involving the use of the ECO test as a threshold requirement for those arrangements, the Commission stated its belief that these rules were "consistent with all the proposed U.S. commitments at the WTO."[27] Further, as the same criteria and procedures would also apply to U.S. carriers with market power in closed foreign markets, there would be no violation of national treatment requirements.[28]

The competitive conditions required by the ECO test continue to provide the necessary elements for an analysis of a foreign market to determine whether a carrier with market power in that country would be able to engage in discrimination in the U.S. market. However, the present requirements should be modified to examine whether the relevant country has implemented WTO commitments (1) to provide unrestricted market access for the provision of the relevant service, (2) to allow the foreign ownership of controlling interests in carriers providing the relevant service, and (3) to meet the requirements of the GATS Reference Paper. The extent to which the ability of the applicant to abuse its market power is limited by effective competition, not the existence of competitive opportunities for U.S. carriers in the relevant country, should be the focus of inquiry.

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27 *Regulation of International Accounting Rates*, Docket No. CC 90-337 Phase II, Fourth Report and Order, (released Dec. 3, 1996) FCC 96-459, ¶ 36, n.61.

28 To ensure consistency with GATS national treatment requirements after January 1, 1998, the Commission should amend its ECO analysis and apply the same requirements to U.S. carriers as to foreign carriers. This modification should apply both to U.S. carriers with foreign carrier affiliates in WTO Member countries and to U.S. carriers with affiliates in non-WTO Member countries. *See* NPRM, ¶ 57 & n.51.

The Commission has already found that post-entry safeguards cannot prevent competitive harm in the U.S. market where the conditions of competition in the foreign market are not sufficient to preclude the leveraging of foreign market power. In establishing the ECO test, the Commission concluded that post-entry regulatory safeguards alone did not "adequately promote an effectively competitive market" where a foreign carrier provided U.S.-outbound services on routes on which it had bottleneck control at the foreign end.[29] Because it lacked "jurisdiction over the foreign carrier that has bottleneck control and that may leverage that control to gain an unfair advantage in the U.S. market," the Commission was "not confident of the effectiveness of any measures we would take to prevent anticompetitive conduct in the use of its foreign bottleneck facilities."[30] The Commission concluded that "full competition on both ends of a communications link is far more effective than safeguards in achieving effective competition and offers U.S. consumers the best opportunity to enjoy the benefits of price, quality and service competition."[31]

The Department of Justice, which is purely focused on competitive concerns, reached similar conclusions in imposing limitations on U.S. market entry by three foreign carriers because of the harms to U.S. competition threatened by their market

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29 *Id.* at 3880.

30 *Id.* at 3913.

31 *Id.* at 3961. See also id. at 3880 ("Effective competition in such circumstances depends upon the ability of U.S. carriers to participate in a competitive market at the foreign end. . . Only with effective competitive opportunities at the foreign end can both the benefits of foreign carrier affiliation and the prevention of anticompetitive conduct actually be achieved.")

power in closed foreign markets. Under the Final Judgment (Consent Decree) in *U.S. v. Sprint Corp.*, Sprint and its joint venture with France Telecom and Deutsche Telecom are precluded from offering "any particular international telecommunications or enhanced telecommunications service between the United States and France or Germany" requiring a license in those countries unless other U.S. carriers have secured licenses.[32] Similarly, the Final Judgment in *U.S. v. MCI Corp. & BT Forty-Eight Co.* prevented MCI from providing BT facilities or services for international simple resale until the UK gave licenses to provide this service on the U.S.-UK route to all qualified U.S. carriers and BT provided interconnection for such services on reasonable terms and conditions.[33]

These decisions demonstrate that the prevention of anticompetitve conduct may properly require the denial of licenses to carriers with market power because other safeguards are insufficient to address the potential harm to competition that would result from their entry to the U.S. market.

3. The GATS Does Not Require a Showing of "a Very High Risk of Harm" to Competition.

The new test of harm to competition proposed by the NPRM is also not necessary to meet WTO requirements. The GATS does not require any particular showing of competitive harm, and certainly imposes no requirement for the "very high risk of harm" proposed by the NPRM.

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[32] *U.S. v. Sprint Corp, & Joint Venture Co*, Final Judgment, § II.C.

[33] *U.S. v. MCI Corp. & BT Forty-Eight Co,* Final Judgment, § II.E.

As noted above, the GATS recognizes a basic right to regulate, including the adoption and implementation of licensing qualifications designed to achieve legitimate objectives. The only constraints on the establishment of a regulatory standard required by the GATS, other than the overall requirements for MFN and national treatment, are those of Article VI. The first of these, that such regulations be "administered in a reasonable, objective and impartial manner," does not prohibit the adoption of a different standard of harm than that suggested by the NPRM, provided it is applied uniformly in a manner that is reasonable, objective and impartial.

A different standard of harm would be equally "based on objective and transparent criteria," as Article VI also requires, and would be no more burdensome than necessary provided that other reasonable conditions would not be sufficient. The retention of the existing Commission requirement for a showing of "substantial harm," therefore, would be fully compatible with WTO requirements.[34]

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[34] When the Uruguay Round was adopted in 1994, the United States signed on to numerous WTO agreements imposing similar requirements for the objective, non-burdensome and impartial administration of laws. The TBT agreement and the Agreement on Sanitary and Phytosanitary Standards are two prime examples. The latter agreement imposed an entirely new set of international rules with respect to the permissibility of food safety regulations. However, the actual changes in regulatory rules and procedures required by this agreement were rather limited, because the Administration proceeded from the assumption that U.S. regulatory practice was for the most part consistent with international trade norms. The Administration took the view that it would adopt only those changes that were strictly necessary to carry out the agreements, and the large majority of the relevant U.S. technical and licensing standards were unaffected. *See* Statement of Administrative Action contained in Message from the President of the United States Transmitting the Uruguay Round Trade Agreements, House Document 103-316, Vol. 1, 103d Congress, 2d Sess. (Sept.27, 1994), 656-57.

4. There Should be no Presumption in Favor of Section 214 Approval or Accounting Rate Flexibility Agreements.

The proposed rebuttable presumption in favor of granting Section 214 applications for carriers from WTO Member countries, thereby placing the burden of proof on opponents of the application to show that there is a "very high risk of harm to competition, " also is not required by GATS. As noted above, the GATS requires only that domestic regulations be administered in a reasonable, objective and impartial manner, which can undoubtedly be met by a regulation that is neutral with respect to the presumption and burden of proof. It is perfectly acceptable under GATS to have a neutral presumption with a requirement that the regulatory authorities establish, based on all available evidence, whether the standard is met. The same conclusions apply to the NPRM's proposal (¶ 150) to establish a presumption in favor of permitting accounting rate flexibility for carriers from WTO Member countries, where a neutral standard would be equally permissible and desirable.

An analogous situation was presented by the U.S. implementation of the WTO Agreement on Antidumping Measures ("Antidumping Agreement"),[35] which places greater limitations on the exercise of regulatory discretion than does the GATS. Article 3.1 of the Antidumping Agreement requires that an injury finding, which can lead to the imposition of additional duties on imported goods, "be based on positive evidence and

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[35] Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994; Marrakesh Agreement Establishing the World Trade Organization, *see* fn.26, *supra,* Annex 1B, 33 I.L.M. 552 (1994).

involve an objective examination" of the injury criteria.[36] Yet, in implementing the agreement, the U.S. has imposed no burden of proof on the domestic industry and no presumption in favor of the foreign producers. Rather, the International Trade Commission ("ITC"), an independent Commission like the FCC, which is charged with making injury determinations under U.S. law, has continued to follow a well-established procedure that relies on a neutral presumption regarding injury.[37]

Therefore, a neutral burden of proof, but with the regulatory body required to make a positive finding on the basis of all available facts, is clearly consistent with the WTO commitments of the U.S. If this practice is acceptable in ITC proceedings under the

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[36] *Cf.* Views of Commissioner Liebler in *Dry-cleaning Machinery from the Federal Republic of Germany*, Inv. No. 751-TA-9, USITC Pub. 1617 (1984) (under the 1979 Antidumping Code, the domestic industry does not bear the burden of proving that it would be materially injured if an existing antidumping duty order was revoked).

[37] The plain language of antidumping statute does not place the burden of proof on any party to an injury proceeding, but instead requires that the ITC's decision be "based on the information available to [the ITC] at the time of the determination." 19 U.S.C. Sec. 1673b(a)(1). *See also Minivans from Japan*, Inv. No. 731-TA-522, USITC Pub. 2402 (July 1991), at 40, n. 135 ("Neither petitioner nor respondent has a 'burden of proof' as such"). *See also, Softwood Lumber from Canada*, Inv. No. 701-TA-312 (Second Remand), USITC Pub. 2753 (1994) at 6 (views of Chairman Newquist and Commissioner Rohr) ("[p]etitioners do not bear a burden of proof or even a burden of coming forward with evidence in support of their arguments").

This policy has been consistently upheld by the Court of International Trade. *See, e.g., Chung Ling Co., Ltd. v. United States*, 805 F. Supp. 56, 62 (Ct. Int'l Trade 1992), "[f]undamentally, in an injury investigation by the Commission, domestic producers have no burden of proof . . . ."). It is also mandated by the legislative history to the trade statute, which states that "in all Commission antidumping and countervailing duty investigations neither petitioner nor respondent has a burden of proof. The Commission conducts its own fact-finding . . . ." Conference Report to the Trade and Tariff Act of 1984, H.R. Rep. No. 1156, 98th Cong., 2d Sess. 182 (1984).

Antidumping Agreement, where the detailed rules regarding administrative procedures are much more rigorous than under GATS, they should be equally acceptable here.

III. FACILITIES-BASED AND RESALE ENTRY SHOULD BE CONDITIONED ON COST-BASED ACCOUNTING RATES.

The safeguards proposed by the NPRM would tolerate a significantly higher degree of anticompetitive behavior than allowed under existing Commission regulations and procedures. Unless the Commission adopts new, equally effective safeguards, the denial of Section 214, Section 310(b)(4) and submarine cable authorizations will continue to be necessary where pre-entry analysis shows foreign market conditions to be insufficiently competitive to ensure that the U.S. market does not suffer harm from the leveraging of foreign market power.

Merely requiring settlement rates on affiliated routes to be at high-end benchmark levels as a condition of any Section 214 authorization to provide facilities-based services on affiliated routes, the safeguard proposed by the Commission, would not remove the strategic pricing advantages that foreign-affiliated carriers will otherwise obtain from U.S. market entry as the result of their above-cost settlement rates. As described in the Affidavit of Dr. William H. Lehr (Attachment 3 hereto) ("Lehr Aff."), the likelihood of such harm would be significantly reduced only if all carriers were required to provide cost-based settlement rates (i.e., at the bottom of the proposed benchmark ranges) as a condition of any Section 214 authorization to provide facilities-based or switched resale services on affiliated routes.[38] If carriers were subject to such a condition, the denial of licenses would generally no longer be necessary as a major safeguard against the competitive harm caused by leveraging above-cost settlement rates. In most instances, other potential abuses could be adequately addressed through post-entry safeguards.

1. **The Provision of U.S.-Outbound Facilities-Based or Switched Resale Services Should Require Cost-Based Settlement Rates.**

All foreign carriers already earn substantial profits on the above-cost settlement rates they charge for terminating U.S.-outbound services, and they will continue to do so if settlement rates are reduced to high-end benchmark levels. The Commission's proposed high-end benchmark settlement rates "still reflect a two- to four-fold markup over economic costs." Lehr Aff. at 10. By acquiring or establishing a U.S. affiliate to provide facilities-based or resold U.S.-outbound services, foreign carriers may stimulate additional settlement subsidies. *Id* at 12.[39] Above-cost settlement rates -- even at high-end benchmark levels -- thus "can facilitate a price-squeeze that would harm both consumers in the US and abroad, and would harm the competitiveness of US telecommunications markets." *Id.*

The foreign carrier could use the above-cost settlements rate to lower its U.S. prices "motivated by a desire to subsidize entry into US markets, to raise rivals costs,

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[38] *See, e.g.*, Lehr Aff. at 11, n.15 ("the appropriate standard is the forward-looking long-run incremental cost that would be incurred by an efficient carrier. This is unlikely to match the current or embedded costs of a monopoly carrier that is unlikely to be efficient.")

[39] *See also*, *Settlement Rate Benchmark NPRM*, Comments of AT&T (filed Feb. 7, 1997), at 39-46; Reply Comments (filed Mar. 30, 1997), at 51-53.

or to generate additional settlement subsidies." *Id* at 13. Because lower prices, which would be matched by unaffiliated U.S. carriers, would stimulate additional outbound traffic, the foreign carrier would obtain an overall net gain because it would receive increased settlement payments. *Id.* at 13-15. However, in their efforts to retain market share, unaffiliated U.S. carriers could suffer losses at levels that would be "unlikely to be sustainable without severe harm to US industry and consumers." *Id* at 15-16, 18-19. "The smaller the market share of the foreign subsidiary and the more elastic is demand, the greater the ability to engage in this strategy." *Id.* at 18. The most simple way to remove this danger to U.S. competition "is to remove the incentive to capture excess settlement subsidies by moving settlement rates in line with economic costs" and to require the establishment of a cost-based settlement rate before a foreign carrier may provide U.S.-outbound services on any such route. *Id* at 21. A settlement rate at the bottom of the proposed benchmark ranges would provide a reasonable proxy for such a cost-based rate, pending the submission of adequate cost information by the foreign carrier.

Any short-term price reductions resulting from the leveraging of foreign market power in this way, which would harm U.S. competition, would be no substitute for the real, long-term price reductions that would result from cost-based settlement rates. Unlike the "illusory" gain to consumers from subsidized competition, *Id.* at 15, "[r]educing settlements to costs . . . would result in a real gain to consumers and would improve, rather than harm the competitive process in the U.S." *Id.* at 16. However, carriers able to leverage above-cost settlement rates in this way would have no incentive to reduce them to costs. *Id.* at 21.

As the Department of Justice has emphasized, such activities indisputably threaten competitive harm to the U.S. market. The Department found in its *Sprint Corp.* investigation that Deutsche Telecom and France Telecom could place unaffiliated U.S. carriers "in a 'price-squeeze' by keeping prices for the monopoly inputs they need well above true economic costs, while simultaneously undercutting them on price in the competitive markets."[40] The Department concluded that "[t]he result could be a substantial lessening of competition in both international telecommunications services and seamless international telecommunications services in the U.S."[41] Other foreign carriers with above-cost settlement rates entering the U.S. international services market would have a similar ability to price-squeeze competing U.S carriers.

The Commission has also recognized that U.S. domestic local exchange carriers "could potentially implement a price squeeze" when they begin offering in-region, long-distance services.[42] The Commission explains that the local exchange carrier's long-distance affiliate could "set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail

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40 *U.S. v. Sprint Corp. & Joint Venture Co.*, 60 Fed. Reg. 44049, 44064 (1995) (Competitive Impact Statement).

41 *Id.*

42 *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, (released May 16, 1997), FCC 97-158 ("*Access Charge Reform Order*"), ¶ 277.

rates at the higher price and risk losing market share."[43] This behavior is possible because local exchange carriers' access charges exceed the true economic cost of providing access services.[44]

Indeed, foreign carriers have a much greater ability to price squeeze their competitors than the local exchange carriers because settlement rates -- even at high-end benchmark levels -- exceed economic cost by a much greater margin than access charges. The present margin of 2.41 cents per minute between current access rates and the underlying economic costs of these services[45] is far smaller than those between the Commission's proposed high-end benchmark settlement rates of 15.4 - 23.4 cents and the underlying cost estimated by the Commission of 6 - 9 cents.[46]

Another significant factor distinguishing the price squeezes that may be undertaken by foreign carriers from those that may be undertaken by domestic local

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43 *Id.* Alternatively, the local exchange carrier may raise access prices to all interexchange carriers, causing its interexchange competitors to either raise their retail rates or to lose profits by maintaining their existing rates in order to maintain market share, while the interexchange affiliate of the local exchange carrier could increase its market share by not matching the price increase. *Id.* Although the Commission's enforcement of high-end benchmark settlement rates would limit such behavior by foreign carriers, those foreign carriers with settlement rates below high-end benchmark levels could potentially raise settlement rates to those levels.

44 *See id.* at ¶ 276.

45 Current access rates are 2.79 cents per minute, while the underlying economic costs of these services are 0.38 cents per minute. *See Access Charge Reform*, CC Docket No. 96-262, Comments of AT&T Corp. (filed Mar. 24, 1997), Attachment 2.

46 *Benchmark Settlement Rate NPRM*, ¶ 47. AT&T estimates that foreign termination costs are, at most, 7.5 cents per minute. *See id.*, Comments of AT&T (filed Feb. 7, 1997), at 30-31 & Attachment E.

exchange carriers is the absence of market access in most foreign countries comparable to that provided in domestic local exchange carrier's markets under the Telecommunications Act of 1996. In the *Access Charge Reform Order*, the Commission found a "reduced likelihood" that domestic local exchange carriers could raise long-distance prices through the use of price squeezes because the Act's requirements for the provision of "unbundled network elements quickly, at economic cost, and in adequate quantities" would allow competitors to seek alternative access services.[47]

Importantly, the Act requires the BOC local exchange carriers to provide this cost-based access to their bottleneck facilities <u>before</u> they may enter long-distance markets.[48] However, only a small proportion number of WTO Members have committed to open their markets.[49]

Even if it were true -- which it is not -- that U.S. carriers could offset a foreign carrier price squeeze by reducing costs elsewhere, as the Commission has previously suggested,[50] such a squeeze would still be anticompetitive as it would transfer to the foreign carrier in the form of increased subsidies cost savings that should be captured by U.S. consumers. Lehr Aff. at 22-23. The Commission's former argument

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47 *Access Charge Reform Order*, ¶ 280. *See also, Foreign Carrier Entry Order*, 11 FCC Rcd. at 3899 (a price squeeze requires the absence of "alternative suppliers or substitutes for the inputs").

48 *See* Section 271, Telecommunications Act of 1996, 47 U.S.C. § 271.

49 *See also* Lehr Aff. at 22 ("While it is true that competition in the foreign market would move settlement prices towards economic costs – thereby destroying the ability to behave anticompetitively – such competition does not exist today.")

50 *Foreign Carrier Entry Order*, 11 FCC Rcd. at 3899.

also assumes that the foreign carrier's goal would be to establish market power, but "[g]enerating additional settlement profits and/or hindering increased competition in the foreign market (e.g., by raising rivals' costs) are even more likely motivations." *Id.* at 23. Indeed, the International Bureau has acknowledged in two recent decisions that a foreign carrier may be motivated engage in a price squeeze to increase its settlements payments if it is able to provide U.S.-outbound services while retaining an above-cost settlement rate.[51] The Bureau found in November 1996 that a carrier with market power in the destination country "might have the ability to price squeeze other carriers on this route (i.e., pricing U.S. resold services at or even below cost in order to generate significant settlement payments to its foreign carrier affiliate)."[52]

Thus, a requirement for high-end benchmark settlement rates will not reduce the likelihood that many foreign carriers would enter the U.S. market as a result of any removal of the ECO test and would seek to exploit their above-cost settlement rates for anticompetitive purposes by engaging in price squeezes. Moreover, alternative post-entry approaches would be insufficient. The Commission has repeatedly rejected its former requirement for the filing of cost support for tariffs by foreign dominant carriers as

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51 *Telstra, Inc.*, ITC-96-321, Order and Authorization (released Nov. 19, 1996) ("*Telstra Order*"). *See also, GTE Telecom Inc.*, ITC-95-443, Order, Authorization and Certificate (released Sept. 16, 1996) ("*GTE Order*"), ¶ 45 (finding that "AT&T has raised a plausible scenario under which GTE could maximize its overall profits by pricing GTE Telecom's U.S. resold switched services at or even below cost in order to generate significant settlement payments to its foreign carrier affiliates").

52 *Telstra Order*, ¶ 11.

unacceptably burdensome,[53] and neither a continuation of the 14-day advance notice period for tariffs (NPRM, ¶ 94) nor a requirement for the separate operation of the U.S. affiliate would allow adequate scrutiny. Further, such safeguards are reactive in nature and require that harm be detected and proven, which is much more difficult in the case of a foreign carrier, as the Commission has previously concluded.[54]

Most importantly, none of the proposed post-entry safeguards would address the root cause of the price squeeze, which is the above-cost settlement rate.[55] However, conditioning entry upon the availability of a cost-based settlement rate would effectively preclude such conduct.

2. The Requirement For Cost-based Settlement Rates Should Also Apply to the Provision of U.S. Outbound Services Through Switched Resale.

A foreign carrier may use above-cost settlement rates to price squeeze unaffiliated U.S. carriers by providing U.S.-outbound services through switched resale just as easily as by providing these services on a facilities-basis. U.S. wholesale markets for

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53 *See Foreign Carrier Entry Order*, 11 FCC Rcd. at 3973; *MCI Communications Corp./British Telecommunications plc.*, 9 FCC Rcd. 3960, 3967 n.68 (1994). *See also Telefonica Larga Distancia De Puerto Rico & LD Acquisition Corp.*, 8 FCC Rcd. 106, 112 (1992) ("While we recognize AT&T's concern that the above-cost component of accounting rates may be used by a foreign carrier to subsidize its affiliated U.S. carrier's competitive operations in the United States, this concern is addressed by our dominant carrier policies, which require that LD provide us with cost support for its tariffed international services").

54 *See Foreign Carrier Entry Order*, 11 FCC Rcd. at 3903. *See also* Lehr Aff. at 24; *id.* (noting that "[i]f harm occurs, it may not be reversible).

55 See *id.* at 23-24 ("While these additional remedies are appropriate and will assist in deterring a wide class of anticompetitive behavior, they would not deter the price squeeze strategy described above.")

telecommunications services are highly competitive with low entry costs. Lehr. Aff. at 16. As equivalent profits may be obtained from a resale price squeeze as from a facilities squeeze, "the mode of entry does not affect the attractiveness of executing the price squeeze strategy." *Id.* at 17. Indeed, the two recent International Bureau decisions acknowledging the likelihood of price squeezes to generate increased settlements outpayments to foreign carrier affiliates both concerned switched resale services.[56]

Resale entry also has major advantages over facilities-based entry for the foreign carrier - - and particularly so under the proposals advanced in the NPRM and in the *Benchmark Settlement Rate NPRM.* As proposed by the Commission, foreign carrier entry to provide switched resale services on affiliated routes would not even be subject to the proposed requirement that settlement rates on such routes be at the upper-end of the benchmark range. Foreign carriers would thus be entirely free to take maximum advantage of their present settlement rates -- at frequently five or ten times the underlying economic costs[57] -- in harming U.S. consumers and carriers. "[T]he higher the settlement rate, the more attractive the [price squeeze] strategy." Lehr Aff. at 17.

Additionally, resale entry "is much less expensive and less capital intensive" than facilities-based entry and therefore "less risky and can occur more rapidly." *Id.* at 18. Resale is therefore a logical first step for a foreign carrier seeking U.S. market entry -- just

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[56] *See Telstra Order* (application by U.S. affiliate of foreign carrier to provide switched resale services on affiliated route); *GTE Order* (application by U.S. carrier to provide switched resale services on route on which affiliated foreign carrier controlled bottleneck facilities).

[57] *Benchmark Settlement Rate NPRM,* ¶ 7

as it was for many U.S. facilities-based carriers. *See id* at 16.[58] Under the policy proposed by the NPRM, resale entry would become even more attractive, especially as resellers are also subject to less stringent post-entry regulation than facilities-based carriers.[59]

Consequently, the Commission should abandon its proposed distinction between facilities-based and switched resale entry and require that both entry modes be subject to the same requirement for cost-based settlement rates on affiliated routes.[60]

IV. THE PREVENTION OF 'ONE-WAY' BY-PASS REQUIRES COST-BASED SETTLEMENT RATES OR THE REGULATION OF SWITCHED SERVICES PROVIDED OVER INTERNATIONAL PRIVATE LINES UNDER ACCOUNTING RATE FLEXIBILITY RULES.

The NPRM (¶ 49) reaffirms the severe competitive harm that would result if foreign carriers are able to send their U.S.-inbound traffic over international private lines, and thus by-pass the settlements process, while continuing to receive above-cost

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58 *Cf. Foreign Carrier Entry Order*, 11 FCC Rcd. at 3929 (noting that facilities-based entry "becomes less important, particularly as an initial means of penetrating the U.S. market" if foreign carriers may enter via switched resale).

59 *See* Lehr Aff. at 17; NPRM, ¶ 31 *See also*, 47 C.F.R. § 63.10(a)(4); *Foreign Carrier Entry Order*, 11 FCC Rcd. at 3927-8;

60 As described in AT&T's Comments in response to the Benchmark Settlement Rate NPRM, the requirement for cost-based settlement rates for the provision of facilities-based, switched resale and switched services provided over international private lines should apply to all authorizations granted since the issuance of that NPRM and to all applications pending at that time. *See id.*, Comments of AT&T (filed Feb. 7, 1997) at 41, n.67. Similarly, all safeguards adopted in response to this NPRM should apply to all authorizations issued after its publication and to all pending applications. Otherwise, carriers will seek to "jump the gun" by obtaining authorization prior to the implementation of any new requirements.

settlement rates on U.S.-outbound traffic to their counties.[61] Under the Commission's present rules, such harm is prevented by limiting these services to countries meeting the requirement for equivalency (i.e., that "afford[] resale opportunities equivalent to those available under U.S. law"[62]). This safeguard ensures that U.S. carriers have the same opportunity to by-pass the settlements process on U.S.-outbound traffic that is available to the foreign carrier on U.S.-inbound traffic.

Unless U.S. carriers have this opportunity, and if no effective alternative safeguard is adopted, foreign carriers with above-cost settlement rates would have the incentive to send all their U.S.-inbound IMTS traffic over international private lines -- to obtain cost-based U.S. termination rates -- while requiring U.S. carriers to continue to pay them above-cost settlement rates.

A foreign carrier could use the open U.S. market to obtain additional profits from its bottleneck termination facilities -- and to raise U.S. carrier costs and U.S. consumer prices -- by engaging in one-way by-pass through self-correspondence with a

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61 As the NPRM describes (¶ 49), the concern with switched services over international private lines is "the potential for distortion of competition in the U.S. IMTS market when a foreign carrier collecting above-cost settlement rates is able to send its switched traffic over resold private lines into the United States, but U.S. carriers are unable to send their traffic over private lines in the reverse direction, and must continue to pay a relatively high settlement rate." *See also, Benchmark Settlement Rate NPRM*, ¶¶ 11, 75; *Regulation of International Accounting Rates*, 7 FCC Rcd. 559, 561 (1990) ("'one-way' resale would be detrimental to the U.S. public interest"); *ACC Global Corp.*, 9 FCC Rcd. 6240, 6242-43 (1994); *Market Entry and Regulation of Foreign-affiliated Entities*, 11 FCC Rcd. 3873, 3924 (1995) ("permitting unilateral evasion of the settlements process would exacerbate the U.S. settlements deficit and ultimately increase the burden on U.S. ratepayers"); *Cable & Wireless, Inc*, 11 FCC Rcd. 1766, 1767 (1996).

U.S. affiliate or through a correspondent relationship with an unaffiliated U.S. carrier. Such conduct may be motivated by the foreign carrier's desire to raise its rivals' costs, either to limit competition in the U.S. market, as the Department of Justice has found,[63] or to limit the ability of U.S. carriers to compete in the foreign carrier's home market. *See* Lehr Aff. at 10, n.14, 20. The foreign carrier may also seek to accelerate the flow of settlement rate subsidies to provide a larger war chest to fund other anticompetitive activities in the U.S. market.

Notwithstanding the effectiveness of the equivalency test in preventing these potential harms to competition in the U.S. market -- as evidenced by the NPRM's proposal to retain the test for non-WTO countries -- the NPRM (¶ 50) proposes to remove the equivalency requirement for the provision of these services between the U.S.

(footnote continued from previous page)

[62] 47 C.F.R. § 63.18 (e) (3).

[63] As described above, MCI was precluded from providing "any telecommunications facilities or services to be used by BT for international simple resale between the United Kingdom and the United States" until all qualified U.S. carriers obtained licenses to provide these services on the U.S.-UK route and were offered interconnection with BT's domestic network on standard, nondiscriminatory terms and conditions. *U.S. v. MCI Communications Corp. & BT Forty-Eight Co.*, 1994-2 Trade Cas., ¶ 70,730 (CCH), (D.C.D.C. 1994) (Final Judgment). This provision was "directed at actions by BT, using its dominant position in the United Kingdom, that would discriminate in favor of MCI, including the diversion of most or all of BT's traffic from the United Kingdom through MCI . . . Such conduct could raise prices to United States consumers or otherwise harm competition in the United States, unless United States carriers are licensed to operate in the United Kingdom and interconnected with BT so they can respond effectively to BT's conduct." *Id.*, 59 Fed. Reg. 33015, 33020 (1994) (Competitive Impact Statement).

and WTO Member countries.[64] As safeguards against one-way by-pass, the NPRM (¶¶ 50-51) proposes to rely on WTO Member countries' market-opening commitments, on the high-end benchmark settlement rate condition proposed in the *Benchmark Settlement Rate NPRM* and on reporting requirements.

Yet, none of these safeguards would be adequate to prevent the severe harm to U.S. carriers and consumers that would be caused by allowing unrestricted use of these services between the U.S. and all 130 WTO Member countries. Market-opening abroad would not provide sufficient protection against one-way by-pass, settlement rates would do so only if they are required to be at <u>cost-based</u> rather than high-end benchmark levels, and post-entry safeguards would not be effective.

Thus, the Commission should adopt a cost-based settlement rate requirement or, alternatively, it should review applications for the provision of switched services over international private lines under similar criteria to those the NPRM proposes to apply to flexible accounting rate agreements. Flexible agreements would subject to denial on a showing that conditions of competition in the relevant country are not sufficiently competitive to warrant deviation from the requirements of the International Settlements Policy. NPRM, ¶ 151.

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[64] The NPRM does not state whether applications to provide switched services over international private lines between the U.S. and WTO Member countries would also benefit from a "rebuttable presumption." As described above, no such presumption is required by WTO commitments made by the U.S. or otherwise warranted. However, irrespective of whether such a presumption would apply to these applications, the Commission should make clear that any application -- whether by the U.S. affiliate of a foreign carrier or by an unaffiliated U.S. carrier wishing to provide these services in

(footnote continued on following page)

With switched services provided over international private lines, just as with flexible accounting rate arrangements -- from which these services are indistinguishable -- the cause of competitive harm is discrimination against U.S. carriers where market conditions in the country in question provide the ability to distort competition in the U.S. Therefore, unless cost-based settlement rates are available to all U.S. carriers, applications for the provision of switched services over international private lines, like those for flexible accounting rate arrangements, should be denied where sufficiently competitive market conditions do not exist.

1. The Safeguards Proposed by the NPRM Would Not Provide Adequate Protection Against 'One-way' By-Pass.

As described above in Section I, a comparison of WTO Member countries' commitments with the requirements of the equivalency test fails to support the NPRM's optimism (¶ 50) that the WTO agreement "substantially reduces" the by-pass threat. Only a small number of countries would provide equivalent outbound by-pass opportunities to U.S. carriers in 1998. The NPRM also fails to recognize that the ability of carriers from WTO countries with closed markets to increase their monopoly profits in this way would provide a major disincentive to any accelerated or additional liberalization.

Nor would requiring settlement rates on the relevant route to be at high-end benchmark levels provide a sufficient safeguard, whether the U.S.-inbound traffic

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correspondence with a foreign carrier -- would be denied on a showing of the requisite risk to competition.

was sent over owned or leased international private lines. As AT&T has described in the *Settlement Rate Benchmark* proceeding, the wide margin between the cost-based U.S. termination rates of under 7.5 cents per minute that foreign carriers would obtain for their U.S.-bound traffic and the Commission's proposed high-end benchmark levels of 15.4 - 23.4 cents would provide them with significant cost savings on every U.S.-inbound minute -- providing a powerful incentive to by-pass those benchmark rates.[65]

Although AT&T supports the Commission's proposal to use settlement rates to address by-pass, such an approach will prevent one-way by-pass only if rates are required to be at cost-based levels (i.e., at the low end of the benchmark ranges proposed in the *Benchmark Settlement Rate NPRM*) as a condition of providing these services. Otherwise, foreign carriers will continue to seek lower cost U.S. termination through the use of owned or leased international private lines -- thereby increasing U.S. outpayments, U.S. carrier costs and U.S. consumer prices. As the *Benchmark Settlement Rate NPRM* recognizes, "[b]y ordering all carriers to pay settlement rates at the lower end of the benchmark range for switched traffic, the Commission would eliminate the financial harm from above-cost rates that makes competitive harm possible."[66]

The "post-entry safeguards" proposed by the NPRM (¶ 51) would be insufficient to address the problem. The dominant carrier requirement for the filing of quarterly traffic and revenue reports (*id.*, ¶ 98) would provide, at best, partial information

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[65] *See Settlement Rate Benchmark NPRM*, AT&T Comments (filed Feb. 7, 1997), at 34-39; Reply Comments (filed Mar. 30, 1997), at 47-51; Supplemental Comments (filed June 24, 1997), at 1-4.

on "deviations from expected traffic flows" (*id.*). Such reports would be relevant only where a dominant foreign carrier provided these services in correspondence with a U.S. affiliate. They would not apply to foreign dominant carriers that engaged in inbound by-pass through arrangements with unaffiliated U.S. carriers -- the most likely scenario under which inbound by-pass would occur -- or to any activities by foreign non-dominant carriers.

Other existing reporting requirements are also inadequate, as AT&T described in its Comments in the *Settlement Rate Benchmark* proceeding.[67] Reliance upon the annual Section 43.61 reporting process would entail substantial delays in any relief, while there has been little compliance with the Commission's existing traffic reporting requirement for switched services provided over international private lines (*see* NPRM, ¶100, n.96).[68] The introduction of new traffic reporting requirements by the Commission would also impose a major compliance burden upon U.S. carriers and could

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66 *Benchmark Settlement Rate NPRM*, ¶ 83.

67 *Id.*, AT&T Comments (filed Feb. 7, 1997), at 37-39.

68 Carriers authorized to provide these services are required to file traffic reports every six months during the initial three year period after an equivalency finding. *See fONOROLA Corp.*, 9 FCC Rcd. 4066, 4070 (1994) (establishing the filing requirement for the U.S.-Canada route); *ACC Global Corp.*, 9 FCC Rcd. at 6269 (U.S.-U.K. route); *Cable & Wireless, Inc.*, 11 FCC Rcd. at 1772 (U.S.-Sweden route). However, AT&T's research indicates that only 13 of 87 required reports were filed for the U.S.-Canada route in 1994-95, only 18 of 100 required reports were filed for the U.S.-U.K. route in 1994-96, and only 6 of 16 required reports were filed for the U.S.-Sweden route in 1996.

entail the disclosure of competitively sensitive information.[69] Substantial administrative resources would also be required to review reports by multiple carriers on large numbers of routes.

Moreover, where traffic deviations could lead to a possible loss of license, incentives to provide inaccurate or misleading reports would be strong, while such behavior would often be difficult or impossible to detect. For these reasons, AT&T believes that to attempt to address one-way by-pass through such post-entry safeguards would be overly burdensome and would not be successful.

2. The Commission Should Prevent In-Bound By-Pass by Requiring a Cost-Based Settlement Rate, or by Adopting a Similar Approach to That Proposed for Accounting Rate Flexibility Arrangements.

The equivalency test, established for more than five years[70] and reaffirmed less than two years' ago in the *Foreign Carrier Entry Order*,[71] has proven to be a highly effective regulatory tool for recognizing where countries provide sufficient U.S.-outbound by-pass opportunities to U.S. carriers to allow authorization of these in-bound services without harm to the public interest,[72] and where they do not.[73] AT&T,

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69 The UK approach of requiring each carrier to maintain specific inbound-outbound ratios for IPL switched traffic to and from each country does not appear to offer any easy solution. Because a carrier cannot control its inbound traffic, required traffic ratios could not be met without either extended reporting periods or through the extensive use of estimates and adjustments that greatly increase the complexity of the reports and the difficulty of enforcement.

70 *Regulation of International Accounting Rates*, 7 FCC Rcd. 559 (1991).

71 *Foreign Carrier Entry Order*, 11 FCC Rcd. at 3925.

72 *See fONOROLA Corp.*, 7 FCC Rcd. 7312 (1992) (equivalency finding for Canada); *ACC Global Corp.*, 10 FCC Rcd. 6240 (1994) (UK); *Cable & Wireless, Inc.*, 11 FCC

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therefore, supports the NPRM's intention (¶ 59) to retain the equivalency test for non-WTO countries. However, as demonstrated above, reliance upon WTO Member countries' commitments, a high-end benchmark settlement rate condition and post-entry safeguards would provide much less protection against in-bound by-pass than the equivalency test. Unless the Commission imposes a cost-based settlement rate condition, additional safeguards will be required to protect the U.S. market against competitive harm.

AT&T suggests that the Commission adopt a similar approach for these services to that which the NPRM (¶¶ 144-54) proposes for accounting rate flexibility arrangements. Specifically, the Commission should recognize that with switched services provided over private lines, just as with accounting rate flexibility arrangements, "WTO membership alone will not guarantee conditions in a foreign market are sufficiently competitive to prevent foreign carriers with market power from discriminating against U.S. carriers" and that "WTO Member countries that have made weak or no market

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Rcd. 1766 (1996) (Sweden); *Communications TeleSystems International*, File No. ITC-95-444, Memorandum Opinion and Certification (released Dec. 31, 1996) (New Zealand).

[73] *See ACC Global Corp.*, 11 FCC Rcd 10923 (1996) (denying equivalency finding for France and Germany); *Cherry Communications, Inc.*, File No. ITC-96-183, Memorandum Opinion and Order, (released Mar. 31, 1997) (Hong Kong).

access commitments are unlikely to be sufficiently competitive to warrant deviation from the requirements of the ISP." NPRM, ¶ 151.[74]

Accordingly, with switched services provided over international private lines, as with proposed accounting rate flexibility arrangements, "a showing that market conditions in the country in question are not sufficiently competitive to prevent a carrier with market power in that country from discriminating against U.S. carriers," *id.,* should warrant denial of an application. As the NPRM (¶¶ 151-52) further proposes, evidence that the relevant country "has not complied with its . . . commitment, its commitment has not taken effect, or it made no commitment" to provide both (1) market-access, and (2) fair rules of competition as required by the WTO Reference Paper, should be sufficient to make such a showing. The relevant market access required here should be the ability to provide switched services over international private lines.

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[74] In fact, there is no difference in substance between switched services provided over international private lines and the alternative payment arrangements encouraged under the Commission's Phase II, Fourth Report and Order in *Regulation of International Accounting Rates*, CC 90-337, (released Dec. 3, 1996), FCC 96-459 ("*Flexibility Order*"). Both types of arrangements allow the provision of IMTS services without the International Settlements Policy requirements for an equal division of accounting rates, proportionate return of traffic and uniform accounting rates. Indeed, two of the most recently proposed alternative payment arrangements presented to the Commission for approval under the *Flexibility Order* are provisioned with international private lines and are thus identical in all respects to switched services provided over international private lines. *See Primus Telecommunications Group, Inc.*, ISP-97-W-091, Letter dated Apr. 18, 1997, to Mr. Troy Tanner, FCC, from Mr. Neil Hazard, Primus; *Telegroup, Inc.*, ISP-97-PDR-302, Letter dated May 2, 1997 to Mr. Troy Tanner, FCC, from Mitchell F. Brecher Esq. & Robert E. Stup, Jr. Esq.