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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Rules and Policies on Foreign Participation	)	
in the U.S. Telecommunications Market	)	File No. IB 97-142

AT&T COMMENTS IN SUPPORT OF MCI PETITION FOR RECONSIDERATION AND OPPOSITION TO PETITIONS OF BELLSOUTH, KDD AND SBC

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Dated: February 10, 1998

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SUMMARY

Because high settlement rates provide the same ability to cause competitive harm whether services are provided on a facilities basis or through switched resale, the Commission should require additional safeguards before carriers with market power at the foreign end may provide switched resale services on affiliated routes. While above-cost settlement rates make price squeeze strategies attractive to foreign-affiliated resellers seeking to raise rivals' costs or to gain U.S. market share, detection of such conduct would be very difficult. In addition to the benchmark settlement rate condition and other measures proposed by MCI, the Commission should impose a "bright line" test to ensure that prices on affiliated routes are not below the average prices at which services are obtained from underlying facilities-based carriers.

The Commission should reject proposals by SBC, KDD and BellSouth that would undermine safeguards against the abuse of market power. Because competitive harm may occur from U.S. carrier investments in foreign carriers as well as foreign carrier investments in U.S. carriers, U.S. obligations under the WTO Agreement require the same notification and review procedures for both types of investments, contrary to the arguments by SBC. The proposal by KDD to extend the presumption of non-dominance to all carriers without bottleneck local exchange facilities that have two or more facilities-based competitors ignores the market power that may be retained in such circumstances -- as shown by the International Bureau's 1996 finding that KDD, which does not control bottleneck local exchange facilities, has market power in Japan. The Commission should also dismiss BellSouth's attempt to use the *Foreign Participation Order* to avoid meeting Section 271 requirements.

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FOR RECONSIDERATION AND OPPOSITION TO
PETITIONS OF BELLSOUTH, KDD AND SBC.

AT&T Corp. ("AT&T") hereby submits its Comments in Support of the Petition for Reconsideration filed in the above-referenced proceeding by MCI Telecommunications Corporation ("MCI") and its Opposition to the Petitions for Reconsideration filed by BellSouth Corporation ("BellSouth"), Kokusai Denshin Denwa Co. Ltd. ("KDD"), and SBC Communications, Inc. ("SBC").

I. ADDITIONAL SAFEGUARDS ARE REQUIRED FOR SWITCHED RESALE ENTRY.

The *Foreign Participation Order* reaffirms (¶ 192) that carriers providing facilities-based service to affiliated foreign markets have the ability to engage in "predatory price squeeze[s]" even after they are required to lower settlement rates to benchmark levels "because the settlement rate benchmarks we adopted in the *Benchmarks Order* are still above cost." However, the *Order* fails to take sufficient steps to prevent competitive distortion resulting from market entry by the switched resale affiliates of foreign carriers with settlement rates above benchmark levels.

To ensure that resale entry is subject to adequate safeguards, MCI (p. 2) asks the Commission to condition switched resale authorizations to serve affiliated routes on the provision of benchmark rates. Alternatively, MCI requests (*id.*) that such authorizations be conditioned on commitments to meet the glidepath and benchmark requirements of the *Benchmark Order*, and the filing of additional information including all contracts and arrangements for services on the affiliated route, with the expedited imposition of benchmark rates if there is competitive distortion.

Contrary to the findings of the *Foreign Participation Order*, whether entry is on a facilities basis or through switched resale, high settlement rates provide the same ability to cause competitive harm. Additional safeguards should accordingly be imposed on the switched resale affiliates of carriers with foreign market power. In addition to the measures proposed by MCI, the Commission should establish a "bright line" pricing test requiring the imposition of "best practice" rates if switched resellers' prices on affiliated routes are below the average prices at which they obtain service from underlying facilities-based carriers.

1. Switched Resellers Have the Ability and Incentive To Engage In Price Squeeze Strategies.

Carriers providing switched outbound services to affiliated foreign markets in which they have market power on a facilities-basis or through switched resale have the same incentives to use their control over settlement rates to raise rivals' costs and to fund other anticompetitive strategies. As MCI observes (p. 5), the critical issue is "the foreign-affiliate's control over an essential cost input . . . (accounting rates), rather than on the method by which the affiliate provides its services."

According to the *Foreign Participation Order* (¶ 199), switched resellers are less likely to engage in predatory price squeezes because "[t]he lack of control over facilities means that it would be impossible for a switched reseller to force all facilities-based carriers to cease serving a route indefinitely." (Emphasis added.) The Commission thus relies (*id.*) upon the continued existence of "at least one facilities-based carrier in the market from whom the reseller has to buy service" to defeat predation by a foreign-affiliated switched reseller. But rather than seeking to displace the switched reseller by raising wholesale prices or by competing at the retail level, as expected by the *Order* (¶ 199), a surviving facilities-based carrier would more likely elect to share monopoly rents on the affiliated route with the carrier that would retain control over the facilities-based carrier's essential cost input, the settlement rate.

The *Order* acknowledges (*id.*, n.404) that the benchmark condition or other safeguards are necessary "[t]o the extent that a switched reseller's affiliation with a facilities-based carrier may create a significant potential for a price-squeeze in an individual circumstance."[1] But where there is no pre-existing affiliation, the switched reseller may still "benefit from the exclusion of competition" (¶ 199) through other arrangements with the underlying facilities-based carrier. In this way, a price squeeze by a switched reseller would have the same adverse impact on competition as a price squeeze by a facilities-based carrier.

The *Order* also fails to recognize the increased incentives to engage in predatory price squeeze behavior that exist where there are above-cost settlement rates at the foreign end of

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1 *See also*, Letter dated Nov. 5, 1997 to the Honorable William E. Kennard, Chairman, Federal Communications Commission, from Larry Irving, Assistant Secretary for Communications and Information, U.S. Department of Commerce, at 4 ("It is in those cases where an

(footnote continued on following page)

a U.S. international route -- and that affect both facilities-based and switched resale affiliates of the foreign carrier controlling those rates. Unlike traditional predatory schemes offering recoupment only after competitors have been driven from the market,[2] above-cost settlement rates provide the opportunity for immediate profits to be obtained from below-cost pricing strategies.

Above-cost settlement rates ensure that the foreign-affiliate of the predating facilities-based or resale carrier will obtain increased profits if other U.S. carriers attempt to preserve market share by following the below-cost price reductions of the predating carrier. Where settlement rates are above cost, increased U.S.-outbound calling on the affiliate route will always result in increased settlements profits to the foreign carrier controlling the settlement rate. Thus, even if competing U.S. carriers would not "accept losses indefinitely" (¶ 202), any below-cost reductions in prices -- short-term or long-term -- that are made by U.S. carriers in response to below-cost pricing by the predating foreign-affiliated carrier will increase U.S.-outbound calling and generate increased settlement profits at the foreign end.[3]

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applicant is affiliated with facilities-based carriers at both ends of a route that there appears to be both greater incentive and ability to engage in anticompetitive behavior.")

2 The incentive to engage in predatory pricing does not require the ability "to force all facilities-based carriers to cease serving a route permanently," (¶ 199) (emphasis supplied), but only "for long enough both to recoup the predator's losses and to harvest some additional gain." *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

3 The carriers most likely to engage in such conduct are those terminating the majority of U.S.-outbound traffic in the affiliated foreign market. As smaller carriers have little incentive to engage in conduct that would provide greater benefits to their larger competitors in the foreign market, no benchmark requirement is necessary for the U.S. affiliates of non-dominant foreign carriers that terminate more than 50 percent of their U.S.-outbound traffic on the affiliated route with non-affiliated carriers at the foreign end.

But if, as found by the *Order* (¶ 202), no competing U.S. carrier chose to follow the price reductions of the foreign-affiliated facilities-based or resale carrier -- an unlikely result in the highly competitive U.S. international market -- the predating carrier would still "gain market share in the United States" (*id.*). This would be a likely objective, particularly where settlement rates at the foreign end are far enough above cost that any "reduced total profits for the integrated foreign carrier" (*id.*) would not be a significant concern.

Price squeeze strategies causing competitive distortion in the U.S. market would therefore be attractive to both facilities-based and resale foreign-affiliated carriers with above-cost settlement rates, even if they did not subsequently raise U.S. calling prices. To prevent such distortion, the U.S. switched resale affiliates of carriers with market power should be subject to a "bright line" pricing test on affiliated routes, in addition to the safeguards sought by MCI.

2. There Would Be No Easy Detection of Price Squeezes By Switched Resellers.

There is no support in the record for the finding (¶¶ 204-05) that the easier detection of price squeeze behavior by resellers renders any benchmark condition unnecessary. Both MCI and AT&T presented uncontradicted evidence that resellers' wholesale arrangements with facilities-based carriers are highly complex, continually changing and non-transparent, making any identification of "suspect" resale prices (¶ 204) virtually impossible. The large and thriving "spot market" in wholesale services, accurately described by MCI (p. 7) as "like a 'resale trading floor' where resellers can constantly change their traffic to be routed through the lowest cost carrier at any given time," exemplifies the problem. Instead of making detection of below cost pricing "easier," as the *Order* mistakenly concludes (¶ 205), the extensive continually up-dated pricing information provided by the spot market would conceal such conduct from detection by the Commission and other carriers.

3. **Additional Safeguards Are Required To Prevent Competitive Harm.**

Under the regulatory framework established by the *Order*, carriers providing switched resale services to affiliated foreign markets are now far more likely to cause competitive harm in the U.S. market than foreign-affiliated facilities-based carriers. Resale entry is "less expensive initially and less capital intensive, and thus can occur more rapidly than facilities-based entry." (¶ 213). Most significantly, resellers may provide services on affiliate routes without lowering settlement rates on those routes to benchmark levels -- thus maintaining rates far above cost to fund their predatory conduct.

To prevent this result, the benchmark condition, or other additional safeguards should be imposed on the switched resale affiliates of carriers with foreign market power. In addition to the measures proposed by MCI, the Commission should establish a "bright line" pricing test similar to that established by the International Bureau's recent *TSC Order* requiring the imposition of "best practice" rates if switched resellers' prices on affiliated routes are below the average price at which they obtain service from underlying facilities-based carriers.[4] Such a condition, in addition to a requirement for the filing of information concerning these arrangements to allow expedited enforcement action, would not "limit additional entry" to the U.S. market (¶ 213), but would limit the ability of foreign-affiliated switched resellers to make anticompetitive use of above-cost settlement rates.

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4 *Telmex/Sprint Communications, L.L.C.*, File No. ITC-97-127, Order, Authorization and Certificate, (rel. Oct. 30, 1997), DA 97-2289 ("*TSC Order*"), ¶ 62.

II. PRIOR REVIEW IS REQUIRED OF ALL U.S. CARRIER AFFILIATIONS.

Liberalized market entry rules require effective safeguards against the abuse of market power.[5] Because such harm may occur from U.S. carrier investments in foreign carriers as well as from foreign carrier investments in U.S. carriers, U.S. obligations under the WTO Agreement require the same notification and review procedures for both types of investments. (¶¶ 70, 140, 334). Such action is well within the Commission's authority to protect the public interest from anticompetitive conduct.[6] Contrary to SBC's misplaced concerns (pp. 2-3 & n.5) that investments in carriers in WTO countries such as Guatemala could be rendered "void" under these rules, the *Order* finds (¶ 70) that with respect to such countries "our new entry standard will rarely, if ever, prohibit a U.S. carrier from making a greater than 25 percent investment in a foreign carrier."[7]

The application of the ECO test to U.S. investments in carriers in non-WTO countries will only restrict acquisitions of dominant carriers in closed markets -- situations where

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5 The Commission reaffirms (¶ 145) that "[a]bsent effective regulation in our market, we are concerned that a foreign carrier with market power in an input market at the foreign end of a U.S. international route has the ability to exercise, or leverage, that market power into the U.S. market to the detriment of competition and consumers." Under the procedures established by the *Order*, pre-entry review will continue to assist the Commission to address these and other critical public interest concerns, although only applications involving non-WTO countries will henceforth be subject to the ECO test.

6 *See Atlantic Tele-Network, Inc. v. F.C.C.*, 59 F.3d 1384 (D.C. Cir. 1995); *Market Entry and Regulation of Foreign-affiliated Entities,* 11 FCC Rcd. 3873, 3960-61 (1995) ("*Foreign Carrier Entry Order*").

7 However, to reduce the burden of compliance, the Commission should lower the sixty-day notification period required by Section 63.11. A thirty-day notification period should instead be employed, similar to the thirty-day waiting period required under the Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. Section 7A.

there are no WTO obligations and the investment would pose a significant risk to U.S. competition. (¶¶ 127, 140.) Additionally, as the Order emphasizes, the Commission's continuing public interest goal of promoting open foreign markets in non-WTO countries is best achieved by using the ECO test "to encourage simultaneous privatization and liberalization." (¶ 142) (Emphasis added.)

SBC wrongly asserts (p. 4) that no consistency with WTO National Treatment obligations is required. Article XVII (National Treatment) of the General Agreement on Trade in Services applies, by its terms, to "all measures affecting the supply of services" and the Commission must accordingly treat investments by WTO country carriers no less favorably than those by domestic carriers.[8] (¶ 140). If U.S. carrier investments in non-WTO countries were not subject to prior review, similar treatment would be required for the U.S. affiliates of all other WTO country carriers, thus reducing the efficacy of the ECO test as a tool to prevent the anticompetitive use of bottleneck facilities in non-WTO countries and to encourage the liberalization of these markets.

III. THE PRESUMPTION OF NON-DOMINANCE SHOULD BE LIMITED TO CARRIERS WITH MARKET SHARES UNDER 50 PERCENT.

Market power is "a carrier's ability to raise price by restricting its output of services" (¶ 144) and is not limited to carriers with local exchange bottlenecks. As KDD (p. 7) acknowledges, "international gateway bottlenecks" may also exist. This is demonstrated by the International Bureau's September 1996 finding that KDD has "significant market power in the

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8 There is no merit to KDD's claim (p. 10) (emphasis in original) that dominant carrier safeguards violate the National Treatment principle unless they "apply to all carriers." As the

(footnote continued on following page)

facilities-based IPL market" in Japan, notwithstanding its lack of control over bottleneck local exchange facilities.[9]

The Bureau's finding was based upon "a totality of the circumstances," including Japan's high IPL prices and the absence of sufficient market entry, in addition to KDD's market share and the existence of market entry barriers.[10] KDD seeks (pp. 4-9) to replace the need for such competitive analysis before carriers with market shares over 50 percent may be found non-dominant with a presumption that no carrier without bottleneck facilities, however high its market share, can have market power following the entry of just two facilities-based competitors.

While the rebuttable presumption adopted by the *Order* (¶ 161) that carriers with less than 50 percent market shares in each relevant market do not have market power is consistent with the findings of antitrust courts, there is no such support for the far-reaching presumption sought by KDD. As found by the *Foreign Participation Order* (¶ 159), the entry of new facilities-based competitors will not immediately preclude the exercise of market power in the future.

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Order concludes (¶ 374), regulation of carriers with market power is "not based on nationality but on objective economic analysis."

9 *KDD America Inc.*, 11 FCC Rcd, 11329, 11337-38 (1996) (Order, Authorization and Certificate).

10 *Id. See also, e.g., Motion of AT&T Corp. To be Declared Non-Dominant for International Service*, 11 FCC Rcd.17963, 17976 (1996) (Order) ("[A]s the Commission and the antitrust courts have continually recognized, market shares, by themselves, are not the sole determining factor of whether a firm possesses market power. Other factors, such as demand and supply elasticities, conditions of entry and other market conditions must be examined to define a relevant market, and determine whether a particular firm can exercise market power.")

Although incumbent market power should diminish over time where WTO commitments to open markets completely are implemented in full, there can be no certainty that new carriers will always have sufficient capacity to constrain incumbents when they begin service, that consumers will be sufficiently demand-elastic, or that other market conditions will not reduce competitive pressures. The Commission should accordingly follow the policy established by the *Order,* which ensures that dominant carriers are subject to appropriate regulation, while allowing (¶ 233) carriers with market shares over 50 percent to show through "appropriate economic analysis" that such regulation is unnecessary because they lack market power.

IV. NO SIMILAR TREATMENT IS REQUIRED OF BELL OPERATING COMPANY ENTRY INTO IN-REGION LONG-DISTANCE MARKETS.

BellSouth seeks to bootstrap the new entry rules for WTO member carriers into similar treatment of Bell Operating Company ('BOC") applications for the provision of in-region long-distance services, but again fails to acknowledge the specific statutory requirements to which the BOCs are subject under Section 271 of the Telecommunications Act, and which are unaffected by the WTO Agreement. Among other things, the Act requires full implementation by the BOCs of a 14-point competitive check-list before they may provide in-region domestic long-distance service.[11] These requirements arise out of the unique market position occupied by these

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[11] *See, e.g., Application by BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-region InterLATA Services in Louisiana*, CC Docket No. 97-231, Memorandum Opinion and Order, (rel. Feb. 4, 1998), FCC 98-17.

incumbent monopolists as well as the fact that the BOCs were subject to similar restrictions under the Modification of Final Judgment. Neither the WTO Agreement nor the *Foreign Participation Order* thus provide any basis for allowing the BOCs to avoid opening their local markets to competitors in accordance with the requirements of Section 271.[12]

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12 The specific nature of the obligations that the BOCs must fulfill before they may provide in-region long-distance services contrasts with the open entry into the domestic long-distance market that, unlike the BOCs, foreign carriers from all countries have always enjoyed. The ECO test has never applied to foreign carrier applications to provide domestic interexchange services and has imposed no limitation on such entry, even by carriers with monopolies in closed foreign markets. *See Foreign Carrier Entry Order*, 11 FCC Rcd. at 3939. The Commission has thus long employed "different entry standards to address different risks of competitive harm." (¶ 58).

CONCLUSION

For the above-mentioned reasons, the Commission should require additional safeguards for the provision of switched resale services on affiliated routes by carriers with market power at the foreign end, but should reject the modifications proposed by BellSouth, KDD and SBC.

Respectfully submitted

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February 10, 1998

CERTIFICATE OF SERVICE

Helen Elia, do hereby certify that on this 10th day of Feburary, 1998 a copy of the foregoing "AT&T Comments In Support of MCI Petition For Reconsideration and Opposition to Petitions of BellSouth, KDD and SBC" was mailed by U.S. first class mail, postage prepaid, upon the parties on the attached service list:

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