156. Commenters generally support the Commission's proposed approach of providing a transition schedule based on countries' level of economic development, but they disagree on what the duration of the transitions should be.[267] MCI and Sprint both agree with the Commission's proposed transition schedules, although MCI urges the Commission to adopt the shortest of the proposed transition periods.[268] The Alexis de Tocqueville Institution states that the Commission's proposals allow "time for countries to plan and adjust" and give "ample opportunity for countries to accelerate the introduction of competition to their markets."[269] Sprint states that a waiver from compliance with the schedule should be allowed where extraordinary hardship is shown.

157. AT&T, Coalition of Service Industries, and WorldCom argue that the proposed transition periods are too long. AT&T urges the Commission to require that U.S. carriers negotiate rates within the benchmarks with carriers in upper income countries by June 1, 1998, with carriers in middle income countries by January 1, 1999, and with carriers in lower income countries by January 1, 2000.[270] WorldCom supports a transition schedule of 18 months for upper income countries, two years for upper middle income countries, 30 months for lower middle income countries, and three years for lower income countries.[271] Coalition of Service Industries argues that the benchmark settlement rates should be implemented by January 1, 1998 for upper income countries and by January 1, 2000 for middle and low income countries.[272] Both WorldCom and AT&T oppose any exceptions to the transition schedules such as providing longer transition periods for negotiations with foreign carriers most severely affected by the benchmarks.[273]

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[267] Singapore Telecom, however, states that settlement rate reform cannot work fairly unless implemented in a reasonable and nondiscriminatory fashion for all countries according to the same timetable. Singapore Telecom Comments at 3.

[268] MCI Comments at 6.

[269] Alexis de Tocqueville Institution Reply at 3; *see also* Frontier Comments at 4 (arguing that a four to five year transition period for developing countries is reasonable).

[270] AT&T Comments at 19.

[271] WorldCom Comments at 10-11.

[272] Coalition of Service Industries Comments at 3.

[273] WorldCom Comments at 12 (Commission "must adhere to a black line deadline, and not adopt any exceptions that will all but swallow the rule itself); AT&T Comments at 20 (only exceptions from transition periods should be for "temporary emergencies" such as war, famine or natural disasters).

158. On the other hand, several commenters contend that the proposed transition periods are unrealistic for developing countries and should be lengthened for lower and middle income countries.[274] GTE argues that for almost all developing countries, the transition periods must be longer than the proposed 2 to 4 years. It further argues that, at a minimum, the transition period for middle income countries should be four years.[275] Tricom argues that the transition period for lower middle income countries should be at least 4 to 5 years. COMTELCA argues for even longer transition periods, 7 to 10 years.[276] France Telecom argues that some flexibility should be retained to allow longer transition periods where "reasonably necessary."[277] CANTO and GTE contend that transition periods should be tailored to individual countries' needs. GTE suggests that the gap between current settlement rates and a country's benchmark could be the basis for establishing transition periods, while CANTO argues that a country's transition should not end before a rate rebalancing plan has been enacted and completed.[278] GTE also contends that countries committed to lowering accounting rates and rebalancing tariffs should be given a longer transition period.[279] Telefónica de España also argues that the transition periods must be tied to rate rebalancing.[280] It further states that if the transition periods are not adjusted in this manner, the Commission should double the transition schedule for upper income countries and even further lengthen the transition schedule for other countries.[281] Israel argues that the transition periods can be unreasonable for upper income countries, depending on their economic situation.[282]

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274 *See, e.g.*, Cable and Wireless Comments at 14; GTE Comments at 15-22; TSTT Comments at 3; COMTELCA Comments at 15; Telefónica de España Comments at 63-65.

275 GTE Comments at 15-16, 18.

276 COMTELCA Comments at 15.

277 France Telecom Comments at 13.

278 CANTO Comments at 6. COMTELCA agrees with this proposal and states that AT&T's suggestion to shorten the transition periods "should be rejected out of hand." COMTELCA Reply at 19.

279 GTE Comments at 21-22.

280 Telefónica de España Comments at 40-48. *See also* India Reply at 2; Telefónica del Perú Comments at 15 (transition periods should take into account progress being made in rate rebalancing).

281 *Id.* at 65.

282 Israel Comments at 1.

159. Several commenters urge the Commission to require U.S. carriers to negotiate proportionate annual reductions in settlement rates during the transition periods.[283] Sprint states that a 4 to 5 year transition for low income countries would be too long unless the Commission requires U.S. carriers to negotiate proportionate annual reductions during the transition period.[284] WorldCom states that the Commission should consider mandating a "glide path" for negotiations with any country eligible for a transition period of two or more years.[285] KDD, on the other hand, urges the Commission to reject a glidepath approach because "it would be inherently arbitrary as well as a nightmare for the FCC and carriers to monitor and administer."[286]

160. MCI, WorldCom, and AT&T oppose providing an additional transition period for negotiations with foreign carriers for which annual reductions in the spread between their current settlement rate and their benchmark will exceed a certain percentage. AT&T notes that the beneficiaries of any such measure would be the carriers that have been most resistant to reducing their accounting rates to comply with Commission and ITU policies.[287] WorldCom similarly notes that additional transition time would benefit carriers that maintain the highest rates.[288] MCI, however, states that a waiver should be available if a U.S. carrier can show that the carrier with whom it is corresponding would be subject to extraordinary hardship due to the benchmark settlement rates.[289]

c. Discussion

161. The substantial discussion in the record about the potential negative impact of our settlement rate benchmarks on lower income countries supports the need for a transition schedule for implementation of the benchmarks.[290] Nonetheless, we remain committed to achieving settlement rates within the benchmarks as soon as feasible without forcing undue

283 AT&T Comments at 20; MCI Comments at 7; Sprint Comments at 17; WorldCom Comments at 8.

284 Sprint Comments at 17.

285 WorldCom Comments at 11.

286 KDD Reply at 25.

287 AT&T Comments at 20.

288 WorldCom Comments at 12.

289 MCI Comments at 7.

290 *See generally Rural Telephone Coalition v. FCC*, 838 F.2d at 1314-15.

disruption of both U.S. and foreign carriers' operations. Therefore, we adopt transition periods and other adjustment mechanisms that balance these competing concerns of providing time for carriers to make adjustments and expeditiously reducing rates to a more cost-based level.

162. We adopt a transition schedule that is based primarily on the categorization of countries we use to calculate our settlement rate benchmarks, the World Bank and ITU's GNP per capita classifications. As discussed in Section II.A.2, *supra*, we believe this classification scheme provides a reasonable basis for determining a country's ability to transition to a more cost-based system of settlement rates without undue disruption to its telecommunications network.

163. We agree with commenters who argue that basing our transition periods solely on the World Bank and ITU's GNP per capita categories may not provide sufficient consideration of the adjustment problems that the poorest countries will encounter.[291] In most of the poorest countries, telecommunications infrastructure is severely underdeveloped. We agree with commenters that the transition to a more cost-based system could be most severe for those countries with very low levels of telecommunications network development. We therefore establish a separate category for the "least telecommunications developed" countries for purposes of transitioning to our settlement rate benchmarks.[292]

164. We base this additional category on countries' level of teledensity as measured by lines per one hundred inhabitants, rather than GNP per capita. We believe that GNP per capita is generally an accurate indicator of a country's level of telecommunications network development. However, GNP per capita may not adequately reflect the level of telecommunications network development for the least developed countries. The ITU has also observed that the generally strong correlation between level of economic development, as measured by GNP per capita, and telecommunications development, as measured by level of teledensity, is substantially weaker among the poorest countries.[293] For this reason, we will consider countries' level of teledensity, as suggested by some commenters,[294] for purposes of

[291] TSTT Comments at 3; Panama Comments at 22.

[292] *See* Appendix C. We note that countries that fall into this category for the transition schedule also appear in one of the four economic development categories based on income per capita for purposes of establishing the relevant benchmark.

[293] The ITU plotted the relationship between GDP per capita and teledensity for the 48 "Least Developed Countries" as recognized by the United Nations General Assembly, and found a correlation coefficient of 0.5. ITU Telecommunications Indicators at 4.

[294] *See, e.g.*, TSTT Comments at 3; France Telecom Comments at 14.

determining which countries are the "least telecommunications developed." We will include countries with a teledensity of less than one in this "least telecommunications developed" category. As the ITU has noted, a level of teledensity less than one is generally a strong indication that a country's telecommunications infrastructure is severely underdeveloped.[295]

165. We will require U.S. carriers to negotiate settlement rates with their foreign correspondents in accordance with the following schedule:

carriers in upper income countries	1 year from implementation of this *Order*[296]
carriers in upper-middle income countries	2 years from implementation of this *Order*
carriers in lower-middle income countries	3 years from implementation of this *Order*
carriers in lower income countries	4 years from implementation of this *Order*
carriers in countries with teledensity less than 1	5 years from implementation of this *Order*

166. AT&T, Coalition of Service Industries, and WorldCom urge the Commission to adopt shorter transition periods than those proposed in the *Notice* -- AT&T and Coalition of Service Industries for all countries and WorldCom for lower income countries. We are sensitive to the concerns raised by these commenters that the transition periods proposed in the *Notice* are too long. We also would like to see settlement rates within the benchmarks as soon as possible. In fact, we fully expect that for many countries, market forces unleashed by the WTO Basic Telecom Agreement will bring settlement rates within the benchmarks before the end of the transitions periods we adopt here. U.S. carriers already have settlement rates at or below the benchmarks with several countries, including the United Kingdom, Sweden, and Canada. However, for many countries, we do not believe it is feasible to expect U.S. carriers to negotiate rates within the benchmarks in a shorter time frame than the transition periods proposed in the *Notice*. As the record demonstrates, a rapid shift to more cost-based rates could create adjustment problems for carriers in countries with significantly distorted rate schedules.[297] A rapid shift to more cost-based rates could also have a short-term impact on telecommunications network development in those limited cases where settlement revenues are a major source of funding for network development. We note that it is in the best interest

295 ITU Telecommunications Indicators at 4.

296 The effective date of this *Order* is January 1, 1998.

297 *See, e.g.*, GTE Comments at 21-22; Telefónica de España Comments at 65; Telefónica del Perú Comments at 15.

of U.S. carriers and consumers to avoid undue disruption of foreign carriers' operations.[298] A well developed global telecommunications network provides the telecommunications infrastructure necessary to support international commerce and trade.

167. GTE and Tricom urge the Commission to adopt longer transition periods -- GTE for middle income countries and Tricom for lower middle income countries. Other commenters express concern that the transition periods proposed in the *Notice* are unrealistic for developing countries. We have lengthened the transition periods for lower middle income countries and those with teledensity less than one in response to the concerns in the record. We believe that the schedule we adopt here, with additional transition time for lower middle income countries and countries with teledensity less than one, provides a reasonable balance between the need to achieve settlement rates that are more cost-based as soon as feasible and the need to ensure that accounting rate reform does not unduly disrupt both U.S. and foreign carriers' operations.

168. Cable and Wireless and GTE argue that the transition periods are unrealistic and do not take into account the experience to date of countries introducing competition, including the United States. Cable and Wireless cites the examples of the United States where, it states, the introduction of competition took 15 years, the United Kingdom, which had a similar timeframe, and the European Union, with timeframes of 12-17 years.[299] We recognize that the transition to competition takes time and requires difficult adjustments. However, the transition periods we adopt here are not intended to be schedules for implementation of competition in other countries. Rather, they are intended to provide some time for carriers in all countries, even those that have not introduced competition, to make the adjustments necessary to transition to a more cost-based system of accounting rates.

169. GTE suggests that the gap between current settlement rates and a country's benchmark could be the basis for establishing transition periods.[300] We disagree. Such a policy would be unfair and tend to favor carriers with the highest settlement rates. GTE further contends that countries committed to lowering settlement rates and rebalancing tariffs should be given a longer transition period. Telefónica de España also urges us to tie the transition periods to rate rebalancing. Telefónica de España goes on to argue that, if we do

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[298] *See* CANTO Comments at 2-3 (noting that the benchmark settlement rates could undermine the Commission's statutory mandate to make available a rapid and efficient worldwide communications service with adequate facilities by negatively affecting the ability of carriers in developing countries to maintain and expand their networks).

[299] Cable and Wireless Comments at 14. GTE similarly cites the experience of the United States in introducing competition. GTE Comments at 16.

[300] GTE Comments at 18.

not tie transition schedules to the rebalancing of tariffs, we should double the transition schedule for upper income countries and even further lengthen the transition schedule for other countries. The transition periods we adopt, however, are intended to address the concern of GTE and Telefónica de España by balancing the need for providing carriers time to make adjustments with the need for reducing rates expeditiously to a more cost-based level.

170. Telefónica de España, Telefónica Larga Distancia de Puerto Rico, and KDD argue that the transition periods are inconsistent with the five year transition period in our *Access Charge Reform Order* for independent local exchange carriers to reduce their interstate access rates to reflect forward-looking costs.[301] KDD further states that the Commission should adopt a transition period of at least five years beginning from the effective date of the WTO Basic Telecom Agreement.[302] We do not find our decision with regard to transition periods here inconsistent with our *Access Charge Reform Order*. In the *Access Charge Reform Order* we provided for a five year transition period to give competition in the local market sufficient time to develop. In this proceeding, however, the transition periods for settlement rate benchmarks have a different intent -- to ease the transition to a more cost-based system of settlement rates where competitive forces cannot achieve this goal. As discussed throughout this *Order*, we believe that we cannot rely on the market in all instances to reduce settlement rates to more cost-based levels. Moreover, we note that the transition schedule we adopt today provides additional time to reach more cost-based accounting rates after the end of the transition set forth in ITU Recommendation D.140, which had called for more cost-based rates by this year.

171. GT&T cites our *Universal Service Order* in arguing that the proposed transition periods are inconsistent with the Commission's domestic policy. Specifically, GT&T cites to our decision not to require U.S. incumbent local exchange carriers serving rural and/or insular environments to calculate their costs based upon forward-looking economic costs for a period of at least three years. It states that this decision "repudiates [our] proposal to require foreign carriers serving rural and/or insular countries to comply with FCC-prescribed settlement rates subject to a one- to four-year transition period."[303] We are not, however, basing our benchmarks on a TSLRIC methodology. Rather, the benchmarks are calculated using the TCP methodology, which, as shown in Section II.A.1. of this *Order*, results in benchmarks that are substantially above any reasonable measure of incremental costs.

[301] *Telefónica de España and Telefónica Larga Distancia de Puerto Rico July 30 Ex Parte* at 3; *KDD June 5 Ex Parte* at 3.

[302] *KDD June 5 Ex Parte* at 3.

[303] *GT&T June 18 Ex Parte* at 4.

172. We agree with commenters who contend that a schedule of annual percentage reductions is necessary to ensure that progress is made in negotiating settlement rates within the benchmarks. As these commenters note, annual percentage reductions would avoid a situation where U.S. carriers are unable to negotiate settlement rate reductions until the end of the applicable transition period.[304] This situation would delay any benefits from the settlement rate benchmarks until several years from the effective date of this *Order*. We therefore expect U.S. carriers to negotiate proportional annual reductions in settlement rates. Under this schedule of reductions, U.S. carriers should negotiate twenty percent reductions annually of the spread between a carrier's current settlement rates and the relevant benchmark for carriers with a five year transition period. For carriers with a four year transition period, the difference should be reduced by 25 percent annually; for carriers with a three year transition period, the difference should be reduced by thirty-three percent annually; and for carriers with a two year transition period, the difference should be reduced by fifty percent per year.

173. We will not, however, mandate that U.S. carriers meet these annual reduction targets. We believe such a requirement would place unnecessary restrictions on the ability of U.S. carriers to negotiate settlement rate arrangements with their foreign correspondents that take into account the needs of both parties and, as KDD notes, would be difficult to administer and monitor. U.S. carriers should retain some flexibility in their negotiations during the transition period. For example, if a U.S. carrier negotiates an accounting rate agreement that would achieve a settlement rate within the relevant benchmark by the end of the transition period, we would be less concerned about whether progress is made in negotiating annual reductions. We emphasize, however, that we may take enforcement action if a U.S. carrier is unable to make any progress in negotiating settlement rate reductions during the transition periods and settlement rates remain well in excess of our benchmarks.

174. In addition to the transition schedules, we will consider providing additional transition time for negotiations with foreign carriers in countries for which annual reductions in settlement rates, according to our transition schedule, would entail a loss of greater than 20 percent of the country's annual telecommunications revenue.[305] In considering the need for additional transition time, we will assume U.S. carriers negotiate proportionate annual reductions in the difference between the current settlement rate and the applicable benchmark rate. Thus, for example, if a U.S. carrier is negotiating with a carrier in a country with a four year transition period, we will look at whether a reduction of 25 percent of the difference between the current settlement rate and the applicable benchmark will entail a loss of greater than 20 percent of the country's annual telecommunications revenue. A U.S. carrier providing service to a country that meets this standard may file a request with the International Bureau

[304] *See, e.g.*, WorldCom Comments at 11.

[305] We sought comment on this proposal in the *Notice* at ¶ 67.

seeking a waiver of the applicable transition period. Allowing additional transition time for countries that meet this standard will prevent countries facing significant declines in their telecommunications revenues as a result of our benchmarks from experiencing undue disruptions in their networks.

175. We proposed in the *Notice* to provide additional flexibility in implementation of the benchmarks beyond our transition periods for U.S. carriers and their correspondents in developing countries that have demonstrated an actual commitment to fostering entry and promoting competitive market environments.[306] We stated that such additional flexibility would serve two purposes: it would recognize the challenges to developing countries posed by the introduction of cost-based rates and encourage the development of competitive markets necessary to achieve cost-based settlement rates. Telefónica de España agrees with this proposal, arguing that we should not apply benchmarks to developing countries that have set a date certain for introducing competition.[307] AT&T, on the other hand, opposes this proposal, arguing that the proposed transition periods already take into account the needs of developing countries by providing those countries higher benchmarks and longer transition periods.[308] WorldCom also opposes this proposal, arguing that it is inherently contradictory. It states that if a route is competitive, settlement rates will drop below the benchmarks, and if a route is not competitive, the settlement rate benchmarks are necessary.[309]

176. We agree with AT&T that our transition periods adequately take into account the challenges faced by developing countries in moving to more cost-based rates, especially given the longer transition periods we adopt here for lower-middle income countries and countries with teledensity lower than one. The transition periods are intended to provide carriers an opportunity to make necessary adjustments, such as rate rebalancing, to move to a more cost-based settlement system. These same adjustments are required to implement competitive reforms successfully. We also note that the WTO Basic Telecom Agreement significantly advances our goal of encouraging the development of competitive markets.[310]

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306 *Notice* at ¶ 70.

307 Telefónica de España Comments at 70-72.

308 AT&T Comments at 18-19. Some commenters urge us to take into account the concerns of countries introducing competition in implementing our benchmarks. *See, e.g.*, Panama Comments at 26; Mexico Comments at 9-12; Poland Comments at 2; PTI Comments at 9-10; Israel Comments at 1-3. Taiwan suggests that we adopt transition schedules based on liberalization schedules committed to by WTO Member countries. Taiwan Comments at 2.

309 WorldCom Comments at 13.

310 *See, e.g., Foreign Participation Notice* at ¶ 30.

Moreover, we are concerned that a policy which would create an exemption based on market conditions in the destination market from our requirement that U.S. carriers negotiate settlement rates within our benchmarks may not be consistent with our MFN obligations under the GATS.[311] We thus decline to adopt our proposal in the *Notice* to permit additional flexibility in the application of our benchmarks beyond the transition periods for U.S. carriers serving developing countries that have committed to introducing competitive reforms.

3. Enforcement of Benchmarks

a. The Notice

177. We stated in the *Notice* that we would consider taking enforcement measures to ensure that U.S. carriers make adequate progress in negotiating settlement rates at or below the benchmarks.[312] We proposed, as an initial measure, to identify foreign carriers that are reluctant to engage in meaningful progress toward negotiating settlement rates at or below the relevant benchmark and to convey to the responsible government authorities our concern about continued high settlement rates and the lack of meaningful progress, and to seek their support in lowering settlement rates.[313]

178. We also proposed stronger steps that we would consider in those cases where a foreign carrier fails to respond to a U.S. carrier's efforts to achieve settlement rate progress. We emphasized that in each case our actions would apply to U.S. carriers within our jurisdiction, not to their foreign correspondents. Specifically, we sought comment on the following measures: (i) directing U.S. carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions aimed at reaching the benchmark level; (ii) directing U.S. carriers to settle at a rate that is no higher than the transition rate goals until a foreign carrier agrees to a reasonable schedule of reductions aimed at reaching the benchmark level; (iii) directing U.S. carriers to settle at or below the benchmark rate and to continue paying at that rate until we determine that meaningful progress in the form of accounting rate reductions is being made; and (iv) directing U.S. carriers to pay a settlement rate no higher than the benchmark rate.[314]

b. Positions of the Parties

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311 *See* Section II.C.3, *infra*.

312 *Notice* at ¶¶ 87-90.

313 *Id.* at ¶¶ 87-88.

314 *Id.* at ¶ 89.

179. Several commenters urge us to adopt clear and effective mechanisms to achieve the benchmark settlement rates.[315] AT&T argues that only through active enforcement can we obtain compliance with the benchmarks adopted in this *Order*.[316] MCI states that if a U.S. carrier makes a showing that it has been unable to reach an agreement that meets the relevant benchmark within a reasonable time frame, a U.S. carrier could request us to use our statutory authority to facilitate compliance with this *Order*.[317] Frontier asserts that we can, and should, utilize each of the enforcement options proposed in the *Notice* as individual circumstances dictate.

180. AT&T recommends that we establish a "complaint" process with expedited procedures, including a time frame for our decision.[318] AT&T argues that we should require such filings to show "only that the foreign carrier has not complied with the applicable benchmark rate, or has not made the necessary interim step toward that rate during the transition period."[319] Upon such a showing, AT&T contends that we should prescribe the settlement rate to be paid to that foreign carrier by all U.S. carriers.[320] Both WorldCom and AT&T argue that the remedy we order should be a prescription of rates, rather than agreements to schedules of reductions or determinations of adequate progress.[321]

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315 *See, e.g.*, CSI Reply at 4; SDN Reply at 1.

316 AT&T Comments at 31; *see also* WorldCom Comments at 13.

317 MCI Reply at 8.

318 AT&T Comments at 33. AT&T proposes a procedure that requires comments to be filed on a complaint within 28 days from the date of the public notice. AT&T requests 10 additional days for the complaining U.S. carrier to file reply comments. WorldCom argues that we should issue an order responding to a complaint no later than three months after the filing of the complaint. WorldCom Comments at 13.

319 AT&T Reply at 17.

320 *Id.* at 18.

321 AT&T Reply at 18; WorldCom Comments at 14 (*citing* AT&T Corp., MCI Telecommunications Corp., Sprint and LDDS WorldCom Petitions for Waiver of the International Settlements Policy to Change the Accounting Rate for Switched Voice Service with Peru, *Order and Authorization*, 11 FCC Rcd. 12107 (1996); AT&T Corp. and MCI Telecommunications Corp., Petition for Waiver of the International Settlements Policy to Change the Accounting Rate for Switched Voice Service with Bolivia, *Order and Authorization*, 11 FCC Rcd. 13799 (1996)).

181. A number of commenters oppose the enforcement of our settlement rate benchmarks.[322] Indonesia argues that we should use benchmarks only, if at all, as "guidelines for U.S. carriers as their initial offered-rates to negotiate with their corresponding relations, subject to bilateral agreements between the parties involved."[323] KDD contends that we cannot adopt an enforcement procedure because Section 208 of the Act, which governs complaints, applies only to acts or omissions of a "common carrier subject to this Act." KDD asserts that because a foreign carrier would not qualify as a "common carrier subject to this Act" it cannot be subject to a Section 208 complaint.[324] SBC argues that our enforcement proposals will likely prove harmful to relationships between U.S. international carriers and their foreign correspondents. SBC argues that "directing U.S. carriers to take certain actions -- some of which are likely to appear hostile from the foreign carriers' perspectives -- . . . would potentially undermine the ability of U.S. carriers to continue negotiations and to develop creative, potentially beneficial solutions to any international accounting disputes."[325] France Telecom expresses concern that the proposed enforcement measures could have a "chilling effect" on multilateral discussions of accounting rate reform.[326]

182. ACC asserts that if we decide to adopt our benchmarks proposals, we must protect smaller carriers from foreign carriers' reprisals so that the larger U.S. carriers are not the only beneficiaries of our action.[327] Justice Technology also expresses concern about a potential backlash against new international carriers as a result of our benchmark settlement rates.[328] TRA argues that we should not require "small to mid-sized" carriers to abrogate an existing operating agreement in order to protect them from retaliation by foreign carriers.[329] TRA states that, while adoption of our benchmarks proposals may "serve a broad public policy purpose, the global benefits will be lost on small to mid-sized carriers whose

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[322] *See, e.g.*, Indonesia Reply at 2; SBC Comments at 6; ASETA Comments at 2; Deutsche Telekom Comments at 11; Korea RPOAs Comments at 2, 4; European Union Reply at 1-2, New T&T Comments at 3.

[323] Indonesia Reply at 2.

[324] KDD Reply at 24.

[325] SBC Comments at 6; *see also* Lattelekom Comments at 2 (requiring U.S. carriers to breach contracts will undermine U.S. carriers' credibility and ultimately prove counterproductive).

[326] France Telecom Comments at 14.

[327] ACC Comments at 9.

[328] Justice Technology Comments at 2-3.

[329] TRA Comments at 6.

businesses are lost or damaged during the process."[330] For enforcement to be effective, though, AT&T argues that our exercise of prescription authority must apply to all U.S. facilities-based carriers.[331]

183. We also note that in our *Accounting Rate Flexibility Proceeding*, AT&T suggested that carriers would be assisted in their accounting rate negotiations if we required all accounting rate agreements to have annual expiration dates. Several parties -- including MCI, WorldCom and TRA -- opposed AT&T's proposal of time-bounded rate agreements, arguing that it would harm small carriers or could be disruptive to carrier negotiations. We stated that we would consider that issue in this *Order*.

184. Some commenters have raised the issue of time-bounded agreements in their comments filed in this proceeding. To protect "small to mid-sized" carriers from foreign carrier retaliation, TRA argues that we should not require such carriers to enter only into short-term settlement rate agreements.[332] WorldCom also opposes our proposal to require U.S. carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions. WorldCom contends that certain foreign administrations would be unwilling to renew such operating agreements with all but the one or two largest U.S. carriers.[333]

c. Discussion

185. Because we have found that settlement rates above the relevant benchmarks after the relevant transition period will not produce just and reasonable rates, we will take appropriate enforcement measures as may be necessary to ensure that U.S. carriers satisfy our benchmark requirements. As an initial measure, we will identify foreign carriers that are reluctant to engage in meaningful progress toward negotiating settlement rates at or below the relevant benchmark. We will convey to the responsible government authorities our concern about continued high settlement rates and the lack of meaningful progress, and seek their support in lowering settlement rates. In our contacts with the responsible government authorities, we will emphasize the need for cooperation in achieving the goal of cost-based rates, enlist their active support in achieving that goal, cite relevant ITU recommendations such as Recommendation D.140, and suggest further discussions that may be necessary.

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[330] *Id.* at 7.

[331] AT&T Reply at 18.

[332] TRA Comments at 6.

[333] WorldCom Comments at 14.

186. When a foreign correspondent fails to respond to a U.S. international carrier's efforts to achieve a settlement rate that complies with the requirements of this *Order*, we will allow the U.S. international carrier to ask us to consider stronger steps. As it is clearly within the interest of a U.S. international carrier to negotiate rates at or below the relevant benchmark, we believe that we can rely primarily on such a carrier-initiated enforcement process.[334] Pursuant to the procedures we adopt in this *Order*, a U.S. international carrier may file a petition that:

(1) demonstrates that it has been unable to negotiate a settlement rate with its foreign correspondent that complies with the rules and policies we adopt in this *Order*; and

(2) requests enforcement measures be taken to ensure that no U.S. carrier pays that foreign correspondent an amount exceeding the lawful settlement rate benchmark.

The U.S. international carrier should file its petition with the Office of the Secretary, Federal Communications Commission, 1919 M Street, NW, Room 222, Washington, DC 20554. The petitioning carrier must serve the foreign correspondent with a copy of the petition and a copy of the procedural rules governing replies to the petition.[335] The foreign correspondent or other interested party will have thirty-five days from the date on which we place the petition on public notice to file comments or an opposition to the U.S. international carrier's petition. We will allow ten additional days for replies to any comments or oppositions.

187. We will ensure compliance with our settlement rate benchmarks. We believe that we have the authority to use any of the enforcement measures proposed in the *Notice* to respond to a carrier's petition. As we discuss in Section II.E. of this *Order*, our authority includes the ability to prescribe a change in settlement rates whenever we determine such rates to be unlawful. We do not at this time adopt any set enforcement mechanism, but will instead consider the individual circumstances surrounding each carrier-initiated petition to determine the appropriate enforcement action to take. We agree with AT&T that whatever enforcement action we take with regard to a complaint about a foreign correspondent's unwillingness to negotiate a settlement rate at or below the relevant benchmark must apply to

[334] We agree with KDD that Section 208 does not provide for complaints to be filed pursuant to that section against a common carrier not subject to the Act. We do not here, though, rely on Section 208. Our enforcement mechanism merely allows carriers to alert us to the fact the settlement rates being paid by U.S. international carriers to their foreign correspondents are inconsistent with the rules and policies we adopt in this *Order*.

[335] *See* 47 C.F.R. § 1.47.

all U.S. international carriers' dealings with that foreign correspondent in order for enforcement of our benchmarks to be effective.[336]

188. Some commenters express concern that enforcement of the benchmark settlement rates will lead to reprisals against smaller carriers.[337] We will continue to safeguard U.S. carriers against discriminatory treatment by foreign carriers by vigorously enforcing our ISP.[338]

189. Although we decline at this time to anticipate exactly which enforcement measure would be appropriate in a given situation, we do agree with those commenters that argue that we should refrain from using one particular proposed enforcement mechanism.[339] We believe that requiring U.S. international carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions would impose unnecessary financial burdens on U.S. international carriers. Such an action by us would require carriers to be continually engaged in negotiations for short-term agreements. We find that the other proposed enforcement mechanisms will provide us with the ability to ensure compliance with our benchmarks.

190. The benchmark requirements we adopt in this *Order* will become effective on January 1, 1998.[340] The transition periods for U.S. carriers to negotiate settlement rates at or below the benchmark rates will begin on that date. However, we will consider, on a case-by-case basis, grandfathering settlement rate agreements that were negotiated prior to the effective date of this *Order* that do not comply strictly with the benchmark requirements we adopt here. Our standard for grandfathering such agreements will be whether approval of the agreement is in the public interest. We will find an agreement to be in the public interest if it serves the same goals we have set forth in this *Order* and if it achieves settlement rates at or

336 *See* AT&T Reply at 18.

337 *See, e.g.*, TRA Comments at 6-7; ACC Comments at 9; Justice Technology Comments at 2-3.

338 *See Accounting Rate Flexibility Order* at ¶ 71. The European Union suggests we reconsider the efficacy of our proportionate return and symmetrical settlement rate requirements in light of the increasingly liberalized world market conditions. The European Union states that changing world market conditions result in a situation where these requirements could actually impede competition. European Union Reply at 3. As we stated in our *Accounting Rate Flexibility Order*, we agree that our ISP could impede the development of competition in some circumstances. We thus adopted rules to permit U.S. carriers to deviate from the ISP where appropriate market conditions exist.

339 *See, e.g.*, TRA Comments at 7; WorldCom Comments at 14.

340 Except those matters subject to OMB approval, pursuant to the Paperwork Reduction Act of 1995, Pub. L. No. 104-13, which will become effective upon such approval.

below the relevant benchmark within a reasonable period of time. We reiterate that if, in the future, there is a multilateral consensus on a substantially equivalent international measure to achieve our goals of a cost-based system of settlements in a timely manner, we will waive enforcement of the benchmark settlement rates.

C. Section 214 Authorization Conditions

191. We proposed in the *Notice* to apply the settlement rate benchmarks to address potential distortions in the U.S. market for IMTS that could be created by the current system of above-cost settlement rates. We proposed to address these potential market distortions because they impede our policy of creating greater competition in the IMTS market in order to lower international calling prices for U.S. consumers.

192. We identified in the *Notice* two types of market distortions that could be created by above-cost settlement rates. The first is the potential for a foreign carrier and its U.S. affiliate to execute a "price squeeze" against other carriers in the U.S. IMTS market. A price squeeze is a predatory tactic in which the U.S. affiliate sets its prices so close to the international settlement rates charged by the foreign carrier that the other carriers cannot match the prices without losing money, even if they are more efficient than the U.S. affiliate. Such a strategy would be made possible by the fact that the foreign carrier controls an essential input for providing service in the U.S. IMTS market, and the price charged for that input -- the international settlement rate -- is substantially above the economic cost of providing the service. Although the U.S. affiliate might pay the same settlement rate paid by its competitors, it would consider the actual economic cost incurred by the foreign carrier rather than the above-cost settlement rates when setting its IMTS prices.

193. The second type of market distorting behavior that could be created by above-cost settlement rates is one-way bypass of the settlements system. This could occur if a foreign carrier collecting above-cost settlement rates is able to send its switched traffic over 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. We have stated on several occasions that such one-way bypass of the settlements system is not in the public interest because it would greatly exacerbate the traffic imbalance, and, therefore, the U.S. net settlements deficit on the route where it is occurring.[341] An increase in the U.S. net settlements deficit would ultimately lead to higher collection rates for IMTS on the affected route as carriers pass through to consumers increased settlement costs.

[341] *See Notice* at ¶ 11. *See also* Regulation of International Accounting Rates, *First Report and Order*, 7 FCC Rcd 559, 561, ¶¶ 17-20 (1991).

194. To address these potential market distortions that could result from above-cost settlement rates, we proposed to condition various types of authorizations to provide international services from the United States on compliance with the benchmark settlement rates. We adopt the proposed conditions with certain modifications in response to the record, as described in the next two sections. We address separately our conditions for carriers that seek to serve affiliated markets as facilities-based switched or private line carriers and our rules that will govern all U.S. carriers in their use of facilities-based or resold private lines for the provision of switched services.

1. Condition for Service to Affiliated Markets

a. Notice

195. We proposed in the *Notice* to condition the facilities-based switched and private line authorizations of carriers seeking to serve affiliated foreign markets from the United States on the affiliated foreign carrier offering U.S. international carriers a settlement rate for terminating U.S.-originated traffic on the affiliated route that is at or below the appropriate benchmark. We further proposed that if, after the foreign-affiliated carrier has commenced service to the affiliated market, we learn that the carrier's service offering has caused a distortion of competition on the affiliated route, we would order that the affiliated foreign carriers' settlement rates on that route be reduced to the bottom of the range or revoke the authorization of the carrier to serve the affiliated market. An authorization granted to a facilities-based carrier would thus be granted subject to a condition to this effect.

196. We sought comment on what mechanism or approach we should use to determine when there has been a distortion of competition in the IMTS market and the lower settlement rate should be applied. We also requested comment on how our proposal would affect the effective competitive opportunities test ("ECO") we adopted in the *Foreign Carrier Entry Order*.[342]

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[342] *Foreign Carrier Entry Order*, 11 FCC Rcd 3873 (1995). The ECO test considers: (i) whether U.S. carriers are permitted, as a matter of law, to offer international facilities-based services in the foreign country; (ii) whether there exist reasonable and nondiscriminatory charges, terms and conditions for interconnection to a foreign carrier's domestic facilities for termination and origination of international services, and whether there are adequate means to monitor and enforce these conditions; (iii) whether competitive safeguards exist in the foreign country to protect against anticompetitive practices; and (iv) whether there is an effective regulatory framework in the destination country to develop, implement and enforce legal requirements, interconnection arrangements and other competitive safeguards. 47 C.F.R. §63.18(h)(6); *Foreign Carrier Entry Order* at ¶¶ 42-55. In our *Foreign Participation Notice*, we tentatively concluded that we should eliminate the ECO test as part of our public interest analysis of pending and future Section 214 applications filed by foreign carriers from WTO Member countries that seek to provide facilities-based, resold switched, or resold non-interconnected private line services. *See*

b. Positions of the Parties

197. Commenters disagree about our proposal to use the settlement rate benchmarks to condition authorizations to provide international facilities-based service from the United States to an affiliated foreign market. Some commenters support our proposal, some oppose it on the ground that it is not necessary, and others seek to modify it because it is not stringent enough.

198. WorldCom supports our proposal "because it is a narrowly-tailored remedy that addresses potential competitive distortions without limiting the ability of foreign carriers to enter the U.S. market."[343] WorldCom states that in addition to the proposed authorization condition, we should continue vigorously to enforce the ISP on all routes. The Alexis de Tocqueville Institution concurs that revenues from artificially high settlement rates could be used to subsidize a facilities-based affiliate competing in the U.S. market. It states that such a subsidy could be used "to unfair competitive advantage through marketing efforts or predatory pricing."[344]

199. AT&T supports the concept of using settlement rate benchmarks to condition authorizations, but argues that, as proposed by the Commission, the conditions are not sufficient to prevent anticompetitive behavior in the U.S. market for IMTS. AT&T argues that foreign carriers are able to impose a price squeeze on U.S. carriers by cutting their U.S. prices potentially as low as the foreign carriers' TSLRIC of U.S. origination and foreign market termination. AT&T states that such conduct would harm competition by limiting the participation of existing carriers and by discouraging further market entry.[345] AT&T also expresses concern about the ability of foreign carriers to use a U.S. affiliate to lower prices in the U.S. market for IMTS. According to AT&T, this price-cutting strategy would enable a foreign carrier to earn additional settlements revenue by stimulating additional U.S.-outbound traffic to its home market from all carriers from the United States to its home market.[346]

200. AT&T argues that because the proposed benchmark ranges still exceed economic cost, our proposed condition would not remove the "strategic pricing advantages"

Foreign Participation Notice at ¶ 32.

[343] WorldCom Comments at 15.

[344] Alexis de Tocqueville Institution Reply at 4-5.

[345] AT&T Comments at 43.

[346] *Id.* at 41-42.

enjoyed by carriers serving affiliated foreign markets from the United States.[347] Thus, AT&T argues, we should condition a carrier's authorization to provide facilities-based service to an affiliate on that carrier's offering U.S. carriers settlement rates at or below the low end of the benchmark range. ICA also supports such a condition.[348] AT&T opposes any attempt to identify anticompetitive behavior through regulatory monitoring, as proposed in the *Notice*, on the ground that it would require the reimposition of burdensome reporting requirements recently removed by the Commission.[349] AT&T concludes that the only viable alternative to its proposal is to continue to limit U.S. market entry for the provision of facilities-based and switched resale services to foreign carriers meeting the ECO test.[350]

201. In contrast to AT&T, HKTI and GTE argue that the proposed condition is not necessary. HKTI asserts that the potential relationship between above-cost accounting rates and any anticompetitive behavior in the U.S. market for IMTS is "totally attenuated."[351] HKTI asserts that there has been no demonstration that foreign carriers are in fact receiving significant "transfer payments" through settlements. HKTI further asserts that "a proper calculation of net settlements, correcting for the diversion of direct revenues to U.S. carriers as a result of refile, callback and other reverse charge services, may show that deficits are actually incurred by foreign carriers. HKTI also states that any company can cross-subsidize an affiliate through profits and there is no way the Commission could effectively separate out the specific effects of above-cost accounting rates from profits.[352]

202. GTE states that it is implausible that a foreign carrier would cross-subsidize a U.S. affiliate in order to offer below-cost prices in the U.S. market because it will never be able to recoup, in the form of later monopoly profits, the losses it suffered. GTE contends that increasing competition in the U.S. market for IMTS means that it would be impossible for a foreign carrier to gain a monopoly position, much less retain that monopoly long enough to recoup excess profits. GTE concludes that it would be irrational under these circumstances

[347] *Id.* at 40.

[348] ICA Reply at 5-6.

[349] AT&T Comments at 44.

[350] *Id.* at 40-41; 46.

[351] HKTI Comments at 17.

[352] *Id.* at 18.

for a foreign carrier to offer below-cost service offerings in an attempt to monopolize a segment of the U.S. market for IMTS.[353]

203. ABS-CBN states that the condition is not necessary in all circumstances. ABS-CBN cites its own situation, where according to ABS-CBN, it could not cross-subsidize a foreign affiliate with settlement payments from U.S. international carriers because per minute U.S. settlement rates are barely enough to cover its per minute payout to the incumbent Philippine carrier for local termination services.[354] It further states that the "subsidies" most likely to frustrate competition in the U.S. market are those which major U.S. carriers obtain by virtue of their domestic long-distance businesses. ABS-CBN states that major U.S. carriers have a cost structure that is hard to match because they can spread their joint costs over more customers and have more pricing flexibility on individual rates.[355]

204. The United Kingdom suggests that the Commission make a distinction between liberalized and monopoly markets for purposes of applying the authorization condition. It states that the real anticompetitive behavior to be avoided would involve the ability of a foreign carrier terminating its own traffic to charge its affiliate a lower or no settlement rate. The United Kingdom states that such behavior is not a concern where the foreign market is open and other carriers on the route can self-terminate.[356]

205. Sprint also opposes our proposed condition for authorizations to provide facilities-based switched service to affiliated markets on the ground that it is not necessary. Sprint states that "the Commission can under all circumstances rely on its benchmarks as a basis for exchanging traffic for any foreign carrier."[357] It further argues that foreign carrier entry and investment in the U.S. market generally should be encouraged. With respect to the question of mechanisms to detect distortion in the U.S. market, Sprint urges us to approach this question "with great care," as one party's perception of competition distortion may be viewed as robust competition by another party.[358]

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[353] GTE Comments at 25-26; *see also* Telefónica de España Reply at 49 (agreeing with GTE's argument).

[354] ABS-CBN Reply at 4-5.

[355] *Id.* at 5.

[356] United Kingdom Comments at 4.

[357] Sprint Comments at 22.

[358] *Id.* at 22-23.

206. MCI disagrees with our proposal to condition carriers' authorizations to provide facilities-based service to affiliated markets as proposed in the *Notice*. Instead, MCI urges us to retain the ECO test to address potential distortion concerns.[359]

c. Discussion

207. We are not convinced by commenters who argue that our proposed authorization condition is unnecessary. We believe it is appropriate to prevent potential anticompetitive distortions in the U.S. market for IMTS by conditioning a carrier's authorization to provide facilities-based switched or private line services to a market in which its affiliated foreign carrier provides service on that foreign carrier offering U.S. carriers a settlement rate to terminate U.S.-originated traffic on the affiliated route that is at or below the relevant benchmark. We are also not convinced by AT&T's arguments that the condition should be more stringent. We therefore adopt the conditions for facilities-based switched and private line service to affiliated markets as proposed in the *Notice*. We also adopt a rebuttable presumption to determine when there has been a distortion of competition in the U.S. market for IMTS and we should take enforcement action.

208. Before we address foreign carriers' incentives to engage in price squeeze behavior, we conclude that a U.S.-licensed carrier does have the *ability* to engage in price squeezes that create distortions in the U.S. market for IMTS when it provides facilities-based service to a market in which its affiliated foreign carrier provides the terminating service and collects above-cost settlement rates.[360] We refer to such markets as "affiliated markets." A price squeeze refers to a particular, well-defined strategy of predation that would involve the foreign carrier setting "high" (above-cost) international settlement rates while its U.S. affiliate offers "low" prices for domestic IMTS services in competition with the other carriers. Because the foreign carrier's international termination services are a necessary input for providing IMTS services, the foreign carrier can create a situation where the relationship between its "high" international settlement rates and its U.S. affiliate's "low" prices for IMTS services forces competing carriers either to lose money or to lose customers even if they are more efficient than that affiliate at providing international services. This unprofitable relationship between the input prices and the affiliate's prices, not the absolute levels of those prices, defines a price squeeze.

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[359] MCI Comments at 9-10.

[360] The Commission's rules provide, *inter alia*, that a U.S. carrier is considered to be affiliated with a foreign carrier when a foreign carrier owns a greater than twenty-five percent interest in, or controls, the U.S. carrier. *See Foreign Carrier Entry Order* at ¶ 73; 47 C.F.R. § 63.18(h)(1)(i).

209. A U.S. affiliate of a foreign carrier will still set its own prices based on the foreign carrier's economic cost of providing international termination services because this will maximize their combined profits. In this sense, a price squeeze would have much the same effect as price discrimination in which the foreign carrier charged its U.S. affiliate lower settlement rates than it charged all other carriers. The affiliate will also take into account the effect of its prices on the settlement revenues earned by the foreign carrier.

210. We sought comment in the *Notice* on whether a foreign carrier has the *incentive* to use revenues from above-cost settlement rates to subsidize an affiliate providing international services in the U.S. market. We noted that a foreign carrier may not have this incentive because in serving its home market directly through a U.S. affiliate, the foreign parent would no longer receive the settlement payment it formerly received from other U.S. carriers to terminate traffic to that market. In its comments, AT&T asserts that foreign carriers collecting above-cost accounting rates do have an incentive to enter the U.S. market and undercut competitors. According to AT&T, the incentives lie in three additional sources of profit for a U.S. affiliate of a foreign carrier: (1) the foreign carrier may earn profits from terminating U.S.-inbound traffic; (2) to the extent that its U.S. collection rate exceeds costs, the foreign carrier may use its affiliate to earn profits on U.S.-outbound traffic; and (3) by using its affiliate to lower price in the U.S. market, the foreign carrier may earn additional settlements revenue for the foreign carrier by stimulating additional U.S.-outbound traffic to its home market from all carriers.[361] GTE, on the other hand, argues that it would be irrational for a foreign-affiliated carrier to offer below-cost service offerings in the U.S. market because it would be impossible for a foreign carrier to gain a monopoly position in the U.S. market, much less retain that monopoly long enough to recoup excess profits lost by offering below-cost service. GTE thus concludes that our benchmark conditions are not necessary.[362]

211. We agree with AT&T that in markets that are not fully competitive and are characterized by substantial margins between costs and prices, such as some segments of the U.S. market for IMTS, a foreign carrier collecting above-cost settlement rates would have the ability and incentive to enter the U.S. market and charge lower prices for IMTS. As AT&T notes, such a strategy could generate additional revenue for the foreign carrier by stimulating additional U.S.-outbound traffic to its home market from all carriers. To the extent that its U.S. affiliate's prices remain above its costs, the lower prices are consistent with increased competition or more efficient operation, and consumers clearly benefit from the development. On the other hand, where the U.S. affiliate sets its prices below its own costs of providing

[361] AT&T Comments at 41. *See also* ESI Comments at 9 (A foreign carrier would have an incentive to subsidize a U.S. affiliate in order to build a competitive force in the U.S. market.).

[362] GTE Comments at 25-26.

service, the lower prices may be the result of a predatory price squeeze and distort competition. Nonetheless, we do not agree with GTE that our benchmark conditions are unnecessary. The consequences of carriers opting to engage in a price squeeze strategy are serious enough for us to take preventive measures. As long as foreign carriers are possibly able to engage in predatory price squeeze behavior, we find that the public interest is best served by adopting the Section 214 authorization condition we proposed in the *Notice* to prevent such behavior and protect competition in the U.S. market for IMTS.

212. ABS-CBN states that the condition for provision of facilities-based service to affiliated markets is not necessary for carriers like itself whose settlement revenues barely cover local termination costs.[363] While it may be true that some carriers have greater ability than others to engage in anticompetitive behavior, we believe a rule of general applicability is more administratively efficient, and more importantly, would result in greater regulatory certainty for Section 214 applicants than a case-by-case determination. In addition, case-by-case determinations of the need for competitive conditions could lead to long delays in processing Section 214 applications.

213. We note that in our recent *Access Charge Reform Order* and *Classification of LEC Long Distance Service Order*, we addressed the potential for BOCs to engage in price squeeze behavior when providing in-region interLATA services. In the *Access Charge Reform Order*, we concluded, following analysis similar to that here, that an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. In the *Access Charge Reform Order*, however, we concluded that we have in place adequate safeguards against such conduct,[364] and in the *Classification of LEC Long Distance Service Order*, we concluded that imposing advance tariffing and cost support data requirements on BOC interLATA affiliates would not be an efficient means of preventing the BOCs from engaging in a price squeeze strategy.[365] In the *Access Charge Reform Order*, we also took comfort from current market conditions and regulatory developments. In particular, we noted that: (1) interexchange carriers could respond to an incumbent LEC's attempted price squeeze by entering the local market through the use of unbundled network elements priced at cost-based rates; (2) it is unlikely, given the presence of excess sunk network capacity, that an incumbent LEC could

[363] ABS-CBN Reply at 5.

[364] *Access Charge Reform Order* at ¶ 278.

[365] *See* Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, *Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, FCC 97-142 (rel. April 18, 1997), *recon.* FCC 97-229 (rel. June 27, 1997).

successfully engage in predatory conduct aimed at gaining market power in markets for interexchange services; and (3) domestic antitrust laws offer a measure of protection against a predatory price squeeze.

214. The conditions we adopt today are consistent with our recent treatment of price squeeze concerns in other contexts. For example, our requirement that a foreign carrier's settlement rates be at or below the relevant benchmark as a condition of Section 214 authorization for a carrier to provide IMTS service on an affiliated route is analogous to the approach we adopted with respect to an incumbent LEC's interstate exchange access rate -- an important component reflected in the rates charged to end users. In the *Access Charge Reform Order*, we concluded that rates preferably should be set by competition, not regulation.[366] If access markets were competitive, predatory price squeezes could not be used profitably to distort competition in interexchange markets. Because incumbent LECs currently have little or no competition in the provision of access to their exchange access facilities, however, we have taken, and continue to take, action to ensure that the incumbent LEC access rates continue to move toward the underlying cost of providing access services. In that *Order*, we determined that where competition does not develop over the next several years, we will require carriers to file cost studies that will enable us to ensure that all customers receive the benefit of more efficient prices.

215. Settlement rates similarly represent a cost component that is reflected in the rates charged to end users. As with access charges, U.S.-owned carriers do not, for the most part, have a competitive international market from which to purchase international termination services. While we believe that the WTO Basic Telecom Agreement will lead to the development of increased competition in foreign carriers' markets, this process has just begun, and competitive alternatives are not currently available. Consequently, international settlement rates generally remain far above competitive levels. Moreover, unlike in the domestic interexchange market, we have no jurisdiction over the foreign provider of termination services, and we do not have the same range of regulatory tools available as we have in the domestic context to address competitive distortions. We thus have only a limited ability to affect the development of competition in the international termination services market.

216. We believe there are several factors that suggest that predatory price squeezes may be potentially a greater problem on international routes than they are in the domestic interexchange context. First, on many international routes, the margin of settlement rates above cost is greater than the margin for interexchange access charges. At the same time, there may be less competition for end users than in the domestic interexchange context. On

[366] *Access Charge Reform Order* at ¶¶ 258-84.

such routes, the potential for distortion is higher. Second, in the domestic interexchange context, interexchange carriers can mitigate the effects of a price squeeze and avoid access charges by winning local customers and serving them by means of unbundled network elements set at cost-based rates. No comparable mechanism is available on international routes. Third, in the *Access Charge Reform Order*, we recognized that the existence of four established interexchange networks made it unlikely that predatory price squeezes could be successful. In contrast, on certain international routes, there is little excess capacity available to competitors. Moreover, if an international carrier were forced to exit, the foreign carrier's affiliate might be able to take control of the other carrier's facilities, which would make new entry less likely and thus increase the likelihood that predation would be successful. For these reasons, we believe predatory price squeezes pose a potentially more serious threat on international routes than in the interexchange context. Our benchmarks will help to protect competition in U.S. IMTS markets by reducing the extent to which foreign carriers and their U.S. affiliates can manipulate price-cost margins (the margin between the price of the good and the price of the inputs needed to produce the good) in ways that distort markets.

217. Our assessment of the need to adopt a Section 214 authorization condition to address the potential for price squeezes has changed since we first reviewed this issue in the *Foreign Carrier Entry* proceeding.[367] We there concluded that it was unnecessary to impose such a condition. We did not find on that record persuasive evidence that foreign carriers that entered our market pursuant to our ECO framework could successfully engage in a price squeeze. We reasoned that foreign carriers could not unilaterally set settlement rates because they are established through negotiation with U.S. carriers; that high settlement rates could be offset by lower prices for other inputs or by carrier efficiencies; and that the benefits of additional price and service competition from foreign carriers entering our market after an ECO finding offset the possibility of economic harm to unaffiliated U.S. carriers. We also stated our belief that increased global competition itself would encourage foreign carriers to move toward cost-based levels.

218. The balance of considerations has changed significantly since the *Foreign Carrier Entry Order*. As we stated earlier in this *Order*, our action here comes after the time period for implementation of ITU Recommendation D.140 has concluded, yet settlement rates remain far above cost-based levels. Against this backdrop, the prospect of freer entry into the U.S. market after January 1, 1998 pursuant to our rulemaking proposals implementing the WTO Basic Telecom Agreement increases our concern that foreign carrier entry could create competitive distortions in the U.S. market. We find on this record that foreign carriers have the ability to engage in a price squeeze and that the consequences of carriers opting to engage

[367] *See Foreign Carrier Entry Order* at ¶¶ 68-70.