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November 12, 1997

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

Dear Mr. Caton:

Re: IB Docket No. 96-261, International Benchmarks; IB Docket No. 97-142, Foreign Participation

On Monday, November 10, Stanley J. Moore, Senior Attorney, and Michael Batross, Director, International, Pacific Bell Communications, Carl Frank of Wiley and Rein, and I met with Gina Keeney, Chief, and Robert Calaff and Mindy Ginsburg, Assistants to the Chief, International Bureau; Diane Cornell, Chief, Telecommunications Division, Troy Tanner, Chief, Policy and Facilities Branch, and Kathryn O'Brien of the Telecommunications Division; and with Ari Fitzgerald, Legal Advisor to Chairman Kennard, and Karen Gulick, Legal Advisor to Commissioner Tristani, to discuss the issues summarized in Attachment A. Messrs. Moore and Batross and I met with Peter Tenhula, Legal Advisor to Commissioner Powell, on these same issues. In addition, we provided a copy of Attachment B to Ms. Gulick. We are filing this notice today because FCC offices were closed yesterday for Veteran's Day. We are submitting two copies of this notice in accordance with the Commission's rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions.

Sincerely,

Attachment

cc: R. Calaff, D. Cornell, A. Fitzgerald, M. Ginsburg, K. Gulick, G. Keeney, K. O'Brien, T. Tanner, P. Tenhula

ATTACHMENT A

Switched Resale

SBC Communications, Inc.

IB Dockets Nos. 96-261, 97-142

November 1997

SBC Background

- Certificated U.S. international carrier (out-of-region)
- U.S. carrier with some foreign "affiliations"
- Forthcoming entrant in long distance business
- Intends to compete vigorously with established carriers

SBC Position

- AT&T proposal would chill U.S. competition
- AT&T proposal would chill foreign competition
- No practical basis for AT&T concerns

Procedural Flaws

- Should be addressed in reconsideration of *Benchmark* order rather than the *Foreign Participation* proceeding
- Insufficient notice: FCC signal released only after comments and replies filed.

Proposal Sweeps too Broadly

- Conduct at issue would be predatory, which is already illegal - no additional FCC policy necessary
- Reseller pricing below cost easily detectable
- Existing reporting requirements adequate

Price Squeeze Unrealistic

- No evidence it has ever occurred
- No reseller has or could obtain 10 percent market share
- Customers price for a "basket" of routes
  - Global coverage required - impractical to carve-out markets
  - Customers will not leave existing carrier for price reductions in just a few markets

Price Squeeze Unrealistic

- Reseller contracts permit short-term price increases
- Facilities-based carriers have lower cost structures - resellers cannot undercut
- "Affiliate" rule covers non-controlling investments
- Potential to lose all leverage over foreign carriers

AT&T Proposal Anticompetitive

- Existing market oligopolistic
- Resellers dropping price is evidence of competitive market starting to work
- Resale traditional path for new carrier entry

Public Policy Problems

- Handicaps U.S. overseas investment
- Possibly inconsistent with WTO/GBT (not least burdensome safeguard)
- In any event, *Benchmark* Section 214 conditions should not apply to non-dominant foreign carriers

Recommendation

- Critically examine AT&T's underlying economic assumptions
- Help, not hinder, international competition
- Reject AT&T request

SBC COMMUNICATIONS INC
Opposition To AT&T's Proposed Condition on Resale Services

Background and History

To date, the number of traditional "facilities-based" "half-circuit" international carriers has been relatively small, in part due to the relatively high cost of market entry. Indeed, the U.S. international telecommunications marketplace is far less competitive than the U.S. domestic long-distance market. To foster U.S. carrier entry in the market for international services, the Commission permits the resale of private lines to provide switched services (variously called "interconnected private lines," "international simple resale" or "ISR") and the resale of switched services to provide switched services. The latter method of market entry is often used by new carriers to gain a foothold to compete with existing international market participants. In an effort to keep out such competition, AT&T and other established carriers have launched an attack on this market entry mechanism.

Overview of Resale Services

The resale of switched services to provide switched services fosters entry to the international market more effectively than either facilities-based services or ISR because it does not require U.S. carriers to create an expensive domestic infrastructure prior to market entry. Nor does it require new entrants to establish difficult to obtain bilateral correspondent relationships with foreign carriers. (Foreign dominant carriers have little incentive to contract with newer carriers and, thus, represent a significant barrier to entry.) Instead, new entrants enter into relationships with existing U.S. carriers to resell switched services already subject to agreements with foreign carriers. In this way, a reseller simply uses the services of established underlying carriers.

Resellers of unaffiliated carriers' switched services have traditionally been permitted unconditional authorization and even presumed non-dominant by the FCC. Although recently the issue of imposing restrictions on switched resale has surfaced, the Commission, in its *Order* granting GTE Telecom 214 Authorization, deferred the question of whether to restrict or to impose any conditions on resale to affiliated markets. Moreover, the Commission seized the opportunity presented in the *Foreign Participation NPRM* to reaffirm the pro-competitive nature of resale.

SBC plans to enter and compete vigorously with established carriers in the market for international services via switched resale. Once established as a viable competitor, SBC would increase its market share over a number of years through the provision of facilities-based service and international simple resale. SBC does have a few affiliations with foreign carriers, including Chile and South Africa, and is seeking

additional investment opportunities abroad as countries privatize their telecommunications industries.

Traditional Accounting Rate System

Pursuant to regulatory tradition, U.S. carriers sending traffic to overseas locations enter into bilateral correspondent relations for the termination of telephone calls with foreign carriers. An "accounting rate" is negotiated between the U.S. and foreign carrier to provide a mechanism for sharing the cost of each one minute of international telephone service. The U.S. carrier pays the foreign carrier one-half of the negotiated accounting rate, the "settlement rate," for each minute of international telephone service handled by the foreign carrier.

WTO Basic Telecom Agreement

On February 15, 1997, the WTO Basic Telecom Agreement was adopted among 69 countries, covering 95% of the global market for basic telecommunications services. In this agreement, member countries committed to open their markets for basic telecommunications services to foreign suppliers and to enforce fair rules of competition. In the United States, the FCC is implementing its own commitments in the *Foreign Participation NPRM*. One result of the WTO Basic Telecom Agreement is increased competition in the global market for international telephone message service (IMTS). Such competition is likely to exert downward pressure on accounting rates and, possibly, enable new entrants to bypass the traditional accounting rate system altogether through the development of alternative means for routing traffic. Flexibility in accounting rates is consistent with the Commission's *Flexibility Order* authorizing certain U.S. carriers to enter into payment arrangements that deviate from traditional settlements policy.

Benchmark Order

In the *Benchmark Order*, the FCC prescribed lower benchmark settlement rates for U.S. carriers to pay their foreign correspondents in as little as one, or as many as five, years. The appropriate transition period depends on the relative wealth of the foreign correspondent country. The transition plan was designed to give foreign carriers time to adjust to the new rates without undue disruption to international service.

In addition, the *Benchmark Order* established two conditions applicable to foreign-affiliated carrier entry in the facilities-based and ISR markets. Both conditions require U.S. carriers to forego the FCC's transition period and instead immediately negotiate reductions in settlement rates to benchmark levels. Consistent with its long-

standing practice, the Commission did *not* impose similar conditions on entry via resale of switched services, because in that case, as discussed above, the reseller contracts with a U.S. carrier, not a foreign carrier, for carrying traffic between the two countries.

AT&T's Proposed Condition on Resale Services

AT&T now proposes to extend the benchmark conditions applicable to facilities-based and ISR services to the resale of switched services. AT&T asserts that U.S. carriers with foreign affiliates will drop their prices below cost, unfairly competing with AT&T and other established carriers, by cross subsidizing U.S. operations with profits from the foreign affiliate settlement charges. AT&T calls this a "price squeeze." As a result, AT&T proposes that resellers with foreign affiliates be denied (or lose) their authorizations if settlement rates on affiliated routes are not within benchmarks.

Problems with AT&T's Proposed Condition on Resale Services

(1) AT&T's proposal is a sharp departure from long-standing Commission policy. Less than five months ago, the agency said, in the *Foreign Participation NPRM,* that it "continue[s] to believe that the resale of international switched services by a U.S. carrier whose foreign affiliate has market power in the destination country does not present a substantial possibility of anti-competitive conduct in the U.S. international services market." (*NPRM,* ¶ 31).

(2) AT&T's proposal is procedurally improper. Only after the comment period in the *Foreign Participation NPRM* had closed did the FCC suggest that it would consider conditioning resale.

(3) AT&T's theoretical assertion does not comport with the real world.

- Numerous international carriers have been reselling switched services pursuant to FCC authority for over 10 years without being accused of pricing below costs or engaging in price squeezes. Indeed, the Commission has repeatedly rejected the "price squeeze" theory of competitive harm.

- Resellers affiliated with foreign carriers would be unlikely to drop their prices below cost and lose money on the U.S. end. It is unlikely that a reseller offering below-cost service on one affiliated route could increase its market share sufficiently to generate foreign-affiliate profits because customers select a carrier based on a "basket" of service offerings.

- AT&T's proposed condition on resale would create holes in resellers' scope of service. Resellers that invest overseas through consortia are unable to exert control over their foreign affiliates, and, thus, could not compel reductions in settlement rates. Conditioning resale on benchmark settlement rates would force these pro-competitive resellers to cease providing widespread service to U.S. consumers.

(4) The conduct AT&T fears would amount to "predation," which is already unlawful. No additional FCC policy is necessary.

(5) If a carrier with a foreign affiliate did engage in predation, it would be easily detectable. U.S. carriers providing service to resellers control the resellers service costs. Resellers file international tariffs, thus permitting public knowledge of resellers service prices. Established U.S. carriers thus have the incentive and ability to monitor resellers to ensure that their prices remain above costs, and can complain to the Commission or DOJ if resellers engage in anti-competitive conduct.

(6) Because resellers do not deal directly with their foreign affiliates, no competitive distortion of the market is possible. Indeed, because established carriers have much lower costs – because they own, rather than merely use, underlying international transmission facilities such as cables – AT&T and established carriers will always have lower costs than resellers and can more than meet any reseller price reductions.

(7) Burdening entry via resale would chill U.S. carrier entry in the U.S.-international market. Resale of switched services affords new carriers a low-cost and rapid way of entering the market. Burdening the very vehicle that SBC and other U.S. companies expect to use to enter the market for international services would freeze competitive entry, thus perpetuating the existing oligopoly. Indeed, AT&T's real mission may be to shield its high-margin international services from competition.

(8) The AT&T proposal would handicap overseas investment by U.S. companies. Such a policy (i) is bad for U.S. industry; (ii) will halt the spread of pro-competitive management abroad that can encourage competition; (iii) contradicts assurances from the U.S. government that nothing in the WTO Basic Telecom Agreement would be used to attack U.S. company investments in foreign telecommunications carriers; and (iv) limits U.S. participation in pro-competitive privatizations.

SBC Request For Denial of AT&T's Proposed Condition on Resale Services

Whether or not the FCC conditions the resale of switched services to provide switched services may determine whether SBC, and other U.S. companies, emerge as competitors in the international long distance market. SBC thus requests the Commission to re-affirm that rapid U.S. company entry to the international services market via switched resale is pro-competitive. To do so, the FCC should confirm that switched resale by U.S. companies with foreign affiliates presents no anti-competitive danger and refuse to condition switched resale by U.S. companies with foreign affiliates on the foreign-affiliates immediate reduction of settlement rates to the benchmarks.