incumbent carriers have introduced specifically to preserve their monopoly rents in the face of competition. Foreign carriers even assert that their own monopoly rents should be excused because of the purported failure of U.S. carriers to reflect settlements reductions in prices -- contrary to the evidence already presented by AT&T (pp. 9-12) that the competitive U.S. market has ensured that savings in settlements costs are reflected in lower U.S. prices and will continue to do so. AT&T also commits to reduce its U.S. international rates to reflect fully its net settlement cost reductions resulting from Commission enforcement of benchmarks. As AT&T describes below and in Section IV, the arguments advanced by Foreign Commenters in opposition to the NPRM's proposals are without merit and should be disregarded.

1. Above-Cost Settlement Rates, not the Traffic Imbalance, is the Critical Public Interest Concern.

Numerous Foreign Commenters deny any need for benchmarks by claiming that the high U.S. settlements outpayment is the result of U.S. activities and policies rather than above-cost settlement rates. For these Commenters, the culprits are socio-economic factors, such as social habits, trade relationships or disparities in wealth that lead to greater U.S.-outbound than U.S.-inbound calling volumes.[33] They also blame refile, Commission-encouraged call-back practices, and the country-direct services of U.S. carriers.[34] But these Foreign Commenters overlook that the U.S. settlements outpayment would be a minor matter if it was not laden with above-cost subsidies. **In fact, if all U.S.**

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[33] *See, e.g.*, Portugal Telecom at 4; C&W at 21-22.

[34] *See, e.g.*, Singapore Tel at 3-5; Jamaica Telecom at 11; Telefonica Del Peru at 10, 11; KDD at 8, 9.

international traffic from 1992 through 1995 had been subject to settlement rates of $0.075, the figure proposed by AT&T (pp. 30-31) as a reasonable surrogate for foreign carriers' TSLRICs, rather than the actual settlement rates that applied during this period of as much as ten, twenty, or even thirty times this level,[35] the U.S. settlements deficit for 1992 would have been only $369 million, increasing to $663 million in 1995.[36] Instead, at the inflated rates that foreign carriers have required from U.S. carriers, the settlements deficit for 1992 was $3.5 billion and increased to $ 4.9 billion in 1995.[37] Thus, the traffic imbalance, by itself, is not the issue here. Indisputably, above-cost settlement rates are responsible for the large size of the deficit.

Contrary to the claims of Foreign Commenters, the U.S. traffic imbalance long preceded the advent of call-back, refile, or country-direct services.[38] Commission data show that as early as the 1970's, no doubt because of such factors as higher U.S. incomes and teledensity, greater U.S. economic growth, and more prevalent telephone

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35 *See, e.g.,* AT&T at Attachment A.

36 These estimates are calculated by multiplying the 1992 and 1995 traffic imbalances of 4,921 million minutes and 8,841 million minutes, respectively, by the AT&T-proposed TSLRIC surrogate of $0.075. *See also,* AT&T at Attachment B (FCC 43.61 data). Thus, contrary to C&W (p. 24), HKTI (pp. 14-16) and GTE (p. 5), there would not be a large settlement deficit even with cost-based settlement rates. Even if these assertions were correct, this would not be of concern as such a deficit would reflect increased U.S. telecommunications services exports, rather than high subsidy payments to foreign carriers.

37 *See* Federal Communications Commission, 1992 Section 43.61 International Telecommunications Data, Dec. 1993; Federal Communications Commission, 1995 Section 43.61 International Telecommunications Data, Feb. 1997. Incredibly, Singapore Tel (p. 6) contends that the existing deficit may be "too low."

38 *See, e.g.,* NTC at 2; Telefonica de Espana at 37-40.

usage, U.S.-outbound international traffic consistently exceeded U.S.-inbound traffic by a ratio of about 1.4:1.[39] As increasing competition in the U.S. market in the 1980's lowered U.S. collection prices and stimulated more outbound traffic, the outbound-inbound ratio increased after 1981 by an annual average 3.5 percent to its 1995 level of 2.26:1.[40]

The assertions by Foreign Commenters that U.S. carriers' country-direct services are a major cause of the large U.S. outpayment are wrong.[41] These services account for less than 10 percent of AT&T's U.S.-billed international minutes. Equally erroneous is the assumption that all calls made on country-direct services would otherwise be foreign-billed.[42] While some traveling U.S. customers use these services in place of foreign carriers' services, particularly where high foreign collection rates are further increased by hotel surcharges, AT&T data indicates that the majority of country-direct calls represent migration from traditional collect calling or stimulated minutes.

As the Japanese carrier ITJ (p. 15) observes, "based on ITJ's experience, U.S. carrier-marketed calling card services often are most attractive to U.S. customers, including business travelers, because they allow unified billing statements, and they permit

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39 *See* Federal Communications Commission, Trends in the International Telecommunications Industry, Aug. 1996 at 15. This data excludes Canada and Mexico traffic.

40 *See id.* at 19. *See also*, Federal Communications Commission, 1995 Section 43.61 International Telecommunications Data, Feb. 1997. This ratio includes Canada and Mexico traffic. If Canada and Mexico traffic is excluded, the outbound-inbound ratio increased by an annual average of 3 percent after 1981 to a 1994 level of 2.42:1. *See* Federal Communications Commission, Trends in the International Telecommunications Industry, Aug. 1996 at 15.

41 *See, e.g.*, Lattelkom at 4; PNTC at 16-17.

42 *See* KDD at 8-9.

users to communicate in English, [and] sidestep unfamiliar dialing practices when making an international call . . ."[43] Similarly, Jamaica Telecom (p. 8) notes that country-direct services are "essentially collect calls" and are popular with poor Jamaicans who wish to call on this basis -- confirming AT&T's experience that a large proportion of international collect calling, which would not otherwise be foreign billed, has now migrated to country-direct services. In short, foreign carriers greatly exaggerate the effect of country-direct services on the traffic imbalance.

Equally misplaced are the contentions by some foreign carriers that the growing popularity of call-back and refile somehow derives from "below cost" sales of capacity to resellers by U.S. facilities-based carriers.[44] They make this claim in the erroneous belief that the U.S. carrier's settlement cost is equivalent to the settlement rate and that return traffic does not reduce this expense.[45] In fact, as the UK (p. 4) and DT (p. 7) recognize, the key factor behind call-back is foreign carriers' high collection rates. Indeed, for all the protests voiced by foreign carriers that their collection rates are allegedly the same as or lower than collection rates in the U.S.,[46] the most compelling

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[43] ITJ's comments contradict the assertions by KDD (pp. 8-9) "that the originating carriers would bill all reverse-billed traffic in the absence of Japanese and U.S. reverse-billed services" and consequently that the U.S. settlements imbalance is "largely attributable" to these services rather than foreign carriers' settlement rates.

[44] *See, e.g.*, HKTI at 5-6; VSNL at 4.

[45] *See, e.g.*, HKTI at 8; UK at 1, 4. As AT&T has explained (pp. 6, n.8,10 & pp. 9-10), the settlements process is a "netting" process, and settlement costs are determined by dividing net outpayments by total U.S. billed minutes. Even sales at half of the settlement rate, contrary to HKTI's assertion (p. 8), are not necessarily below cost.

[46] *See, e.g.*, HKTI at 10-11; VSNL at 4 & Annex 1.

evidence to the contrary is the inroads that call-back operators are making in their markets by providing foreign customers with cheaper U.S. prices and the absence of any similar services in the reverse direction. Ironically, as indicated by CHC (p. 3), foreign carriers' above-cost settlement rates ensure that they still make profits from call-back and thus give them less incentive to reduce collection rates in order to recapture customers -- contrary to the intent of the Commission in authorizing call-back services.[47] By reducing these profits, benchmark rates would encourage the desired result.

Refile is the subject of foreign carrier complaint here as well, although it remains a marginal factor in most markets.[48] This arbitrage is the direct and inevitable result of the price discrimination foreign carriers practice by maintaining even-higher settlement rates on their non-U.S. international routes and will disappear only when all settlement rates are reduced to cost. Several foreign carriers fear that the adoption of benchmark rates will lead to greater refile activity through the U.S.[49] But any increased potential for arbitrage will also provide a powerful incentive for foreign carriers to reduce settlement rates on all routes, just as the much lower U.S. settlement rate U.S. carriers

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[47] *See VIA USA, Ltd.*, 9 FCC Rcd. 2288, 2290 (1994) (call-back activity "could place significant downward pressure on foreign collection rates, to the ultimate benefit of U.S. ratepayers and industry.") In fact, unless the foreign carrier's collection rate is at least double the settlement rate, the foreign carrier will make greater profits from call-back than from its own foreign-originated traffic. This is because call-back transforms a U.S.-inbound call into a U.S.-outbound call, thus in effect doubling the settlement inpayment received by the foreign carrier.

[48] *See, e.g.*, Telmex at 15, n.32 (estimating that refile accounts for approximately 5 percent of its settlement revenues). Foreign carriers also overlook that their above-cost settlement rates continue to provide them with profits on refile traffic.

[49] *See* Singapore Tel. at 7; HKTI at 6.

obtained from Germany in early 1996 quickly led other European countries to reduce U.S. rates by like and, in some cases, by greater amounts. Thus, as emphasized by CHC (pp. 7-8), strong Commission action here will have broad pro-competitive effects.

With their chorus of complaints about country-direct services, call-back and refile, the view of most Foreign Commenters is apparently that the large U.S. settlements outpayment is exclusively the fault of U.S. carriers for designing and providing attractive service offerings to their customers. Yet, the real issue here is the above-cost elements of settlement rates that are the cause of three quarters of the outpayment and the direct result of foreign carriers' market power. The Commission should reject this predictable reaction to the NPRM's proposals from those with most to gain from continuing the status quo and should introduce benchmarks as recommended herein.

2. AT&T Will Ensure That Net Savings in Settlement Costs Are Passed Through to U.S. Consumers.

The NPRM's concern (¶ 91) that consumers should receive the benefits of savings in settlements costs is shared by many Commenters.[50] But there is no justification for claims that past savings have not been reflected in lower prices.[51] AT&T has demonstrated (pp. 9-12) that its customers have received the full benefit of its reductions in settlement costs. AT&T's settlement costs savings for the 1992-95 period were fully reflected in prices on a dollar-for-dollar basis as measured by AT&T's average revenue per minute.

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[50] *See, e.g.*, Leadership of the House Commerce Committee 2; TRA at 7-8; C&W at 20; UK at 3.

[51] *See, e.g.*, Telmex at 13; Telstra at 3, 5.

As AT&T has explained (*id.*), net settlements cost reductions -- not settlement rate reductions -- are the appropriate measure in assessing the impact of settlement changes on U.S. carrier pricing. Commenters that contend otherwise misunderstand the distinction between settlement rates and net settlement costs. As AT&T showed, because the settlements process involves a "netting" approach whereby payments are made on the imbalance of calls delivered, the settlement costs of U.S. carriers are determined not only by settlement rates but also by the ratio of outbound U.S. calls to inbound U.S. calls. Focusing only on settlement rate levels and ignoring the outbound/inbound ratio, as many Commenters do, is an incomplete view.[52]

Commenters uniformly focus on the nominal settlement rates that U.S. carriers negotiate, which have indeed shown some decline over recent years -- approximately 18 percent on a worldwide average between 1992 and 1995, as AT&T has shown (pp. 6-7). However, the Commenters ignore that these lower rates have been paid

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[52] *See, e.g.*, GTE at 7; Telefonica de Espana at 26; COMTELCA at 10. Thus, contrary to Telefonica de Espana (p. 26, n.68), return traffic does not provide a separate revenue stream, but is rather part of the calculation of the effective settlement rate that is the proper measure of settlement costs (*see* AT&T at 6, n.10).

Conversely, the claim by Singapore Tel (p. 5) that the NPRM makes a misdirected attempt to align "notional" settlement rates with cost is also wrong. Because the settlements process involves "netting," U.S. and foreign carriers complete balanced minutes without any settlements costs paid to one another. Instead, in return for a minute delivered, each carrier terminates a minute of the other. On balanced minutes, therefore, each carrier gains the benefit of its efficiencies, incurring only the network costs they incur to terminate the other's minute. For imbalanced minutes, foreign carriers collect above-cost settlement rates on each and every minute. Contrary to the assumptions of some foreign carriers (*See, e.g.*, GTE at 6-9 & Attachment 1-2), U.S. carriers derive no profit from this exchange because of the close similarity in the underlying U.S. and foreign termination costs. *See* AT&T at 28-30; fn. 28, *supra*.

on an increasing percentage of outbound minutes in this period. U.S. carriers paid settlements on 55 percent of their U.S. billed traffic in 1995, but only on 48 percent of that traffic in 1992 (*see* AT&T at 9, n.16). As AT&T has further demonstrated (pp. 10-11), its per minute settlement costs, which must be recovered on average for every one of its U.S. billed minutes, actually declined by only $0.05 per minute, from $0.37 in 1992 to $0.32 in 1995.

Moreover, as should be expected in the competitive U.S. market, this $0.05 reduction in AT&T's settlement costs was fully reflected in its prices.[53] As AT&T's evidence shows (*id.*), its average revenue per minute declined from $1.04 in 1992 to $0.96 in 1995, or by a greater amount than the reduction in settlement costs shown by the effective settlement rate. AT&T's preliminary data for 1996 show further reductions in the effective settlement rate to $0.31 and further reductions in average revenue per minute to $0.90 -- for cumulative settlement cost reductions of $0.06 since 1992 and cumulative price reductions in the same period of $0.14.

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[53] Commenters such as FT (p. 6, n.12) and SBC (p. 4) are correct that market forces ensure that cost reductions are reflected in prices, but they wrongly conclude that the U.S. market requires increased competition to allow market forces to have this result. The U.S. international market is competitive today, as evidenced by the flow-through of settlement cost reductions that has taken place. While AT&T welcomes additional competitors, entry by foreign carriers with above-cost settlement rates would rather lead to competitive distortion, as AT&T has shown (pp. 39-46) and explains further below. Premature market entry by the Bell Operating Companies before they face effective competition in their local exchange areas would have similar consequences. *See, e.g.*, Letter dated December 13, 1996, concerning Competitive Impact of Bell Operating Companies' Entry Into Long Distance, to Don Russell, Esq., Chief, Telecommunications Task Force, Antitrust Division, U.S. Department of Justice, from David W. Carpenter, Esq., Counsel for AT&T, at 15-23 .

AT&T expects the competitive U.S. market to ensure that further reductions in settlement costs -- such as those resulting from strong Commission enforcement of benchmarks -- are similarly reflected in U.S. carrier prices. To provide additional certainty that Commission action on benchmarks will directly 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. There is therefore no basis for any claim that U.S. consumers will not receive the full benefits of benchmark settlement rates.

Because of the different factors affecting country pricing, the impact of net settlement cost reductions will be measured globally, rather than on a country-by-country basis. Contrary to the assumptions of many Commenters,[54] price reductions in the U.S. international services market, as in other competitive industries, are taken where competition is most intense, and are not strictly tied to route-specific settlement costs. In order to compete effectively, and to price services rationally, AT&T takes pricing actions in response to competitive pressure and customer demand. Thus, the recently-announced AT&T **One Rate** International Plan offers residential customers new low "anytime" rates to more than 200 countries, including $0.12 per minute to the UK and $0.35 per minute to most European countries. This new calling plan provides discounts that are, on average, 31 percent lower than those offered under AT&T's best permanent plans for residential customers in 1996. Yet, many of the countries covered by the **One Rate** International Plan have not reduced settlement rates to any meaningful extent in recent years.

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[54] *See, e.g.*, Telstra at 4-5; HKTI at 11.

The $0.14 decline in AT&T's average revenue per minute from 1992 through 1996 demonstrates the falsity of another foreign Commenter claim -- that U.S. prices have risen in recent years.[55] All of these Commenters focus on standard international tariffs and ignore the much-lower rates offered under the international calling plans that AT&T and other U.S. carriers market aggressively to their customers. Telstra (p. 5), for example, contends that "very attractive" U.S. rates are available only to "major businesses, wholesalers and large-volume customers." In fact, calling plans account for more than two-thirds of AT&T's international consumer minutes.

It is particularly instructive to compare the prices offered under the AT&T **One Rate** International calling plan now being widely advertised to U.S. consumers with the supposedly "lower" rates Foreign Commenters claim are available in foreign markets.[56] In every instance, the AT&T rate is lower than the allegedly cheaper foreign rate, often by more than 50 percent. For example, Telstra (p. 5) claims a lower Australian rate on calls between the U.S. and Australia of $1.03 per minute, yet the AT&T **One-Rate** International plan charges $0.44.[57] IDC (p. 6) cites the Japanese rate of $1.28 per minute as undercutting U.S. rates on U.S.-Japan calls, but the rate under the AT&T plan is

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[55] *See, e.g.*, Telmex at 14; Telstra at 3, 5.

[56] *See* Telstra at 4,5; HKTI at 10, 11 & Appendix A; VSNL at 4 & Annex 1; Telmex at 14; Singapore Tel at 6; IDC at 6.

[57] *Id.*

$0.47.[58] Similarly, the assertion by Singapore Tel (p. 6) that the Singapore per minute rate of $0.84 is lower is contradicted by the AT&T plan rate of $0.39.[59]

The continued downward trend in U.S. prices is but one indicator of the highly competitive nature of the U.S. international market, in which elasticities of supply and demand are high, and AT&T, the largest carrier, has suffered a rapid decline in market share.[60] The claims by Telefonica de Espana (p. 26) that U.S. carriers' retail prices and foreign carriers' settlement rates require equivalent regulatory treatment by the Commission fail to recognize that U.S. retail prices are set in a competitive market, while foreign settlement rates, which are nothing more than access charges for call termination on bottleneck facilities, are not.[61] As the NPRM states (¶ 31), "competitive market forces" would "[i]deally" set international call termination prices. It is precisely because

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[58] *Id.*

[59] *Id.* The same is true for the claims made by HKTI, VSNL and Telmex. AT&T's **One Rate** International plan offers U.S. consumers $0.60 per minute from the U.S. to Hong Kong, compared to HKTI's supposedly lower rate of $0.87. *See* HKTI at 10-11. AT&T's **One Rate** plan rate of $1.11 to India is far below the $1.93 rate referenced by VSNL (p. Annex 1), and AT&T's rate of $0.65 to Mexico is lower than the $0.86 rate highlighted by Telmex (pp. 13-14).

[60] *See Motion of AT&T to be Declared Non-Dominant for International Service*, FCC 96-209, Order, (released May 14, 1996), at ¶¶ 37, 42-63.

[61] Foreign Commenters also fail to recognize that U.S. international carriers incur costs in addition to settlement costs and the network traffic origination costs for outbound U. S. international calls. These include the network cost of terminating inbound U.S. international calls (return traffic) and additional outbound traffic costs, including billing, collection, advertising and marketing. Moreover, contrary to Telefonica de Espana (p. 31) which cites an outdated AT&T figure for marketing expenses compiled on a company-wide basis, advertising and marketing expenses are higher for international calls than domestic calls due to the need to target marketing efforts to multiple markets.

market forces cannot be relied upon to reduce settlement rates that further Commission action is now required.

3. Benchmark Settlement Rates Would Fully Compensate Foreign Carriers for Their Termination Costs.

There is also no substance to Foreign Commenters' claims that their costs of termination exceed the proposed benchmark rates.[62] AT&T has shown (pp. 15, n. 29, pp. 27-31) that the NPRM (¶ 40) and the appended study by the Commission's International Bureau ("International Bureau Study") correctly concluded that tariff component prices are still far above cost.

First, two of the three components of tariff-component prices, international transmission and domestic distribution, use foreign carrier tariffs that include retail expenses and overhead, which have no relevance to international termination costs, and often generous profit margins. Only one foreign carrier suggests that dedicated international private line tariffs are an inappropriate proxy for the international

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[62] *See, e.g.*, Telefonica de Espana at 49-62; JTM at 3; Chunghwa at 2; FT at 10, 11. The assertion by Telecom Italia (p. 4) that its settlement rates "are now, and indeed, have been cost-based" is invalid as it assumes that "opportunity costs, and the value of service" may be considered in addition to "direct, traffic-related costs." In adopting TELRIC, the "element" variant of TSLRIC, for its cost-based network element pricing rules, the Commission specifically rejected the claim that "opportunity costs" should be considered. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between the Local Exchange Providers and Commercial Radio Service Providers*, CC Docket 96-98 and 95-185, First Report and Order (released Aug. 8, 1996), at ¶¶ 708-11. Similarly, "value of service" concepts have no bearing here as they are, by definition, unrelated to underlying cost.

transmission component, and its challenge is based on inaccurate information.[63] FT (p. 10) suggests that the multiplication factor of four is uncommon, but AT&T's experience is to the contrary. Indeed, AT&T understands that many smaller carriers use multiplication factors of six and seven. Nor are lower multiplication factors necessary for facsimile and data traffic, as Telefonica de Espana (p. 58) contends, as DCME equipment handles this traffic at a factor of four, and newer equipment can do so at a factor of eight. Importantly, TSLRIC principles require costs to be based on the most efficient technology available for providing the foreign carrier's international termination services. *See* AT&T at 24. Telefonica de Espana's further complaint (p. 59) that the NPRM has unreasonably assumed a usage of 8,000 minutes per month per circuit is again contradicted by AT&T's experience that this assumption is in fact very conservative. But where this assumption is shown to be incorrect, tariff component prices may be revised accordingly.

The claim that tariff-component prices should not be based upon domestic tariffs unless rebalancing has taken place is also unjustified.[64] While several Commenters contend that domestic calls in some countries are provided below some measure of "cost," there is no evidence that their domestic tariffs are below economic cost as measured by TSLRIC. In fact, the experience of Mexico and the UK, two countries that have calculated domestic interconnection costs based upon long run incremental cost ("LRIC")

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[63] Switched traffic usage does not carry noticeably greater risks than the leasing of private lines, contrary to the Telefonica de Espana's claim (pp. 57-58) that private line lease costs are lower than switched traffic operational costs for this reason. Telefonica also fails to consider the profits and retail expenses included in private line tariffs.

[64] *See, e.g.,* GTE at 23; PBCom at 5; Telefonica de Espana at 40-47.

principles,[65] indicates that their domestic tariffs are far above this measure of economic cost. In both countries, these interconnection costs are for the ubiquitous domestic termination of traffic delivered to the incumbent carrier (i.e., Telemex or BT) at any point in their networks, and are therefore comparable to the costs incurred for the domestic distribution of international calls -- the same cost component for which the NPRM uses domestic tariffs. In Mexico, interconnection costs derived under LRIC-based principles have been established at $0.02-0.024,[66] while the NPRM sets Mexico's tariff-based national extension costs at $0.125. In the UK, where the NPRM sets tariff-based national extension costs at $0.087, the regulator has proposed a LRIC-based interconnection charge of $0.012.[67] The use of these domestic interconnection rates for benchmark purposes, rather than domestic tariffs, would result in country-specific rates for Mexico of $0.067 (rather than $0.168 as proposed by the NPRM) and for the UK of $0.055 (rather than $0.13 as proposed by the NPRM). Significantly, both these lower rates based on domestic interconnection rates are well within the $0.075 that AT&T has proposed (pp.

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[65] *See Network Charges From 1997*, OFTEL Consultative Document, Dec. 1996 ("*OFTEL Consultative Document*"), at 5. *See also, e.g.*, Administrative Order by Which the Secretariat of Communications and transportation Establishes the Rate Regulation Applicable to Interconnection Services by Public Telecommunications Networks Authorized to Provide Long Distance Services Apr. 26, 1996 ("*Mexico Domestic Interconnection Order*"), at 6. Moreover, AT&T believes that the LRIC prices put forward by the UK regulator based upon a "hybrid" model would be significantly lower if other models, such as the Hatfield model, were used.

[66] *See Mexico Domestic Interconnection Order*, at 3-4 (establishing interconnection charges for domestic long-distance calls of 0.164-0.190 pesos).

[67] *See OFTEL Consultative Document*, Table 3.6 (proposing interconnection charge of 0.074 pounds).

30-31) as a reasonable cost surrogate pending the receipt of satisfactory foreign carrier data.

Additionally, as the International Bureau Study appended to the NPRM reports, the large preponderance of U.S.-outbound calls are made to international gateway cities and the foreign carrier's domestic distribution of this traffic is the equivalent of local rather than long-distance calling. For this very reason, WorldCom (p. 9, n.25) suggests that the national extension component is "probably overstated."[68]

Contrary to some Commenters,[69] even with the national extension measured at zero in Barbados, Hong Kong and Kuwait, where domestic calls are made without charge, it is still likely that their overall tariff-component prices are fully compensatory. Because of their small size, these countries have low domestic distribution costs that are probably well within the above-cost margins included in the other two cost components of tariff-component prices. In any event, as explained above, any foreign carrier demonstrating that the proposed tariff-component price is below cost as measured

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[68] There is also no basis to the claim by ABS-CBN (pp. 5-8) that the NPRM does not make sufficient disclosure of information concerning national extension costs. Every U.S. international carrier, including ABS-CBN, has full information concerning the in-country distribution of its U.S.-originated traffic, and every foreign carrier receiving settlement payments, including ABS-CBN's affiliate in the Philippines, has such information concerning the U.S.-originated traffic that it terminates. Interested parties can therefore ascertain from their own data and from the tariffs listed in the NPRM (*see International Bureau Study*, at Appendix D) whether the NPRM's proposed national extension costs "overstate or understate the actual termination costs." (ABS-CBN p. 7). ABS-CBN makes no showing that its data is inadequate for this purpose.

[69] *See* FT at 10; Telefonica de Espana at 55.

by TSLRIC should always be able to obtain a commensurate increase in its tariff-component price.[70]

Contrary to the Commenters that suggest that foreign carriers may legitimately inflate their domestic distribution costs by including universal service subsidies,[71] the Commission has previously emphasized that U.S. carriers and users should pay only the costs of international termination and should not be required to subsidize "the cost incurred by foreign carriers to use the domestic network for purely domestic services, or for international calling between the foreign country and a country other than the United States."[72] Further, as AT&T has described (pp. 25-27), the Commission should establish clear criteria for the treatment of network "access charges" and other similar surcharges by which countries seek to maintain subsidy payments as they open their markets to competition. Otherwise, as their settlement rates are moved closer to cost, foreign governments and carriers will simply establish local access charges at levels that will compensate for the lost source of subsidy from U.S. and other non-national consumers. Already, Chile, the Dominican Republic, Hong Kong, Mexico, and the Philippines have set up non-cost-based access charges of this type. In some instances, these access charges are discriminatory, such as those by Chile and Mexico, which levy dramatically higher amounts on inbound international calls than on outbound international

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70 *See* fn 7.

71 *See*, Telefonica de Espana at 54; Jamaica Telecom at 10-11.

72 *Regulation of International Accounting Rates*, Phase II, 11 FCC Rcd. 6332, 6335 (1996) (Order on Reconsideration).

and domestic long-distance calls. *See* AT&T at 26. Other access charges are simply excessive, as with the charge levied by the incumbent carrier in the Dominican Republic (*see* Tricom, p.4)[73] and the $0.35-0.50 charge levied by PLDT in the Philippines (*see* ABS-CBN, p. 4). Many other countries are likely to follow suit unless the Commission makes clear that it will not tolerate such continued subsidies from U.S. consumers in any form.

In the first instance, as the benchmark rates proposed by the NPRM are already far above cost, consideration of these local access surcharges or other subsidies is only appropriate for the purpose of establishing the cost-based rates that are to mark the lower end of the benchmark ranges. Contrary to ABS-CBN (p.10), the existence of high access charges is no reason to defer the enforcement of benchmarks. Nor should benchmark rates be raised to accommodate these charges, as Tricom (p.7) suggests,[74] or to accommodate other subsidies.

Additionally, these access charges should be included in the TSLRIC settlement costs that are to mark the lower end of the range for each foreign carrier only if they give equal treatment to all carriers, whatever their national origin, and to all types of domestic and international traffic. *See* AT&T at 26-27. Such a requirement for non-

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[73] Tricom (p. 4) alleges that this access charge is "nearly three times higher than the Commission's rate for the national extension costs in the Dominican Republic."

[74] While any resulting negative impact on competitive carriers in foreign countries would be unfortunate, the Commission's overriding priority here should be the reduction of unreasonable settlement rates that raise prices to U.S. consumers. Such carriers should rather bring pressure on their regulators and governments to reduce access charges to reasonable levels.

discrimination should itself help to ensure that foreign carriers and consumers are not required to shoulder unreasonable charges. Above-cost access charge payments to affiliated entities should also be disallowed as these are merely internal transfer payments. *Id.*

However, further precautions are also necessary to guard against unduly excessive access charges, such as the charge levied in the Dominican Republic and in the Philippines. The existence of these charges, which appear to be applied to all carriers and traffic on a non-discriminatory basis, demonstrates the proclivity of some incumbent local monopolists to exploit their bottlenecks to the fullest extent possible. In order to ensure that local monopoly carriers in other countries are not encouraged to follow their example, the Commission should limit the maximum non-cost based access charge to be included in settlement costs to $0.05 per minute. Capping these surcharges in this way would allow reasonable contributions to be made to universal service obligations, without perpetuating in a different guise the massive subsidy payments that are provided by above-cost settlements.

Equally unfounded are claims by some foreign carriers that they are disadvantaged by fluctuations in exchange rates.[75] Such fluctuations -- which may also benefit carriers -- are inherent in all international business activities and carriers may reduce their exposure by engaging in the same currency hedging activities as companies that provide other products and services. Nor is there substance in Telefonica de Espana's

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[75] *See* KDD at 11; FT at 12-13.

claim (pp. 59-63) that purchasing power parity ("PPP") conversion factors should be used to compute benchmarks rather than market exchange rates. PPP conversion tables are used by international organizations to make international comparisons of living costs and living standards, but the market exchange rate is the arbiter of how much foreign currency is required to purchase the goods and services of another country. This applies just as much to the cost of terminating international telecommunications traffic as to the import-export business or to tourism. The use of PPP conversion factors to compute benchmarks would lead to systematic distortions in the level of compensation received by foreign carriers.[76] Contrary to Telefonica de Espana's assertions, a considerable body of research -- reported in the same economic authority cited by Telefonica de Espana -- finds that price levels are indeed lower in poorer countries.[77]

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[76] The extent to which the use of PPP conversion factors would distort foreign carrier compensation is shown by the case of India, for which the International Bureau derived national extension costs of 6.3 rupees per minute. Converted at a market exchange rate of 34.2 rupees per dollar, this becomes the 18.3 cents per minute quoted by the International Bureau Study. *See* International Bureau Study at 14. The result of computing the cost of the national extension using the PPP conversion factor for India of 6.48 rupees per dollar rather than the market exchange rate, would be to over-pay for the value of the service provided. *See* DRI/McGraw-Hill, First Quarter 1997 World Economic Outlook, Appendix at A-12 (PPP conversion factor for India). Converting the rupee cost of 6.3 rupees per minute to dollars at the PPP rate would produce a benchmark cost of 97 cents per minute, which in turn would produce a revenue of 33.2 rupees when converted to local currency on the foreign exchanges. The payment of 33.2 rupees for a service that cost 6.3 rupees should not be the Commission's intention, but would be the effect of using the methodology proposed by Telefonica de Espana.

[77] *See, e.g.*, Paul R. Krugman and Maurice Obstfeld, *International Economics* (3d ed. 1994), at 417. Telefonica de Espana's authority also makes clear that the Heckscher-Ohlin model, on which Telefonica's claim is based, has not done well empirically. One study quoted by Krugman and Obstfeld found that the model's predictions were

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IV. THE COMMENTS FILED IN THIS PROCEEDING CONFIRM THAT THE COMMISSION POSSESSES AMPLE AUTHORITY TO MANDATE SETTLEMENT RATES.

Numerous Commenters support the Commission's tentative conclusion that it has authority to regulate U.S. carrier settlement arrangements with foreign correspondents. Most notably, the Department of State and the U.S. Trade Representative (as well as the Department of Commerce) "applaud the Commission's investigations" and "express" their overarching "support" for the NPRM proposals.[78] Certainly the executive branch departments with prime responsibility over the United States' foreign commercial relations would have objected if it were true, as some have argued,[79] that the steps outlined in the NPRM are inconsistent with the U.S. treaty obligations.

By contrast, many foreign monopolists (and some domestic carriers who own substantial shares of foreign carriers) claim that the Commission lacks authority to mandate settlement rates. Most of those parties' objections were fully addressed and refuted in AT&T's opening comments. In particular, as AT&T pointed out (pp. 45-47), Section 201 requires that all "charges" and "practices . . . shall be just and reasonable" and explicitly authorizes the Commission to "prescribe such rules and regulations as may be necessary" to effectuate that requirement. Indeed, Section 205 provides in express and unambiguous terms that "the Commission is authorized and empowered to determine and

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wrong 70 percent of the time. *Id.* at 78. This is not a reliable theoretical basis from which to question the NPRM's cost calculations.

[78] *See* USTR, Commerce, State at 1-2.

[79] *See, e.g.*, C&W at 4-5; Telintar at 11-23; Portugal Telecom at 8.

prescribe what will be the just and reasonable charge . . . and what classification, regulation, or practice is or will be just, fair and reasonable." 47 U.S.C. § 205. These provisions directly apply to all "foreign communication." *Id.* at § 152(a). Because U.S. carrier settlement arrangements with foreign correspondents are clearly "practices" and "charges" in connection with "foreign communication," those arrangements fall squarely within the Commission's powers.

As AT&T further demonstrated (pp. 47-50), those settlement arrangements are not insulated from the Commission's review merely because they are memorialized in inter-carrier contracts. Section 211 requires "[e]very carrier subject to this chapter [to] file with the Commission copies of all contracts, agreements, or arrangements with other carriers, or with common carriers not subject to the provisions of this chapter." This mandatory filing requirement serves one primary purpose: "Because of that requirement, the [Commission] can review those contracts and, where necessary, can cause them to be modified."[80] Accordingly, numerous judicial and Commission decisions confirm that the Commission has ample authority to modify the terms of inter-carrier contracts.

As AT&T also explained (pp. 50-56), neither the Communications Act nor Commission regulations exempt contracts with foreign carriers from the Commission's jurisdiction, especially given that the Commission's proposed enforcement measures (¶ 89) would directly bind only U.S. carriers. The mandatory filing requirement for inter-carrier contracts explicitly extends to contracts between carriers subject to the Act and carriers

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[80] *American Broadcasting Co. v. FCC*, 643 F.2d 818, 824 (D.C. Cir. 1980).

"not subject to the provisions of this chapter." 47 U.S.C. § 211. Further, as the Commission has previously concluded, Section 201 "seems clearly" to give the Commission "authority to measure any applicable contract against the public interest . . . even though one of the parties to the contract is not subject to [the Commission's] jurisdiction."[81] This was clearly the holding of the three-judge Court in *RCA Communications, Inc.* v. *United States*,[82] and, as AT&T further demonstrated (pp. 55-57), the ITU regulations do not in any way diminish this authority.[83]

Implicitly recognizing the weakness of their prior arguments, a number of Commenters have now sought to rely on two additional grounds of authority. First, a number of Commenters claim that Commission precedent in the Section 214 context forecloses the Commission's assertion of jurisdiction over international settlement rates. Second, a number of foreign monopolists claim that a U.S. Supreme Court decision construing the Commission's limited power over radio broadcasting demonstrates that the Commission lacks power to regulate contractual arrangements between communications common carriers. As shown below, these arguments have no more merit than the arguments addressed in AT&T's initial comments.

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81 *Interconnection Facilities Provided to the International Record Carriers*, 63 F.C.C.2d 761, 766 (1977).

82 43 F. Supp. 851, 854 (S.D.N.Y. 1942).

83 *See* International Telecommunications Regulations (Melbourne 1988), Dec. 9, 1988, S. Treaty Doc. No. 13, 102d Cong., 1st. Sess. 9, 14 (1991) (Article 6.2.1).

1. Prior Commission Orders Regulating Facilities Used for Foreign Communication Do Not Limit the Commission's Jurisdiction Over Contracts with Foreign Correspondents.

A number of Commenters claim that "past proclamations of the Commission consistently have" disavowed its authority to establish "accounting rates unilaterally."[84] The Commission's orders, however, hold no such thing.

The leading authority cited for this false proposition is *AT&T: Application for Authority Under Section 214 of the Communications Act to Construct and Operate a Third Florida-St. Thomas Cable*.[85] In that order, which concerned applications by AT&T and other American carriers for authorization under Section 214 to construct an underwater cable pursuant to a joint undertaking with a foreign correspondent, the Commission did state that "foreign correspondents" are "beyond" the Commission's direct "jurisdiction." However, in a passage not quoted by the Commenters who invoke this decision, the Commission stated: "However, in fulfilling our obligation under the statute to pass upon those portions which are owned by U.S. common carriers or in which the United States has an interest, we must necessarily look at the whole facility and the use to be made of it."[86] Accordingly, the Commission proceeded to impose a number of conditions to its grant of Section 214 authorization, notwithstanding the fact that one of the parties to the applicable Construction and Maintenance Agreement was a foreign

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[84] *See, e.g.*, C&W at 6.

[85] 88 F.C.C. 2d 1630 (1982).

[86] 88 F.C.C. 2d at 1640.

correspondent.[87]

The Commission's conclusion that it had authority to review the use of the "whole facility," notwithstanding the fact that part of that facility was outside the physical boundaries of the United States, was nothing more than a straightforward application of Section 2(a). That provision gives the Commission jurisdiction over "all interstate and foreign communication . . . which originates and/or is received within the United States,"[88] whether or not the communication travels over some facilities physically located in foreign jurisdictions. Indeed, although the definition of "foreign communication" in the original Senate Bill contained the proviso "in so far as such communication or transmission takes place within the United States,"[89] the statute, as enacted, contains no such limitation. Thus, by giving the Commission authority to regulate all "practices" and "charges . . . in connection with such communication," Congress expressed its evident intent that the Commission's authority not be limited to regulating the practices of U.S. carriers within the United States. The Commission's decision in *Third Florida-St. Thomas Cable*, therefore, is in no respect inconsistent with the NPRM's tentative conclusion that the Commission has jurisdiction to regulate U.S. carrier settlement arrangements with foreign correspondents.

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[87] 88 F.C.C. 2d at 1635-39.

[88] 47 U.S.C. § 152(a).

[89] *See RCA Communications v. United States*, 43 F. Supp. 851, 855 (S.D.N.Y. 1942).

2. The Supreme Court's Construction of the Commission's Authority Over Radio Broadcasting Licensing Has No Application Here.

Lacking a basis in the provisions of the Communications Act that govern the Commission's regulation of telecommunications services, a number of carriers[90] invoke the Supreme Court's construction of the Commission's limited authority over broadcast licensees in *Regents of University System of Georgia v. Carroll*[91] in support of their argument that the Commission lacks authority to modify contracts between U.S. carriers and third parties. *Carroll*, however, has no application at all to the Commission's far broader powers over communications carriers.

Although the Court in *Carroll* held that the Commission lacked the authority "to determine the validity of contracts between licensees and others,"[92] the Court explicitly held that its conclusion "was the inevitable result of the statutory scheme of licensing."[93] As the Court explained, the Commission's Title III powers do not include the power "to issue cease and desist orders."[94] Instead, when regulating the broadcast industry, the Commission "has at its disposal only the cumbersome weapons of criminal penalties and license refusal and revocation."[95]

By contrast, the Commission's Title II powers explicitly include, not only

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90 *See, e.g.*, Telefonica Del Peru at 7-8 & n.11.

91 338 U.S. 586 (1950).

92 *Id.* at 602 (emphasis added).

93 *Id.* at 601.

94 *Id.* at 602.

95 *Id.*