

EX PARTE OR LATE FILED



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November 18, 1997

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

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NOV 18 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Ex Parte Meeting
IB 97-142 - Rules and Policies on Foreign Participation in the
U.S. Telecommunications Market

Dear Ms. Salas:

On Monday, November 17, 1997, Mark Baker, Jim Talbot and I of AT&T, and Marius Schwartz, on behalf of AT&T, met with Chairman Kennard, Michael Riordan, Ari Fitzgerald, Diane Cornell, Bob Calaff and Kathy O'Brien to discuss the settlements manipulation by foreign affiliate entrants. AT&T demonstrated that switched resellers, can manipulate the settlements subsidy in favor of their affiliates. AT&T also discussed its concerns with the Telmex/Sprint 214 and the Sprint accounting rate modification.

Because of the lateness of the day, two copies of this Notice are being submitted on the following business day to the Secretary of the Federal Communications Commission in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Attachments

cc: Chairman Kennard
Michael Riordan
Ari Fitzgerald

Diane Cornell
Bob Calaff
Kathy O'Brien

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October 28, 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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NOV 18 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20036

ExParte **Re: Rules and Policies on Foreign Participation in the U.S.
Telecommunications Market, IB Docket No. 97-142;
Telmex/Sprint Communications, L.L.C., File No. ITC-97-127.**

Dear Mr. Caton:

We discussed with the International Bureau last week how switched resale, like the provision of facilities-based services, allows the manipulation of the settlements and proportionate return process through "affiliate call-turnaround," "call volume enhancement" and "affiliate reorigination." By engaging in such practices, all of which are made possible by relatively recent industry developments, such as call-turnaround technology and the refile/reorigination of international traffic, a carrier with above-cost settlement rates serving an affiliated market can obtain additional monopoly profits and raise rivals' costs in the U.S. This may occur just as easily whether the foreign-affiliated carrier provides U.S. international services through switched resale or through a facilities-based authorization. This letter provides additional information concerning these practices.

1. Affiliate call-turnaround

A foreign affiliate (such as Telmex) could transform its U.S.-inbound traffic into U.S.-outbound traffic by establishing a call-turnaround link with its U.S. resale affiliate (such as Telmex/Sprint). The foreign affiliate would thereby receive settlements payments on the U.S.-outbound traffic generated by its U.S. resale affiliate as a result of the call-turnaround activity, thus *doubling* the negative impact to U.S. carriers of the settlements payments lost on the inbound traffic as a result of these activities.

File with case no. 022
10/28/97

Unlike existing call-turnaround, which is generally conducted by competitors of incumbent foreign carriers, the affiliate call-turnaround activity described here would require *no* change in Telmex's retail prices in Mexico, as it would not affect those prices in any way. Affiliate call-turnaround would simply allow Mexico-U.S. calls to be provisioned as U.S.-Mexico calls, thus minimizing Telmex's costs and doubling the settlements paid on each call by U.S. carriers. It would work as follows:

- Telmex would continue to market Mexico-U.S. calls in Mexico at existing collection rates and with no awareness by its customers that their calls were being delivered via call-turnaround.
- Telmex would use call-turnaround technology (data control link to its U.S. resale affiliate Telmex/Sprint) to turn northbound minutes into southbound minutes. Each minute subtracted from northbound stream and added to southbound stream would increase the U.S.-Mexico traffic imbalance by two minutes. Telmex would thus obtain \$0.79 in additional settlement payments (twice the \$0.395 U.S.-Mexico settlement rate) on each call-turnaround minute.
- Telmex's U.S. resale affiliate Telmex/Sprint would complete the call-turnaround link back to Mexico by reselling Sprint's facilities-based services to Mexico, either under a wholesale tariff or under contract (e.g., a Section 211 carrier-to-carrier non-tariffed contract), and would obtain U.S. domestic termination for the calls by reselling domestic termination services purchased from Sprint.
- The total costs incurred by Telmex's U.S. resale affiliate Telmex/Sprint may not exceed the U.S.-Mexico settlement rate of \$0.395 that would be generated by each call-turnaround minute. Telmex/Sprint would pay Sprint a wholesale rate (generally fairly close to the "net" settlement rate that takes account of inbound traffic) plus perhaps 5 cents per minute for domestic U.S. termination.
- After reimbursing these costs, Telmex would profit by approximately \$0.395 on each call-turnaround minute (\$0.78 gained from increasing the U.S.-Mexico traffic stream by two minutes, less approximately \$0.395 in costs).
- Sprint would obtain increased wholesale business. It would also receive a larger share of inbound traffic under proportionate return rules because the call-turnaround traffic would increase its U.S.-outbound market share. These benefits would more than offset its loss of inbound traffic to call-turnaround.

- Other U.S. carriers would have no benefits to offset the loss of inbound traffic to call-turnaround and to Sprint's increased market share. They would therefore experience increased settlement outpayments and higher costs.

U.S. carriers would not have the same incentive or opportunity to engage in similar practices in the reverse direction. In the first instance, on many international routes there would be no financial incentive to turn U.S.-outbound minutes into U.S.-inbound minutes. The key element in the financial viability of the call-turnaround scheme described above is the availability of U.S.-outbound services at low wholesale rates. Few foreign carriers make their IMTS services available for resale, however, and AT&T is aware of none that do so at wholesale rates. It would therefore be necessary to purchase U.S.-inbound minutes in the foreign market at foreign *collection* rates -- which, in most instances, are at least twice the amount of the settlement rate, thus removing much or all of the potential profit from the call-turnaround activity.

Any such profits would also be reduced by the need to purchase foreign market termination at rates that are frequently far above cost. A further impediment preventing U.S. carriers from engaging in such activity would be the likely potential difficulty of obtaining termination for such services in foreign markets at all in the face of strong opposition from the incumbent carriers whose settlement payments from U.S. carriers would be at risk.

2. Call Volume Enhancement

"Call volume enhancement" refers to the artificial generation of U.S.-outbound calls in order to increase settlement payments to a foreign affiliate. This practice is potentially profitable where a U.S. resale affiliate may purchase U.S. carriers' outbound services to the affiliated foreign carrier's home country at less than the nominal U.S. settlement rate with that country. While the U.S. resale affiliate pays only the U.S. *wholesale* rate on each incremental minute of outbound traffic generated by this activity, each of those minutes generates a payment of the *nominal (incremental) settlement rate* from the underlying U.S. facilities-based carrier to the affiliated foreign carrier. It would work like this:

- Telmex/Sprint would use readily-available technology to generate completed U.S.-Mexico calls that would constitute new southbound minutes. Each such minute would increase the U.S.-Mexico traffic imbalance accordingly and require a payment to Telmex by the underlying U.S. facilities-based carrier of the \$0.395 U.S.-Mexico settlement rate.
- Telmex/Sprint would purchase the necessary capacity for this traffic from Sprint at the wholesale rate, which is lower than the \$0.395 nominal settlement rate because it reflects the "netting" of outbound and inbound traffic on the route. After reimbursing Telmex/Sprint for this amount,

Telmex would profit by the amount of the margin between the wholesale rate and the nominal settlement rate.

- Sprint would obtain increased wholesale business. It would also receive a larger share of inbound traffic under proportionate return rules because the new traffic would increase its U.S.-outbound market share.
- Other U.S. carriers would experience increased settlement outpayments and higher costs.

This activity would arbitrage the low *wholesale* rates that are widely available in the U.S. against the *nominal* settlement rate payments that are generated by incremental minutes of outgoing traffic. As U.S. carriers are unable to purchase U.S.-inbound services in foreign markets below nominal settlement rates, U.S. carriers would not have the same ability to engage in similar practices in the reverse direction.

3. Affiliate Reorigination

The creation of an affiliate relationship such as Telmex/Sprint also provides increased incentives to engage in "affiliate reorigination" practices that may adversely affect other U.S. carriers by reducing their return traffic. For example, Sprint may increase its market share of U.S.-Mexico minutes, and its share of proportionate return on that route, by reoriginating Country X - Mexico traffic through the U.S. Other U.S. carriers, however, would receive proportionately *fewer* minutes of Mexico-U.S. return traffic as a result of these activities and would thereby experience higher costs.

Such activities provide an unfair advantage to the affiliated U.S. carrier where they result from the leverage of foreign market power -- such as from the foreign affiliate's ability to refile its traffic from a closed third market through the U.S., or simply from the foreign carrier's privileged access to information unavailable to U.S. carriers concerning settlement rates between the foreign affiliate's home market and third countries.

4. Likelihood of Detection

All of these practices would be difficult to detect. None of the underlying arrangements require Commission approval, and the carriers participating in them would no doubt seek to attribute the resulting shifts in traffic to other causes.

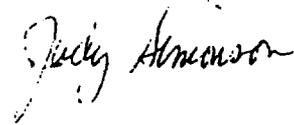
Additionally, as noted above, the potential occurrence of these activities is of relatively recent origin. Consequently, the fact that foreign-affiliated carriers that already possess Section 214 switched resale authorizations may not have engaged in such practices is of no evidentiary weight.

* * * *

To prevent a foreign-affiliated carrier with above-cost settlement rates from manipulating the settlements and proportionate return process to obtain additional monopoly profits and raise rivals' costs in the U.S. in these ways, the Commission should place appropriate conditions -- especially requiring immediate adoption of the benchmark settlement rate -- on Section 214 authorizations for the provision of international switched resale services on affiliate routes.

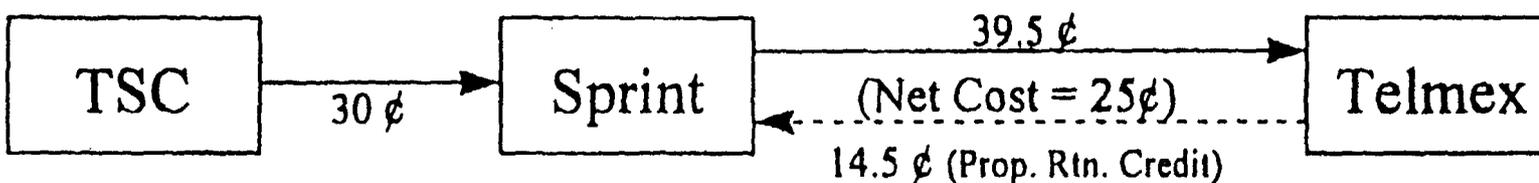
I would be pleased to provide further information concerning these issues.

Respectfully submitted,



cc: Diane J. Cornell, Esq.

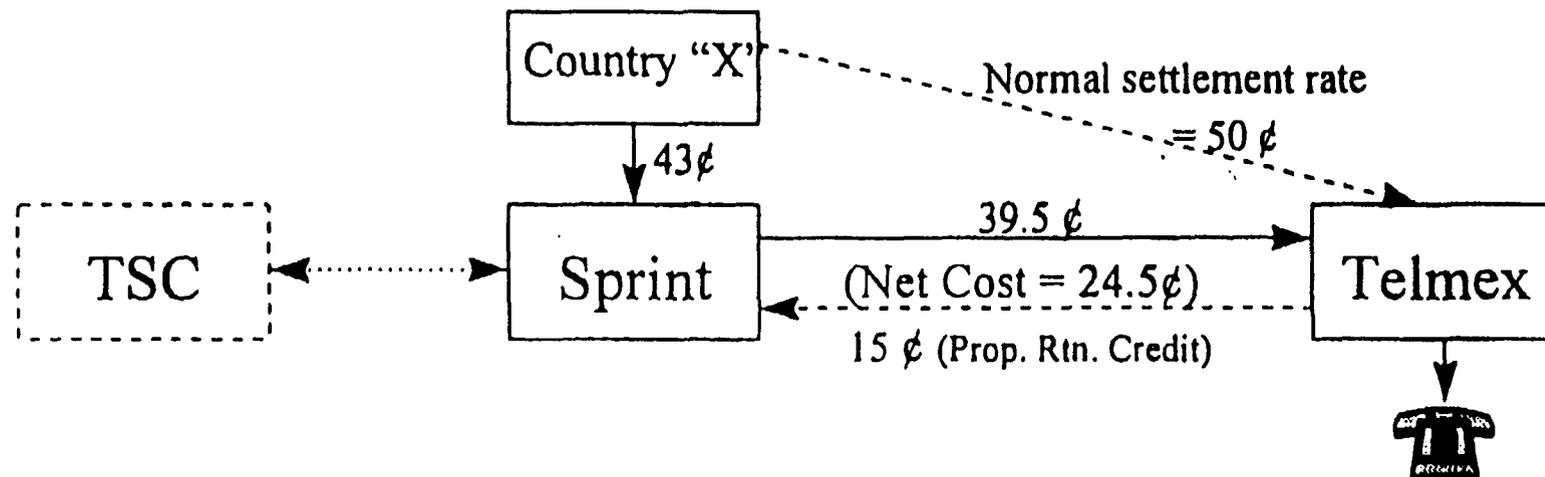
Call Volume Enhancement



	Before	After	Net Impact
Telmex	<ul style="list-style-type: none"> • 2,500M Southbound Minutes • 1,000M Northbound Minutes • \$593M Net Settlements Revenue 	<ul style="list-style-type: none"> • 2,700M Southbound Minutes • 1000M Northbound Minutes • \$671M Net Settlements Revenue • \$64M Paid to TSC to Cover Costs 	Gain of \$14M
Sprint	<ul style="list-style-type: none"> • 275M Southbound Minutes • 110M Northbound Minutes • \$85M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 475M Southbound Minutes • 176M Northbound Minutes • \$118M Net Settlements Outpayment • \$60M International Wholesale Revenue 	Gain of \$7M
TSC	• N/A	<ul style="list-style-type: none"> • 200M Generated Minutes • \$60M International Wholesale Cost • \$64M Reimbursement from Telmex 	Gain of \$4M
Other U.S. Carriers	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 890M Northbound Minutes • \$528M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 824M Northbound Minutes • \$553M Net Settlements Outpayment 	Loss of \$25M

- TSC artificially generates 200M S/B minutes
- TSC pays Sprint 30¢ per minute; TSC reimbursed 32¢ per minute by Telmex
- Sprint receives a net addition of 66M N/B minutes due to "market share" growth
- Telmex gains 7¢ per new S/B minute

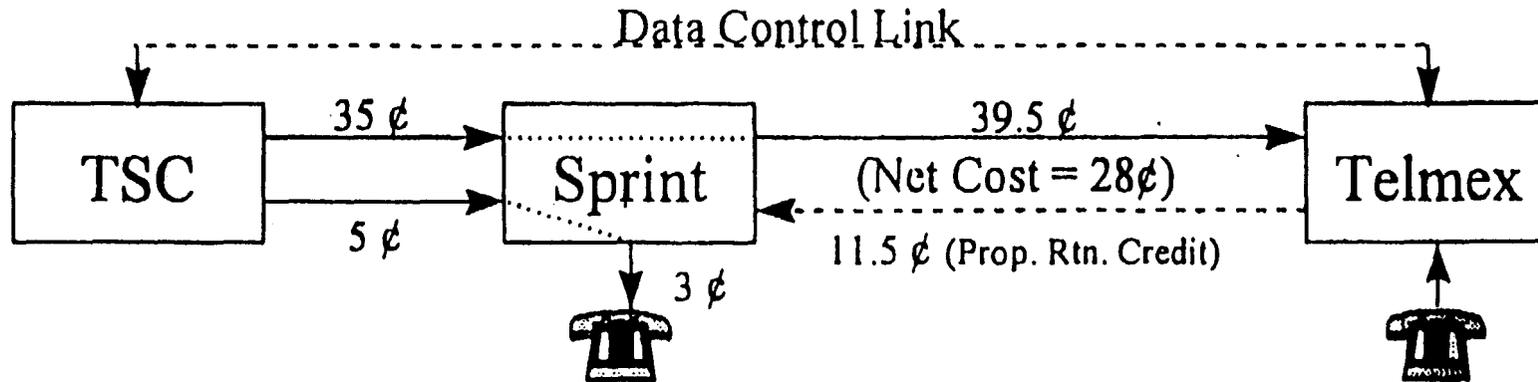
Affiliate Reorigination



	Before	After	Net Impact
Telmex	<ul style="list-style-type: none"> • 2,500M Southbound Minutes • 1,000M Northbound Minutes • \$593M Net Settlements Revenue 	<ul style="list-style-type: none"> • 2,800M Southbound Minutes • 1000M Northbound Minutes • \$832M Net Settlements Revenue • \$50M Loss of 3rd Country Settlements • \$14M Covering Payment from Sprint 	Gain of \$3M
Sprint	<ul style="list-style-type: none"> • 275M Southbound Minutes • 110M Northbound Minutes • \$85M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 375M Southbound Minutes • 144M Northbound Minutes • \$91M Net Settlements Outpayment • \$14M Covering Payment to Telmex • \$43M Reorigination Revenue 	Gain of \$3M
Country "X"	<ul style="list-style-type: none"> • \$50M Net Settlement to Telmex 	<ul style="list-style-type: none"> • 43M Reorigination Payment to Sprint 	Gain of \$7M
Other U.S. Carriers	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 890M Northbound Minutes • \$528M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 856M Northbound Minutes • \$541M Net Settlements Outpayment 	Loss of \$13M

- Sprint "reoriginates" 100M minutes of Country "X"- Mexico traffic through US at a price to "X" of 43¢/minute
- Telmex loses 11¢/minute (50¢ - 39.5¢); requires compensation from Sprint
- 43¢ price covers Sprint net costs of 24.5¢/minute plus 14¢/minute compensation to Telmex
- Sprint gains 34M N/B minutes due to "market share" growth

Affiliate Call Turnaround



	Before	After	Net Impact
Telmex	<ul style="list-style-type: none"> • 2,500M Southbound Minutes • 1,000M Northbound Minutes • \$593M Net Settlements Revenue 	<ul style="list-style-type: none"> • 2,700M Southbound Minutes • 800M Northbound Minutes • \$751M Net Settlements Revenue • \$86M Paid to TSC to Cover Costs 	Gain of \$72M
Sprint	<ul style="list-style-type: none"> • 275M Southbound Minutes • 110M Northbound Minutes • \$65M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 475M Southbound Minutes • 141M Northbound Minutes • \$132M Net Settlements Outpayment • \$70M International Wholesale Revenue • \$10M Domestic Wholesale Revenue • \$7M Additional Access Charges 	Gain of \$6M
TSC	• N/A	<ul style="list-style-type: none"> • 200M Foreign Resold Minutes • 200M U.S. Resold Minutes • \$70M International Wholesale Cost • \$10M Domestic Wholesale Cost • \$86M Reimbursement from Telmex 	Gain of \$6M
Other U.S. Carriers	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 890M Northbound Minutes • \$528M Net Settlements Outpayment 	<ul style="list-style-type: none"> • 2,225M Southbound Minutes • 659M Northbound Minutes • \$619M Net Settlements Outpayment • \$7M Savings in Access Charges 	Loss of \$84M

- Using CTA technology, Telmex (with TSC) turns 200M N/B minutes into S/B minutes; Increases US outpayment by \$158M
- TSC pays Sprint 35¢/minute for Int'l link and 5¢/minute for domestic termination
- Sprint receives a net addition of 31M N/B minutes due to "market share" growth
- Telmex reimburses TSC 43¢/minute to cover costs