used ROM chips shipped by their manufacturer, but over time the industry shifted to remote programming via modems. These sophisticated, electronically-controlled coin operated phones that did not rely on an exchange-provided coin line came to be known as "smart payphones" and even, occasionally, as "smartphones."

Smart payphones greatly simplified payphone operations and were even adopted by the established telephone companies, where they could save money compared to the more complex exchange-controlled system. But they also made COCOTs completely practical, as good to the consumer as any other payphone. As COCOTs became remotely programmable, the payphone business started to feel like a way to generate---dare I say it---passive income. All you had to do was collect the coins. Well, that and keep the phone in working order, which would become a struggle for the thinly staffed and overleveraged Payphone Service Providers (PSPs) that would come to dominate the industry.

One of the new entrants into the payphone business was a company that specialized in exactly the kind of remote management these new smart payphones required: Jaroth Inc., which would do business as Pacific Telemanagement Solutions or PTS. Today, PTS is the largest PSP in the United States, but that isn't saying a whole lot. They enjoyed great success in the 1990s, though, and were so well-positioned as a PSP in the '00s that they often purchased the existing payphone fleet from former Bell Operating Companies that decided to abandon the payphone business.

The 1990s were a good time for payphones, and they were also a good time for investment scams. Loose enforcement of regulations around investment offerings, the Dot Com Boom, and a generally strong economy created a lot of opportunities for "telecom entrepreneurs" that were more interested in moving money than information.

The problem of 1990s telecommunications companies funded in unscrupulous ways is not at all unique to payphones, although it did reach a sort of apex there. I will take this opportunity to go on a tangent, one of those things that I have always wanted to write an article about but have never quite had enough material for: MMDS, the Multichannel Multipoint Distribution Service.

MMDS was, essentially, cable television upconverted to a microwave band and then put through directional antennas. It was often marketed as "Wireless Cable," sort of an odd term, but it was intended as a direct competitor to conventional cable television. I think it's fair to call it an ancestor of what we now call WISPs, using small roof-mounted parabolic antennas as an alternative to costly CATV outside plant. Some MMDS installations literally were early WISPs: MMDS could carry a modified version of DOCSIS.

Wireless cable got a pretty bad rap, though. If you pay attention to WISPs, you will no doubt have noticed that while the low capital investment required can enable beneficial competition, it also enables a lot of companies that you might call "fly by night." Some start out with good intentions and just aren't up to the task, while some come from "entrepreneurs" with a history of fraud, but either way they end up collecting money and then disappearing with it.

MMDS had a huge problem with shady operators, and more often of the "history of fraud" type. Supposed MMDS startups would take out television and newspaper ads nationwide offering an incredible opportunity to invest in this exciting new industry. The scam took different forms in the details, but the most common model was to sell "shares" of a new MMDS company in the four-to-five-digit range. Investors were told that the company was using the capital to build out their network and would shortly have hundreds of customers.

In practice, most of these "MMDS startups" were in cities with powerful incumbent cable companies and, even worse, preexisting MMDS operators using the limited spectrum available for such a wideband service. They never had any chance of getting a license, and didn't have anyone with the expertise to actually build an MMDS system even if they got one. They just

pocketed the money and were next seen on a beach in Mexico or in prison, depending on the whims of fortune.

These wireless cable schemes became so common, and so notorious, that if you asked a lot of people what wireless cable was the two answers you'd get are probably "no idea" and "an old scam."

It only takes a brief look at newspaper archives to find that the payphone industry was a little sketchy. There are constant, nationwide, near-identical classified ads with text like "buy and retire now" and "$150k yearly potential" and "CALL NOW!". Sometimes more than one appear back to back, and they're still nearly identical. None of these ads give a company name or really anything but a phone number, and the phone numbers repeat so infrequently that I suspect the advertisers were intentionally rotating them. This was pretty much the Craigslist "work from home" post of the era.

To understand payphone economics better, let's talk a little about how the payphone business operated. Telephone companies had long run payphones on the same payment model, by finding a location for the payphone (or being contacted by the proprietor of a location) and then offering the location a portion of revenue. In the case of incumbent telcos, this was often a fixed rate per call. So someone owned the location and the payphone operator paid them in the form of a royalty.

COCOTs enabled a somewhat more complex model. A COCOT might be located in a business, connected to a telephone company line, and remotely programmed by a service provider, all of which were different companies from the person that actually collected the money. The revenue had to get split between all of these parties somehow, but COCOTS weren't regulated and that was all a matter of negotiation.

Much like the vending machine industry today, one of the most difficult parts of making money with a payphone was actually finding a good location---one that wasn't already taken by another operator. As more and more PSPs spread across the country, this became more and more of a challenge. So you can imagine the appeal of getting into the payphone hustle without having to do all that location scouting and negotiation. Thus all the ads for payphone routes for sale... ostensibly a turnkey business, ready to go.

Ah, but people with turnkey, profitable businesses don't tend to sell them. Something is up.

Not all of these were outright scams, or at least I assume some of them weren't. There probably were some PSPs that financed expansion by selling or leasing rights to some of their devices. But there were also a lot of... well, let's talk about the second largest PSP of the late '90s.

Somewhere around 1994, Charles Edwards of Atlanta, Georgia had an idea. His history is obscure, but he seems to have been an experienced salesman, perhaps in the insurance industry. He put his talent for sales to work raising capital for ETS Payphones, Inc., which would place and operate payphones on the behalf of investors.

The deal was something like this: ETS identified locations for payphones and negotiated an agreement to place them. Then, they sold the payphone itself, along with rights to the location, to an investor for five to seven thousand dollars a pop. ETS would then operate and maintain the payphone while paying a fixed monthly lease to the investor who had purchased it---something like $83 a month.

It was a great deal for the investors---they didn't need any expertise or really to do any

work, since ETS arranged the location, installed the phones, and even collected the coins. In fact, most investors purchased phones in cities far from where they lived, such was the convenience of the ETS model. There was virtually no risk for investors, either. ETS promised a monthly payment up front, and the contract said that they would refund the investor if the payphone didn't work out.

The ETS network was far larger than just Edwards could manage. Most of the investment deals were sold by independent representatives, the majority of them insurance agents, who could pick it up as a side business to earn some commission. Edwards sold nearly 50,000 payphones on this basis, many of them in deals of over $100,000. Small-time investors convinced of the value by their insurance agents, many of them retirees, put over $300 million into ETS from 1996 to 2000.

There was, as you might have guessed, a catch. One wonders if the payphones were even real. I think that at least many of them were; ETS ran job listings for payphone technicians in multiple cities and occasionally responded to press inquiries and complaints about malfunctioning payphones bearing their logo. Besides, the telecom industry recognized ETS as a huge PSP in terms of both installed base and call volume.

What definitely wasn't real was the revenue. ETS was a ponzi scheme. In 2000, the SEC went for Charles Edwards, showing that ETS had never been profitable. Edwards sponsored a NASCAR team and directed millions of dollars in salary and consulting fees to himself, but in the first half of 2000 ETS lost $33 million. The monthly lease payments to investors were being made from the capital put in by newer investors, and even that was drying up.

SEC v. ETS went on for six years, in good part due to an appeal to the Supreme Court based on ETS' theory that a contract that paid a fixed, rather than variable, monthly rate could not be considered a security. In 2006, Charles Edwards was convicted of 83 counts of wire fraud and sentenced to thirteen years in prison.

Edwards was far from the only coin-op fraudster. ETS was not unusual except in that it managed to be the largest. When a class-action firm and several state attorneys general went after ETS, their press releases almost always mentioned a few other similar payphone schemes facing similar legal challenges. Remember all of those classified ads? I suspect some of them were ETS, but ETS also had a more sophisticated sales operation than two-line classifieds. Most of them were probably from competitors.

The payphone industry crashed alongside ETS; ETS almost certainly would have collapsed (albeit likely more slowly) even if it had been above board. Increasing cellphone ownership from the '90s to '00s made payphones largely obsolete, and more and more established telcos and PSPs decided to drop them. One of the reasons for PTS's ascent was its willingness to buy out operators who wanted out: in 2008, PTS bought most of AT&T's fleet. In 2011, they bought most of Verizon's fleet. Almost every incumbent telephone company got out of the payphone business and most of them sold to PTS.

Given all that, you might think that payphone scams were only a thing of the '90s. And they mostly were, but you can imagine that there was an opportunity for anyone who could adapt the ETS model to the internet age.

Pantheon Holdings did just that. It's even more difficult to untangle the early days of Pantheon than it is ETS. Pantheon operated through a variety of shell companies and brands, but "the Internet Machine Company" was perhaps the most to the point. Around 2005, Pantheon built "internet kiosks" where customers could check their email, print documents, and even make phone calls for a nominal cash or credit card payment. Sometimes called "global business centers," these kiosks were presented as an exciting business opportunity to mostly elderly

investors who were given the opportunity to buy one for just $18,000.

Once again, the kiosks were real, but the revenue was not. Pantheon placed the machines in low-traffic locations and did nothing to market them. By 2009, more than a dozen people had been convicted of fraud in relation to the Internet Machines.

Pantheon kiosks still turn up on the junk market.

[1] I spent quite a bit of time researching the history of payphone regulation to try to understand exactly what did change in 1984, how many COCOTs operated and on what legal basis from 1970-1984, etc. I did not have much success. What I can tell is that COCOTs were very rare prior to 1984 (so rare that the FCC apparently didn't know of any, according to a 1984 memo, despite the 1970 example), and by the late '80s were very common. The FCC seems to have taken the view, in 1984, that COCOTs had always been legal, and just weren't being made or used on any significant scale. That's somewhat inconsistent, though, with the fact that suddenly after 1984 divestiture a bunch of companies started making COCOTs for the first time. My best guess right now is that from 1970-1984 COCOTs were probably legal but were something of a gray area because of the lack of any regulations specifically applying to them. Some combination of divestiture broadly "shaking up" the phone industry, electronics making COCOTs much more feasible, and who knows what else lead multiple companies to get into the COCOT business in the mid-'80s. That lead the FCC to issue a series of regulatory opinions on COCOTs that consistently upheld them as legal, culminating in the 1996 act dropping payphone regulation entirely.