

burdensome than necessary to ensure the quality of [IMTS];" and (3) **do** impose restrictions on the supply of services.

Moreover, the fact that the Commission issued the NPRM before the conclusion of the WTO Telecom Agreement in no way justifies the NPRM's proposals under the provision that the principles set out in article VI:4 apply at present only to measures that "could not reasonably have been expected at the time the specific commitments in those sectors were made."^{43/} **First**, and most importantly, article VI provides no exception to basic GATS obligations of MFN treatment, national treatment and market access, even if the **additional** obligations of article VI:4 are not yet fully applicable. **Second**, the "reasonably expected" limitation by its own terms applies only to "specific commitments" (i.e., market access and national treatment), and not to the GATS MFN obligations that exist independently of any "specific commitments."^{44/}

2. There Is No "Competition Exception" Under The GATS

The GATS also does not contain a "competition exception" that would justify the NPRM's proposals based upon the Commission's tentative view "that the traditional accounting rate system must be reformed because it . . . creates competitive distortions and inefficiencies in the global telecommunications market."^{45/} To the contrary, the GATS imposes affirmative obligations on WTO Members to prevent anticompetitive action by monopoly service suppliers,^{46/} and to enter into consultations at the request of a WTO Member regarding business practices of any service

^{43/} Id., art. VI:5(a)(ii).

^{44/} See id., art. II.

^{45/} NPRM ¶ 1; see also id. ¶¶ 75-86.

^{46/} See GATS, art. VIII.

supplier.^{47/} In addition, almost sixty countries (including the United States) agreed in the WTO telecommunications negotiations to a "Reference Paper" imposing regulatory obligations with respect to their domestic markets. The Reference Paper includes an obligation regarding anti-competitive practices: provides: "Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices."^{48/}

These affirmative GATS obligations are intended to facilitate the opening of world services markets, not to authorize national measures that violate the basic obligations of the GATS.^{49/} A "competition exception," therefore, does not exist because it could defeat the central market-opening purpose of these GATS obligations of MFN treatments, national treatment and market access. The Commission cannot avoid the fact that the NPRM's proposals would clearly violate the GATS obligations.

IV. NO COMMENTER PROVIDED ANY LEGAL AUTHORITY FOR THE COMMISSION TO ENFORCE MANDATORY BENCHMARKS OR ABROGATE EXISTING SETTLEMENT RATE AGREEMENTS

No commenter provided any legal support for the Commission to invalidate or rewrite existing settlement rate agreements between U.S. and foreign carriers. In its own comments, the Executive Branch recognized the legal shortcomings of the NPRM:

We are prepared to continue working with you so the Commission ensures that Executive Branch policies and legal authorities regarding national security, foreign

^{47/} See id., art. IX.

^{48/} Reference Paper, ¶ 1.1, attached to Communication from the United States, WTO Doc. S/GBT/W/1/Add.2/Rev.1, at 5 (Feb. 15, 1997).

^{49/} See Comments of GTE at 30-31 (arguing that the Reference Paper's competition provision does not justify an MFN violation).

policy, law enforcement, competition, and telecommunications, trade and investment policy, as well as interpretation of international agreements are respected.^{50/}

While the Executive Branch has moderated its tone, it has not retreated from its 1990 position that "the Commission cannot compel foreign entities to accept settlement rates prescribed by the Commission"^{51/} Thus far, neither the NPRM nor commenters such as AT&T or Sprint has heeded these concerns about the legal authority for imposing mandatory benchmarks on foreign carriers or invalidating their existing settlement rate contracts. The Commission still lacks authority under U.S. and international law to enforce the NPRM's proposals against foreign carriers.

A. The Communications Act Provisions Cited By AT&T And Sprint Do Not Allow The Commission To Invalidate Or Rewrite Existing Settlement Rate Agreements Between U.S. And Foreign Carriers

AT&T and Sprint claim that the Commission has the statutory authority to adopt the NPRM's proposals. The Communications Act, however, provides no such authority in the provisions cited by AT&T and Sprint: (1) Section 2; (2) Section 201; and (3) Section 205.

1. The Commission Lacks Jurisdiction Over Foreign Carriers Under Section 2 Of The Communications Act

Section 2 of the Communications Act fails to provide the Commission with the authority to prescribe and enforce international settlement rates against foreign carriers. Neither the general jurisdictional grant in Section 2(a) nor the connecting carrier exemption in Section 2(b) provides any basis for the NPRM's proposals.

^{50/} Comments of the Office of the U.S. Trade Representative, Dep't of Commerce, and Dep't of State, IB Docket No. 96-261, at 2 (filed Feb. 7, 1997) (emphasis added).

^{51/} Comments of the National Telecommunications and Information Administration, CC Docket No. 90-337, at 17 (filed Oct. 12, 1990).

First, both AT&T and Sprint mistakenly argue that the Commission's authority to regulate "foreign communication by wire or radio" under Section 2(a) includes the authority to enforce settlement rate benchmarks against foreign carriers.^{52/} Section 2(a) grants the Commission authority only over "all persons engaged **within the United States in such communication**. . . ."^{53/} Foreign carriers that merely provide the foreign half-circuit to terminate international calls via their own international and domestic network do not engage in foreign communications **within the United States** and are therefore not subject to the Commission's enforcement powers.

Sprint's admission that "one of the carrier parties to the agreement (e.g. a foreign carrier) is not subject to the Commission's jurisdiction" entirely undercuts the claim that the Commission has the authority to enforce settlement rate benchmarks against foreign carriers.^{54/} Jurisdiction is defined variously as "[a]uthority or control," "[t]he extent of authority or control," and "[t]he territorial range of authority or control."^{55/} Without jurisdiction over foreign carriers, the Commission lacks any statutory authority to enforce settlement rate benchmarks against those carriers or to control their settlement rate practices.^{56/}

^{52/} See Comments of AT&T at 47 (arguing that the Commission's rate prescription powers "are explicitly made applicable to all 'foreign communication by wire or radio' by Section [2(a)]"); Comments of Sprint at 5-6 (arguing that "[i]nasmuch as traffic settled under accounting rates either originates or terminates in the U.S., it falls squarely within the Act's definition of a 'foreign communication'").

^{53/} 47 U.S.C. § 152(a) (emphasis added).

^{54/} See Comments of Sprint at 5.

^{55/} American Heritage Dictionary 978 (3d ed. 1992).

^{56/} Uniform Settlement Rates on Parallel International Communications Routes: Memorandum Opinion and Order, 84 FCC 2d 121, 122 (1980) ("Unlike domestic telecommunications, our jurisdiction over international service applies only to one end of the service. Authority over the foreign end resides in the particular foreign correspondent.").

Second, contrary to AT&T's unsubstantiated assertion, Section 2(b) does not provide a loophole for direct Commission regulation of foreign carriers.^{57/} Section 2(b) does not grant the Commission jurisdiction beyond that granted in Section 2(a). To the contrary, Section 2(b) limits the jurisdiction otherwise granted in Section 2(a). Moreover, the D.C. Circuit has stated unequivocally that Section 2(b) was intended to immunize certain **domestic** local carriers from Commission jurisdiction: "The exclusion embodied in Section 2(b)(2) was meant to protect State jurisdiction over local telephone facilities" whose engagement in interstate communication was incidental to the provision of intrastate services.^{58/} Since Section 2(a) provides no basis for jurisdiction over foreign carriers and since Section 2(b) limits the Commission's jurisdiction further, Section 2(b) cannot possibly serve as a basis for asserting jurisdiction over foreign carriers.

Third, neither Section 2 nor any other provision of the Communications Act evidences the intent of Congress to apply the Communications Act's enforcement provisions extraterritorially. Proponents of enforcing benchmarks against foreign carriers must overcome the presumption against extraterritorial application of

^{57/} See Comments of AT&T at 56.

^{58/} General Telephone Co. of California v. FCC, 413 F.2d 390, 402 (D.C. Cir.), cert. denied, 396 U.S. 888 (1969). See also General Telephone Co. of Southwest v. United States, 449 F.2d 846, 855 (5th Cir. 1971) (citing with approval the D.C. Circuit's conclusions in General Telephone Co. of California). AT&T relies on a single Commission decision for its jurisdictional argument under Section 2(b)(2). See Comments of AT&T 51 n.86 (citing Western Union Telegraph Co.: Memorandum Opinion and Order, 75 FCC 2d 461, 476-77, 479 (1979)). The Commission's decision in Western Union, however, is of little precedential value because the Commission failed to note, much less distinguish: (1) the D.C. Circuit's rejection of jurisdiction over foreign carriers via Section 2(b)(2) in General Telephone Co. of California, or (2) the legislative history of Section 2(b)(2) which the D.C. Circuit examined in General Telephone Co. of California.

U.S. law.^{59/} This presumption "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord."^{60/} Because the Commission and the commenters who support the NPRM's proposals have failed to overcome the presumption against extraterritorial application, it must be assumed that the Congress intended the enforcement provisions of the Communications Act to apply only within the territorial jurisdiction of the United States.

Finally, lacking jurisdiction over foreign carriers under Section 2, the Commission cannot extend the enforcement provisions of Sections 201 and 205 to foreign carriers. Sections 201 and 205 themselves provide no textual authority for Commission jurisdiction over foreign carriers.

2. The Commission Lacks The Authority To Prescribe Settlement Rates Under Section 201 Of The Communications Act

AT&T and Sprint mischaracterize Section 201(b) of the Communications Act as a license to prescribe and enforce settlement rate benchmarks against foreign

^{59/} See Foley Bros., Inc. v. Filardo, 336 U.S. 281, 285 (1949) (noting the long-established canon of statutory construction that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."); Equal Employment Opportunity Comm'n v. Arabian American Oil Co., 499 U.S. 244, 250 (1991) ("EEOC v. Aramco") (finding that the petitioner had failed to overcome the presumption against extraterritorial application of Title VII to regulate the employment practices of U.S. employers who employ U.S. citizens abroad).

^{60/} EEOC v. Aramco, 499 U.S. at 248. See also Benz v. Compañía Naviera Hidalgo, S.A., 353 U.S. 138, 147 (1957) ("For us to run interference in such a delicate field of international relations there must be present the affirmative intention of the Congress clearly expressed. It alone has the facilities necessary to make fairly such an important policy decision where the possibilities of international discord are so evident and retaliative action so certain."). As for the possibility of retaliatory action in response to the NPRM, see Comments of Directorate General of Telecommunications, P&T, People's Republic of China, IB Docket No. 96-261, at 2-3 (filed Feb. 7 1997) ("China Telecom will never accept any unilaterally stipulated 'benchmark' settlement rates 'transition period'. Also, China Telecom will reserve the right to take certain countermeasures provided the FCC insists on doing so.").

carriers.^{61/} In fact, Section 201(b) explicitly limits the Commission's ability to regulate intercarrier rates involving foreign carriers. Following a grant of general authority to prescribe just and reasonable intercarrier rates, the second proviso of Section 201(b) of the Communications Act provides that

nothing in this [Act] or in any other provision of law shall be construed to prevent a common carrier subject to this [Act] from entering into or operating under any contract with any common carrier not subject to this [Act], for the exchange of their services, if the Commission is of the opinion that such contract is not contrary to the public interest^{62/}

This second proviso is thus a caveat to, not an enlargement of, the Commission's authority to regulate intercarrier rates.^{63/} The Commission is not authorized to prescribe rates for contracts with foreign carriers beyond the Commission's jurisdiction. Rather, the second proviso limits the Commission's authority to rejecting settlement rate contracts.^{64/} If the Commission refuses to approve a settlement rate contract, the

^{61/} See Comments of AT&T at 48 (claiming that the Commission may "prescribe what particular 'charges' and 'practices' carriers may adopt. By its terms, this authority applies to foreign as well as domestic communication services."); Comments of Sprint at 6 ("The Commission . . . has jurisdiction over the contracts between a U.S. carrier and a foreign carrier, including the rates established under those contracts.").

^{62/} 47 U.S.C. § 201(b) (emphasis added).

^{63/} See also Comments of GTE at A-12 (noting that Section 201(b)'s second proviso "is narrower than the authority to determine whether U.S. carriers' charges or other practices are 'just and reasonable' under the main body of section 201(b)").

^{64/} AT&T suggests that Section 211 of the Communications Act authorizes the Commission to invalidate or rewrite intercarrier contracts involving foreign carriers. Comments of AT&T at 50. The NPRM, however, does not rely on Section 211 as statutory authority for its proposals. See NPRM ¶ 19. Furthermore, Section 211 does not define or expand the Commission's jurisdiction over foreign carriers. See 47 U.S.C. § 211(a) (imposing requirements on "[e]very carrier subject to this chapter"). Section 211(a) thus indicates that it does not define the category of carriers subject to the Communications Act. AT&T also suggests that the Commission's power to prescribe rules and regulations somehow grant the Commission additional authority over foreign

(continued ...)

U.S. carrier must attempt to renegotiate the contract or else suffer the legal consequences of breach.^{65/} The Commission may choose to reject the contract for purposes of establishing the settlement rate, but it cannot impose its own rate on the foreign carrier and it cannot immunize the U.S. carrier from liability for breaching the contract.

3. The Commission Lacks The Authority To Prescribe Settlement Rates Under Section 205 Of The Communications Act

The Commission has no authority under Section 205 of the Communications Act to prescribe a settlement rate in the form of a benchmark or to enforce it against foreign carriers. Section 205 allows rate prescription only where a rate "is or will be in violation of any of the provisions of [the Communications Act]."^{66/} Accordingly, Section 205 applies only to rates (1) within Commission's jurisdiction, and (2) that violate another provision of the Communications Act.

^{64/} (... continued)

carriers. Comments of AT&T at 47. To the contrary, the Commission's power to prescribe rules and regulations "to carry out the provisions of [the Communications] Act" under Section 201(b) does not grant the Commission any authority to judge the validity of settlement rate agreements beyond that granted by the actual provisions of the Communications Act, such as the main body of Section 201(b). See 47 U.S.C. § 201(b).

^{65/} See RCA Communications, Inc. v. United States, 43 F. Supp. 851, 855 (S.D.N.Y. 1942) ("RCA Settlements Case") (noting that observance of the Commission's rate cap "will make it necessary for the [U.S. carrier], if it cannot secure an amendment of the existing agreements, either to break its contracts for foreign messages or to bear the loss on outgoing messages itself."). AT&T claims that these statements by the district court were not the holding of the RCA Settlements Case. Comments of AT&T at 54 n.95. Similar statements were, however, integral to the U.S. Supreme Court's holding in Regents of the University System of Georgia v. Carroll: "We do not read the Communications Act to give authority to the Commission to determine the validity of contracts between licensees and others." 338 U.S. 586, 602 (1950).

^{66/} 47 U.S.C. § 205(a).

Section 205 does not permit the Commission to enforce prescribed rates against foreign carriers since the Commission has no jurisdiction over these carriers. Sprint readily admits that the Commission "cannot require the foreign carrier to pay a particular settlement rate."^{67/} As the U.S. Supreme Court made clear in Carroll, however, the Commission is also powerless to immunize U.S. carriers from liability for breach of contract.^{68/} AT&T's suggestion that the Commission issue cease and desist orders to enforce prescribed rates would only expose AT&T and other U.S. carriers to liability.^{69/}

Even assuming that Section 205 gives the Commission the authority to enforce mandatory benchmarks against foreign carriers -- and surely it does not -- the NPRM's proposals ignore the procedural requirements of Section 205. To prescribe a rate under Section 205, the Commission must hold a hearing and make a finding that the proposed rate is not just and reasonable.^{70/} Even with jurisdiction, the Commission would violate these Section 205 requirements by prescribing rates through a rulemaking.

B. AT&T Misrepresents The Obligations Of The U.S. Government Under The ITU Regulations

Even if the Commission had jurisdiction over foreign carriers, adoption and enforcement of these proposals is still prohibited by the treaty obligations of the U.S. Government. AT&T has failed to demonstrate that the Commission has any

^{67/} Comments of Sprint at 7.

^{68/} Carroll, 338 U.S. at 602.

^{69/} See Comments of AT&T at 47-48.

^{70/} See 47 U.S.C. § 205; American Telephone & Telegraph Co. v. FCC, 487 F.2d 865, 874-75 (2d Cir. 1973) (noting that in prescribing rates for carriers subject to its jurisdiction, the Commission may not "circumvent[] the statutory hearing and finding requirements on the basis of its claimed broad inherent regulatory power").

authority under the Regulations of the International Telecommunications Union^{71/} to take the unilateral retaliatory actions proposed in NPRM.

1. Statement No. 69 Is Not A U.S. Reservation To The ITU Regulations

Recognizing that the NPRM's enforcement proposals are inconsistent with the binding treaty obligations of the U.S. Government, AT&T claims that Statement No. 69, made by the U.S. Government at the time of the signing of the ITU Regulations, excuses the U.S. Government from its treaty obligations.^{72/} Statement No. 69, however, is not a reservation at all, but instead the right to make future reservations, which the U.S. Government has not done.^{73/}

In submitting the ITU Regulations to the U.S. Senate for advice and consent, Secretary of State Eagleburger explained that Statement No. 69 was not a reservation. "In statement No. 69, the United States declared its right to submit further reservations at the time of deposit of its instrument of ratification. Because no additional U.S. reservations are proposed, this statement does not require ratification by the United States."^{74/}

The U.S. Government is further precluded from using Statement No. 69 as a basis to ignore U.S. Government treaty obligations because the Executive Branch: (1) did not make Statement No. 69 a reservation in the manner required by the ITU

^{71/} International Telecommunications Regulations: Telephone and Telegraph Regulations, done at Melbourne, Dec. 9, 1988, S. Treaty Doc. No. 102-13 (1991) (entered into force for the United States definitively Apr. 6, 1993) ("ITU Regulations").

^{72/} See Comments of AT&T at 53; ITU Regulations, Final Protocol, Statement No. 69 ("The United States of America . . . reserves its rights to take whatever acts it deems necessary, at any time, to protect its interests.").

^{73/} See Letter of Submittal of U.S. Sec'y of State Lawrence Eagleburger at 3 (July 15, 1991), reprinted in S. Treaty Doc. No 102-13, at X (1991) ("Letter of Submittal").

^{74/} Id.

regulations;^{75/} and (2) did not reaffirm Statement No. 69 in its instrument of ratification -- an action required for a reservation to be effective as a matter of international law.^{76/} The U.S. Government may not, therefore, take any action pursuant to Statement No. 69 -- such as the imposition of mandatory settlement rates on foreign carriers -- that is otherwise inconsistent with the ITU Regulations.^{77/}

2. The ITU Regulations Forbid, Rather Than Invite, Interference By Foreign Governments In A Carrier's Settlement Rate Practices

AT&T misrepresents the text of the ITU Regulations in a strained effort to provide the Commission with some authority to determine the validity of settlement rate agreements. AT&T suggests that the ITU Regulations authorize the Commission to enforce obligation of carriers to "establish and revise accounting rates . . . taking into account . . . relevant cost trends."^{78/} The ITU Regulations, however, clearly forbid such unilateral government action. **First**, the ITU Regulations require "mutual agreement" of

^{75/} The ITU Regulations permit reservations so long as they apprise the other parties of the reserving party's understanding of its obligations. See ITU Regulations, art. 10.3.

^{76/} See Letter of President George Bush Ratifying the ITU Regulations (Dec. 23, 1992) (on file with the U.S. Dep't of State); Standards on Reservations to Inter-American Multilateral Treaties art. A.2, OAS Doc. OEA/Ser.P, AG/doc.375/73 rev. 1 (Apr. 12, 1973) ("Reservations to a treaty have no effect whatever if the reserving state does not reiterate them at the time of depositing its instrument of ratification or adherence."), reprinted in Digest of U.S. Practice in Int'l Law 180 (1973).

^{77/} Ironically, the sole reservation to the ITU Regulations taken by the U.S. Government reflects concern about extraterritorial application of other countries' laws and regulations: "The United States of America formally declares that it does not, by signature of these Telecommunications Regulations, nor by any subsequent approval thereof, . . . accept any obligation to enforce any provision of the domestic law or regulations of any other Member." ITU Regulations, Final Protocol, Statement No. 39. In effect, the United States reaffirmed "the sovereign right of each country to regulate its telecommunications" as enshrined in the Preamble to the ITU Convention.

^{78/} See Comments of AT&T 57; ITU Regulations, art. 6.2.1.

the carriers to enter into or revise settlement rate agreements.^{79/} Under the NPRM, however, the Commission would act unilaterally and in spite of the protests of other ITU Members and of the ITU itself.^{80/} **Second**, the ITU Regulations grant only carriers the authority to conclude settlement rate agreements.^{81/} While the ITU Regulations in no way infringe upon the rights of ITU Member governments to regulate their carriers, they do not allow those governments to control other Members' carriers.

V. THE COMMISSION SHOULD IMPOSE COST-BASED RATES ON U.S. CARRIERS BEFORE IMPOSING COST-BASED RATES ON FOREIGN CARRIERS

The NPRM specifically expressed concern with the high IMTS prices and margins enjoyed by U.S. carriers, which the Commission "attribut[ed] in part to limited competition in the IMTS market. . . ."^{82/} AT&T and the other U.S. carriers ignored this

^{79/} ITU Regulations, art. 6.2.1. & App. 1, § 1.1.

^{80/} See Comments of ITU at 1-2. The initial comments of ITU members and their carriers evidence a serious dispute over the scope and application of the ITU Regulations. The International Telecommunications Union Convention the United States to resolve this dispute only by seeking arbitration with the other ITU parties, not by unilaterally seeking to impose settlement rates. See International Telecommunication Convention, done at Nairobi, Nov. 6, 1982, S. Treaty Doc. No. 99-6 (1985) (entered into force for the United States definitively Jan. 10, 1986). The ITU Convention forbids the U.S. Government from resorting to unilateral action. Id. See also Comments of Telefónica Internacional at 20-21.

^{81/} ITU Regulations, art. 6.2.1 & App. 1, § 1.1. AT&T's suggestion that the parties to settlement rate agreements contemplated governmental interference is therefore specious. See Comments of AT&T 51-52. Moreover, any such interpretation of the settlement rate contracts would depend upon the law of state or country governing the provisions of the contract. Because most settlement rate agreements do not include choice-of-law or forum selection provisions, it is not clear which jurisdiction's contract law would apply.

^{82/} NPRM ¶ 9.

portion of the NPRM, making no attempt to justify their average margins of \$0.55 per minute on international calls.^{83/}

Foreign governments, foreign carriers and even some U.S. carriers, however, were quick to point to the hypocrisy of attempting to force down toward cost the rates foreign carriers charge for use of their domestic networks while not attempting to decrease the much larger margins of U.S. carriers. Even the United Kingdom Government, which is generally sympathetic to the goal of reducing settlement rates, notes that it may be difficult to convince some countries that they should reduce their settlement rates when U.S. carriers already enjoy "a margin of some 175% between settlement and collection rates"^{84/}

^{83/} Comments of Telefónica Internacional at 25-26.

^{84/} Comments of United Kingdom Government, IB Docket No. 96-261, at 3 (filed Feb. 7, 1997); see also Comments of Pacific Bell Communications, Inc., IB Docket No. 96-261, at 3-4 (filed Feb. 7, 1997) ("Accounting rates have steadily declined (in terms of cents per minute) during the last decade. . . . During the same period, collection rates (and with them collection revenues) have continually increased.") (footnotes and citations omitted); Comments of GTE at 7 & Attachs. 1,2 (AT&T's retained revenue exceeds settlement rates on numerous routes); Comments of Cable & Wireless, Inc., IB Docket No. 96-261, at 18-19 (filed Feb. 7, 1997) (collection rates have increased on U.S. to Hong Kong route while settlement rates have decreased); Comments of CANTO at 2 ("U.S. carriers have refused to agree to lower their collection rates in exchange for a lower settlement rate"); Comments of Telecom Italia at 4 ("The available American evidence indicates that the operating margins now enjoyed by U.S. international carriers on calls to Italy range from about 60 to more than 80 percent") (citing P. W. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services 270 (MIT Press, 1996)); Comments of KDD at 10 (during the period 1990-1995, settlement rates on U.S.-Japan decreased 53% while AT&T's collection rate decreased only 13%); Comments of Singapore Telecommunications Ltd., IB Docket No. 96-261, at 10 (filed Feb. 7, 1997) ("Rather than seeking to regulate the settlement rates charged by foreign carriers, the FCC should seek to regulate the retail rates charged by U.S. carriers to U.S. consumers"); Comments of Telstra Corporation Ltd., IB Docket No. 96-261, at 4-5 (filed Feb. 4, 1997) (settlement rates on U.S.-Australia route have declined 44% while AT&T has raised its collection rate twice); Comments of VSNL at 5 (the "FCC should concern itself with the per minute margin of US carriers as this is a matter wholly within its jurisdiction and
(continued ...)

AT&T attempts to show that it has passed settlement rate decreases through to consumers.^{85/} There are two problems with AT&T's analysis. **First**, once the correct data are used, it is clear that AT&T has not passed all of its settlement rate reductions through to U.S. consumers. **Second**, and more significantly, even if AT&T actually passed through all settlement rate reductions, AT&T would still be left with an enormous price-cost margin that dwarfs the margin that foreign carriers receive for carrying half of the call.

A. AT&T Has Not Passed All Settlement Rate Reductions Through To U.S. Consumers

Contrary to its assertions, AT&T has not passed all settlement rate reductions through to U.S. consumers.^{86/} AT&T relies on a data series that does not accurately measure settlement rate reductions to make its claim. The much more accurate data series published by the Commission and relied on in the NPRM makes it clear that AT&T does not pass through all settlement cost savings to consumers.

The Commission calculates weighted average settlement rate data on an annual basis and reports this series in "Accounting Rates For International Message Telephone Service Of The United States."^{87/} The Commission relied on this data in the NPRM, stating that the weighted average settlement rate declined from \$0.515 per

^{84/} (... continued)

would help FCC to achieve its aim of lowering the collection rate charge by US carriers to US residents"); Comments of Hong Kong Telecom International at 11-12, 19-21 & Apps. A & B ("The accounting rate between Hong Kong and the U.S. has declined by 57% in the last five years. Yet, the consumer rates charged by AT&T for calls to Hong Kong have been increased a number of times in the same period").

^{85/} Comments of AT&T at 9-12.

^{86/} Id. at 10.

^{87/} See, e.g., FCC, Accounting Rates For International Message Telephone Service Of The United States 6 (Dec. 1, 1996).

minute in 1992 to \$0.365 per minute in 1996.^{88/} Telefónica Internacional used the same Commission data series to show that weighted average settlement rates have declined 48%, from \$0.70 per minute in 1987 to \$0.365 per minute in 1996.^{89/}

Figure 1 shows AT&T's (1) collection rates, (2) weighted average settlement costs, and (3) margin between collection rates and settlement costs for 1991 to 1995. AT&T's collection rates come from AT&T's Chart A,^{90/} the weighted average settlement cost data are taken from the Commission's official publication relied on in the NPRM,^{91/} and the margin is just the difference between the two.

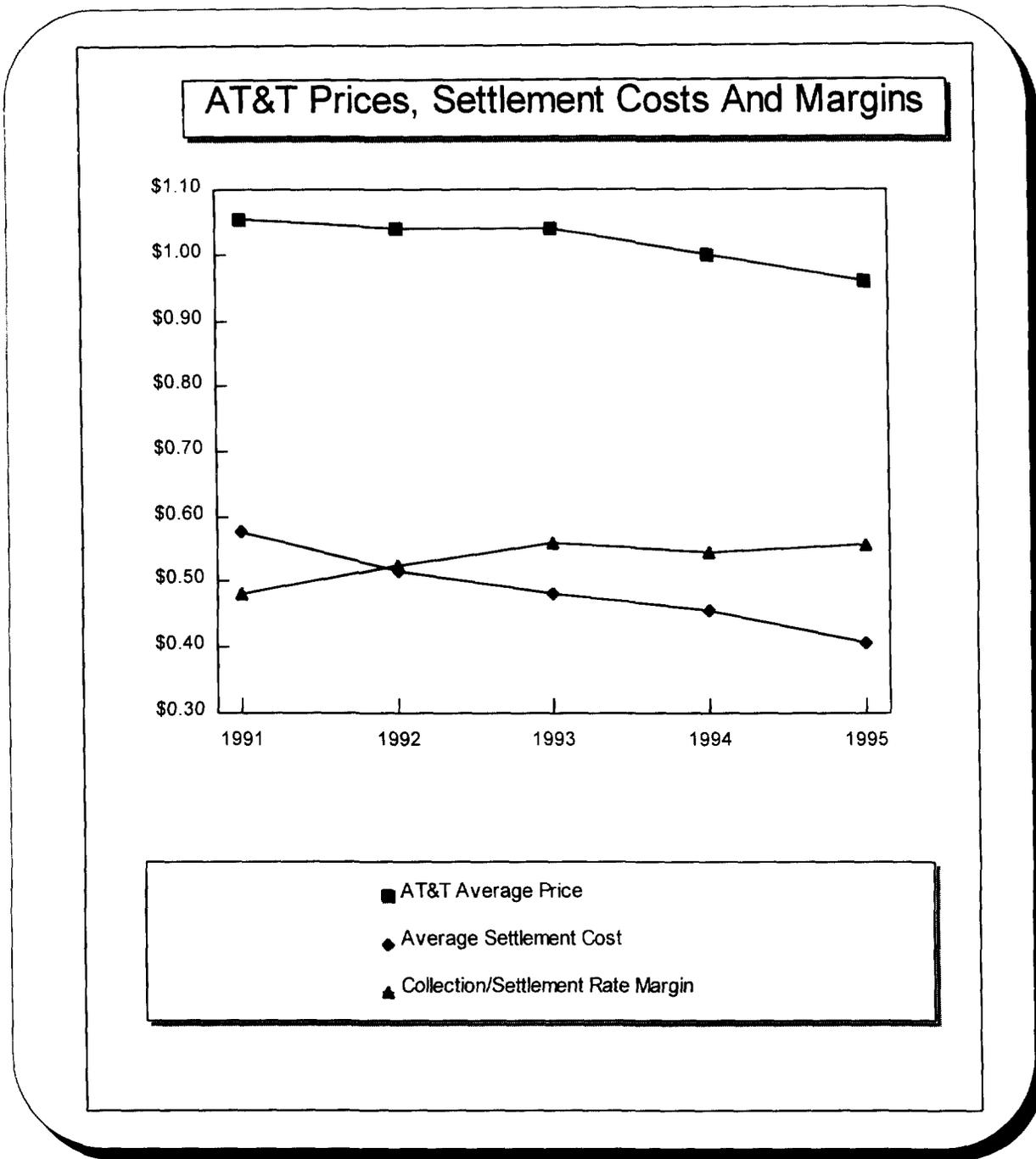
^{88/} NPRM ¶ 26 & n.34.

^{89/} Comments of Telefónica Internacional at 26-27 & fig. 1.

^{90/} Comments of AT&T at 7. In addition, Figure 1 contains data for 1991 taken from AT&T's Section 43.61 filings with the FCC.

^{91/} FCC, Accounting Rates For International Message Telephone Service Of The United States at 6.

Figure 1



Between 1991 and 1995, AT&T's weighted average settlement rate costs declined \$0.17, from \$0.575 to \$0.405. AT&T's average collection rate, however, declined only \$0.095, from \$1.055 to \$0.96. Thus, AT&T kept 44% -- \$0.075 per minute -- of the cost savings for itself. Moreover, during the same period, AT&T also

benefited from decreased domestic access charges of more than \$0.01 per minute,^{92/} and decreased network costs through improved technology.^{93/} Unfortunately, data on AT&T's collection rates are not yet available for 1996. The Commission, however, has determined that settlement rates **decreased** another 10%, \$0.04 per minute, to \$0.365 per minute in 1996.^{94/} Meanwhile, AT&T **increased** its international rates by an average of 4.8% in 1996.^{95/}

Not wanting to face these facts, AT&T derives a new data series for measuring settlement rate reductions based on Section 43.61 data reported to the Commission. The data used by AT&T do not accurately measure settlement rate decreases because: (1) they include significant surcharges and other fees that are not in the basic settlement rate; and (2) they include payments and revised payments for previous years. The benchmarks proposed in the NPRM do not include amounts for surcharges or out-of-period payments, and a proper analysis of the amount of settlement rate decreases should not either.

B. AT&T Cannot Defend Its Large And Increasing Price-Cost Margin

Even if AT&T had passed all settlement rate reductions through to consumers in the past, or was required to do so in the future, AT&T would still be left with much greater margins above incremental costs than foreign carriers for calls originating in the United States. Accepting AT&T's data for illustrative purposes only, Figure 2 replicates AT&T's Chart B and adds a new line showing the incremental cost

^{92/} Monitoring Report, Table 5.11 at 474 (CC 87-399) (May 1996).

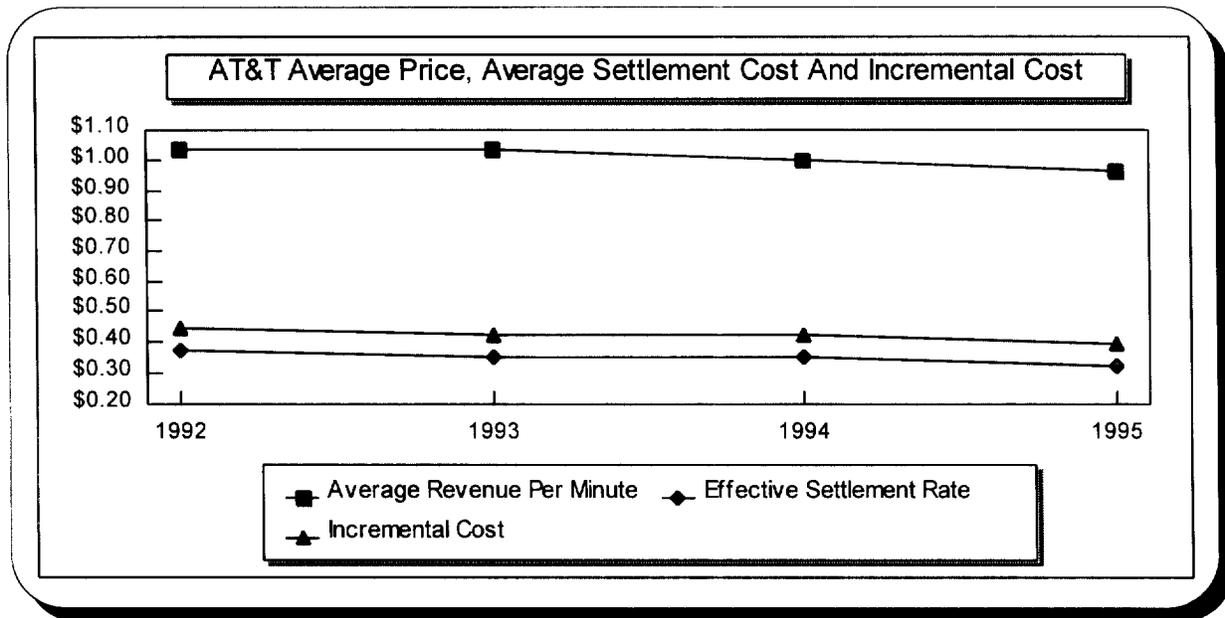
^{93/} NPRM ¶ 9.

^{94/} FCC, Accounting Rates For International Message Telephone Service Of The United States at 6.

^{95/} John J. Keller, AT&T and Rivals Boost Rates Further, Wall St. J., Nov. 29, 1996, at A-3.

to AT&T of providing IMTS, based on the "effective settlement rate" calculated by AT&T and the \$0.075 per minute average network cost figure supplied by AT&T.

Figure 2

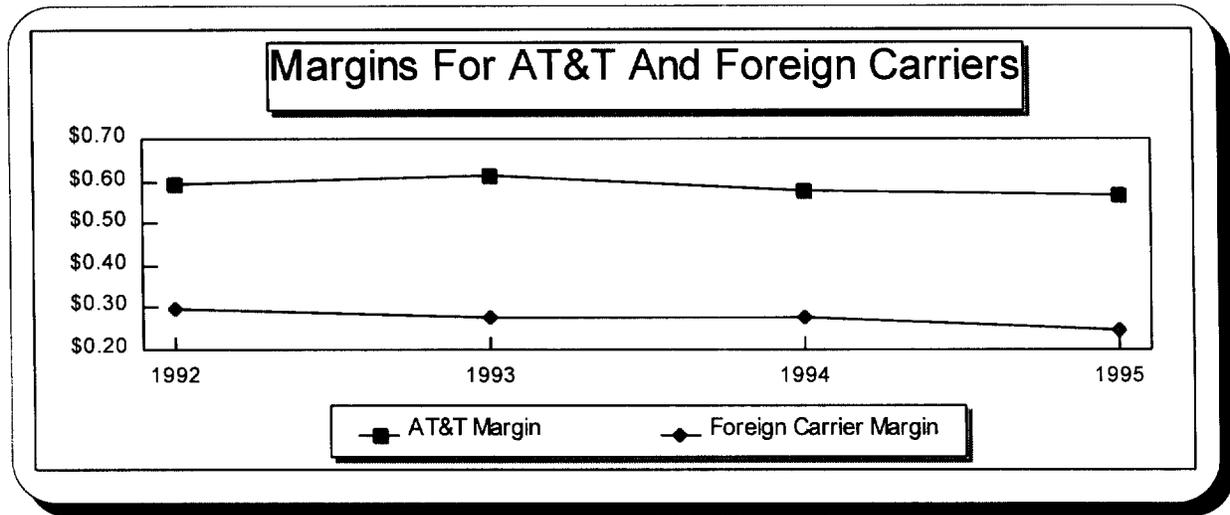


The entire region between AT&T's average revenue per minute (top line with squares) and AT&T's incremental cost (middle line with triangles) is AT&T's margin above incremental cost. According to AT&T's own calculations, its margin for IMTS was at least \$0.565 per minute each year.^{96/}

Figure 3 compares AT&T's margin above incremental cost with the margin above incremental cost for the foreign carrier for calls originating in the United States.

^{96/} This is more than the \$0.55 per-minute margin calculated previously by Telefónica Internacional. See Comments of Telefónica Internacional at 25-26.

Figure 3



Using AT&T's own U.S. IMTS figures, AT&T's price-cost margin on U.S. outbound international calls of \$0.565 per minute in 1995 is more than twice the average foreign carriers' margin of \$0.245 per minute.^{97/}

If the Commission wants to reduce collection rates charged to U.S. consumers, then the Commission should focus on reducing the enormous margins of AT&T and other U.S. carriers instead of on settlement rates. The U.S. carriers' margins are more than twice the size of the margins of foreign carriers. Moreover, the Commission has no legal, policy or moral basis for limiting foreign carriers to recovery of their incremental costs for carrying traffic on their domestic and international networks before the Commission places the same limitation on U.S. carriers.

^{97/} AT&T margin is computed as AT&T's Average Revenue Per Minute (from AT&T Chart B) - AT&T's Effective Settlement Rate (from AT&T Chart B) - Average Network Costs (which AT&T asserts are \$0.075 per minute). The foreign carrier's margin is computed as the Effective Settlement Rate (from AT&T Chart B) - Average Network Costs.

VI. THE COMMISSION SHOULD TIE ANY MANDATORY SETTLEMENT RATE REFORM TO RATE REBALANCING

As Telefónica Internacional demonstrated in its initial comments, any unilateral effort by the Commission to lower settlement rates should be tied to rate rebalancing for two reasons. **First**, the ability of foreign carriers to reduce settlement rates depends on effective rate rebalancing in their home markets. Most foreign carriers cannot make settlement rate reductions (1) without corresponding collection rate reductions to avoid losing more market share to callback services, and (2) without corresponding local rate increases to make up for the revenues that have been typically used for subsidizing universal service. Such rate rebalancing is itself tied to a host of sensitive domestic political and economic issues, such as infrastructure development and universal service, that are the province of foreign governments, not carriers.^{98/}

Second, tying settlement rate reductions to rate rebalancing will align the interests of foreign carriers with those of the FCC and the U.S. carriers in lower settlement rates. In addition, foreign carriers need rate rebalancing in order to respond to increased competition. By aligning its interests with those of foreign carriers, the FCC's efforts to reduce settlement rates will be much more likely to succeed.

Telefónica Internacional explained in its initial comments that the settlement agreements entered into by U.S. carriers and Telintar offer an important model of how settlement rate reductions can be tied to rate rebalancing.^{99/} As the Financial Times recently explained, "Argentina boasted some of the world's cheapest

^{98/} Comments of Telefónica Internacional at 40-43. See also Comments of the Republic of Panama, IB Docket No. 96-261, at 27 & 32 (filed Feb. 7, 1997); Comments of GTE at 21-22; Comments of the National Telecommunications Commission of the Republic of the Philippines, IB Docket No. 96-261, at 32-33 (filed Feb. 4, 1997); Comments of Teléfonos de Mexico, S.A. de C.V., IB Docket No. 96-261, at 20-21 (filed Feb. 7, 1997) ("Comments of Telmex").

^{99/} Comments of Telefónica Internacional at 47-49.

local calls and most expensive long distances charges."^{100/} Telintar and Telefónica de Argentina ("TASA") have worked for years to obtain the rate rebalancing which would make them more competitive. Telintar has contracted with MCI, WorldCom and Sprint to significantly reduce settlement rates as soon as rate rebalancing was permitted by the Argentine Government.

It now appears that the efforts by Telintar and TASA to obtain broad rate rebalancing succeeded. The Argentine Government has permitted significant rate reductions for international and domestic long distance services, while permitting local rates to be increased. International rates have decreased an average of 43 percent. This reduction has already had a marked impact on the settlement imbalance: with more calls being placed to the United States, the imbalance is already dropping.

This government-approved rate rebalancing has permitted Telintar to follow through on its advance commitments with MCI, WorldCom, and Sprint for settlement rate reductions tied to rate rebalancing. Accordingly, effective January 1997, Telintar's accounting rate dropped to \$1.12 per minute. This rate will drop further to \$0.92 effective February, 1997 and to \$0.85 effective October, 1997, a reduction of \$0.58 per minute (41%) since 1996.

The agreements between the U.S. carriers and Telintar demonstrate that tying settlement rate reductions to rate rebalancing works. The Argentine carriers needed rate rebalancing in order to reduce settlement rates. The U.S. carriers (and U.S. Government) wanted lower settlement rates. By contractually tying the two goals together, the Argentine carriers were provided with an incentive to obtain significant settlement rate reductions through necessary rate rebalancing. After a lengthy political struggle, the Argentine carriers successfully persuaded the Argentine Government to adopt rate rebalancing.

^{100/} Mathew Doman, Reforms Provoke Protest, Financial Times, Mar. 19, 1997, at TC7.

Contrary to AT&T's complaints that tying settlement rate reductions rate rebalancing "has no legal or practical value,"^{101/} Telintar followed through on its contractual commitments to provide U.S. carriers with settlement rate reductions of 41% by the end of 1997. Indeed, AT&T has rushed to join its U.S. counterparts in signing a new settlement rate agreement with Telintar adopting the same settlement rates made possible by the agreement tying settlement rate reductions to rate rebalancing.^{102/} Similarly, any FCC policy that imposes mandatory settlement rate reform must tie settlement rate reductions to rate rebalancing in order to recognize the important economic, political and legal realities facing foreign carriers.

The Argentine example also demonstrates that there are many highly sensitive domestic political, economic and legal issues embedded in rate rebalancing. The Financial Times reports that:

Thousands of Argentines have taken to the streets to protest the impact on their wallets of the latest preparatory move for eventual wider opening of the country's telecoms marketplace.

The cause of the public outcry has been a long-discussed and, most argue, long-overdue realignment of the long-distance and local call charges levied by Argentina's telephony twins, Telecom and Telefónica. . . .

The price changes mean line rental and local call charges will increase by about 40 per cent, but distance rates will fall by as much as 60 per cent. That is, if the besieged government of President Carlos Menem holds the line in face of the widespread public and internal political protest.

^{101/} AT&T Opposition to Request by MCI for Waiver of International Settlements Policy to Implement Change in Accounting Rate for Switched Voice Service with Argentina at 2 (Nov. 5, 1996) (ISP 96-W-393).

^{102/} Letter from Martin Gitter, District Manager, Law and Public Policy, AT&T to William F. Caton, Acting Secretary, Federal Communications Commission (Mar. 24, 1997).

The loudest opposition to change comes from lower and middle-class phone users in and around Buenos Aires. With little need to either call abroad or to phone other Argentine provinces, they face on the downside of the supposedly revenue-neutral rate rebalance.^{103/}

In addition, the government's rate rebalancing program has been subject to numerous court actions.^{104/}

The street demonstrations and court actions in Argentina underline the fact that neither the FCC nor foreign carriers can dictate the timetable for the necessary rate rebalancing. Nevertheless, by tying the goal of lower settlement rates directly to rate rebalancing, the Commission can at least be sure that the foreign carrier is working to obtain lower settlement rates.

Both the NPRM and AT&T propose transition schedules that do not allow countries the necessary time to rebalance their rates. AT&T's proposal, in particular, is absurdly unrealistic, as it would require all countries, regardless of level of development, to meet the Commission's benchmarks in less than three years.^{105/} This draconian schedule is premised on the assumption that foreign carriers have the ability to lower their settlement rates at will and that they have refused to do so to date out of sheer "intransigence,"^{106/} "recalcitrance," and "footdragging."^{107/} Such an assumption is completely unwarranted. As just discussed, the ability of foreign carriers to lower their

^{103/} Doman, Reforms Provoke Protest at TC7.

^{104/} For example, in Defensor del Pueblo de la Nacion v. Estado Nacional, the plaintiff, Nation People's Defender, is seeking to overturn Article 2 of Decree 92/97 in order to maintain the current rate structure. A similar action has been filed by the Argentinean Consumers Association. A final decision on this issue is expected shortly from the Supreme Court of Justice.

^{105/} Comments of AT&T at 20.

^{106/} Id. at 13.

^{107/} Id. at 20.

settlement rates is frequently tied directly to domestic rate rebalancing which the carriers do not control. To provide foreign carriers with the incentive to reduce settlement rates, these reductions should be tied to rate rebalancing.

The Commission should thus not shorten the transition schedule, as AT&T proposes, but tie the transition schedule for any mandatory settlement rate reform directly to rate rebalancing. Such a correlation would ensure that settlement rate reductions occur as quickly as is politically and economically possible.

VII. THE COMMISSION SHOULD NOT CONDITION THE AUTHORIZATIONS OF FOREIGN-AFFILIATED CARRIERS ON SETTLEMENT RATES WITHIN THE BENCHMARK

The Commission should not condition the entry of foreign-affiliated carriers on settlement rates within the proposed benchmarks.^{108/} While such a condition is not necessary to deter anti-competitive behavior, it would create a harmful barrier to entry, stifling competition in both the U.S. and global telecommunications markets.

The Economic Strategy Institute ("ESI") asserts that there are two anti-competitive practices that foreign carriers can engage in to create advantages in the U.S. international services market: price squeezing and transfer pricing.^{109/} Both of these assertions are wrong. **First**, ESI claims that, once in the U.S. market, a foreign carrier:

could use its monopoly power to protract or raise already above-cost accounting rates (i.e. include some of the costs of its U.S. affiliate in the charge), and then underprice competitors along domestic and international service routes. In addition, [a carrier] could replicate this pattern on other

^{108/} NPRM ¶ 80. See also Comments of Telefónica Internacional at 70; Comments of Hong Kong Telecom International at 17, 25-26; Comments of Telmex at 24-27; Comments of GTE at 24-26; Comments of Sprint at 21-24; Comments of KDD at 24-25.

^{109/} Erik R. Olbeter, Reforming the Accounting Rate Regime, Economic Strategy Institute (Feb. 1997).

routes where it maintains a monopoly in the foreign country.

^{110/}

In other words, ESI asserts that a foreign carrier could use above-cost accounting rates to price squeeze its competitors. This argument is wrong. Neither a foreign carrier nor its affiliate have the ability to raise the price of inputs at the U.S. end of a call -- the essential ingredient in a price squeeze. As the Commission itself has recognized, whether or not the settlement rates are above-cost is irrelevant, as the foreign-affiliate will also be paying (or the foreign carrier will forgo) those funds.^{111/}

Additionally, as ESI itself acknowledges,

[i]f the market for foreign international facilities-based communication is competitive (and assuming no capacity restraints exist), then foreign firms cannot raise prices without losing business and hence no price squeeze can occur.^{112/}

ESI assumes that such a competitive environment will take more than ten years to develop.^{113/} However, the WTO Telecom Agreement provides for competitive markets in many countries within a year. Thus, even if a price squeeze were possible in a monopoly environment, it would not be possible in the post-WTO Telecom Agreement world.

Second, ESI asserts that foreign firms can use transfer pricing to price squeeze their U.S. competitors.^{114/} Again, ESI is wrong. Regardless of whether a

^{110/} Olbeter, Reforming the Accounting Rate Regime at 7.

^{111/} NPRM ¶ 80.

^{112/} Id.

^{113/} Id.

^{114/} Olbeter, Reforming the Accounting Rate Regime at 29; Robert Cohen, International Message Telephone Service and Competition: An Economic Analysis of Price Squeezes and Its Implication for International Settlement Rates and Rules on Foreign Entry into the U.S. Communications Industry, Economic Strategy Institute at 37 (Feb. 1997).