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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
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International Settlement Rates	)	IB Docket No. 96-261
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COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

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SUMMARY

MCI fully supports the Commission's efforts to lower accounting and settlement rates and to implement benchmarks that are more closely aligned with actual cost. Competition is being introduced on some international routes, but many foreign carriers continue to insist on the payment of accounting rates that fail to reflect cost efficiencies resulting from improved technology and are far in excess of actual costs. These inflated settlement charges result in uneconomical prices for U.S. carriers and consumers, create incentives for competitive distortion in the U.S. outbound and inbound international markets and harm the public interest by contributing to the increasing U.S. outpayment to foreign carriers. For these reasons, MCI supports the use of benchmark rates to encourage foreign carriers to bring accounting rates and settlements more in line with the actual cost of service.

Unfortunately, obtaining accurate data on foreign carrier's actual costs of terminating traffic is not a simple task. Until such data are available, a reasonable alternative interim solution, as proposed by the Commission, is to use benchmarks based on foreign tariff rate components (rate-based benchmarks). Although rate-based benchmarks still are likely to be well above cost, they will be a reasonable temporary alternative that moves rates closer to cost.

The most reasonable approach would be to calculate rate-based benchmarks wherever possible on a country-specific basis, appropriately constrained as described herein, rather than average a pool of many countries in similar phases of development. MCI recommends also that the Commission adopt the shortest recommended transitions. Although MCI believes that negotiation and consensus building at the international level is the best means of achieving more cost-based rates in the shortest period of time, carriers should be able to request Commission intervention to implement these benchmark rates should reasonable efforts at persuasion fail.

With respect to the conditions of authorization for foreign carriers, the ECO test -- adopted less than two years ago -- provides a solid framework for evaluating the ability of a foreign carrier to distort competition in the U.S. market. Moreover, the availability of cost-based settlement rates would be an important indication that a favorable ECO finding may be warranted. Conversely, rate-based benchmarks alone are inadequate to ensure against competitive distortion in the U.S. market. On a route without effective competitive opportunities, any foreign carrier that participates in the U.S. market at a benchmark rate substantially above cost could seriously distort competition on the route, e.g., by engaging in inbound by-pass of the accounting rate system, to the severe competitive disadvantage of other U.S. carriers. MCI therefore urges the Commission to retain its established ECO-test to address issues of competitive distortion, but also to analyze the level of the accounting rates charged by the carrier as a part of, but not as a substitute for, the ECO-test.

If necessary, the Commission's standards will need to be refined to be consistent with obligations under future multilateral treaties. However, the U.S. Government should not commit to such agreements unless it is assured that it may retain adequate measures to prevent competitive distortion in the U.S. market.

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COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI Telecommunications Corporation (MCI), by its undersigned counsel, hereby submits its comments in response to the Federal Communications Commission's (Commission's) Notice of Proposed Rulemaking (Notice)[1] in the above-captioned proceeding.

MCI fully supports the Commission's efforts to lower accounting and settlement rates and to implement benchmarks that are more closely aligned with actual cost. The Commission's proposal to establish benchmarks derived from foreign tariffed rate components (rate-based benchmarks) would be an important interim step towards this goal. For foreign carrier authorizations, MCI urges the Commission to continue to evaluate whether effective competitive opportunities (ECO) are available in the foreign market, because a real opportunity to compete in a foreign market is the most effective deterrent against competitive distortion. As part of the ECO test, the Commission should also assess the level, in relationship to underlying costs, of the settlement rates that the applicant charges U.S. carriers to terminate international calls in its home country.

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[1] Notice of Proposed Rulemaking, International Settlement Rates, IB Docket No. 96-261, (Released December 19, 1996)

I. THE PROPOSED BENCHMARK METHODOLOGY IS A REASONABLE WAY TO DEVELOP INTERIM TARGET ACCOUNTING RATES

As the Commission recognizes, in a competitive market for the origination and termination of international services, settlement rates would more closely approximate cost. [2] Although competition has resulted in reduced settlement rates on some routes, only a few routes -- most notably, the U.S. to U.K. route -- have been fully liberalized.[3] Thus, many carriers continue to insist on the payment of accounting rates that fail to reflect cost efficiencies resulting from improved technology and are far in excess of actual costs.[4]

These inflated settlement charges result in uneconomical prices for U.S. consumers, and create incentives for competitive distortion in the U.S. outbound and inbound international markets.[5] Furthermore, excessive settlement rates contribute to the increasing U.S. outpayment to foreign carriers.[6] Collectively, these economic distortions slow international telecommunications growth and, as a consequence, hamper progress and productivity in world telecommunications markets.

The Commission proposes to use rate-based benchmarks as a target for reducing accounting rates.[7] Although the Commission indicates that incremental cost would be a more

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[2] Id. at para. 3.

[3] Id. at paras. 14 and 23.

[4] Id. at para. 7.

[5] Id. at para. 11.

[6] Id. at para. 8.

[7] Id. at 40.

accurate theoretical model for measuring costs,[8] the necessary data may not be readily available at the present time.[9] In fact, obtaining accurate cost data consistently developed for the multitude of nations with which U.S. carriers correspond is a formidable task. MCI firmly supports moving settlement rates toward their true cost and urges the Commission to continue to work with foreign governments, both individually and through international organizations to encourage the production of more accurate, country-specific cost information.

While that process is underway, the Commission proposes to develop benchmarks based on tariff components utilized by the foreign operator in its home territory.[10] MCI believes that this would be a reasonable compromise as an interim solution for the purpose of negotiating more reasonable settlement rates.

Using foreign tariffed rates as the basis for developing transitional negotiating target accounting rates has several advantages, despite the obvious flaws.[11] The Commission recognizes that such rates would be nondiscriminatory in that they would represent the same rates charged by foreign carriers to their domestic customers.[12] Moreover, the resulting rates

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[8] As the Commission explains: "Because long run incremental cost is the level to which prices would tend in a competitive market, we believe it should be the preferred cost standard for establishing benchmark settlement rates. Prices at an incremental cost level would maximize consumer welfare." Notice at para. 32.

[9] Notice at para. 33.

[10] Id.

[11] Id. at para. 40.

[12] Id.

would be lower than the accounting rates carriers currently pay.[13] For these reasons, MCI urges the Commission to adopt interim benchmark rates, using tariff components as proposed, as a means of encouraging reductions in settlement rates and moving these rates closer to cost.

Applying the tariff-component approach described above, the Commission points to two alternatives for converting the tariff components into benchmarks for a particular route: an average rate for groups of countries with similar economic development or, alternatively, country-specific rates.[14]

MCI recommends against adopting averaged benchmark rates. Country-specific benchmark rates -- appropriately constrained as proposed below -- would be more widely accepted because they would be derived from pricing data uniquely applicable to the operations of individual countries. Moreover, whereas average rates would result in foreign operators charging one rate (the average rate) to foreign interconnection customers and a different rate (the country-specific tariffed rate) to domestic interconnection customers, country-specific rates would eliminate such discrimination.

The Commission suggests that averages would avoid including tariff inefficiencies in benchmark rates.[15] MCI disagrees. The use of averages would instead apportion the effect of the most excessive tariff regimes across all countries. A better solution would be to require each foreign carrier to meet the lower of its country-specific benchmark or a targeted rate that is

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[13] Id.

[14] Id. at para. 39.

[15] Id. at para. 45.

twenty percent above the mean for its country's economic development category. This approach would be more flexible than a simple averaged rate, yet reduce the impact of inefficiencies.[16] Thus, MCI recommends that the benchmark represent the lower of the calculated country-specific rate-based benchmark or the applicable averaged benchmark rate for the economic category proposed by the Commission, plus twenty percent.

The Commission seeks comment on whether certain factors, such as the geographic location of a country in relationship to the United States, or geographic size, should be considered in calculating benchmarks.[17] MCI submits that it would be premature for the Commission to try to develop a complex scheme of cost relationships based on multiple factors, when cost data are scarce and the Commission has no experience implementing the proposed benchmarks. Instead, the Commission should permit a demonstration that other factors should be taken into account in setting benchmarks, particularly if the country-specific rate substantially exceeds the averaged rate plus twenty percent. All parties would then be able to review and consider these factors in context, rather than speculate on their impact in theory.[18]

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[16] This approach would also minimize the impact in the unlikely event any organization would attempt to manipulate benchmarks by raising its tariffed rates.

[17] Notice at para. 55.

[18] As discussed above, the Commission has not been able to gather information for all countries, so MCI supports the use of averages as an interim step for countries where data are currently unavailable. Of course, organizations should be permitted to make a showing of their actual tariff-based or cost data.

II. THE COMMISSION SHOULD IMPLEMENT BENCHMARK RATES DECISIVELY AND EXPEDITIOUSLY

The Commission proposes transitions to the targeted rate-based benchmarks over a period of years, depending upon the country's economic development category.[19] However, as the Commission recognizes, benchmark rates calculated based on foreign tariff components still would be well above cost-based rates.[20] Moreover, actual costs are likely to continue to decline over time. Without a commensurate decrease in the benchmark, the difference between the benchmark rate and cost would increase year after year.

For these reasons, transition periods should not be permitted to extend too far into the future. MCI does not object to establishing somewhat longer transition periods to benchmark rates for lower income countries. As the Commission recognizes, U.S. carriers' ability to negotiate a charge that complies with benchmarks without undue disruption of its or its foreign correspondent's operations diminishes as the level of economic development decreases.[21] MCI urges the Commission, however, to adopt the shortest of its recommended transition periods. Specifically, the transition to benchmark rates should be completed within one year of the effective date of the order for high income countries,[22] within two years for middle income countries, and within four years for lower income countries.[23]

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[19] Notice at para. 62.

[20] Id. at para. 42.

[21] Id. at para. 61.

[22] Id. at para. 63.

[23] Id.

U.S. carriers should attempt to negotiate a proportional annual reduction of the spread between the current settlement rates and benchmarks in cases where the applicable transition period is greater than one year. Proportional annual reductions would permit U.S. carriers and customers to realize more quickly the benefits of rates closer to cost-based levels. These interim adjustments also would lessen the impact of sudden rate reductions to foreign operations. Thus, for middle-income countries, rates should be reduced by at least 50 percent of the spread the first year and the remaining 50 percent the following year. For low-income countries, rates should be reduced by at least 25 percent of the spread each year. The Commission also should continue to accept modifications to tariff information as it becomes available over time and, if necessary reduce the benchmarks accordingly.

At this juncture, the Commission should not automatically allow a longer transition for particular circumstances, e.g., if annual reductions would be particularly large for an individual country due to a particularly high initial accounting rate.[24] MCI has recommended target rates that would permit a carrier with a high initial rate to meet a benchmark twenty percent above an average rate for its country's economic category. This approach would give carriers in countries where efficiencies have not been achieved more than adequate latitude. In any event, a waiver of the transition period should be available if it can be demonstrated that the rules subject a foreign operator to extraordinary hardship. This process would be preferable as it would also allow all parties an opportunity to comment.

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[24] Id. at para. 67.

To reap the benefits of moving accounting rates closer to costs, the Commission should utilize all available means for implementing benchmarks rates that are consistent with its authority and the settlement negotiation process. Thus, should a U.S. carrier demonstrate that it has been unable to negotiate the applicable benchmark (or an interim proportional reduction toward the benchmark) within a reasonable timeframe and seeks Commission intervention, the Commission should contact the responsible government authorities of the country in question and make every effort to enlist their support and assistance in achieving the applicable benchmark.[25] Ultimately, if necessary, a U.S. carrier could request the Commission to utilize its authority under the Communications Act to achieve the objectives set out in the Notice.

III. INTERNATIONAL SERVICE AUTHORIZATIONS SHOULD BE BASED UPON AN ANALYSIS OF EFFECTIVE COMPETITIVE OPPORTUNITIES (ECO) INCLUDING A COST-BASED SETTLEMENTS ELEMENT -- NOT UPON THE ACHIEVEMENT OF INFLATED BENCHMARK RATES

The Notice proposes to address potential competitive distortions created by above-cost accounting rates by conditioning various types of authorizations of foreign carriers on the achievement of rate-based or cost-based benchmarks.[26]

For example, the Bureau proposes that authorizations to provide facilities-based services to an affiliated market be conditioned on the foreign affiliate offering U.S. licensed international carriers a settlement rate within the rate-based benchmark range proposed in the Notice.[27] For international simple resale (ISR), the Bureau proposes to condition foreign carrier authorizations

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[25] Id. at para. 88.

[26] Id. at para. 76.

[27] Id.

on the availability on the route of rate-based benchmarks, or, in the alternative, more cost-based rates.[28] Where authorizations are conditioned upon achievement of benchmark rates, the Commission proposes to monitor the route and, if competitive distortion occurs, either order a reduction in settlement rates to the low end of the benchmark range or revoke the foreign carrier's authorization.[29]

MCI disagrees with this approach. To address potential competitive distortion concerns, the Bureau should continue to enforce the ECO test, which was adopted less than two years ago.[30] When U.S. carriers have a choice of foreign carriers with which to terminate international traffic because effective competitive opportunities exist, incentives are reduced for foreign operators to distort competition in the U.S. market. Thus, to the extent possible, the Commission seeks to "encourage the development of competitive markets for the termination of international services."[31]

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[28] Id. at paras. 82 and 84.

[29] If competitive distortion is found for facilities-based service, the Bureau proposes either to order that settlement rates to that country be reduced to the bottom of the range or to revoke the authorization of the carrier to serve the affiliated market. Id. at paras. 76. If such distortion is discovered on a route authorized for ISR, the Bureau proposes to order all U.S. international carriers to pay settlement rates at the low end of the benchmark range, i.e., at a level the Bureau believes represents the actual cost of terminating international traffic in the United States. Id. at para. 83.

[30] MCI comments briefly here on the Bureau's questions in its Notice related to the ECO test. However, the primary issue of the Notice is benchmark accounting rates. Thus, it would be inappropriate to modify the ECO test here without a further NPRM that properly notices and provides the opportunity to address fully the implications of any proposed changes to the Commission's current entry standard.

[31] Id.

The ECO test is an important tool for reaching the Commission's goals, because it provides a framework within which to consider, prior to permitting foreign carrier entry, whether competition is working in a foreign market and the resulting impact on competition in the U.S. market. Only if real opportunities to compete exist in foreign markets can competitive distortion be constrained. Thus, the primary consideration of the Commission should continue to be whether effective competitive opportunities are available in the foreign country as outlined in its Foreign Carrier Entry Order.[32]

MCI agrees, however, that the movement toward cost-based rates can and should be considered, but not as a substitute for the other critical factors of the ECO-test. As shown below with respect to inbound bypass, the existence of settlement rates approaching cost-based levels would indicate a lessened ability to distort competition. Thus, the achievement of cost-based settlement rates should be considered as a positive factor in a determination as to whether a country passes the ECO test. The best mechanism to eliminate the ability of a foreign carrier to distort competition in the United States and to ensure that rates gravitate toward true costs is the existence of effective competitive opportunities on the route, as measured by the four elements of the ECO test.

Even less supportable would be any condition for authorization or standard for entry based solely on meeting the proposed rate-based benchmarks. Authorizing a foreign carrier with a stranglehold on the foreign market to operate without constraints in the U.S. market, simply

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[32] Market Entry and Regulation of Foreign-Affiliated Entities, Report and Order, IB Docket 95-22, 11 FCC Rcd 3873 (1995) (Foreign Carrier Entry Order). MCI recognizes that, if a WTO agreement is reached, the Commission may need to refine its ECO test to ensure it is consistent with the U.S. obligations under the agreement.

because it meets a belt-tightened but nonetheless bloated benchmark, would permit that carrier to distort competition in the U.S. outbound and inbound market -- the very result that the Commission is trying to prevent in this docket.

A primary market distortion concern is inbound bypass. On a route where effective competitive opportunities are not available, even if the foreign operator were to agree to rate-based benchmark settlement rates, it would continue to reap excessive profits. Meanwhile, if the same foreign operator were permitted to terminate traffic in the United States via international simple resale (ISR), the foreign carrier would have the incentive to send its traffic to an affiliate to avoid paying the equivalent above-cost settlement to a U.S. carrier. Thus, the foreign carrier would have both the motivation and the ability to distort the U.S. termination market on the route and reap excessive profits on the foreign termination, to the competitive disadvantage of U.S. carriers and, ultimately, the detriment of U.S. consumers. As a result, the U.S. balance of payment deficit also would increase.

Where effective competitive opportunities are available on a route, the incentive for a foreign carrier to engage in inbound bypass is constrained by the ability of other carriers to terminate traffic with the foreign carrier of their choice. Also, the real opportunity to compete would lead to more cost-based settlement rates, which would mitigate the impact of inbound bypass because the foreign carrier would not gain a substantial windfall by terminating with an affiliate, as opposed to corresponding with another U.S. carrier.

For these reasons, the preferred method of constraining competitive distortion in the U.S. telecommunications market is through continued enforcement of the ECO test prior to

permitting entry. The achievement of cost-based settlement rates should be considered as an important element of, but not as a substitute for, the ECO test.

IV. THE COMMISSION SHOULD PRESERVE MARKET DISTORTION SAFEGUARDS, MODIFIED AS APPROPRIATE TO ADDRESS OBLIGATIONS UNDER ANY PROSPECTIVE MULTILATERAL AGREEMENT

The Commission requests comment on whether its benchmark proposals would be consistent with obligations that may be imposed by a multilateral agreement should the U.S. Government become a signatory to an agreement on basic telecommunications in the ongoing WTO negotiations, which are scheduled to conclude on February 15, 1997. MCI reserves comment until it has the opportunity to examine in detail any agreement that may result from these discussions. If the U.S. Government determines that the quantity and quality of the offers from other countries are sufficient to warrant a commitment to a multilateral agreement, it must also be assured that it will be able to implement the competitive safeguards necessary to prevent market distortion, consistent with the obligations of a WTO agreement.

CONCLUSION

MCI fully supports the Commission's efforts to lower accounting and settlement rates and to implement its proposed benchmarks. MCI agrees with the Commission's proposal for calculating interim benchmarks in the absence of reliable cost data, with the qualifications noted above. These actions will reduce substantially economic anomalies that work to the detriment of U.S. carriers and consumers and, indeed, their foreign counter-parts. For authorizations, MCI urges the Commission to retain its ECO test, which is the best standard for preventing market distortion. MCI further recommends that the Commission consider a foreign operator's implementation of cost-based settlement rates as an important component of that test. If necessary, the Commission's standards will need to be refined to be consistent with obligations under future multilateral treaties, but the U.S. Government should not undertake such obligations unless it is assured that it will retain adequate authority to prevent competitive distortion in the U.S. market.

Respectfully submitted,

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