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June 5, 1997

Mr. William Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Room 222 Mail Stop 1170  
Washington, D.C. 20554

Re: Ex Parte Presentation in IB Docket No. 96-261

Dear Mr. Caton:

On behalf of Kokusai Denshin Denwa Co. Ltd. ("KDD"), we are submitting this letter to supplement the record in the above-referenced proceeding to include the FCC's recent decisions in the Access Charge Reform and Universal Service proceedings. See Access Charge Reform, CC Docket Nos. 96-262 et al., FCC 97-158, rel. May 16, 1997 [hereinafter "Access Reform Decision"]; Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 97-157, rel. May 8, 1997 [hereinafter "Universal Service Decision"]. Although KDD has not attached copies of those decisions to this letter due to their length, we hereby incorporate those decisions into the record in the above-referenced rulemaking proceeding.

KDD submits that the FCC's decisions in the Access Charge Reform and Universal Service proceedings are inconsistent, as shown below, with the FCC's settlement rate benchmark proposals in IB Docket No. 96-261. International Settlement Rates, IB Docket No. 96-261, FCC 96-484, rel. Dec. 19, 1996 (Notice of Proposed Rulemaking) [hereinafter "Settlement Rate Notice"]. These inconsistencies are troubling not only because they cast doubt upon whether the FCC may adopt its settlement rate benchmark proposals consistent with the standards of the Administrative Procedure Act (5 U.S.C. § 706), but also because they raise serious issues of compliance with the National Treatment principle

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pursuant to the recent World Trade Organization ("WTO") agreement, which will become effective on January 1, 1998. Therefore, KDD urges the FCC that, to the extent the FCC proceeds further to adopt mandatory settlement rate benchmark policies,<sup>1</sup> the FCC modify its settlement rate benchmark proposals in IB Docket No. 96-261 to be consistent with the actions taken by the FCC in the Universal Service and Access Charge Reform proceedings.

#### A. Transition Period.

In the Settlement Rate Notice (at ¶ 63), the FCC proposed to establish a transition period for foreign carriers to comply with FCC-prescribed settlement rate benchmarks ranging from one to four years depending upon the level of economic development of the foreign country. For high-income countries such as Japan, the FCC proposed a one-year transition period beginning from the effective date of the FCC's rules adopting mandatory settlement rate benchmarks.

By contrast, in the Access Reform Decision, the FCC effectively created a transition period of at least five years for U.S. incumbent local exchange carriers ("ILECs") to reduce their interstate access rates to reflect forward-looking economic costs. The FCC stated that it would not prescribe cost-based access rates for the ILECs at this time, and that it would require ILECs to submit forward-looking economic cost studies no later than February 8, 2001 (i.e., five years after the effective date of the Telecommunications Act of 1996) for all access services which are not subject to substantial competition at that time. Access Reform Decision at ¶ 267. The FCC stated that it chose the five-year transition period "in order to give competition sufficient time to develop substantially in the various markets for interstate exchange access services." Id. at ¶ 268. The FCC also justified a five-year transition period because it would give the FCC additional time to develop the "regulatory tools" necessary to establish cost-based access rate benchmarks. Id.

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<sup>1</sup> Through submission of this letter, KDD does not modify its position, as stated in comments and reply comments filed in the above-referenced proceeding, that the FCC should not adopt its settlement rate benchmark proposals. As KDD demonstrated in its comments and reply comments, the FCC cannot adopt its proposals because it lacks the necessary sovereign and statutory jurisdiction; the proposals are contrary to binding international regulations; the FCC has misapprehended the nature, causes and consequences of the settlements imbalance; there is no empirical support for the FCC's proposals in the record; and the proposals would violate the Most Favored Nation and National Treatment obligations under the WTO Agreement. This letter raises considerations that apply only in the event the FCC decides, notwithstanding the objections of KDD and other commenting parties, to adopt mandatory settlement rate policies.

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The FCC's transition proposal in IB Docket No. 96-261 cannot be reconciled with the five-year transition it adopted in the Access Charge Reform proceeding. If the FCC believes that the U.S. telecommunications industry should have five years after the effective date of the Telecommunications Act of 1996 to produce a market solution to the problem of high domestic access rates, then the FCC should give foreign countries at least five years after the effective date of the WTO agreement (*i.e.*, until January 1, 2003) to develop an effective market response to the problem of high global settlement rates.

It is clearly appropriate to begin any transition to FCC-prescribed settlement rate benchmarks with the effective date of the WTO agreement. The FCC chose to measure the five-year transition period for domestic access rates from the effective date of the Telecommunications Act of 1996 presumably because that legislation established a binding legal framework for the development of exchange access competition in the United States. That rationale justifies beginning any transition to FCC-prescribed settlement rate benchmarks with the WTO agreement, which establishes a binding global framework for the development of national telecommunications competition in countries who are signatories. As to the length of the appropriate transition period, there is no reason to believe that the U.S. industry will develop competitive solutions for local markets in the United States more slowly than foreign countries will develop competitive solutions for their national markets. Therefore, KDD submits that if the FCC proceeds with its proposal to adopt settlement rate benchmarks, it should adopt a transition period for settlement rate benchmarks of at least five years beginning from the effective date of the WTO agreement.<sup>2</sup>

Applying the same transition period to settlement rates as to interstate access charges also is justified by the reality that settlement rates are the functional equivalent of terminating access charges for international switched traffic. In particular, U.S. international carriers hand-off international switched traffic to foreign carriers in much the same manner that U.S. carriers hand-off domestic long distance traffic to an ILEC at the terminating end

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<sup>2</sup> It is no answer to suggest that foreign carriers have already enjoyed a transition period measured from the FCC's initial efforts to persuade foreign carriers to reduce settlement rate levels in CC Docket No. 90-337 or perhaps the adoption of CCITT Rec. D.140. It is only with the adoption of the WTO agreement that countries have a binding obligation to open their telecommunications markets to competitive entry, just as the conditions for local competition in the United States did not fully exist until adoption of the Telecommunications Act of 1996. Were the FCC to have begun the access charge transition period from the first efforts to introduce local access competition in the United States, it would have started with the FCC's Expanded Interconnection proceeding (CC Docket No. 91-141) in 1992, if not the creation of the access charge regime itself in 1983, rather than the Telecommunications Act of 1996.

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of the call. By contrast, settlement rates bear much less similarity to unbundled network elements, where a carrier purchases an entire facility or network functionality from an ILEC for its exclusive use. 47 U.S.C. § 251(c)(3). When U.S. carriers pay a single, per-minute settlement rate to have their traffic terminated in a foreign country, they do not purchase the facilities or network functionalities used by the foreign carrier to terminate the traffic. Therefore, in determining the appropriate transition period for FCC-prescribed settlement rates, the appropriate comparison is with the FCC's treatment of domestic access rates, not unbundled network elements.

### **B. Reliance Upon Market Forces.**

In the Settlement Rate Notice (at ¶ 47), the FCC proposed to adopt final rules specifying mandatory settlement rate benchmarks with which each foreign carrier would be expected to comply by the end of the applicable transition period. The FCC proposed such benchmarks despite acknowledging that it lacked data on foreign carriers' termination costs. E.g., Settlement Rate Notice at ¶ 33. There is no reason to believe that the FCC's proposed settlement rate benchmarks are the settlement rates that would be produced in a competitive market environment. Nevertheless, the FCC has proposed to prescribe such rates through regulation rather than rely upon global market forces to generate market-driven settlement rates under the new WTO agreement.

By contrast, the FCC did not calculate in advance the cost-based access rates that U.S. ILECs would be expected to implement by February 8, 2001. Rather, the FCC adopted a market-based approach on the theory that "competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers." Access Reform Order at ¶ 42. The FCC stated that "emerging competition will provide a more accurate means of identifying implicit subsidies and moving access prices to economically sustainable levels." Id. at ¶ 44. The FCC reasoned that "where competition is developing, it should be relied upon in the first instance to protect consumers and the public interest." Id. The FCC also noted that any FCC-prescribed rates inevitably would be inaccurate and risk causing uneconomic market distortions as well as harmful industry disruption. Id. at ¶¶ 45-46.

KDD submits that the FCC's decision to rely in the first instance upon market forces to generate cost-based access rates in the United States cannot be reconciled with its proposal to prescribe mandatory settlement rate benchmarks without regard to global market forces that exist today and which will intensify significantly after the WTO agreement becomes effective on January 1, 1998. If the FCC truly believes that competitive forces should be relied upon in the first instance to generate market-driven results, then it should apply that approach to international settlement rates. Certainly, the risk that FCC-prescribed rates will be inaccurate, cause uneconomic distortions, and generate harmful industry

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disruption is as great, if not greater, for international settlement rates than for domestic access charges.

Moreover, there is no basis for suggesting that the WTO agreement will be less successful than the Telecommunications Act of 1996 in generating competitive entry into previously closed market segments. In the Access Reform Decision (at ¶ 265), the FCC noted that "competition will do a better job of determining the true economic cost of providing [local] services" because, in a competitive market, carriers can bypass the rates established by the entrenched carrier by entering that market and providing the service to themselves. Id. Of course, that same process will produce market-driven settlement rates under the WTO agreement. If U.S. carriers believe that settlement rates on a route are excessive, they will be able to bypass those rates by entering the foreign market and providing their own terminating (and, if they wish, foreign originating) services at market-driven rates.<sup>3</sup> The FCC stated that it would be "imprudent" to "prejudge" the effectiveness of the Telecommunications Act of 1996 in generating exchange access competition, id. at ¶ 269, and the FCC similarly should not seek to prejudge the effectiveness of the WTO agreement, in combination with existing market forces, to generate effective competitive conditions in foreign telecommunications markets. KDD submits that the FCC should apply its own regulatory philosophy, as affirmed in the recent Access Reform Decision, by relying in the first instance upon competitive forces under the WTO agreement to establish market-driven settlement rates.

### C. Methodology.

In the Settlement Rate Notice (at ¶¶ 51-52), the FCC estimated that the forward-looking economic costs of terminating international switched traffic in the United States are less than \$.06/minute, and that foreign carriers incur terminating costs of approximately \$.09/minute. The FCC did not disclose either the data or the methodology by which it produced those figures, although the FCC did concede, as noted above, that it lacks any actual data regarding the terminating costs of foreign carriers. On the basis of those estimates, the FCC concluded that the settlement rate benchmarks produced by the TCP approach (ranging from \$.154/minute to \$.234/minute) are a conservative if not generous estimate of cost-based settlement rates for all foreign carriers.

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<sup>3</sup> Similarly, the FCC's statement that its experience in observing emerging local competition in the United States will enable it to prescribe rates in the future more efficiently and effectively (Access Reform Decision at ¶ 269) applies with equal force to international settlement rates. The FCC's relatively primitive Tariff Component Pricing (TCP) approach is no substitute for competition in establishing market-driven settlement rates.

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In the Access Charge Reform and Universal Service decisions, which it issued six months after the Settlement Rate Notice, the FCC concedes that there is no methodology today that can reliably generate forward-looking economic cost estimates. In the Access Reform Decision (at ¶ 44), the FCC stated that "as a practical matter, accurate forward-looking cost models are not available at the present time to determine the economic cost of providing access service." The FCC estimated that the development of reliable models might take "a year or more" to complete. Id. Further, in the Universal Service proceeding, the FCC examined at length the two principal cost models -- the Hatfield Model and the Benchmark Cost Proxy Model (BCPM) -- and rejected each model as having "significant unresolved problems." Universal Service Decision at ¶¶ 244-245. The FCC expressed hope that the models would be sufficiently reliable by August, 1998 for use in estimating the forward-looking economic costs of non-rural ILECs. Id. For rural ILECs, the FCC predicted that it could take three years or more before the models could produce reliable forward-looking economic cost estimates. Id. at ¶¶ 291-294.

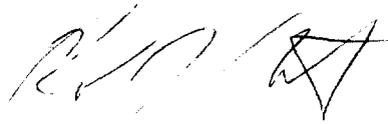
The FCC's rejection of the prevailing cost models in the Access Charge Reform and Universal Service proceedings completely eliminates the factual predicate of the FCC's proposed settlement rate benchmarks. If the FCC cannot estimate the forward-looking termination costs incurred by U.S. carriers for whom it has or can obtain all necessary cost data, the FCC certainly lacks the ability to estimate such costs for foreign carriers for whom it admittedly has no data at all. Nor does the FCC have any record basis for determining whether the settlement rate benchmarks generated by its TCP approach are above or below foreign carriers' forward-looking economic costs plus a reasonable allocation of joint and common costs. Given the FCC's failure to disclose the data or methodology upon which it based the cost estimates in the Settlement Rate Notice, the lack of a reliable methodology for estimating forward-looking economic costs, and the absence of necessary data on foreign carriers' costs, the FCC cannot lawfully adopt settlement rate benchmarks on a mandatory basis. Instead, as KDD showed above, the Commission should rely in the first instance upon competition under the WTO agreement to generate market-driven settlement rate structures and levels.

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For the foregoing reasons, KDD submits that the FCC, to the extent it proceeds to adopt settlement rate benchmark policies in IB Docket No. 96-261, modify its proposals to be consistent with its recent decisions in the Access Charge Reform and Universal Service proceedings.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'R. J. Aamoth', with a stylized flourish at the end.

Robert J. Aamoth

cc: Hon. Reed E. Hundt  
Hon. James H. Quello  
Hon. Susan Ness  
Hon. Rachelle B. Chong  
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