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TELEGLOBE

November 20, 1995

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. Room 222
Washington, D.C. 20554

Re: Ex Parte, IB 95-22, Market Entry and Foreign Affiliated Entities

Dear Mr. Caton:

Please be advised that on November 9, 1995, Phil Walker and I met with the following persons regarding the above referenced proceeding:

Rudy Baca
Julius Genachowski

Attached are two copies of documents distributed at those meetings.

Sincerely,

Charles A. Tievsky
Assistant Vice President
Regulatory Affairs

cc: Rudy Baca
Julius Genachowski

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Teleglobe USA Inc.

Presentation Regarding

Market Entry and Regulation of Foreign-Affiliated Entities

IB Docket 95-22

November 9, 1995

Greater U.S. Openness Leads to Greater Opportunities Abroad for US Carriers

- The Commission must continue to encourage liberalization abroad through policies that acknowledge the development of opportunities for U.S. carrier entry abroad

- Canada is among the most liberal telecommunications markets in the world

Application of the Commission's Proposed "Effective Market Access" Test

- Market entry test should apply only to routes on which the applicant has an "affiliation" with a dominant foreign carrier, rather than universally
- A foreign carrier shareholder in a U.S. international applicant is in no better position than a U.S.-based shareholder to influence the market entry policies of a country in which it has no presence
- An overseas correspondent carrier has no greater incentive to discriminate in favor of a U.S. carrier that is partially foreign-carrier owned than it has regarding a U.S. carrier in which there is no foreign investment
- A more critical factor would be the relative importance of the U.S. carrier's revenue stream to the overseas entity, and the extent to which the two companies trade with each other in other goods and services
- AT&T will always have much greater economic clout with an overseas administration than Teleglobe because of the size of its traffic base

Affiliation Threshold

- Should be based on a control standard rather than an artificial trigger point
  - » Absent control there is little opportunity for discrimination
- Alternatively, determination should be based on the maximum equity permitted by the home markets of the carrier seeking entry
  - » E.g., Canada currently permits 46% foreign equity investment by U.S. carriers into Canadian carriers (20 direct ownership in voting shares + (33% x 80%=26%) indirect ownership in Canadian holding company with remaining 80% of voting shares)
  - » If Canada increases its level of permitted foreign ownership, the U.S. should afford a corresponding increase

Definition of "Facilities-Based Carrier"

- The policy adopted should seek to foster competition without undermining the Commission's policies intended to prevent "one way resale"

- Facilities-based carrier definition should include not only ownership of IRU's, but leases of bulk transmission capacity for U.S. half-circuits where the carrier seeks to establish a traditional bilateral operating agreement

- The Commission has acknowledged that facilities-based carriers may acquire undersea cable facilities through lease or purchase

Market Entry and Refile are Unrelated Factors

- Market entry issues are distinct from those of accounting rate arbitrage and refile
- Facilities-based market entry presumes the opportunity to acquire facilities and commence operations within international accounting rate conventions
- Effective Market Access test must not include element <u>compelling</u> that U.S.-affiliated carriers abroad be permitted to refile outgoing international traffic via the U.S. (i.e., settle that traffic at U.S. accounting rates)
- Issue of refile is under investigation in the <u>Fonaccess</u> proceeding and need not be addressed here
- Canadian policy proscribing routing of switched traffic to third countries over resold private lines to the U.S. has no bearing on ability of facilities-based carriers in Canada to establish switched and dedicated transiting agreements through the U.S. (which is already permitted)

Resale

- The open entry resale policy fosters liberalization abroad
- The U.S. must continue to lead by example for the benefit of U.S. interests in entering overseas markets
- The U.S. would be the first to adopt a reciprocal entry test for resellers, thereby creating a new barrier to entry
- Resale fosters increased competition and leads to lower prices and greater service innovation
  - » Conclusion of competitive carrier decisions
  - » Importance of resale recognized recently in FCC's $1 million fine to AT&T for refusing to permit reseller opportunity to acquire tariffed services

Resale

- Opponents of effective resale competition seek to prevent encroachment of their profit margins by limiting the pool of the most capable new entrants
  - Resale opportunities heighten rather than diminish the need for foreign carriers to obtain facilities-based authorizations
    - Resale remains economic to a finite level, after which facilities ownership is necessary to compete with lower cost providers

Resale

» Resale is inferior to facilities-based entry
  - No control of facilities
  - No return traffic
  - Far fewer economies of scale
  - No opportunity to deal directly with overseas correspondents to expand relationships and opportunities
  - No ability to participate in development of new cable systems
  - Perceived by the marketplace as less desirable than facilities-based entry (e.g., Wall street values a reseller at less than one third the value of a similar sized facilities-based carrier)
  - Resale entry permits a measured entrée into competitive markets which leads to financial pressures to establish a facilities-based presence

Resale

- Even if the Commission adopts an equivalent market access test for resale entry, Canada is the definitive open market for resellers
  - » Canada deemed first equivalent country for international simple resale from the U.S. in fONOROLA
  - » Canadian resellers are essentially unregulated
    - – Prior authorization not required
    - – No tariff filing requirement
    - – No reporting obligations
    - – Opportunity to interconnect with domestic carriers and resellers and to establish direct connection to Teleglobe Canada

Resale

- The Commission should determine that countries which have been deemed "equivalent" for ISR are presumptively open for IMTS and non-interconnected private line resale

- Thus, if AT&T's position were correct that resale is a equivalent to facilities-based entry, Canada is <u>already open</u> to both types of competition

Canada Continues to Afford U.S. Carriers with Competitive Entry Opportunities

- AT&T's intent to acquire up to 46% equity in Unitel is lawful under current Canadian policies

- Any U.S. carrier can obtain a similar percentage in Canadian carriers providing domestic service and international facilities-based service to the U.S. (76% of the total Canadian international market)

- U.S. carriers may hold non-voting equity interests in Teleglobe Canada without limitation

Teleglobe Canada Advocates Greater Liberalization of U.S. investment in Canadian International Telecommunications Market

- Teleglobe Canada operates pursuant to a five-year mandate through March 1997

- In July 1995, Industry Canada commenced a proceeding to address the Teleglobe mandate as well as the structure of overseas competition issues generally

- On October 27, Teleglobe Canada filed comments advocating establishment of multi-carrier facilities-based market competition and the establishment of a regulatory environment that fosters fair and sustainable competition

Teleglobe Canada Advocates Greater Liberalization of U.S. investment in Canadian International Telecommunications Market (cont.)

- Teleglobe Canada seeks legislative change permitting U.S. affiliated carriers to acquire interests in Canadian facilities-based overseas carriers, including Teleglobe
  - » Current law limits foreign carrier ownership of Teleglobe voting (but not non-voting) shares
  - » Non-voting equity participation is not presently restricted

- In light of Teleglobe Canada's dependence on the Stentor companies for more than 80% of its traffic, Teleglobe asks that the Government delay Stentor's direct entry into the overseas market unless through increased investment in Teleglobe
  - » Additional time is necessary to establish the transition rules needed to avoid stranded investment and and to permit development of a competitive market

Teleglobe Canada Inc.

Submission in Response to

***Canada Gazette*, Part I, 22 July 1995, Notice DGTP-008-95**

Review of Canadian Overseas Telecommunications and Specifically Teleglobe Canada's Role

27 October 1995

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Summary of Teleglobe's Position

- *The Government should further liberalize Canadian telecommunications competition by opening the overseas market to facilities-based competition. Entry would be allowed to all Canadian carriers which obtain the appropriate licences. Competition should be introduced in the overseas facilities market upon establishment of the legislative and regulatory environment necessary to foster fair and sustainable competition.*

- *In a fully competitive environment there is no justification for the Company to continue to be subjected to its own particular regime under the* Teleglobe Act. *All Canadian overseas carriers should operate under an amended* Telecommunications Act.

- *Regulatory changes are needed to provide an environment of fair and sustainable facilities-based competition in overseas telecommunications. Further deregulation of Teleglobe, particularly in the area of pricing flexibility, is a necessary prerequisite to increased overseas competition.*

- *The Government should delay the entry of the Stentor carriers into the overseas facilities-based market, in recognition of the vulnerability of Teleglobe's investments in its extensive overseas network.*

- *As a precondition to the licensing of Canadian entities affiliated with US carriers, for overseas facilities-based services in Canada, the Government should ensure that Canadian service providers are afforded US market entry opportunities broadly equivalent to those available to US companies in Canada.*

- *Until a rules-based integrated North American market is established, the current policy regarding bypass of Canadian facilities must be maintained and enforced. Teleglobe recommends that the Government enter into formal negotiations with the United States and Mexico to establish a framework for a North American-wide marketplace for basic telecommunication services.*

- *If the Government introduces overseas facilities-based competition, it should adopt a policy in favour of multiple signatories to INTELSAT and INMARSAT.*

I. Introduction

Teleglobe welcomes the Government's Notice published in the *Canada Gazette*, Part I, 22 July 1995. This review of Canadian overseas telecommunications and specifically Teleglobe Canada Inc.'s[1] mandate is timely, as the Government is also formulating major policy initiatives regarding wider issues such as technological "convergence" and the information highway.

This year the Minister of Industry has received two reports on these important policy issues. In May the Canadian Radio-television and Telecommunications Commission (CRTC) submitted its report on convergence and information highway related issues following five weeks of public hearings.[2] In September the Information Highway Advisory Council (IHAC) submitted its final report after more than a year of deliberation.[3] With the benefit of these reports, the Minister is expected to announce soon the Government's information highway policy.

In March 1995 the CRTC initiated, at Teleglobe's request, a public process to consider a streamlined regulatory framework for the Company.[4] As the Government indicates in the *Gazette* Notice, Teleglobe's mandate review and this CRTC regulatory process are being conducted in parallel.

It is appropriate to have fundamental questions related to Canadian overseas telecommunications and specifically Teleglobe's mandate resolved in conjunction with these important policy and regulatory decisions. It is essential that policy decisions regarding the structure of Canada's overseas telecommunications market take into account the domestic and international forces shaping the industry as a whole.

Canada is among the world's leaders in fostering the development of liberalized competition in its telecommunications markets. Substantial competition already exists in the domestic long-distance and international markets. Given the global trend in favour of harnessing the benefits of competition for businesses and

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1 Teleglobe Canada Inc. is referred to as "Teleglobe" and "the Company" in this submission.

2 Competition and Culture on Canada's Information Highway: Managing the Realities of Transition, CRTC Report, presented to the Government 19 May 1995.

3 The Challenge of the Information Highway, Final Report of the Information Highway Advisory Council, September 1995.

4 Telecom Public Notice CRTC 95-11, Review of the Regulatory Framework for Teleglobe Canada Inc., 10 March 1995.

consumers, Teleglobe shares the Government's objective of broadening competition in Canadian telecommunications. However, as reflected in the Telecommunications Act,[5] Canadian policy seeks to balance multiple objectives -- including the development of telecommunications as an important social policy instrument, and the promotion of competitive market forces.

The important question in this review is to determine and implement the appropriate *means* to reconcile and achieve the Government's objectives. Consistent with the introduction of more competition in Canadian telecommunications, the Company submits that substantial changes to both the legislative and regulatory environments are essential to give Teleglobe and its competitors the necessary *structural and operational flexibility* to adapt to these new competitive realities.

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[5] S.C. 1993, c. 38.

II. Teleglobe's Mandate: An Historical Perspective

In order to appreciate fully the specific nature of Teleglobe's mandate and the magnitude of the challenge the Company currently faces, it is necessary to consider Teleglobe's historical role in the Canadian telecommunications industry.

Specifically, it must be recalled that Teleglobe's status is largely the result of Government policies. Indeed, the fact that the Company is the subject of a Government-initiated mandate review demonstrates that Teleglobe's current role in the Canadian telecommunications industry is the product of *public policy* decisions.

Teleglobe submits that any decision on the Company's mandate must be considered in the context of the following specific historical developments.

Historical Uniqueness of Teleglobe's Mandate: 1950 - 1987

From its earliest days following World War II, Teleglobe has been an instrument of national policy. The Company was established in 1950 as the Canadian Overseas Telecommunications Corporation (COTC) through the Crown's acquisition of the Canadian assets of Cable & Wireless and Canadian Marconi. By this action, the Government created a *segregated industry structure* for Canada, with Teleglobe operating as the sole interface for overseas telecommunications.

In this context, the Company's operating mandate has *not* included traffic between Canada and the United States. This is in large part due to the evolution of the Canadian and US domestic networks, which favoured established cross-border relationships between Canadian telephone companies and their US counterparts for numbering and network planning.

For nearly four decades, Teleglobe was a Crown corporation whose state ownership fulfilled essentially *national sovereignty* and *national security* objectives. Furthermore, the Government wished to facilitate Commonwealth communications in response to competition from the United States, which was establishing direct circuits between the US and many Commonwealth countries. Canadian ownership and control of Teleglobe was considered fundamental to the achievement of these objectives.

Privatization and Teleglobe's Mandate: 1987 - 1997

Teleglobe was sold to private interests in April 1987 following enactment of the *Teleglobe Act.*[6] At that time, the government reiterated the strategic social and economic importance of Teleglobe as the country's sole overseas telecommunications carrier. The privatized Teleglobe accordingly was subjected to a number of obligations, including:

- The Company was placed under the regulatory purview of the CRTC.

- Regulatory approval was required for transfers of effective control of Teleglobe as well as for disposal of certain Company assets.

- Restrictions were placed on the ownership of Teleglobe by both domestic and foreign carriers. Canadian designated common carriers[7] were limited to one-third of Teleglobe's voting shares, while foreign carriers were prohibited from holding voting shares of the Company.

Some of these obligations have constrained the Company's capacity to forge strategic alliances at a time when the flexibility to pursue such relationships is vital for the survival of all international carriers.

At the time of privatization, the government stated that Teleglobe's exclusive mandate would be guaranteed for at least five years. It was also provided that the mandate could be extended depending on the Company's performance record.

In 1992, after finding that "Teleglobe Canada has essentially provided efficient, high-quality telecommunication facilities and services to Canadians",[8] Teleglobe's exclusive mandate was renewed for an additional five years. At the time of the renewal, the government stated that a review would be conducted after three years, in 1995. Teleglobe understood this to be an indication that the Government would offer the Company a two-year period of adjustment if a future decision was made not to renew the mandate.

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6 An Act respecting the reorganization and divestiture of Teleglobe Canada, S.C. 1987, c. 12 (hereinafter, "the Teleglobe Act").

7 "Designated common carriers" are defined in the *Teleglobe Act*, Schedule I. The designated common carriers are: the Stentor companies, and edmonton telephones, Northern Telephone Company Limited, Québec-Téléphone, Télébec Ltée and Thunder Bay Telephone. Canadian carriers *not* considered designated common carriers include Unitel, Sprint Canada and *fONOROLA*, among others.

8 Government Extends Teleglobe Canada Mandate, Communications Canada News Release, 18 March 1992.

Overseas Services Competition

While Teleglobe has been granted an exclusive mandate for the provision of *facilities* for overseas telecommunications until at least 1997, the period since privatization has seen the opening by the government and the CRTC of competition in overseas telecommunications *services*. Competition in overseas enhanced services was formalized with the approval of the Free Trade Agreement[9] in 1987 whereby all such services, both domestic and overseas, were confirmed to be opened to competition. Subsequently, in 1990 the resale of overseas private lines was approved by the CRTC.[10]

The CRTC expanded overseas resale competition in 1991 to allow "joint use" of resold overseas private lines.[11] This decision marked the start of an increasingly robust competitive market in overseas telephone message services on a resale basis.

The CRTC placed a number of limitations on the overseas resale market to protect against unfair foreign competition. First, resale was only allowed to countries that also allowed such arrangements. Second, "third country" routing of traffic either originating or terminating in Canada was prohibited. Third, Canadian facilities-based carriers under the CRTC's jurisdiction were not allowed to route their traffic through a reseller.

In 1991, with increasing competition in overseas services, Teleglobe saw the need to pass control of end-user rates to Canadian domestic service providers. After CRTC approval of the principle, the Globeaccess$_{TEL}$ wholesale service rates were developed and approval was granted in 1993.[12]

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9 Canada-United States Free Trade Agreement (FTA), 1987 .

10 Telecom Decision CRTC 90-2, Teleglobe Canada Inc. -- Resale and Sharing of International Services, 23 February 1990.

11 Telecom Decision CRTC 91-21, Teleglobe Canada Inc. -- Regulation After the Transition Period, 19 December 1991.

12 Teleglobe Canada Inc., International Globeaccess Service Tariff (CRTC 9015), approved in Telecom Decision CRTC 93-15, Restructuring of Overseas Message Toll Service and a New Interconnecting and Operating Agreement between Teleglobe and Stentor, 27 September, 1993. (Effective 1 December 1993.)

Dependency on Stentor Traffic

Traditionally, the Stentor carriers have provided the Company with the vast majority of its traffic and revenues. Even since the introduction of domestic long distance facilities-based competition in 1992,[13] Stentor has remained Teleglobe's main customer, representing fully 80% of the Company's traffic.[14]

Teleglobe has invested in overseas network facilities and infrastructure to provide high quality and efficient services to the entire Canadian retail market. The introduction of overseas facilities-based competition would undoubtedly lead Canadian carriers, including the Stentor carriers, to consider alternatives for the routing of their overseas traffic. The Company could expect to experience a loss of market share and increased vulnerability due to market entry by competitors with potentially lower overall cost structures, which result from their partnership with major US carriers as well as their own, often extensive, domestic networks.

Teleglobe has been pursuing a business strategy aimed at expanding and diversifying the Company's activities outside Canada, while at the same time improving the quality and pricing of services to Stentor and the other Canadian carriers and resellers. Since privatization, Teleglobe has reduced telephone service prices by more than 50%. It has also embarked on a strategy of increasing its carriage of non-Canadian traffic, that is traffic which neither originates nor terminates in Canada, as a percentage of its total traffic volume. Teleglobe's non-Canadian traffic will exceed 120 million minutes by year end 1995 -- just over 7% of total traffic.

In spite of these efforts to diversify its customer base, the fact remains that the Company is reliant on the traffic sourced through Stentor for the bulk of its operating revenues.

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13 Telecom Decision CRTC-92-12, Competition in the Provision of Public Long Distance Voice Telephone Services and Related Resale and Sharing Issues, 12 June 1992.

14 Stentor subcribes to the Globeaccess$_{TEL}$ service and has committed to routing its outgoing overseas traffic over Teleglobe's network. This ten-year agreement, subject to early termination if Globeaccess$_{TEL}$ rates result in inappropriate commercial conditions for Stentor, has been approved by the CRTC for a period including one year after the end of Teleglobe's exclusive mandate. Teleglobe has also signed interconnection and operating agreements with Unitel, *fONOROLA*, Sprint Canada and ACC Long Distance.

Conclusions

Teleglobe has evolved over the years, largely as a result of government policy, to become a unique and highly specialized component of the Canadian telecommunications industry. Current legislation and regulations reflect this situation. The transition from a "carrier's carrier" with an exclusive mandate, highly dependant on a single domestic customer, to that of a modest-sized player in a competitive overseas facilities-based market, poses a significant challenge for Teleglobe.

The Company is ready to face this challenge. However, the Government must recognize the magnitude of the changes that will result from the opening of the overseas facilities-based market. It would be inappropriate to introduce competition in this market segment without first addressing the historical realities. Specifically, current legislation and regulation, designed for different circumstances, must be modified. This should be done expeditiously and as a prerequisite to the introduction of overseas facilities-based competition. Furthermore, the Government should establish conditions which ensure that Teleglobe, and the Canadian overseas market generally, are not subjected to unfair domestic or foreign competition.