

DOCKET FILE COPY ORIGINAL

ORIGINAL

RECEIVED
MAR 31 1997

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

International Settlement Rates)

) File No. IB 96-261
)
)

REPLY COMMENTS OF AT&T CORP.

Mark C. Rosenblum
Elaine R. McHale
James J. R. Talbot

295 N. Maple Avenue
Room 3252H3
Basking Ridge, NJ 07920
(908) 221-8023

Gene C. Schaerr
Daniel Meron
1722 Eye Street, N.W.
Washington, D.C. 20006

Dated: March 31, 1997

No. of Copies rec'd
List ABCDE

024

Table of Contents

SUMMARY	i
I. THERE IS WIDE AGREEMENT THAT EXISTING SETTLEMENT RATES ARE FAR ABOVE COST AND SHOULD BE REDUCED	1
II. THE MAJORITY OF U.S. COMMENTERS SUPPORT ACTIVE COMMISSION ENFORCEMENT OF NEW SETTLEMENT BENCHMARKS	4
1. The Proposed Benchmarks Are a Reasonable Step Toward Cost-Based Rates.....	5
2. U.S. Commenters Support a Rapid Transition to Benchmarks with Interim Reductions During the Transition Period	8
3. Benchmark and Transition Requirements Should Apply to all Countries	10
4. U.S. Carrier Average Cost Data Provide A Generous Surrogate for Foreign Carriers' TSLRICs and should be used to Mark the Lower End of Benchmark Ranges.....	14
5. U.S. Commenters Support Commission Prescription of Settlement Rates	17
III. FOREIGN COMMENTERS FAIL TO DEMONSTRATE THAT FURTHER COMMISSION ACTION TO REDUCE SETTLEMENT RATES IS UNNECESSARY	19
1. Above-Cost Settlement Rates, not the Traffic Imbalance, is the Critical Public Interest Concern.....	20
2. AT&T Will Ensure That Net Savings in Settlement Costs Are Passed Through to U.S. Consumers.	25
3. Benchmark Settlement Rates Would Fully Compensate Foreign Carriers for Their Termination Costs.....	31
IV. THE COMMENTS FILED IN THIS PROCEEDING CONFIRM THAT THE COMMISSION POSSESSES AMPLE AUTHORITY TO MANDATE SETTLEMENT RATES	39

1.	Prior Commission Orders Regulating Facilities Used for Foreign Communication Do not Limit the Commission's Jurisdiction Over Contracts with Foreign Correspondents	42
2.	The Supreme Court's Construction of the Commission's Authority Over Radio Broadcasting Licensing Has No Application Here.....	44
V.	THE COMMISSION SHOULD STOP SETTLEMENT SUBSIDIES UPON U.S. MARKET ENTRY TO PREVENT COMPETITIVE DISTORTION	46
1.	Cost-based Settlement Rates are Necessary to Prevent Carriers Providing U.S.-Inbound Switched Services Over International Private Lines From Engaging in "One-Way Bypass"	47
2.	Cost-based Settlement Rates are Also Required to Prevent Competitive Price Distortion Where U.S.-Outbound Switched Facilities-based and Resale Services are Provided to Affiliated Markets	51
3.	Cost-based Settlement Rate Conditions Would be Consistent With GATS Obligations.	54
	CONCLUSION	55

SUMMARY

A strong U.S. consensus supports the Commission's initiative to revise benchmark settlement rates. The majority of U.S. Commenters agrees with the NPRM that above-cost settlement rates raise consumer prices, distort market performance and restrict market growth. These U.S. Commenters stand firmly behind all three key elements of the NPRM's proposals: new benchmark rates based upon tariff component prices; brief transition periods; and strong Commission enforcement. They also agree that benchmark and transition requirements should apply to all countries, with no exceptions for liberalized or developing countries. Further, as recommended by most U.S. international facilities-based carriers, annual proportionate reductions should be required toward benchmark rates during the transition period.

But the most critical need is for strong Commission action to ensure compliance. Every U.S. international facilities-based carrier filing comments supports the Commission's use of the authority it unquestionably possesses to prescribe benchmark rates. As AT&T recommends, this can best be achieved through Commission action under expedited procedures in response to carrier complaints.

U.S. Commenters also support the NPRM's proposals to use settlement rates to address competitive distortion. Even some non-U.S. Commenters from liberalized markets recognize this concern. As AT&T demonstrates, the Commission should go beyond the benchmark rates that the NPRM would require for inbound switched services over international private lines and for outbound switched facilities-based and resale services. Settlement rates can provide effective safeguards against competitive distortion

only if they are set at economic cost, rather than at benchmark levels. No party has shown that these concerns are misplaced.

Predictably, the many non-U.S. carriers, governments and regulators that have responded to the NPRM are much less supportive. While espousing the need for cost-based accounting rates in principle, Foreign Commenters --including the U.S. affiliates of foreign carriers -- neither justify their own settlement rates as based upon any proper measure of economic cost, nor display any readiness to adopt cost-based rates in the future. Instead, they oppose benchmarks on the spurious grounds that the Commission lacks jurisdiction to enforce them, notwithstanding the overwhelming weight of authority to the contrary. They contend that the large U.S. outpayment is the fault of U.S. carriers for providing attractive services to their customers -- overlooking that it is the subsidy-laden nature of that outpayment that is the issue here. Indeed, if all U.S. international traffic in 1995 had been subject to AT&T's proposed surrogate cost-based settlement rate of \$0.075, rather than to above-cost settlement rates of many times this level, the U.S. settlements deficit would have been \$663 million -- less than one seventh of the actual settlements deficit in that year of \$4.9 billion.

Equally unfounded is the claim that U.S. consumers have not received the benefits of settlements cost reductions. As AT&T demonstrated in its initial comments, the competitive U.S. market has ensured that savings in settlements costs have been fully reflected in consumer prices. This is underscored by AT&T's preliminary data for 1996, which continue to show greater reductions in prices than in settlement costs. Nevertheless, to provide further assurance that reductions in settlement costs will benefit

U.S. consumers, AT&T commits to reduce its U.S. international rates to reflect fully AT&T's net settlement cost reductions resulting from Commission enforcement of new benchmarks. Accordingly, there is no basis for any claim that U.S. consumers will not receive the full benefits of benchmark settlement rates.

For these reasons, the Commission should move swiftly to establish and enforce benchmark settlement rates on all U.S. international routes, with mandatory annual reductions toward benchmark levels during the transition period. Strong Commission enforcement of benchmark rates would result in significant consumer benefits by reducing prices for international services. At the same time, a Section 214 requirement for cost-based rates for service on affiliated routes would ensure that foreign carriers could not distort competition in the U.S. market.

RECEIVED

MAR 31 1997

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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

REPLY COMMENTS OF AT&T CORP.

Pursuant to the Commission's December 19, 1996 Notice of Proposed Rulemaking,¹ AT&T Corp. ("AT&T") submits its Reply Comments on the proposed revision of the Commission's benchmark settlement rates for international switched telephone service between the U.S. and other countries.

I. THERE IS WIDE AGREEMENT THAT EXISTING SETTLEMENT RATES ARE FAR ABOVE COST AND SHOULD BE REDUCED.

The Commission began this proceeding by emphasizing that "a broad multilateral consensus has emerged that the traditional accounting rate system must be reformed because it results in settlement rates that are substantially above costs." NPRM, ¶ 1. The comments reflect broad support for this conclusion from users, carriers, regulators and government, not only in the United States but in many other countries.²

¹ *International Settlement Rates*, IB Docket No. 96-261, Notice of Proposed Rulemaking, (released Dec. 19, 1996), FCC 96-484 ("NPRM"). *See also*, *International Settlement Rates*, IB Docket No. 96-261, Order Granting Extension of Time, (released Feb. 27, 1997).

² A list of Commenters is at Attachment 1.

The Office of the U.S. Trade Representative, the U.S. Department of Commerce and the U.S. Department of State ("USTR, Commerce, State") (p. 2) "applaud the Commission's investigations into the various mechanisms for achieving cost-based accounting rates." The Chairman and Ranking Minority Member of the House Committee on Commerce and the Chairmen of the House Commerce Subcommittees on Telecommunications and on Finance and Hazardous Materials ("Leadership of the House Commerce Committee") (p. 1) "strongly support the Commission issuing rules which move settlement rates to cost for all countries as expeditiously as possible." The Coalition for Services Industries ("CSI") (p. 4) expresses concern that "the above-cost settlement rates that exist today create . . . a windfall for foreign carriers at the expense of US business users." Sprint (p. 3) states that "settlement rates . . . are widely understood to be substantially above any reasonable measure of the applicable costs." Frontier (p. 1) agrees that settlement rates are "far above economic cost."

Many Foreign Commenters also recognize the need to reduce above-cost settlement rates. The Japanese Government ("Japan") (p. 1) "shares the view of the Government of the United States (USG) that international settlement rates should be reduced and cost-based." The UK Government ("UK") (p. 1) compliments the Commission for "a useful contribution to creating new impetus to the internationally agreed objective of making accounting rates more closely reflect the cost of the telecommunication service provided." Deutsche Telecom ("DT") (p. 2) "is acutely aware that the current above-cost accounting rates and high international tariffs impose excessive costs and distort international traffic flows." Telecomunicacione Internacionales De

Argentina Telintar S.A. ("Telintar") (p. 7) states that it too wishes to "move towards more cost-oriented accounting rates." The Regional Technical Commission on Telecommunications of Central America ("COMTELCA") (p. 13) "fully supports efforts to move accounting rates toward cost." Telefonica International de Espana ("Telefonica de Espana") (p. 1) emphasizes that "international settlement rates should continue to decrease." France Telecom ("FT") (p. 3) "believes that all operators should take steps to move accounting rates towards costs. . ." The Telecommunication Authority of Singapore ("TAS") (p. 1) "recognizes that the current international settlement regime . . . requires reform towards 'cost-based' settlement rates." The Solomon Islands Government ("Solomon Islands") (p. 1) "shares the FCC's goal of moving towards international settlement rates which are more cost-oriented." Telefonica Del Peru (p. 6) agrees "that accounting rates should continue to move towards cost."

Nonetheless, there should be no surprise that the strong support for new Commission action to reduce settlement rates that is shown by most U.S. Commenters is not echoed by Foreign Commenters. Significantly, not one of the 42 foreign carriers and 24 foreign governments submitting comments seeks to justify its own current settlement rate with U.S. carriers as being based upon any proper measure of economic cost. Thus, while U.S. carriers, users and government welcome the NPRM's proposals to bring immediate and substantial reductions in the growing settlement rate subsidy of almost \$4 billion that raises prices for U.S. consumers, encourages the denial of foreign market opportunities to U.S. carriers, and causes competitive distortion in the U.S. market, foreign carriers profit by that amount each year from their above-cost settlement rates

with the U.S. Naturally, they do not share the concerns of U.S. carriers and users to reduce these payments as quickly as possible.³

II. THE MAJORITY OF U.S. COMMENTERS SUPPORT ACTIVE COMMISSION ENFORCEMENT OF NEW SETTLEMENT BENCHMARKS.

Most U.S. Commenters express strong support for the Commission's proposals to establish and enforce new benchmark settlement rates that more closely reflect cost. They agree that settlement rates should ultimately be set at total service long run incremental cost ("TSLRIC"), which is the level that would prevail in fully competitive markets. See NPRM, ¶ 31. They concur that the NPRM's proposed tariff component pricing methodology (¶ 39) provides a reasonable interim approach, and they agree with the NPRM's proposal (¶ 63) to apply different transition periods according to economic development levels. However, they also urge that rates should be reduced toward benchmark levels through annual reductions during the transition period, and they recommend that all countries should be subject to benchmark and transition requirements. Most importantly, they urge the Commission to establish the new benchmarks not just as negotiation targets, like the Commission's existing benchmarks, but as mandatory requirements. Thus, as AT&T has emphasized (pp. 31-32), the Commission should enforce the new benchmarks by prescribing settlement rates under expedited procedures in response to carrier complaint.

³ Cf. *Mackay Radio & Telegraph Co.*, 2 FCC 592, 599 (1936) ("to expect the [foreign] telegraph administration to play the competing [U.S.] companies against each other is simply to expect that the [foreign] administration will be headed by good businessmen, loyal to their national interests").

1. The Proposed Benchmarks Are a Reasonable Interim Step Toward Cost-Based Rates.

There is wide agreement among U.S. Commenters that the preferred cost standard for settlement rates should be TSLRIC.⁴ The Leadership of the House Commerce Committee (p. 3) states that "settlement rates ultimately should not be greater than the actual incremental cost of completing an international call for all countries." CSI (p. 4-5) not only urges that "settlement rates must be based on incremental cost," but also asks the Commission to set a "date certain" for the implementation of cost-based rates in each of the three development categories. An approach based on TSLRIC is supported by the Commission's position in the local interconnection proceeding, where it found that this pricing methodology best replicates the conditions of a competitive market. *See* AT&T at 23-25; WorldCom at 5-6. As WorldCom (*id.*) explains, "[e]conomists generally agree that a forward-looking, incremental costing standard is the best reflection of the actual cost of terminating telecommunications traffic."⁵

U.S. Commenters nonetheless endorse the proposed benchmarks as a significant step toward lower settlement rates.⁶ The Leadership of the House Commerce

⁴ *See* AT&T at 14, 21-25; CSI at 4; Frontier at 2; Leadership of the House Commerce Committee at 2; MCI at 3, n.8; TRA at 1; WorldCom at 5-7; Zephyr at 2.

⁵ *See also* AT&T at 22.

⁶ *See* AT&T at 14-22; ACC at 8; CSI at 4-5; Frontier at 1-3; Leadership of the House Commerce Committee at 2; PBCom at 11; Sprint at 3; TRA at 1, 4; WorldCom at 7-8; USTR/State/Commerce at 2. Not surprisingly, GTE the owner of Codetel, the incumbent carrier in the Dominican Republic and the holder of a 26 percent interest in CANTV, the Venezuelan incumbent, echoes the criticisms put forward by many foreign administrations and carriers.

Committee (p. 2) supports the benchmarks as "an interim step toward moving settlement rates to cost." MCI (p. 3) views the benchmarks as "a reasonable compromise as an interim solution" pending the development of country-specific cost data. WorldCom (p. 8) is concerned that the proposed rates are "too high," but welcomes them as "an important step in the right direction toward cost-based rates."⁷

U.S. Commenters express different preferences concerning whether each country's benchmark should be set at the country-specific tariff component price, or at the average tariff component price of all countries in the same income category.⁸ AT&T (pp.

⁷ As demonstrated in Section III below, Sprint's concerns (pp. 11-13) that the international gateway and national extension components of tariff component prices may not adequately reflect foreign carrier costs are misplaced. In any event, Sprint concludes (p. 19) that the Commission may still use the benchmarks as "presumptively reasonable settlement rates" provided foreign carriers and other interested parties have the opportunity to rebut this presumption. WorldCom (pp. 8-9) concurs that foreign carriers are entitled to an administrative review if they believe that benchmark rates do not reflect their cost of providing termination services. AT&T agrees that foreign carriers and other interested parties should always be entitled to demonstrate that their total long run incremental costs are in excess of benchmark levels, but should not be allowed to inflate their benchmark rates artificially through use of other methodologies, such as historic book or embedded cost approaches, or through use of above-cost local "access" charges. See Section III below. As AT&T has shown (pp. 14, 21-25), the NPRM's conclusion (¶¶ 31-32) that international termination services should be priced at TSLRIC is correct and the purpose of new benchmarks should be to move countries toward that level as quickly as possible. To uphold challenges to benchmark rates made on the basis of alternative methodologies would undermine that objective. Additionally, as AT&T (p. 24), Sprint (p. 19) and WorldCom (p. 9) emphasize, the foreign carrier should always carry the burden of proving the nature and magnitude of its costs, as it has access to the necessary information.

⁸ Sprint (p. 16) and WorldCom (p. 9) support country-specific prices on the grounds that this measure gives greater recognition to individual country cost factors, although WorldCom has no "strong preference." Frontier (p. 3) supports average prices out of concern that country-specific prices would treat similarly situated countries differently. CSI (p. 5) also prefers ranges. The few Foreign Commenters addressing

14-17) and MCI (pp. 4-5) propose combining both approaches and setting each country's benchmark rate at the lower of its country-specific tariff component price or the average price of all countries in its income category (or, as recommended by MCI, a rate twenty percent above the mean for the relevant income category). As AT&T has shown (pp. 15-17), combining both approaches would ensure the greatest movement toward cost, while limiting the ability of foreign carriers to discriminate between their domestic consumers and U.S. carriers. Under this solution, the impact of inefficient pricing structures would be reduced, as would the incentive to manipulate benchmarks by increasing or failing to lower domestic prices.⁹

A further consideration is the potential impact of the "Most Favored Nation" ("MFN") obligation to be assumed by the United States under the General Agreement on Trade in Services ("GATS") with regard to basic telecommunications services from January 1, 1998, following the successful February 15, 1997 conclusion of the Negotiations on Basic Telecommunications. Several Commenters maintain that the

(footnote continued from previous page)

this issue prefer country-specific prices. *See* PNTC at 33; Telia at 4; TNZL at 8; Telefonica de Espana at 56-57.

⁹ The scepticism of some Commenters concerning the likelihood of such behavior is contradicted by the claims by several Foreign Commenters that "opportunistic distortions" of this type might indeed occur. *See* C&W Attachment at 5; FT at 11; UK at 2. While the Commission should disallow consideration of any tariff increases undertaken for this purpose, proof of such behavior would be difficult to obtain. In addition, as MCI emphasizes (p. 7), the Commission should reduce benchmarks in accordance with future tariff reductions. To this end, the Commission should establish a simple process to allow U.S. carriers to update Commission information on foreign carrier tariffs at least annually.

use of average prices to establish benchmark prices would be less consistent with MFN as such an approach would not take sufficient account of country-specific cost differences.¹⁰ As AT&T has shown (pp. 28-30) and further demonstrates below, any such differences, if they exist at all, are minor. Moreover, adoption of the approach recommended by AT&T and MCI would address such concerns by relying on country-specific tariff component prices except where these are unreasonably high.¹¹

2. U.S. Commenters Support a Rapid Transition to Benchmarks with Interim Reductions During the Transition Period.

The U.S. Commenters show strong support for a short transition to new benchmark rates. As AT&T has recommended (p. 19), in view of the general failure of foreign carriers to observe existing benchmarks, the Commission would best serve the critical public interest objective of moving settlement rates to cost as quickly as possible by reducing the transition periods suggested by the NPRM and by requiring carriers in upper income countries to comply with new benchmarks by June 1, 1998, carriers in middle income countries by January 1, 1999, and carriers in developing countries by January 1, 2000. Contrary to the claims of foreign carriers, which predictably maintain

¹⁰ See Japan at 4; GTE at 33. No challenge to Commission actions on MFN grounds -- or otherwise founded on WTO obligations -- may be brought in U.S. courts. Section 102(c) of the Uruguay Round Agreements Act, 19 U.S.C. Section 3512(a), denies a private right of action against any department or agency on the basis of a WTO agreement.

¹¹ As any challenge to the benchmarks on MFN grounds would be motivated primarily by the desire to obtain more generous treatment, the Commission should make clear in advance that in any further revision to benchmarks it would seek to establish a single rate for all countries at least as close to cost as the average for upper income countries.

that even longer periods are required than those suggested by the NPRM (§ 63),¹² foreign countries have been on notice that settlement rates need to be reduced to cost-based levels for at least five years, since the adoption of ITU Recommendation D.140¹³ and the issuance of the Commission's first benchmarks in 1992, and even since the issuance of the first NPRM in 1990. As the Leadership of the House Commerce Committee (p. 3) therefore concludes, "that experience has demonstrated that other countries will take as long as possible to reform the settlements system. We therefore support a minimal transition period for countries to reform their settlement rates."

The NPRM's proposal (§ 63) to apply different transition periods for high, middle and low income countries is met with widespread approval from both U.S. and Foreign Commenters.¹⁴ However, U.S. Commenters are also concerned to keep the transition brief.¹⁵ As recommended by AT&T (pp. 2, 14, 19), the Commission should

¹² See, e.g., C&W at 14-15; FT at 13; Tricom at 6-7 (middle income countries require at least four or five years); COMTELCA at 15 (developing countries require seven to ten year period).

¹³ Accounting Rate Principles for International Telephone Service, ITU-T Recommendation D.140, Geneva, 1992. Contrary to some foreign carriers' claims (see AHCIET, p. 4), the adoption of the annexes to this recommendation in 1995 did not restart the transition period.

¹⁴ See MCI at 6; WorldCom at 10-11; Sprint at 16-17; UK at 3; PNTC at 33. However, this approach may also be challenged on MFN grounds. See Japan at 4. As with the benchmarks themselves, the Commission should attempt to dissuade efforts to obtain more generous treatment in this way by indicating that although it would prefer to give longer transition periods to low and middle income countries, it would hold all countries to a shorter rather than a longer period if it was limited to a standard requirement.

¹⁵ Thus, CSI (p. 5) recommends that the transition should be accomplished in "the shortest possible period of time." MCI (p. 6) urges the Commission to adopt the

accelerate its proposed schedule, so that all countries are in compliance with benchmarks by the year 2000.

There is wide agreement among U.S. carriers that annual reductions in settlement rates are necessary during the transition period.¹⁶ As urged by AT&T (p. 20), MCI (p. 7) and Sprint (p. 17), proportionate annual reductions should be required. Without interim reductions, there is a significant risk that foreign carriers will not reduce their settlement rates at all until their implementation deadline, thus maximizing their monopoly profits to the last possible moment. *See* Sprint at 17; WorldCom at 11. Without interim reductions, foreign carriers may also seek to avoid compliance on the grounds that they would suffer unnecessary hardship through such a large reduction in rates. By prescribing a mandatory glidepath, the Commission would prevent such gamesmanship, provide greater certainty for all parties, and move settlement rates more quickly toward cost.

3. **Benchmark and Transition Requirements Should Apply to all Countries.**

As AT&T (pp. 18-20) and other U.S. carriers explain, there is no justification for the exceptions to benchmarks or transition requirements suggested by the NPRM (¶¶ 67, 69, 72) for countries adopting or committing to competitive reform, for developing countries with low levels of network development, or for countries that would

(footnote continued from previous page)

shortest of its recommended transition periods. WorldCom (p. 11) suggests that the transition period for developing countries should be three years, which is one year less than the shortest period recommended by the Commission.

¹⁶ *See* AT&T at 20; MCI at 7; Sprint at 17; WorldCom at 11.

lose more than a certain percentage of their settlement rate or annual revenue in moving to benchmarks. As WorldCom (pp. 12-13) warns, unless the Commission wishes to invite “endless rounds of administrative litigation,” it should “adhere to a black line deadline, and not adopt any exceptions that will all but swallow the rule itself.”

AT&T has shown (p. 18) that even in those countries where competition is well-established, settlement rates are still above cost, often by considerable amounts. Nor does the mere existence of multiple international carriers in a foreign market necessarily mean that settlement rates will be subject to market forces, as new competing carriers frequently maintain identical rates to the incumbent carriers.¹⁷ Thus, as WorldCom (p. 13) concludes, any such forbearance in the case of countries with liberalized markets, or that have agreed to open their markets in the future, would be “inherently contradictory.” This is because where true competition occurs, settlement rates will quickly fall below benchmark levels and the benchmarks will become irrelevant. But where it does not, benchmarks will still be necessary.

For confirmation that benchmarks are necessary in all countries, the Commission need look no further than the Foreign Commenters that claim that they should be exempt from this standard. Three Chilean carriers or their affiliates contend that Chile should be exempt from benchmarks as a liberalized country,¹⁸ although its 1996 settlement rate of \$0.45 is more than twice its tariffed component price. The evidence submitted by AT&T (Attachment C) that Chilean carriers keep their U.S. accounting rates

¹⁷ See AT&T at Attachment C.

¹⁸ See AmericaTel at 12; ENTEL Chile at 1-2; Telefonica de Espana at 69.

in virtual lock-step with each other further demonstrates that the application of benchmarks is fully warranted. The same deficiencies apply to the Philippines, which ABS-CBN (pp. 9-10) seeks to exempt from benchmarks.¹⁹

In Mexico, settlement rates are even less subject to market forces, notwithstanding the claims to the contrary made here by Telmex (pp. 4, 25). This is because under Mexico's recently-adopted regulations governing international switched traffic, all international carriers in Mexico are required to maintain the same accounting rates.²⁰ Mexico goes even further in preventing the existence of Telmex's new international facilities-based competitors from affecting the level of settlement rates by specifically requiring in the new regulations that only the carrier with the largest market share on the international route (i.e., Telmex) may negotiate accounting rates with non-Mexican carriers.²¹ Any exemption from benchmarks for competitive countries would not

¹⁹ Settlement rates in the Philippines are at \$0.50, more than twice the tariffed component price, and the competing international carriers maintain identical settlement rates with each other. *See* AT&T at Attachment C.

²⁰ *See* Rules to Render the International Long Distance Service That Must be Applied by the Concession Holders of Public Telecommunication Networks Authorized to Render this Service, Dec. 4, 1996, Rule 10.

²¹ *Id.* at Rule 13. As an additional measure to ensure that in Mexico the "competitive market processes" identified by Telemex's consultant Indetec International (p. 5) do not "create sufficient incentives and methods to circumvent settlement rates that are perceived to be excessive" (*id.*), the new Mexican regulations also effectively preclude the provision of switched services over resold international private lines. *See id.* at Rule 3 ("Only international port operators shall be authorized to directly interconnect with the public telecommunications networks of operators in other countries in order to carry international traffic."); Rule 7 (providing that "[o]nly long distance service concession holders," i.e., facilities-based carriers, may operate international ports in Mexico). *See also* Rule 10 (requiring all international switched traffic to adhere to proportionate return and uniform accounting rates).

only be undeserved, but would encourage other countries to adopt similar measures to those implemented in Mexico to ensure that liberalization does not lead to lower settlement inpayments.²²

There is also no support among U.S. Commenters for any developing country exemption from benchmarks or transition periods.²³ Even most Foreign Commenters fail to suggest that a general exemption is required for these countries. As AT&T explains (pp. 19-20), developing country needs are already taken into account by the higher benchmark ranges and longer transition periods for middle and low income countries. Frontier correctly notes (p. 4, n.9) that developing countries' use of settlements to fund infrastructure is "not sustainable in the long term" and their transition to benchmarks "should not be indefinite." As indicated by the NPRM (§ 63), these countries' future network needs should rather be met by competitive markets and private capital.

U.S. Commenters also oppose any extended transition periods for countries that would lose more than a certain percentage of their settlement rates or annual revenue in moving to benchmarks.²⁴ As AT&T explains (p. 20), such an exemption

²² Any such exemption would be even less appropriate for countries that are merely "committed" to liberalization in the future. Panama (p. 24) asserts that it should be exempt from benchmarks on these grounds although it proposes (p. 13) to extend its international voice service monopoly and it maintains a settlement rate of \$0.65, unchanged from 1992 and well over twice the top of the relevant benchmark range. Many other countries would likely make similar claims.

²³ Even GTE (pp. 15-22), which asks for much longer transition periods for developing countries, including the Dominican Republic and Venezuela, where it controls or has a significant interest in the incumbent monopolists, Codetel and CANTV, does not suggest that developing countries should receive a permanent exemption from benchmarks.

²⁴ See, e.g., AT&T at 20; MCI at 7; WorldCom at 10-13.

would merely further benefit those foreign carriers that have failed to comply with Commission and ITU policies in the past and have continued to maintain high accounting rates. To reward their past recalcitrance would provide a poor incentive for them to comply with new benchmarks in the future.

4. U.S. Carrier Average Cost Data Provide A Generous Surrogate for Foreign Carriers' TSLRICs and Can be Used to Mark the Lower End of Benchmark Ranges.

As shown above, there is wide agreement among U.S. Commenters that the proper cost standard for settlement rates is TSLRIC, and that reducing rates to this level should be the Commission's ultimate objective. Foreign Commenters are understandably much less supportive, as this would limit their use of settlement rates as a source of subsidy.²⁵ Yet, among the more than 70 initial comments submitted in this proceeding, there is no showing that setting settlement rates at TSLRIC would not best serve the U.S. public interest in obtaining cost-based termination of U.S. international services and in preventing competitive distortion.

TSLRIC-based pricing, as defined by the Commission, is fully compensatory, as it would provide foreign carriers with the opportunity to recover all of the additional costs an efficient supplier would incur to build and operate a network to provide international call termination services, including a "reasonable profit" measured by the costs of attracting capital. It would also allow the recovery of costs that are "common" to or "shared" between two or more network elements. TSLRIC is

²⁵ See, e.g., C&W Attachment at 3; AHCIET at 4.

administratively manageable, and is routinely employed in regulatory proceedings and arbitrations. As AT&T has described (p. 31, n.56), foreign carriers' TSLRICs could be calculated by using a forward-looking economic cost computer model, such as the Hatfield model. Indeed, the Hatfield model was used last year to calculate TSLRIC interconnection costs in Mexico.²⁶

In the immediate future, the NPRM proposes to use TSLRIC as the appropriate measure for the lower end of the benchmark ranges. No U.S. carrier disputes that the Commission should use economic cost for this purpose. Moreover, as AT&T explains (pp. 27-30), the courts have upheld the Commission's reliance upon reasonable surrogates for carrier charges where no precise data are available, and the close similarity in U.S. and foreign carrier costs for the termination of international calls makes U.S. carrier costs a reasonable surrogate.²⁷ AT&T has further shown (pp. 30-31 & Attachment

²⁶ The model was used by the Mexican carrier Alestra, acting on behalf of ACTEL, Mexico's competitive carrier association, to calculate TSLRIC interconnection costs in three Mexican cities, Mexico City, Monterrey and Jalapa. The model found these interconnection costs to be within the same \$0.04-0.07 range it had previously found for interconnection costs in Washington, Pennsylvania and Utah.

²⁷ Sprint (pp. 14-15) would prefer to use foreign carrier cost data but concedes that no such data is likely to be available in the immediate future as foreign carriers have "little incentive to submit useful cost data in this proceeding."

There is no showing that U.S. costs are not representative of those incurred by foreign carriers. As C&W notes (attachment, p. 4), terrain and population density may affect cost, but the U.S. has wide variations in geography and population density and much greater distances than most countries. Thus, AT&T's average worldwide network termination cost of \$0.075 may include domestic distribution from the Eastern U.S. to Hawaii, 4500 miles away. The results of the use of the Hatfield model last year in Mexico provide further evidence of the similarity of U.S. and foreign interconnection costs. See fn. 27, *supra*. There is "some element of distance sensitivity" (see C&W Attachment, p. 4)) with regard to undersea cable (but not satellite) international transmission costs (see AT&T at 29), but any resulting

E) that its estimated average worldwide network termination cost of \$0.075 per minute for inbound international calls likely exceeds foreign carriers' termination costs based upon TSLRIC and provides a generous surrogate for such costs in the absence of foreign carrier data.

The NPRM (§ 53) estimated foreign carriers' incremental costs of international traffic termination as being "[a]t most" no higher than 9 cents per minute. AT&T fully concurs with this estimate, as evidenced by its own smaller average cost figure. Further confirmation of the reasonable nature of the NPRM's estimate is provided by WorldCom's preliminary finding (p. 7, n.21) that its TSLRIC for international call termination is "about 6 to 9 cents per minute."²⁸

(footnote continued from previous page)

variations are still small. Any impact on countries' use of different equipment and network configurations (*see* DT, p. 10) should be assessed under TSLRIC principles, which require the use of the most efficient available technology. Contrary to the assumptions of some Commenters, any higher transportation, insurance, duties and taxes resulting from developing countries' greater reliance on imported equipment for their network infrastructure (*see* PNTC, p. 32) would have only a marginal effect on termination costs, and labor costs outside the U.S. (*see* Telmex, p. 21) are likely to be lower than U.S. labor costs, rather than higher. Certainly, no reliance can be placed upon the 1990 ITU study that is cited by CANTO (p. 3), which was based upon fully allocated historical costs, not TSLRIC principles, and is now more than ten years out of date. *See* International Telecommunications Union, *Follow-Up Study of the Costs of providing and Operating International Telephone Service Between Industrialised and Developing Countries*, Geneva, 1990, at 17. Yet, to the extent that foreign carriers demonstrate that they have higher TSLRICs resulting from greater distance, higher costs of capital or other factors, they should be able to obtain a commensurate increase in the TSLRIC measure used to mark the bottom of their benchmark range.

²⁸ The WordCom figure also demonstrates the falsity of the professed scepticism of one foreign carrier concerning the accuracy of the AT&T figure. *See* HKTII at 28.

5. **U.S. Commenters Support Commission Prescription of Settlement Rates.**

U.S. Commenters recognize the need for strong Commission action to ensure that foreign carriers comply with the new benchmarks. Indeed, every U.S. international facilities-based carrier filing comments in this proceeding supports Commission prescription of settlement rates if necessary to ensure compliance with the new benchmarks.²⁹ This overwhelming support for prescription from the U.S. carriers that engage in the negotiation of settlement rates with foreign carriers should dispel any belief that active enforcement by the Commission will be unnecessary. As AT&T has shown (pp. 5-8,12-14), the Commission's existing benchmarks, which have not been met by most countries more than four years after they were established, demonstrate that any new benchmarks that serve merely as negotiation targets will also be widely ignored. Compliance will be obtained only if the Commission is prepared to mandate benchmark and transition rates pursuant to the ample authority to do so that, as discussed in Section IV below, it unquestionably possesses.

As AT&T (pp. 31-33) recommends, the Commission should take action in response to carrier complaints and under expedited procedures, including a timeframe for the Commission's own decision.³⁰ Such complaints should be required to demonstrate only that the foreign carrier has not complied with the applicable benchmark rate, or has not made the necessary interim step toward that rate during the transition period. On the

²⁹ See ACC at 8-9; AT&T at 31-33; Frontier at 4; MCI at 8; Sprint at 19; WorldCom at 13-14.

³⁰ See also WorldCom at 13-14.

upholding of a complaint, the Commission should prescribe the settlement rate to be paid by all U.S. carriers.³¹

As WorldCom emphasizes (p. 14), the remedy ordered by the Commission should be a prescription of rates rather than agreements to schedules of reductions or Commission determinations of adequate progress. Anything less than a prescription of rates by the Commission would merely encourage non-compliance. For the same reason, as AT&T has urged (p. 33), rates prescribed by the Commission should be below the levels that would otherwise apply. Thus, where foreign carriers have failed to meet transition requirements, U.S. carriers should be required to pay at the benchmark level. Where the benchmark level has not been achieved, the prescribed rate should be below the benchmark level.

If enforcement is to be effective, the Commission's exercise of its prescription authority must apply to all U.S. facilities-based carriers, including the "small to mid-sized" carriers that TRA (pp. 6-7) would exempt in order to protect them from foreign carrier retaliation. Unless all U.S. carriers are required to observe a prescribed rate, foreign carriers will be encouraged to avoid compliance with benchmarks and the settlement rate reductions that TRA (pp. 7-8) wishes to see flowed through to its resale

³¹ As AT&T has described (p. 31), use of a carrier complaint process would help ensure that Commission enforcement addresses those foreign carriers that are most resistant to reducing rates. WorldCom (p. 13) properly emphasizes that a "black line, date certain procedure" is necessary in order to obtain timely compliance. MCI (p. 8) and Sprint (p. 21) also correctly note that U.S. carriers should always seek to establish the required benchmark and transition rates through negotiations with their foreign correspondents. The carrier complaint process should be used only if negotiations are not successful in obtaining compliance by the relevant deadline.

members will not occur. In any event, as ACC indicates (p. 9), the Commission can ensure that small carriers do not suffer reprisals as the result of Commission enforcement action.³²

III. FOREIGN COMMENTERS FAIL TO DEMONSTRATE THAT FURTHER COMMISSION ACTION TO REDUCE SETTLEMENT RATES IS UNNECESSARY.

In marked contrast to the strong support for new Commission action to reduce settlement rates that is shown by most U.S. Commenters, few Foreign Commenters -- including the U.S. affiliates of foreign carriers -- show any receptivity to the NPRM's proposals. In defense of their monopoly rents, foreign carriers are as obdurate in their pleadings as they are in their settlement rate negotiations with U.S. carriers. They contend that the Commission has no jurisdiction to require benchmark rates -- overlooking the U.S. statutory authority, caselaw and prior findings by the Commission that are decidedly to the contrary. Although no foreign carrier is willing to support its existing rate as based upon any proper measure of economic cost, they claim that high U.S. outpayments are rather the result of socio-economic factors or U.S.-inspired call-back, refile and country-direct services, ignoring that lower settlement rates will always reduce the above-cost subsidy that is paid by U.S. carriers and consumers. They contend that the benchmarks are invalidated by non-existent cost differences, or by the network access charges foreign

³² For this reason, U.S. carriers and consumers should not be denied the benefits that will follow benchmarks because of concerns about potential retaliation by foreign carriers, contrary to the view of Justice Technology (p. 2), a U.S. reseller. Although any such retaliation would be directed to facilities-based carriers, not resellers, not one existing U.S. facilities-based carrier suggests that this is a valid reason for the Commission not to adopt benchmarks.