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February 7, 1997

BY HAND DELIVERY

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

Dear Mr. Caton:

There is transmitted herewith an original and four copies of Comments of Portugal Telecom International in Docket No. 96-261.

Should there be any questions concerning the enclosure, please contact undersigned counsel.

Sincerely,

WILKINSON, BARKER, KNAUER & QUINN

By: Leon T. Knauer

Enclosure
cc: All Commissioners

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Before the
Federal Communications Commission
Washington, DC 20554

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In the Matter of	)	
	)	IB Docket No. 96-261
International Settlement Rates	)	

COMMENTS OF PORTUGAL TELECOM INTERNATIONAL

PORTUGAL TELECOM INTERNATIONAL

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February 7, 1997

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SUMMARY OF COMMENTS

Over the past decade, the Commission had adopted a wide variety of measures to encourage the development of competitive markets in the provision of international services, and these policies have already enjoyed considerable success. For example, less than five years ago the Commission established guidelines, or "benchmarks," to help U.S. and foreign carriers establish their settlement rates. Since then U.S. accounting rates have fallen by 29%. Given the recent steps being taken by countries like Portugal to privatize and to open their markets to competition, and given the new technological and market forces, the trend of the last four years will only accelerate in the near future.

Despite this substantial success, the Commission now proposes to change course by adopting a regulatory solution instead of relying primarily on growing market forces. Specifically, in its notice of proposed rulemaking, the Commission proposes to require that U.S. carriers change the accounting rates they pay to foreign carriers to terminate their international traffic. The new call termination rate would be based, not on a rate negotiated with the foreign carrier, but on a rate set unilaterally by the Commission. In effect, the Commission, an agency of the U.S. Government, proposes to establish the rate foreign carriers charge U.S. carriers to terminate U.S.-originated traffic in their country. Portugal Telecom International believes that the Commission's proposal raises considerable complications under both international and U.S. laws.

Portugal Telecom International agrees entirely with the Commission's observation that "competitive market forces [should] determine the pricing for termination of international services" and that competition, rather than regulation, represents "the most effective way to ensure settlement rate reform that results in reasonable international calling prices." *NPRM* at 9 ¶ 20 and 12 ¶ 31. As described in these comments, Portugal is taking dramatic and real steps to privatize its telecommunications infrastructure and to open all its telecommunications markets to unfettered competition.

It is relevant that, while the United States is in the process of extending competition, Portugal is now in the process of introducing competitive forces. And while the United States is attempting to preserve universal service while extending these competitive forces, the challenge facing Portugal is to introduce competition while simultaneously achieving universal service.

The Commission has a choice to make in achieving its objectives. It can pursue a near-sighted approach of new and continued regulation of the international market. Alternatively, Portugal Telecom International suggests that the Commission maintain its current approach of encouraging the introduction of competitive forces in all markets of the world.

BEFORE THE

Federal Communications Commission

WASHINGTON, DC 20554

In the Matter of	)	
	)	IB Docket No. 96-261
International Settlement Rates	)	

COMMENTS OF PORTUGAL TELECOM INTERNATIONAL

Portugal Telecom International ("Portugal Telecom"), by its attorneys, respectfully submits these comments in response to the Commission's *Notice of Proposed Rulemaking*, FCC 96-484 (Dec. 19, 1996) ("*NPRM*") wherein the Commission proposes to require that U.S. carriers change the settlement rates they pay to foreign carriers to terminate their international traffic. The new rate would be based not on a rate negotiated with the foreign carrier but on a rate set unilaterally by the Commission. In effect, the Commission, an agency of the U.S. Government, proposes to establish the rate foreign carriers charge U.S. carriers to terminate U.S.-originated traffic in their country.

These comments are submitted prior to the completion of ongoing discussions of the World Trade Organization on the provision of basic telecommunications services. In this regard, it is relevant that the Commission has informally acknowledged that its accounting rate proposal would survive in the event a World Trade Organization ("WTO") agreement is reached, *only as long as* there is compliance with "most-favored nation status."[1] Based on the importance and relevancy of the WTO negotiations, Portugal Telecom will await the outcome of those negotiations before replying more fully to the issues in this rulemaking on

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1 Telecommunications Reports, p. 21 (Jan. 27, 1997).

such matters as benchmark methodologies, country classifications, the status of competitive reform, anticompetitive behavior and enforcement proposals. A delay in providing a more detailed commentary is also necessary because of the scope and detail of the Commission's proposal, and the brief time interval extended to countries throughout the world for filing. This additional information will be filed on March 10, 1997 when reply comments are due.

I. BACKGROUND

Portugal Telecom directly and through subsidiaries operates local, domestic long distance and international telecommunications networks. Portugal Telecom International, which was incorporated in 1995, is wholly owned by Portugal Telecom. The Portugal Telecom Group PTI has subsidiaries in Africa, Latin America, Asia, Europe and the United States.

The Government of Portugal is fully committed to privatizing key sectors of its economy in order to modernize infrastructure, reduce debt burden, lessen government involvement and strengthen and deepen capital markets. Under legislation enacted in 1990, privatizations in the banking and insurance sectors attracted stockholder investment of nearly US $7 billion through the end of 1995. The objectives of the existing program (the "Privatization Programme") are to complete the divestiture in the banking sector, and to focus on alienations in particular industries[2] and major service operators including telecommunications.[3] Shares to be made available for private investors are set to total, in the

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[2] Basic chemicals and petrochemicals, paper pulp, cement, shipyards, tobacco, steel and petroleum refining.

[3] In addition to telecommunications this includes electricity, airports and motorways.

aggregate, approximately US $4.5 billion by the end of this year. The telecommunications privatization process of Portugal Telecom began in 1995 when the government alienated 27% of its 100% ownership. At present, 49% of the capital of Portugal Telecom is on the market.

The government has also introduced competition in mobile telecommunications. More specifically, TelCel is the privately owned cellular operator in Portugal in which AirTouch, a U.S. company, holds a 51% interest in TelCel. The foreign ownership restrictions which exist in the United States do not exist in Portugal. The other cellular operator is TMN, which is owned by Portugal Telecom. TMN accounts for 48.2% of the cellular phone subscribers in Portugal. The remainder are subscribers of the privately operated company, TelCel.

II. COMPETITIVE FORCES ARE DRIVING DOWN SETTLEMENT RATES

At the outset, Portugal Telecom questions the Commission's conclusion that changes in international settlements practices are occurring slowly. As the Commission notes (*NPRM* at 11 ¶ 26), the average U.S. settlement rate was 51.5¢ per minute in 1992. By November 1996, this rate had declined to 36.5¢ per minute, a 29% reduction in the U.S. settlement rate in only four years. Few goods or services have experienced such a dramatic reduction in price in such a short period of time.

Portugal Telecom also questions the Commission's conclusions that it cannot rely on market forces to achieve additional reform in accounting rates and that, given current settlement rates, foreign countries have a disincentive to introduce competition in their telecommunications markets. *See id.* at 10 ¶ 23. These conclusions are inconsistent with the countless reforms being enacted in many countries (including Portugal) and the 29% reduction in the U.S. settlement rate.

What is more, there is every reason to believe that this trend will continue, if not accelerate. As the Commission notes, the traditional settlement rate system already "is under significant pressure to reform" and current practices are "not sustainable." *Id.* at 7 ¶¶ 14 and 15. Reform of settlement practices is now the subject of studies in numerous international bodies, including the ITU, the OECD, and the WTO's Group on Basic Telecommunications. *Ibid.*

Perhaps even more fundamental are the competitive pressures imposed by the marketplace itself, be it new services like call-back, voice over the Internet, private line resale, or new bypass technologies such as Very Small Aperture Terminals ("VSATs"). As the Commission correctly observes:

> [T]he technological means for bypassing the settlements regime are developing rapidly and the current highly inflated settlement rates provide a strong incentive for such bypass. These growing bypass capabilities and incentives mean that the traditional monopolists' revenue streams no longer provide secure financing for investment in telecommunications infrastructure. *Id.* at 24-25 ¶ 60.

It is relevant in this regard that the problems relating to the imbalance in international telephone traffic are not unique to the United States, but are common in other developed countries. For example, traffic imbalances exist between a number of European countries, and a number of countries in both Africa and Asia. This is because traffic imbalance derives from a number of factors including the wealth, social habits, trade relationships of countries, and the expansion of multinational corporations. For example, outgoing international traffic, which totaled 30.4 billion minutes in 1990, expanded to 54.5 billion minutes in 1994.

Relevantly, entities affiliated with the three major global alliances generated over 50% of the usage in 1994. They are AT&T Unisource, Global One (Deutsche Telekom, France Telecom and Sprint) and Concert (British Telecom and MCI). It is thus clear that, accounting rates aside, the "rich are getting richer." That is, telecommunications providers in the developed countries are substantially increasing their profits and expanding their economic and technological superiority in telecommunications over the developing countries, which, the Commission admits, are the very countries which will be most adversely affected by its proposal to unilaterally reduce settlement rates.

In sum, the action proposed by the Commission in this proceeding appears unnecessary, if not counterproductive. Market forces and international organizations are addressing and resolving this matter.

III. THIS COMMISSION DOES NOT HAVE THE JURISDICTION TO MODIFY THE ACCOUNTING RATES FOREIGN CARRIERS CHARGE TO TERMINATE INBOUND TRAFFIC IN THEIR COUNTRIES

In this proceeding, the Commission proposes to "require" that settlement rates for U.S. carriers with foreign counties be set "at or below" the levels it establishes.[4] As a practical matter, a Commission order to this effect would often require U.S. carriers to breach the terms of their lawful and effective operating agreements with foreign correspondents by

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4 The benchmarks the Commission has proposed to adopt in this proceeding are not "guidelines" but rather prescriptive rates. Conversely, the benchmarks the FCC adopted in 1992 were, in fact,, benchmarks: "By setting this benchmark, we do <u>not</u> intend to prescribe accounting rates for any country or region; rather this benchmark range represents a *guideline* for the amount which the Commission believes U.S. carriers should be paying foreign correspondents to terminate calls from the U.S." *Regulation of International Accounting Rates*, CC Docket No. 90-337 (Phase II), Second Report and Order and Second Further NPRM, 7 FCC Rcd 8040, 8141 ¶ 8 (1992) (emphasis added).

paying instead an accounting rate specified by this Commission. The Commission seeks comment on whether it has the legal authority to change the accounting rate charged by a foreign carrier to terminate inbound traffic in its country. *See NPRM* at 9 ¶ 19.

Portugal Telecom believes that the Commission lacks such legal authority — for the same reason Portuguese regulators do not have the authority to modify the accounting rates which carriers in Portugal pay to U.S. carriers to terminate inbound international traffic in the United States. Indeed, only 14 months ago the Commission recognized that "[w]e do not have jurisdiction over the foreign carrier."[5] If this Commission does not have jurisdiction over foreign carriers, it necessarily follows that it does not have jurisdiction over the rates charged by these carriers.

The Communications Act of 1934, as amended, gives the Commission limited powers over international telecommunications. Specifically, the Commission has jurisdiction over "foreign communication by wire or radio . . . which originates and/or is received within the United States," (Section 2(a)) and that jurisdiction extends only to the U.S. end of an international call. In this regard, nothing in the Communications Act (Section 2(b)(2)) shall be ". . .construed to apply or to give the Commission jurisdiction with respect to . . . any carrier engaged in . . . foreign communication solely through physical connection with the facilities of any other carrier not directly or indirectly controlling or controlled by . . . such carrier."

As importantly, the executive branch of the U.S. Government has previously acknowledged that foreign governments ". . . maintain independent sovereign authority over

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5 *Market Entry and Regulation of Foreign-affiliated Entities*, Report and Order, IB Docket No. 95-22, 11 FCC Rcd 3873, 3813 ¶ 105 (Nov. 30, 1995).

the foreign end of a call." and, accordingly, the Commission ". . . cannot compel foreign entities to accept accounting rates prescribed by the Commission for U.S. carriers."[6]

Judicial precedent in the United States is consistent with this position. At issue in *RCA Communications v. United States*, 43 F. Supp. 851 (S.D.N.Y. 1942), were the rates RCA could charge its customers for telegrams originated in the United States but destined to foreign countries. RCA had followed the international norm of charging twice as much for "urgent" telegrams as the rate it charged for ordinary telegrams, but the Commission directed RCA to lower its retail rate for urgent telegrams to only 50% higher than that for normal telegrams.

On appeal, a three-judge court affirmed this prescription order, holding that the order "falls directly within the terms of the" U.S. Communications Act because the Commission was regulating the rates paid by consumers within the United States.[7] However, the court expressly recognized that the Commission lacks jurisdiction to regulate the rates paid by U.S. carriers to their foreign correspondents to complete U.S.-originated traffic. The court noted that, to modify such interconnection rates, it would be "necessary to secure the consent of the company or administration which operates the other end of the jointly operated circuit, subject to the regulations of its government."[8]

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6 Comments of the National Telecommunications and Information Administration, CC Docket No. 90-337, at 17 (Oct. 12, 1990).

7 *RCA Communications v. United States*, 43 F. Supp. 851, 854 (S.D.N.Y. 1942). The double rate for urgent messages was adopted at an International Telecommunications Conference. As the court noted, because neither the U.S. government nor U.S. carriers were a signatory to these international regulations, the FCC was under no obligation to honor them. *Id.* at 855. Importantly, the United States is now a signatory of the International Telecommunication Union (ITU) regulations.

8 *Id.* at 853. *See also id.* at 855 ("It is true that a reduction of the ratio for 'Urgent' messages from double to no more than one and one-half times the ordinary rate will make it necessary for the plaintiff, if it

(continued...)

The *RCA* case thus holds that, if the Commission believes a U.S. carrier has entered into an agreement with foreign correspondents at an excessive rate, the agency's sole recourse is to adopt a prescription lowering the rates the U.S. carrier can charge its U.S. customers for the service.

International law is to the same effect. Article 1.5 of the ITU Regulations provides that "the provision and operation of international telecommunications services in each relation is pursuant to mutual agreement between administrations [or recognized private operating agencies (RPOAs)]."[9]

Similarly, Section 3.3.1 of Appendix 1 of the ITU Regulations states that "[p]ayment of balances of account shall be effected as promptly as possible, but in no case later than two calendar months after the day on which the settlement statement is dispatched by the creditor administration." The ITU Regulations do not even allow a delay in situations in which one of the parties disputes the amount that it owes.[10] A Commission order directing U.S. carriers not to pay their foreign correspondents the negotiated settlement rates would be inconsistent with this international law.

The Commission makes some important observations in its *NPRM*, specifically, that dramatic changes in telecommunications technologies and markets may require a thorough

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(...continued)

cannot secure an amendment of the existing agreements, either to break its contracts for foreign messages or to bear the loss of outgoing messages itself.").

9 International Telecommunications Union, Final Acts of the World Administrative Telegraph and Telephone Conference, Art. § 1.5 (Melbourne 1988)(hereafter, ITU Regulations). The term "RPOA" is included in brackets because the ITU documents use the phrase "or RPOA" as a footnote to every use of the term "administration."

10 Section 3.3.2 provides that a payment that has come due "shall not be delayed pending settlement of a query on that account" and that, if adjustments are later agreed to, they are to be "included in a subsequent account."

reexamination of current inter-country settlement practices. Nevertheless, the fact remains that this Commission does not have the legal authority to change unilaterally the settlement rates foreign carriers charge U.S. carriers to terminate calls originated within the United States — even if this Commission is "convinced" that such action "will benefit . . . foreign consumers and carriers." *NPRM* at 11 ¶ 25.

IV. THE COMMISSION SHOULD NOT APPLY BENCHMARKS TO COUNTRIES WHICH, LIKE PORTUGAL, ARE COMMITTED TO CREATING COMPETITIVE TELECOMMUNICATIONS MARKETS

Portugal Telecom agrees with the Commission's observation that benchmarks are unnecessary in competitive markets because market forces operate to reduce accounting rates to levels that more closely reflect costs. However, drastic reductions in the settlement rates would sabotage the efforts of countries attempting to establish a competitive environment and have serious deleterious effects on network development. One of the *sine qua non* conditions of effective competition is a mature, developed telecommunications network capable of fulfilling the demand for interconnection under the nondiscriminatory and equal access conditions which have formed the basis of successful competition in countries such as the United States. It is now widely recognized that equal access has been the essential factor which has resulted in better quality telecommunications services to consumers at substantially lower prices in the United States.

Yet change cannot occur overnight. A reasonable transition period is necessary. A sudden and drastic reduction in settlement rates would adversely affect the privatization process and jeopardize the government's goal of introducing full competition. Accordingly, Portugal Telecom requests that the Commission forebear from imposing its benchmark rates, regardless of the impact on carrier revenue, where competition is being introduced, unless the procompetitive course is reversed.

V. THE COMMISSION'S PROPOSED UNILATERAL ACTION ON INTERNATIONAL ACCOUNTING RATES WOULD CONFLICT WITH AND IMPEDE THE ONGOING EFFORTS OF THE EUROPEAN UNION

The European Union began liberalizing its telecommunications markets in the 1980s. Until then, as in almost all the rest of the world (including the United States), telecommunications had been provided in each country exclusively by a national monopoly.[11] The United Kingdom led the way by privatizing British Telecommunications (now BT) in 1981. In 1984, a second telephony license was granted to Mercury Communications, a subsidiary of Cable & Wireless.

In 1982, the European Commission decided, for the first time, that competition rules apply to telecommunications monopolies, and that those monopolies may not abuse their dominant position in the marketplace.[12] The European Court of Justice upheld the European Commission's finding. The Commission has since then relied heavily on the *British Telecom* case, and its sanction by the European Court of Justice, to prevent Member States from expanding their monopolies into new services and technologies, and ultimately, to dismantle the monopolies themselves. In 1987, the Commission published a Green Paper on Telecommunications acknowledging the need for increased competition in order to provide consumers with "a greater variety of telecommunications services, of better quality and at

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11 The monopoly providers of telecommunications services, generally known as "PTTs" were then generally owned and operated by the governments themselves as a public service.

12 *British Telecom*, Commission Decision of December 12, 1982, O.J. (L 360) 36.

lower cost."[13] In the Green Paper, the European Commission announced that traditional forms of organization in the sector (i.e., monopolies), were a hindrance to the development of new technologies. The Green Paper represented the European Commission's commitment to open the telecommunications sector to competition as soon as politically feasible. To begin, all services other than basic telephony were to be liberalized, and basic telephony monopolies were to continue for a limited time only. More importantly, the European Commission declared its intention to firmly pursue competitive policies by stating "[the liberalization process] is iterative, it accepts the existence of a movement, not all aspects of which can be defined today."[14] It also reaffirmed its commitment to provide European users with "greater variety of telecommunications services, of better quality and at lower cost."[15] The European Commission then issued a Services Directive implementing the goals of the Green Paper, and abolishing all service monopolies except simple voice in 1990.[16] In voice, however, it exhorted PTTs to align their accounting rates and collection rates with cost. The Services Directive also ordered European Member States to separate the regulatory from the operational aspects of the telecommunications providers, and instructed the two bodies to maintain an independent, arm's length relationship.

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13 Commission of the European Communities, Green Paper on the Development of the Common Market for Telecommunications Services and Equipment, COM (87) 290.

14 Commission of the European Communities, Towards a Competitive Community-Wide Telecommunication Market in 1992: Implementing the Green Paper on the Development of the Common Market for Telecommunications Services and Equipment, COM (88) 48, p. 13.

15 *Id.*, Preamble.

16 Commission Directive 90/388 on Competition in the Markets for Telecommunications Services, 1990 O.J. (L192) 10.

The European Council then issued an Open Network Provision directive mandating nondiscriminatory and efficient access to the public switched network by users and providers of telecommunications services.[17] In 1993, the Commission issued a Telecommunications Review identifying bottlenecks that stood in the way of competition.[18] The Review recommended abolishing all voice monopolies. Shortly thereafter, the European Council adopted a resolution supporting liberalization of all voice services by 1998. Although four countries with less developed networks were allowed to take a derogation until 2003,[19] the European Union has expressed its recommendation that all countries liberalize voice telephony on the same date: January 1, 1998.

The economic integration of the Member States of the European Union has given rise to a new phenomenon that will exert downward pressure on accounting rates. Businesses seeking to establish themselves in Europe increasingly choose their location based on low telecommunications prices. Therefore, it is in every country's best interest to have low telecommunications prices in order to attract new investment, and promote employment. The European Union has recognized the value of the U.S. competitive model, and has implemented a number of reforms that follow that model. At the same time, the Federal Communications Commission must be aware of the unique economic, political and social conditions of every Member State and the burden that European unification places on countries like Portugal and on their telecommunications operators.

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17 Council Directive 90/387 on the Establishment of the Internal Market for Telecommunications Services, 1990, O.J. (L192).

18 1992 Review of the Situation in the Telecommunications Sector, SEC (92) 1038, and Consultation on the Review of the Situation in the Telecommunications Services Sector, COM (93) 159.

19 These countries are Spain, Portugal, Ireland and Greece.

The issue of how best to bring accounting rates in alignment with costs, and the appropriate timetable for implementing accounting rate reductions, should be left to supranational bodies with jurisdiction over the actions of Portugal and which have full knowledge and understanding of the Portuguese conditions and reality. Those issues should be resolved with the benefit of Portuguese participation in the decision process.

The Commission of the European Communities recently recognized that premature action could:

> . . . threaten the financial stability . . . of telecommunications organizations and obstruct the performance of the task of general economic interest assigned to them, consisting in the provision and exploitations of a universal network. . .[20]

Efforts have been made to "balance differences in *price structures* in preparation for liberalization."[21] However, the European Commission appreciates that exceptions are warranted for member countries with ". . . less developed networks or with very small networks . . . to carry out structural adjustments. . . ."[22]

The European Union has amply demonstrated its commitment to liberalization and the introduction of full competition, and Portugal, as a Member of the European Union, supports the decision of the European Union to liberalize and introduce competition. PTI will abide by all the rules and mandates of the European Union and the Portuguese government in this matter. As a member of the European Union, Portugal is attempting to comply with all of the mandates emanating from that organization for the purpose of making the telecommunications

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20 The Commission of the European Communities, Commission Directive 96/19/EC (March 13, 1996), p. 1.

21 *Id.* at 2 (emphasis supplied).

22 *Id.*

marketplaces of its member states even more competitive. In so doing, one of the most important issues is competitive pricing. The Commission should not superimpose itself into this process.

VI. CONCLUSION

Wherefore, premises considered, it is respectfully requested that the Commission forego its efforts to unilaterally establish settlement rates because it lacks jurisdiction, rates are constantly being reduced by market forces and actions such as this should be addressed by international tribunals.

Respectfully submitted,

PORTUGAL TELECOM INTERNATIONAL

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