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Federal Communications Commission
Office of Secretary

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

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

TO: The Commission

REPLY COMMENTS OF KOKUSAI DENSHIN DENWA CO. LTD.

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SUMMARY

Kokusai Denshin Denwa Co. Ltd. ("KDD") submits that the record in this proceeding conclusively proves that there is no relationship between international settlement rates and the international direct dial ("IDD") collection rates charged by U.S. carriers. That conclusion is underscored by the gross disparity between AT&T's IDD rates for U.S. subscribers and the rates charged by AT&T to its callback customers in foreign countries for calls to the United States. On the U.S.-Japan route, AT&T offers callback service in Japan at $.59/minute for calls on the U.S.-Japan route, while charging U.S. consumers $1.91/minute (over 300% higher) for the same calls. AT&T's tariffs show that it engages in similar discrimination against U.S. subscribers on its direct routes with Austria, Belgium, Brazil, Denmark, Finland, France, Germany, Hong Kong, Italy, Netherlands, Norway, and Sweden. That AT&T can offer such varying rates for identical calls on the same route subject to the same settlement rate shows that it is specious to attribute high U.S. IDD rates in any way to existing settlement rates.

KDD proposes that the FCC require AT&T and all other U.S. carriers to offer IDD rates to U.S. subscribers on a route that are no higher than the applicable rates they would charge to their callback customers in the foreign country for calls to the United States. This requirement would prevent AT&T and other U.S. carriers from accepting supranormal profit margins on their U.S. IDD traffic while accepting far lower profit margins on their callback operations in foreign countries, as they are doing today. Such a requirement would ensure that U.S. carriers pass on settlement rate reductions to their U.S. subscribers as well as to their foreign callback customers, thereby promoting the FCC's goal of reducing IDD rates for U.S. consumers. That requirement also would serve to inject much-needed additional competition into the U.S. international market. KDD is aware of no public policy

reason for permitting AT&T to charge U.S. subscribers 300% more than it charges its Japanese callback customers for making identical calls subject to the identical settlement rate on the U.S.-Japan route.

Further, the record shows that marketplace forces -- including reverse-billed services such as callback, non-traditional routing practices such as refile, and international simple resale -- are fully capable of imposing significant downward pressure upon settlement rates. The recent World Trade Organization ("WTO") agreement removes any basis for unilateral intervention by the FCC. As U.S. Government officials have stated publicly, that agreement by itself will unleash the market forces necessary to reform the accounting rate system and lead to lower IDD rates for U.S. and foreign subscribers.

The FCC must reject AT&T's argument that it has reduced IDD rates to reflect settlement rate reductions in the past. AT&T supports that argument by stating incorrectly that it pays the full settlement rate only on the traffic imbalance on a route, when in fact settlements are calculated and paid for all U.S.-inbound and outbound minutes on a route. Further, AT&T's use of its average revenue per minute ("ARPM") as a proxy for its U.S. IDD rates is improper, as the ARPM reflects callback and other traffic that AT&T carries on a wholesale basis, often for the benefit of foreign rather than U.S. subscribers. The best evidence of AT&T's pricing practices is the FCC's own statistics, which show conclusively that AT&T has raised its IDD rates across the board during the same time period when settlement rates were declining. The principal cause of high U.S. IDD rates is not the settlements process, but the lack of competition in the U.S. international market. KDD submits that, if the FCC adopts the proposed settlement rate benchmarks, the FCC should require that U.S. carriers pass through such reductions to U.S. consumers through lower

IDD rates, and that such IDD rate reductions should apply to the same route as the settlement rate reduction.

There is insufficient data on the record for the FCC to adopt the proposed lower and upper benchmark rates. As regards the lower benchmark rate, no party provided data permitting the FCC to estimate the costs incurred by U.S. carriers to terminate foreign-billed traffic, or the extent of the higher costs incurred by foreign carriers to terminate U.S.-billed traffic. As regards the upper benchmark rate, the record shows that the TCP components are not necessarily cost-oriented and, therefore, they cannot be used to derive a cost-oriented settlement rate benchmark.

In addition, the TCP approach erroneously ignores the concept of purchasing power parity ("PPP"), thereby understating the settlement rate in U.S. dollars necessary to fully compensate foreign carriers for the costs they incur in their own currencies to terminate U.S.-billed traffic. KDD does not agree with commenting parties who suggest that the FCC should consider developing PPP conversion factors. It would be impossible for the FCC to prescribe settlement rates that reflect daily exchange rate or PPP fluctuations. Rather, the FCC should leave it to carriers to allocate such risks among themselves through bilateral negotiations.

In addition, there is a consensus among all commenting parties, with the singular exception of U.S. carriers, that the FCC's proposals would violate the Most Favored Nation and National Treatment principles under the WTO agreement. In addition to the deficiencies already identified in the FCC's proposed rules, KDD submits that the National Treatment principle requires the FCC to adopt market entry policies that are no less favorable to foreign carriers than the policies applied by the FCC to the provision of out-of-region international services by incumbent local exchange carriers such as GTE.

In general, KDD submits that there is no record basis for requiring foreign carriers to comply with any settlement rate benchmarks as a condition of entering the U.S. facilities-based international market. Concerns about alleged cross-subsidies and below-cost pricing are speculative and contrary to economic theory. Further, while it is legitimate for any country to have laws against anticompetitive conduct, it must implement those laws on a post-entry basis, not on a pre-entry basis through conditions in Section 214 authorizations. It would be particularly improper for the FCC to require compliance with the proposed lower benchmark as a condition of market entry given the absence of any record support for such a benchmark.

KDD supports the commenting parties who have shown that the FCC should not adopt a policy that seeks to detect and remedy putative "competitive distortions" in the U.S. IDD market. It would be impossible for the FCC to make an accurate competitive assessment of changes in revenue and traffic flows, or to attribute such changes to actions by foreign carriers as opposed to the reverse-billed and other non-traditional service offerings of U.S. carriers.

AT&T has not successfully defended the FCC's jurisdiction to adopt and enforce settlement rate benchmarks. In its own comments, AT&T repeatedly refers to the proposed rules in such a manner as to leave no doubt that the intent and effect of the FCC's proposed policies are to impose requirements directly upon foreign carriers subject to enforcement actions by the FCC for non-compliance. The FCC's theory of jurisdiction simply does not work because it does not allow other countries to exercise the same degree of regulatory authority over settlement rates as the FCC proposes to exercise here.

Moreover, KDD agrees with those commenting parties who showed that the FCC's proposed rules would contravene accepted principles and requirements of international law.

The FCC's proposed enforcement measures in particular are contrary to the ITU provisions requiring "mutual consent" and "mutual agreement" for operating agreements and accounting rates. Indeed, those measures would vitiate ITR Article 2.8, Article 37 of the ITU Convention, and related provisions which define the term "accounting rate" and require the establishment of accounting rates according to "mutual consent" and "mutual agreement." KDD would reiterate its view that ITU Study Group 3 is the appropriate multilateral forum for considering revisions to the global accounting rate system.

The FCC should reject AT&T's proposal for an accelerated procedure for U.S. carriers to file complaints against foreign carriers who decline to accept FCC-prescribed benchmarks. The FCC lacks authority to adopt such a procedure under Section 208 of the Communications Act, which applies to U.S. but not foreign carriers. Further, the FCC should reject the request of several U.S. carriers to establish a so-called "glide-path" whereby foreign carriers would be required to make partial settlement rate reductions during the transition period prior to the effective date for permanent reductions. The FCC should reject this approach because no party has submitted a coherent, concrete proposal, and any such approach would be inherently arbitrary and impossible to administer.

Lastly, KDD supports Telstra's request for action by the FCC to remedy the actions of U.S. carriers to impose unreasonable requirements upon foreign carriers for the exchange of Internet traffic.

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REPLY COMMENTS OF KOKUSAI DENSHIN DENWA CO. LTD.

Kokusai Denshin Denwa Co. Ltd. ("KDD"), by its attorneys, hereby replies to the comments filed in the above-captioned proceeding.

KDD shares the FCC's belief that current settlement rate levels are not sufficiently cost-oriented and vary inconsistently from one route to another. Like U.S. carriers, KDD has been forced by the current system to pay settlement revenues to foreign carriers that do not closely reflect the cost of terminating international switched traffic in those countries. However, KDD disagrees with the FCC that market forces are not capable of reforming the accounting rate system without unilateral regulatory intervention from concerned regulators. Settlement rates have declined steadily in this decade under the onslaught of market forces, and market pressure will intensify under the new World Trade Organization ("WTO") agreement. KDD urges the FCC to abandon its goal of seeking to work outside the marketplace to prescribe "cost-oriented" settlement rates by regulatory fiat based upon inadequate data. Rather, the FCC's goal should be to facilitate the establishment of competitive pricing for termination services, which can only occur through marketplace forces. To the extent regulatory reforms will help ensure competitively-priced termination, the FCC should work through ITU Study Group 3 as the appropriately constituted multilateral forum to address such issues.

I. THE FCC SHOULD RELY UPON MARKET FORCES TO REDUCE SETTLEMENT RATES

The record shows that market forces are fully capable of imposing significant downward pressure upon settlement rates.[1] In particular, reverse-billed services such as callback, non-traditional routing practices such as refile, and settlements bypass through international simple resale are forcing significant modifications to the current system on many routes. KDD agrees with the United Kingdom that "[c]ompetition must be the preferred mechanism for reducing rates to economically efficient levels."[2] As GTE noted, "[t]he Commission . . . should focus on fostering competitive markets, which will drive accounting rates to appropriately lower levels in the future."[3] One way for the FCC to inject additional competition into the international telecommunications market, as several parties have argued, would be for the FCC to authorize foreign carriers and other new entrants to begin competing against entrenched U.S. carriers immediately.[4] Simply put, there is no need for the FCC to circumvent market forces through unilateral action to ensure that settlement rates will move closer to competitive levels.

The recent WTO agreement removes any basis for the FCC to intervene unilaterally in the settlements process between U.S. carriers and foreign administrations.

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[1] E.g., Government of Japan Comments at 2; Telmex Comments at 6-7; France Telecom Comments at 5; SBC Communications Comments at 2-3; Telefonica Comments at 35-36.

[2] United Kingdom Comments at 2.

[3] GTE Comments at 2.

[4] E.g., Pacific Bell Comments at 9 (encouraging FCC to "grant[] authority for new competitors to begin providing international services in competition with AT&T and other authorized international carriers"); Telmex Comments at 2 (recommending that FCC authorize entry by foreign carriers and "rely on market forces to lead carriers to lower settlement rates").

According to the Office of the United States Trade Representative ("USTR"), the agreement will open markets, promote deregulation, and establish competition in 70 countries representing 95% of global telecommunications revenues.[5] U.S. carriers will be able to enter "nearly 100 percent" of the important telecommunications markets on a facilities and/or resale basis.[6] USTR and the FCC have predicted that the average cost of an international direct-dialed ("IDD") telephone call for U.S. consumers will drop from $1/minute to $.20/minute due to open markets and competition around the world.[7] That prediction necessarily implies that the market forces unleashed by the WTO agreement will lead to competitively priced settlement rates on a global basis. The FCC itself has reached the same conclusion:

> "We believe that the most effective way to ensure settlement rate reform that results in reasonable international calling prices is through the development of competitive markets for IMTS. Effective competition on both ends of an international call would ultimately drive international termination charges closer to costs and erode the subsidy embedded in current settlement rates." Notice at para. 20.

FCC Chairman Hundt also has recognized that telecommunications services are better regulated by markets than by Governments:

> "[C]ommunications markets are definitively not natural monopolies. The delivery of communications services definitively need not be managed by government in lieu of relying on markets. Communications products are in fact in

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[5] See Statement of Ambassador Charlene Barshefsky, Basic Telecom Negotiations, February 15, 1997, at 1-2 [hereinafter "Barshefsky Statement"].

[6] Barshefsky Statement at 1.

[7] Barshefsky Statement at 3; see also "Statement of FCC Chairman Reed Hundt Concerning WTO Agreement on Telecom Services," rel. Feb. 18, 1997.

> almost all respects not different from any other consumers products."[8]

Therefore, the FCC should abandon its effort to supplant market forces through the unilateral imposition of non-market based settlement benchmarks.

II. LOWER SETTLEMENT RATES HAVE NOT BENEFITED U.S. CONSUMERS

A. AT&T's Argument.

Numerous parties have shown that there is no historical or statistical relationship between settlement rates (or reductions in those rates) and the collection rates paid by U.S. consumers for international switched calls.[9] Nevertheless, AT&T contends that its average revenue per minute ("ARPM") has declined to a greater extent than its effective settlement rate from 1992-1995, thereby showing that reduced settlement rates result in lower prices for U.S. consumers.[10] AT&T's argument is incorrect for several reasons.

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[8] See Remarks of Reed E. Hundt, Chairman, Federal Communications Commission, Telecom '95 Strategies Summit, Geneva, Switzerland, "Institutional Responsibilities: Out With The Old, In With The New," October 5, 1995.

[9] See KDD Comments at 10 (noting that AT&T's IDD rate to Japan increased by 13% while the U.S.-Japan settlement rate was declining by 53%); Cable & Wireless Comments at 19 (noting that Hong Kong and U.K. settlement rates declined while U.S. IDD rates to those countries increased or did not decrease); Pacific Bell Comments at 3 ("[t]he size of U.S. collection rates bear[s] little relationship to foreign accounting rates").

[10] AT&T Comments at 9-10. Further, it is worth noting that even AT&T does not dispute that it has failed to pass through all reductions in notional settlement rates, or even all reductions in unit settlement payments, to its consumers through lower IDD collection rates. Id.

First, AT&T has erroneously focused upon its effective settlement rate in analyzing the meaning of its ARPM data. AT&T argues that it pays the full settlement rate only on the traffic imbalance on a route, not on every minute of U.S.-billed traffic.[11] In effect, AT&T is arguing that U.S. and foreign carriers exchange evenly-balanced minutes in a kind of barter arrangement outside of the settlements process, with settlement payments calculated solely upon the traffic imbalance on the route. That portrayal of the settlements process is flatly incorrect. On most routes, including the U.S.-Japan route, U.S. and foreign carriers calculate settlement obligations for every minute of traffic, not just the traffic imbalance. While the actual payment from one carrier to another does in fact reflect a netting of the respective amounts due between the carriers, it is untrue, from both a practical and an economic standpoint, to assert that a U.S. carrier pays the full settlement rate only on the traffic imbalance, or that foreign carriers do not pay the full settlement rate for traffic they terminate in the United States.

The error in AT&T's analysis becomes particularly evident in the context of a non-50/50 division of tolls. In the Notice (at para. 52), the FCC acknowledged that foreign carriers typically incur significantly higher costs to terminate U.S.-billed traffic than U.S. carriers incur to terminate foreign-billed traffic. As KDD noted in its comments, that admission repudiates the FCC's traditional policy requiring a 50/50 division of tolls, and the FCC should permit U.S. and foreign carriers to negotiate non-50/50 arrangements which more closely reflect actual cost disparities on the route.[12] However, in a non-50/50 arrangement where the each carrier charges a different amount to terminate foreign-billed

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[11] E.g., AT&T Comments at 9 ("settlements are paid only on imbalanced minutes, not on every outbound minute").

[12] KDD Comments at 16-18.

traffic, it cannot reasonably be argued that settlements are calculated and paid only on the traffic imbalance. Rather, the carriers calculate their settlement obligations for each minute of traffic prior to the netting process by which actual payments are determined. Therefore, AT&T's effective settlement rate on a route bears no relationship to AT&T's termination costs, the foreign carrier's termination costs, or to the full settlement rate that applies to all traffic in both directions on the route.

Second, AT&T has incorrectly proffered its ARPM as a proxy for its IDD rate levels in the United States. However, AT&T's ARPM reflects, among other things, wholesale rates for callback providers, including AT&T's own callback affiliates overseas, and other lower-margin services that benefit foreign callers, not U.S. consumers. As one example, AT&T offers callback services to callers in Japan at $.59/minute for calls on the U.S.-Japan route, while charging U.S. consumers $1.91/minute for the same calls.[13] Obviously, AT&T's ARPM is dramatically lower for the traffic originated by its callback customers in Japan than for the traffic originated by its customers in the United States. The record confirms that U.S. carriers are providing low wholesale rates to callback operators,[14] who in some cases are providing callback services to countries in which such services are unlawful. In its Tariff F.C.C. No. 27, AT&T provides rates whereby its foreign callback customers can route callback traffic into countries who prohibit both inbound and outbound

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[13] See AT&T Tariff F.C.C. No. 27, Section 24.1.15 (AT&T International Multi-Option Call Completion Service) ($.59/minute for non-800 access usage rate for callback service originating from Japan); AT&T Tariff F.C.C. No. 27, Section 24.1.2.C.1 ($1.91/minute for IDD calls from U.S. to Japan).

[14] E.g., United Kingdom Comments at 1 (noting that U.S. carriers offer wholesale rates to callback operators containing up to a 75% discount off tariffed rates); Cable & Wireless Comments at 22-23 (U.S. carriers offer wholesale rates to callback operators below the settlement rate on the route); Hong Kong Telecom Comments at 8 (U.S. carriers offer wholesale rates to resellers that are as low as 50% of the settlement rate).

callback services.[15] AT&T should not be permitted to reduce its overall ARPM by including wholesale callback traffic, particularly when that traffic is being carried in violation of foreign laws. In sum, absent data from AT&T showing reductions in the ARPM for the traffic it carries for U.S. end-user consumers, a decline in AT&T's overall ARPM does not indicate that settlement rate reductions have resulted in lower prices for U.S. consumers.

B. FCC Data On AT&T Collection Rates.

The FCC's data show that AT&T has imposed nearly across-the-board increases in its collection rates for U.S. consumers during a period when notional and unit settlement rates have been declining steadily. In its most recent International Trends Report, the FCC compiled a table showing that AT&T's residential rate for international direct-dialed calls has increased for every one of the 34 countries listed.[16] The rate increases were most precipitous during 1993 and 1994, the period during which AT&T claims it was flowing through settlement cost reductions to U.S. carriers.[17] Further, the FCC's statistics show

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[15] The ITU has identified 58 countries who prohibit inbound and outbound callback services. See TSB Circular 228, COM 3/ST, International Telecommunication Union, July 18, 1996. AT&T's Multi-OPTION Call Completion Service, whereby it offers callback services in certain foreign countries, plainly shows that AT&T plans to terminate such callback traffic in numerous countries that have prohibited callback service. See AT&T Tariff F.C.C. No. 27, Section 24.1.15. This tariff is evidence of the willingness of AT&T to route callback traffic in violation of the laws of foreign countries. AT&T's tariff shows that it is not complying with the FCC's statement that "as a matter of international comity, we reaffirm our prior conclusion that U.S.-based providers may not offer international call-back using uncompleted call signalling in countries that have specifically prohibited this practice." See VIA USA, Ltd., 10 FCC Rcd 9540, 9541 (1995).

[16] See "Trends in the International Telecommunications Industry," Industry Analysis Division, Common Carrier Bureau, FCC (Aug. 1996) at Table 11 [hereinafter "International Trends Report"].

[17] AT&T Comments at 10.

that AT&T has increased its discount IDD rates from 1993 through 1996.[18] For all but one of the 34 countries listed, AT&T increased either the peak or off-peak rates (or both) for its TrueWorld Savings plan during that period. Therefore, AT&T's statement that "the modest reductions in settlement rates since 1992 have resulted in . . . lower prices for U.S. consumers"[19] is a gross misrepresentation of AT&T's actual pricing behavior.

The principal cause of the high IDD rates charged by U.S. carriers is not settlement costs, but the lack of competition in the U.S. market. As the United Kingdom noted, there is a margin of approximately 175% between the average IDD collection rate ($.99/minute) and the average weighted notional settlement rate ($.356/minute).[20] Introducing more competition into the U.S. IDD market through the WTO agreement and other measures will be far more effective than unilateral settlement benchmarks in reducing the collection rates paid by U.S. consumers.

C. Flow-Through Requirement.

If the FCC's objective through this proceeding is to benefit U.S. consumers, the only way for the FCC to achieve that objective is to require U.S. carriers to pass through settlement rate reductions to U.S. consumers in the form of lower IDD rates. Such a requirement is necessary because U.S. carriers do not have a track record of reducing their

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[18] International Trends Report at Table 12.

[19] AT&T Comments at 9.

[20] United Kingdom Comments at 3. Other commenting parties noted that the high level of IDD collection rates in the United States is caused by lack of competition in the U.S. market, not settlement rate levels. E.g., CANTO Comments at 14; COMTELCA Comments at 9-10; Telefonica del Peru Comments at 10; Telefonica Comments at 26 & Tab. 1; 30 & Figure 2.

IDD rates to reflect settlement rate reductions, and U.S. carriers have made no commitment to do so in this proceeding. In contrast to AT&T's public statements that it will pass through access charge reductions to its customers through lower long distance rates,[21] AT&T has failed to make a similar flow-through commitment for settlement rate reductions.

Further, the FCC should clarify that each U.S. carrier must pass through settlement rate reductions to U.S. consumers in the form of collection rate reductions on the same route. If the FCC does not require U.S. carriers to flow through settlement reductions to their IDD customers in the United States, the putative legal basis for the proposed rules -- that settlement rate benchmarks will produce lower IDD rates for U.S. consumers -- completely disappears on the record in this proceeding.

D. The Callback/IDD Parity Proposal.

The record in this proceeding conclusively proves that there is no relationship between settlement rates and the IDD collection rates charged by U.S. and foreign carriers. That point is underscored by the gross disparity between AT&T's IDD rates for U.S. end-user subscribers and the rates charged by AT&T to its callback customers in foreign countries for calls to the United States. As noted above, AT&T offers callback service in Japan at $.59/minute for calls on the U.S.-Japan route, while charging U.S. consumers $1.91/minute for the same calls. AT&T engages in an equally discriminatory practice for

[21] E.g., "AT&T Chairman Allen Pledges To Pass Access Charge Savings On To Customers," Communications Daily, Feb. 5, 1997; "Telecom Act Was An Act of Congress Not An Act of God, Allen Says," Washington Telecom News, Feb. 10, 1997.

numerous other countries.[22] That AT&T can offer such varying rates for identical calls on the same route subject to the same settlement rate shows that it is specious to attribute high U.S. IDD rates in any way to existing settlement rates.

KDD proposes that the FCC require AT&T and all other U.S. carriers to offer IDD rates on a route no higher than the applicable rates they would charge to their callback customers in the foreign country for calls to the United States. This requirement would prevent AT&T and other U.S. carriers from accepting supranormal profit margins on U.S. IDD traffic while accepting far lower profit margins on their callback operations in foreign countries, as they are doing today. Such a requirement also would ensure that U.S. carriers pass on settlement rate reductions to U.S. as well as foreign customers, thereby promoting the FCC's goal of reducing IDD rates for U.S. consumers. Further, this requirement would effectively serve to inject additional competition into the U.S. international market. In cases where U.S. IDD rates are higher than the callback rates offered by U.S. carriers at the foreign end of the route, that disparity presumably reflects the lesser degree of competition in the United States than in the foreign country. In that situation, using the callback rates as a cost-oriented rate ceiling for U.S. IDD rates would permit U.S. consumers to benefit from developing competition in foreign countries.

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[22] AT&T implements the following discrimination in the rates it charges foreign callback customers for calls to the U.S., and the IDD rates it charges to U.S. end-user subscribers: Austria ($.67/minute versus $1.59/minute); Belgium ($.60/minute versus $1.84/minute); Brazil ($.89/minute versus $2.00/minute); Denmark ($.60/minute versus $1.70/minute); Finland ($.77/minute versus $1.73/minute); France ($.41/minute versus $1.56/minute); Germany ($.44/minute versus $1.39/minute); Hong Kong ($.76/minute versus $2.01/minute); Italy ($.55/minute versus $1.79/minute); Netherlands $.44/minute versus $1.51/minute); Norway ($.55/minute versus $1.55/minute); and Sweden ($.50/minute versus $1.50/minute). See AT&T Tariff F.C.C. No. 27, Section 24.1.15 (AT&T's callback rates to the United States from specified foreign countries); AT&T Tariff F.C.C. No. 27, Section 24.1.2.C.1 (AT&T's IDD rates for U.S. consumers).

III. THE FCC SHOULD NOT ADOPT LOWER OR UPPER BENCHMARKS

A. Lower Benchmark.

There is no record basis to prescribe the low-end settlement benchmark at $.09/minute or any other level. The FCC's proposed two-step approach -- first, estimating the termination costs of U.S. carriers at $.06/minute and, second, adding $.03/minute to reflect the higher costs of foreign carriers -- does not withstand even cursory scrutiny. The estimate of $.06/minute is allegedly based upon AT&T data, which have not been placed on the record and hence may not be relied upon by the FCC. Further, there is absolutely no empirical basis for concluding that the termination costs of foreign carriers are $.03/minute higher. No commenting party provided any data upon which the FCC could conclude that the termination costs of foreign carriers are $.09/minute or lower.

AT&T's statement that "there are no material differences between the costs of U.S. and foreign carriers for the termination of international calls"[23] is insupportable. The FCC itself has recognized that foreign carriers incur higher costs than U.S. carriers to terminate international traffic (see Notice at para. 52), and commenting parties have confirmed that fact.[24] The current record does not supply even a scintilla of evidence upon which the FCC could prescribe a low-end settlement rate benchmark.

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[23] AT&T Comments at 28.

[24] E.g., CANTO Comments at 3; Pacific Bell Comments at 5 n.14; Telstra Comments at 2; COMTELCA Comments at 15; Jabatan Telekom Malaysia Comments at 2-3. Also, KDD placed evidence in the record on the higher cost-of-living in Japan than the United States. KDD Comments at 15-16.

B. Upper Benchmark.

The TCP approach must be abandoned because the record shows that the FCC does not have reliable data to implement that approach. The FCC itself has recognized that the National Extension TCP often does not reflect the underlying component costs. In the Notice (at para. 45), the FCC asserted that "many countries have rate structures that use high international or domestic long distance charges to offset below-cost local service fees."[25] Therefore, by the FCC's own admission, the National Extension TCP does not fully reflect the underlying component costs. Further, the record shows that numerous carriers use settlement revenues to recover a portion of the costs of providing the National Extension TCP.[26] The FCC's recognition that some foreign carriers use settlement revenues to fund "network development," and its proposed transition period for foreign carriers to adjust to lower settlement rates (Notice at paras. 24 & 59), constitute an implicit acknowledgement that foreign carriers today use settlement revenues to support below-cost domestic rates. Therefore, the TCP approach cannot be used as a methodology for establishing settlement rate benchmarks due to a lack of accurate and reliable data on the cost basis of the TCP components.

[25] In addition, the switching TCP understates component costs by failing to include the costs of the 4:1 multiplexer necessary to achieve the FCC's assumed circuit loading configuration. E.g., WorldCom Comments at 9 n.25. Further, other parties have demonstrated that the FCC's assumption of a 4:1 multiplexer does not reflect the manner in which foreign carriers provide service today. E.g., France Telecom Comments at 10. See generally Sprint Comments at 11-12 (noting cost basis of switching and domestic termination TCPs is "problematic").

[26] E.g., Singapore Telecom Comments at 9; CANTO Comments at 15; Telefonica Comments at 41; GTE Comments at 23; France Telecom Comments at 10; DGT Taiwan Comments at 2.

C. <u>Purchasing Power Parity.</u>

KDD agrees with Telefonica[27] that the FCC erroneously ignored purchasing power parity ("PPP") in proposing to adopt settlement rate benchmarks. However, KDD submits that Telefonica has misapplied PPP in urging the FCC to establish even lower overall TCPs for Japan and other developed countries. As KDD demonstrated in its comments, the overall TCP for Japan is significantly too low, not too high.[28] KDD incurs termination and other costs in Japanese yen, not U.S. dollars. Translating those costs into U.S. dollars based solely upon the current exchange rate would result in KDD receiving less (not more) than full compensation for the costs it incurs to terminate U.S.-billed traffic. Put in other words, merely converting KDD's costs in Japanese yen into a TCP (or settlement rate) in U.S. dollars based upon the current exchange rate would result in KDD receiving less purchasing power than it needs to recoup its costs in full.

Further, KDD disagrees with Telefonica's recommendation that the FCC seek to develop PPP conversion factors for its TCP approach. Given daily fluctuations in the exchange rate, and the inherent imprecision in calculating PPP conversion factors, it would be impossible for the FCC to prescribe settlement rates in U.S. dollars that accurately compensate foreign carriers for the costs they incur in their own currencies to terminate U.S.-billed traffic. Indeed, as France Telecom notes, PPP and other factors undermine the FCC's proposal to divide all foreign countries into three categories based upon per capita gross national product.[29] The FCC should permit U.S. and foreign carriers to allocate

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[27] Telefonica Comments at 59-62.

[28] KDD Comments at 16.

[29] France Telecom Comments at 14.

exchange rate and PPP risks among themselves through bilateral negotiations rather than undertake the futile effort of ascertaining unilaterally the "correct" currency ratios for settlement purposes. As the Government of Japan noted, "[i]nternational settlement rates should be decided based on commercial contracts between carriers."[30]

IV. THE FCC'S PROPOSALS WOULD ERECT HARMFUL ENTRY BARRIERS

A. GATS Principles.

Numerous parties agree that the FCC's proposals would violate the Most Favored Nation ("MFN") and National Treatment principles under the new WTO agreement.[31] While KDD will not reiterate those arguments here, KDD would note in addition that the National Treatment principle, at a minimum, prohibits the FCC from adopting a more lenient market entry policy for any incumbent local exchange carriers ("ILECs") for out-of-region international services than it adopts for foreign carriers with market power who seek to enter the U.S. international market. The FCC's policies permit GTE and other ILECs to provide out-of-region international services on a nondominant basis through an affiliate so long as the affiliate (i) maintains separate books of account from the ILEC; (ii) does not jointly own transmission or switching facilities with the IlEC; and (iii)

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[30] Government of Japan Comments at 1.

[31] E.g., Telintar Comments at 19-23; GTE Comments at 28-33; Government of Japan Comments at 4. Further, KDD submits that the FCC should eliminate its "effective competitive opportunity" policy for market entry by foreign carriers, and its equivalency policy for international simple resale, as being contrary to the MFN and National Treatment principles. The FCC should abolish those policies in this proceeding unless it decides to initiate a separate rulemaking proceeding to consider the impact of the WTO agreement upon those and other policies.

takes any tariffed services from the ILEC pursuant to generally applicable tariffs.[32] For a foreign carrier with market power, the U.S. international services market is the functional equivalent of an out-of-region international service. Therefore, the National Treatment principle prohibits the FCC from adopting more rigorous restrictions, either through rules or Section 214 conditions, for foreign carriers with market power than it applies to the ILECs' provision of out-of-region international services.[33]

Further, KDD submits that the FCC must review its entire set of settlement rate benchmark proposals in light of the new WTO agreement. As Pacific Bell notes:

> "the Commission should acknowledge that substantial uncertainty exists with respect to the anticipated interpretation of the agreement by the WTO's governing body. The 'legality' of the FCC's approach will be determined by a foreign juridical body applying multilateral agreements, as opposed to federal judges applying U.S. law. It is entirely possible that the Commission's proposed safeguards may not survive review by a dispute resolution panel in Geneva."[34]

The Commission should not adopt any new settlement rate policies without fully analyzing whether such policies are consistent with the new WTO agreement to which the United States agreed last month.

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[32] See GTE Telecom Incorporated, ITC-95-443, rel. Sept. 16, 1996. For a statement of the FCC's separate affiliate policies, see Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations, 98 FCC 2d 1191, 1198 (1984).

[33] Further, the FCC should consider whether the WTO Agreement, and the MFN and National Treatment principles it embodies, permit it to impose any restrictions upon foreign carrier market entry based upon the alleged market power of the foreign carrier. The FCC classified KDD's U.S. affiliate, KDD America, as a dominant carrier based upon the incorrect finding that KDD controls bottleneck international facilities in Japan.

[34] Pacific Bell Comments at 7.

B. Section 214 Conditions.

The record does not support the FCC's proposal to require foreign-affiliated U.S. facilities-based carriers to comply with settlement rate benchmarks as a market entry condition. The FCC's concerns about cross-subsidy and below-cost pricing are speculative and contrary to economic theory.[35] Further, with the implementation of the WTO agreement next year, foreign carriers will be incapable of such actions because their home markets will be open to competitive entry from U.S. carriers. KDD urges the FCC to benefit from the experience of the United Kingdom:

> "Regulators in some countries can be pressurized by incumbent operators in the international market to introduce restrictions to create 'level playing fields' for incumbents, but which can actually represent a barrier to competitive entry serving only the interests of those incumbent operators. In the UK, we have had most of the license conditions mentioned in para. 8 above in place since 1992 in ISR operators' licenses, but have not felt it necessary to use them once. This, we believe, shows that many of the more alarming potential abusive practices attributed to foreign operators do not materialize. Regulators should therefore be wary of placing too much emphasis on producer interests alone. Not least as a function of their incumbent position, existing operators demonstrate a remarkable ability to meet challenges from new entrants."[36]

Further, the WTO agreement prohibits the FCC from imposing settlement rate benchmarks upon foreign carriers seeking to take advantage of the agreement by entering the U.S. facilities-based international market. The proposed benchmarks would discriminate among countries without empirical basis, and the FCC's failure to insist that U.S. carriers

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[35] E.g., Telefonica Comments at 70; GTE Comments at 24-26; Telmex Comments at 24-27.

[36] United Kingdom Comments at 2.

charge cost-based rates to terminate foreign-billed traffic in the U.S. is an impermissible discrimination in favor of U.S. carriers. In addition, while it is legitimate for any country to have laws against anticompetitive conduct, it must implement those laws on a post-entry basis, not a pre-entry basis.[37] The FCC has no right to erect entry barriers through Section 214 conditions based on the bare assumption that one entrant or all entrants will engage in unlawful conduct.

In the event the FCC decides to require foreign carriers to comply with settlement rate benchmarks as a condition of entering the U.S. market, KDD opposes AT&T's request that the FCC require compliance with the low-end of the benchmark range.[38] The FCC admittedly has no data on the costs incurred by foreign carriers to terminate U.S.-billed traffic, and the FCC lacks jurisdiction to compel foreign carriers to produce cost data for purposes of establishing such a benchmark.

C. Competitive Distortion Standard.

The FCC should not adopt a policy that seeks to detect and remedy putative "competitive distortions" of the IDD market in the United States. As Sprint points out, "one party's perception of competitive distortion is likely to be viewed as robust competition by another party."[39] KDD agrees that it would be difficult if not impossible for the FCC to make an accurate competitive assessment of new developments based solely upon traffic and revenue data. Further, as AT&T notes, it would be virtually impossible to attribute any

[37] E.g., Government of Japan Comments at 2-3.

[38] AT&T Comments at 40.

[39] Sprint Comments at 23.

development which the FCC might view as a possible "competitive distortion" to the conduct of foreign carriers.[40] In particular, the FCC could not distinguish easily between the routing and pricing decisions of foreign carriers, and those of U.S. carriers in offering reverse-billed and refile services, when determining the cause of changes in the traffic or settlements imbalance on a route. KDD agrees with Sprint that "[t]he problem of discrimination is too multifaceted and complex for the Commission to develop a single set of rules that will punish all 'distortions' or provide a rigid code of conduct."[41]

V. THE FCC DOES NOT HAVE JURISDICTION TO ADOPT ITS PROPOSALS

AT&T argues that the FCC has jurisdiction to adopt settlement rate benchmarks because they would "directly bind only U.S. carriers."[42] However, AT&T does not really believe what it says. In its Comments, AT&T asserts that "all countries should be required" by the FCC to comply with the benchmarks, and that the benchmark "requirements should apply to all countries."[43] Further, AT&T argues that the lesson to be learned from the FCC's previous benchmark guidelines is that "timely compliance with the new benchmarks by foreign carriers" requires the prescription of benchmark levels, and that prescription is fully justified "[w]here foreign carriers have not met transition or benchmark requirements."[44] AT&T further argues that all foreign carriers should begin "an immediate

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[40] AT&T Comments at 38.

[41] Sprint Comments at 24.

[42] E.g., AT&T Comments at 52.

[43] AT&T Comments at 1 (Summ.) and 14.

[44] AT&T Comments at 31.