ORIGINAL

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

OCT 16 1998

In the Matter of	)	
	)	
1998 Biennial Regulatory Review –	)	IB Docket
Reform of the International Settlements	)	No. 98-148
Policy and Associated Filing Requirements	)	
	)	
Regulation of International	)	CC Docket No. 90-337
Accounting Rates	)	

REPLY COMMENTS OF AT&T CORP.

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SUMMARY

AT&T supports the removal of unnecessary Commission regulation of the U.S. international market. AT&T therefore approves the removal of the ISP on WTO routes from arrangements with non-dominant foreign carriers and from arrangements with dominant foreign carriers in markets that are sufficiently competitive to prevent harm to the U.S. public interest.

However, AT&T strongly opposes the efforts by some carriers to replace the ISP with new regulatory burdens that would fall disproportionately on larger U.S. carriers and particularly on the largest U.S. carrier, AT&T. AT&T also strongly opposes the removal of filing obligations from below-25 percent flexibility arrangements proposed by the Notice.

Applying a 25 percent traffic threshold on routes where the ISP is removed, and imposing "no unreasonable discrimination" or continued ISP obligations above this level, would raise the costs of larger U.S. carriers and most of all of AT&T -- in effect, subjecting AT&T to a new form of dominant carrier regulation. The imposition of this unjustified and discriminatory handicap on a carrier that the Commission expressly reaffirmed this very month to be without market power would be arbitrary and capricious and harmful to competition.

The Commission may not protect smaller U.S. carriers at the expense of competition, as the D.C. Circuit has emphasized, and the Commission should accordingly reject this blatant quest for competitive advantage. Any concerns resulting from the market power of foreign carriers should be addressed on a non-discriminatory basis by removing the ISP from arrangements with those carriers, if at all, only where competitive

conditions or settlement rates at or near cost-based levels are sufficient to prevent competitive harm.

Allowing secrecy for below-25 percent flexibility arrangements as proposed by the Notice would not only cause similar harm to competition by imposing arbitrary cost disadvantages on larger U.S. carriers but would also create new whipsaw opportunities for foreign dominant carriers to avoid benchmark settlement rates. The major beneficiaries, as warned by the General Services Administration, would be foreign dominant carriers, rather than U.S. consumers. The Commission should decline to adopt this proposal and should also remove the existing 25 percent flexibility threshold.

Whipsaw risks from foreign dominant carriers will persist even after the achievement of benchmark rates. For this reason, the ISP should be removed from arrangements with these carriers only where settlement rates have been lowered to "best practices" levels or where U.S. carriers can terminate traffic through viable ISR arrangements. No party shows that the mere authorization of ISR by the Commission, the primary standard proposed by the Notice, would be sufficient. Nor is there any basis to claims by foreign carriers and their U.S. affiliates that continuation of the ISP is unnecessary or contrary to WTO requirements.

To avoid inconsistency and confusion, the Commission should remove the No Special Concessions rule from the settlement of traffic on all routes on which the ISP is removed from arrangements with foreign dominant carriers. Additionally, the removal of the ISP from arrangements with foreign non-dominant carriers should require public notice of non-dominant status, which should be established independently of any particular U.S. carrier arrangement to protect confidentiality concerns.

The Commission should not adopt the modifications in the ISR rules suggested by the Notice, which would not lead to lower settlement rates and would merely encourage one-way by-pass. Finally, restrictions on BOC "grooming" arrangements should be maintained to prevent the anticompetitive use of regional bottlenecks and above-cost access charges.

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REPLY COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T") hereby submits its Reply Comments in response to the comments filed by other parties[1] concerning the Commission's proposals to change the International Settlements Policy ("ISP") and associated rules.[2]

I. THE RESTRICTIONS ON ABOVE 25 PERCENT ARRANGEMENTS REQUESTED BY SOME CARRIERS WOULD BE ARBITARY AND CAPRICIOUS AND HARMFUL TO COMPETITION.

Predictably, some of AT&T's competitors would like the Commission to (a) apply a 25 percent threshold where the ISP is removed from arrangements with foreign dominant carriers and to impose "no unreasonable discrimination" requirements on arrangements above this level, or (b) remove the ISP only for arrangements affecting 25

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[1] The commenters are listed at Attachment I.

[2] *Notice of Proposed Rulemaking*, IB Docket No. 98-148, CC Docket No. 90-337 (rel. Aug. 6, 1998), FCC 98-190 ("Notice").

percent or less of the traffic on a route. AT&T strongly opposes these efforts to disadvantage larger competitors.

The different treatment these carriers propose for arrangements affecting 25 percent or more of the traffic on a route would be entirely arbitrary, with no relationship to the possession of market power or to any greater likelihood of market distortion and unsupported by any other public interest justification. However, they would burden larger U.S. competitors, and AT&T in particular, with higher costs by limiting their ability to negotiate settlement arrangements on the same basis as other carriers. It is thus hardly surprising that MCI WorldCom supports this approach. Although MCI WorldCom would itself be affected to some degree on many routes, it would be less adversely affected than AT&T, and would derive a key competitive advantage over its larger rival.

The creation of a favored cost position for U.S. carriers with market shares of 25 percent and under would dictate competitive outcomes in the U.S. industry by systematically disadvantaging larger carriers and particularly AT&T, the largest carrier. Imposing such an onerous and discriminatory regulatory handicap notwithstanding the Commission's October 5, 1998 reaffirmation that AT&T does not possess market power would constitute arbitrary and capricious rulemaking. As emphasized by Dr. William Lehr in the attached Reply Affidavit (p. 4), without market power, AT&T has no economic advantage over other U.S. carriers allowing it to obtain uniquely favorable arrangements

with foreign carriers.[3]

Raising AT&T's costs through such regulation would harm competition, as the Commission found in the *AT&T International Non-Dominance Order,* impeding the very objectives the Commission seeks to promote through removal of the ISP, and contravening the deregulatory purpose of this biennial review. Moreover, to protect small carriers at the expense of competition, as the D.C. Circuit affirmed in rejecting the domestic Residual Interconnection Charge in 1996, is not reasoned decisionmaking.

Any such measure is also unnecessary. The Commission already possesses a proven and powerful regulatory tool -- the ISP -- preventing foreign carriers from using the settlements process to harm competition. The issue in this rulemaking should be whether there are now circumstances in which the ISP can be removed on a non-discriminatory basis without adverse effects in the U.S. market. All commenters agree that those circumstances exist for agreements with foreign non-dominant carriers. The ISP can also be removed from arrangements with foreign dominant carriers in some circumstances -- where the foreign market allows viable ISR arrangements or where the foreign carrier provides best practices settlement rates. If the Commission concludes otherwise, it should simply retain the ISP for all U.S. carriers' arrangements with foreign dominant carriers. It should not apply a new and discriminatory version of the ISP just to carriers with market shares over 25 percent.

Competition would also be severely harmed by another type of differential treatment of arrangements above and below the 25 percent threshold -- the removal of

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[3] Attachment III hereto ("Lehr Reply Aff.").

filing obligations for below-25 percent flexible arrangements. The strong concerns expressed by AT&T (pp. 16-25) regarding this proposed modification of the flexibility rules are shared by the General Services Administration, in comments filed on behalf of the consumer interests of the U.S. Government as a major purchaser of international telecommunications services. GSA finds no competitive merit in this proposal and likewise fears that the major beneficiaries would be foreign dominant carriers, which would receive new whipsaw opportunities. Even more harmful would be the expansion of this approach advocated by Sprint, under which the ISP and associated filing requirements would be removed for below-25 arrangements with all carriers on all routes.

1. Proposed Restrictions on 'Above-25 Percent' Arrangements Would Provide Smaller Carriers With Unwarranted Competitive Advantages Over Larger Carriers.

AT&T has demonstrated (pp. 10-25) that the proposal by the Notice (¶ 33) to heighten the differential treatment of 'above-25 percent' and '25 percent or below' arrangements under the Commission's flexibility policy would harm competition, unfairly benefit smaller U.S. carriers over AT&T and encourage market abuse by foreign dominant carriers. Similarly, the Commission should remove the existing arbitrary and discriminatory limitations on above-25 percent flexibility arrangements, which simply raise settlement costs for higher-share carriers over those of lower-share carriers. AT&T at 25-28.

The Commission should reject the efforts by some U.S. carriers to obtain unwarranted competitive advantages over their larger competitors by applying "no unreasonable discrimination" requirement also to above-25 percent arrangements

following the removal of the ISP from arrangements with foreign dominant carriers.[4] Sprint (p. 7) would go further, by removing the ISP from all 25 percent or below percent arrangements, thus ensuring that its larger competitors would be subject to the ISP or "no unreasonable discrimination" restrictions with all foreign dominant carriers, while Sprint itself would be almost completely free of such regulation.

The most telling aspect of the comments by carriers seeking an expanded 25 percent threshold is the absence of supporting justification. No commenter identifies any specific harm resulting from 'above 25 percent' agreements with foreign dominant carriers that cannot be addressed more equitably by removing the ISP from such arrangements, if at all, only under conditions that will prevent any such harm -- *i.e.*, where competitive termination alternatives are available in the form of viable ISR arrangements in the foreign market, where settlement rates have been lowered to best practice levels, or where both these requirements are present. Nor does any commenter explain why any remaining concerns resulting from the market power of foreign dominant carriers should be addressed by placing disproportionate and anticompetitive regulatory burdens on larger U.S. carriers, rather than by continuing to regulate all U.S. carriers on an equal basis, as under the ISP. Further, no commenter shows how the imposition of a 25 percent threshold would serve the pro-competitive objectives that the Commission seeks to achieve by removing the ISP.

The cost disadvantage of such a 25 percent threshold to larger U.S. carriers, and particularly to AT&T as the largest U.S. carrier, is illustrated by Attachment

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[4] *See, e.g.*, MCI WorldCom at 7; CompTel at 10.

II hereto, which lists U.S. carrier market shares to the 40 high income countries that are subject to benchmark rates on January 1, 1999.[5] Under the primary proposal set forth in the Notice (¶ 27), the Commission would remove the ISP for arrangements with dominant carriers in these countries once 50 percent of the traffic on the relevant route is settled at benchmark rates, thus triggering the authorization of ISR.[6] Attachment II shows that differential treatment of 'above-25 percent' and '25 percent or below' arrangements for U.S.-outbound traffic would affect AT&T on 38 of these high income benchmark routes, MCI WorldCom on 32 routes, and Sprint on 3 routes.

However, AT&T would suffer much greater adverse effects than either MCI WorldCom or Sprint from any differential treatment of 'above-25 percent' and '25 percent or below' arrangements on these routes. AT&T's average market share on the 38 routes on which it would be affected is 48 percent -- meaning that almost half its traffic on these 38 routes would fall into the 'above-25 percent' category and would be subject to greater restrictions and administrative burdens than most of its competitors. As MCI WorldCom's average market share on the 32 routes on which it would be affected is 32 percent, only twenty-two percent of its traffic on 32 routes would be included in the 'above-25 percent' category. Sprint would be even more marginally affected, with under 30 percent of its traffic on only 3 routes comprising 'above-25 percent' traffic.

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[5] *See International Settlement Rates*, 12 FCC Rcd. 19806, 19982 (Appendix C) (1997) ("*International Settlement Rate Order*").

[6] As AT&T has described (pp. 2-16), the Commission should not adopt this proposal, but should remove the ISP from arrangements with foreign dominant carriers only when the foreign market allows viable ISR arrangements or the foreign carrier provides settlement rates at the best practices level (currently $0.08).

With a much greater proportion of 'above-25 percent' traffic than any other carrier, AT&T would be affected much more seriously than any other U.S. carrier if 'above-25 percent' agreements were subject to "no unreasonable discrimination" requirements. AT&T's inability to negotiate settlement arrangements on the same basis as its competitors would inevitably raise AT&T's overall unit cost of settlements, and therefore its prices, above those of its competitors. *See also*, AT&T at 19-20. As found by the *AT&T International Non-Dominance Order*, such a result would harm competition because "restricting the competitiveness of the largest carrier only reduces competitive performance in the market."[7] *See also* AT&T at Attachment 1 (Affidavit of Dr. William Lehr); Lehr Reply Aff. at 3, 5.

2. <u>A 25 Percent Traffic Threshold Would Be Entirely Arbitrary.</u>

As WorldCom itself argued to the Commission in 1996 in opposition to proposals in the *Flexibility Order* proceeding to provide favored treatment for carriers with market shares below 5 percent, "[t]here is no principled distinction among U.S. international carriers except on the basis of market power."[8] Similarly here, in the absence of any finding that a 25 percent market share denotes the possession of market power, there is no basis for restricting 'above 25 percent' settlement arrangements with foreign carriers. In particular, there is no basis for any conclusion that a U.S. carrier with more than 25 percent of the traffic on a route is more likely to receive favored treatment from

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[7] *Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, 11 FCC Rcd. 17963, 17966 ("*AT&T International Non-Dominance Order*") (1996).

[8] *See Regulation of International Accounting Rates*, 11 FCC Rcd. 20063, 20076 (1996) ("*Flexibility Order*").

foreign carriers than other U.S. carriers.

Commission precedent confirms that a 25 percent market share on a route is far too small to confer market power on any carrier. The Commission found in 1996 that AT&T lacked market power in international services notwithstanding its then IMTS market share of 59 percent.[9] The Commission has now reaffirmed that finding, dismissing the petitions requesting reconsideration of that decision as follows:

> "Recent developments reinforce our conclusion that AT&T lacks market power in the U.S. international services market. AT&T's overall market share has fallen further to 49.3 percent in 1996. We also note that submarine cable capacity has increased significantly, with the result that AT&T has even less of an ability than previously to control prices by restricting supply. In short, we see no basis for reversing the conclusion the Commission reached in 1996 that AT&T lacks market power in the IMTS market."[10]

As emphasized by Dr. Lehr, "the FCC's finding that AT&T lacks market power over international telephone service, and is therefore, equivalent from a competitive perspective to MCI WorldCom, Sprint, and other competitors in international services eliminates any logical or economic justification for regulating AT&T asymmetrically *vis a*

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[9] *Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, 11 FCC Rcd. 17963,17978 ("*AT&T International Non-Dominance Order*") (1996). *See also, id.* at 17994 ("AT&T alone cannot raise and sustain prices above a competitive level without risking loss of customers to its competitors."); *id.* at 17982 ("the increasingly availability of both multiple operating agreements and of alternative means for U.S. facilities-based carriers to route their international traffic supports a finding to reclassify AT&T as non-dominant" on all but four routes). The same market forces that prevent AT&T from raising consumer prices above the competitive level would also prevent AT&T from lowering prices paid for foreign termination below the levels paid by its U.S. competitors.

[10] *Motion of AT&T to be Declared Non-Dominant for International Service*, CC Docket No. 79-252, Order On Reconsideration, (rel. Oct. 5, 1998), FCC 98-253, ¶19 ("*AT&T International Non-Dominance Reconsideration Order*").

vis other carriers that are similarly deemed to lack market power." Lehr Reply Aff. at 4. Thus, "[l]acking market power, AT&T has no *a priori* economic advantage relative to other U.S. carriers that would allow it to negotiate uniquely favorable deals with the foreign incumbent. Accordingly, the regulatory imposition of higher costs associated with the 25% rule cannot be justified on these grounds." *Id.* at 4-5.

Furthermore, based on the extensive line of antitrust cases holding the "market share below 50 percent is insufficient to evidence market power," and with the observation that "other courts have held that higher levels of market share are insufficient to infer market power,"[11] the Commission last year adopted a rebuttable presumption that a foreign carrier with under 50 percent of the traffic on an international route "lacks sufficient market power to affect competition adversely in the U.S. market."[12] Those foreign carriers may accordingly provide special concessions to any U.S. carrier affecting up to 50 percent of the traffic on a route.[13] In light of these prior Commission findings, any imposition of higher settlement costs on some U.S. carriers based solely on their market shares of over 25 percent on a route would constitute an arbitrary and capricious

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[11] *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, IB Docket No. 97-142, Report and Order and Order on Reconsideration, (rel. Nov. 26, 1997), FCC 97-398 ("*Foreign Participation Order*"), ¶ 161, n.314.

[12] *Id.*, ¶ 161. *See also, id.*, ¶ 163, n.318 (required market share showing may be based on "the percentage of the foreign-carrier's foreign-billed minutes"). The claim by TRA (pp. 4-5) that market power can be exercised below these market share levels is supported neither by facts nor by analysis and provides no grounds for any different conclusion.

[13] *Id.* at ¶ 163.

exercise of the Commission's rulemaking authority.[14]

Proponents of the 25 percent "quota" approach to removal of the ISP provide no justification for the choice of 25 percent as a relevant traffic threshold beyond its adoption in the *Flexibility Order*. Such reliance is misplaced as that decision was entirely arbitrary, unsupported by the record, contrary to the finding in that proceeding that participation in flexibility arrangements should not be determined by "size-based criteria," and harmful to competition, as AT&T demonstrated in its pending Petition for Reconsideration and in its comments here (pp. 25-28). For these reasons, the Commission should remove the arbitrary 25 percent limitation established by the *Flexibility Order*, rather than apply that flawed approach even more broadly, as sought by some parties. Nor is there any basis for the different traffic thresholds suggested by some parties, which also have no relationship to the possession of market power.[15]

Thus, as the Commission acknowledged in the *AT&T International Non-*

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[14] *See, e.g., Transactive Corporation v. U.S.*, 91 F. 3d 232, 236 (D.C. Cir. 1996) ("agency action is arbitrary when the agency offered insufficient reasons for treating similar situations differently"); *Tenneco Gas v. FERC*, 969 F.2d 1187, 1214 (D.C. Cir. 1992) ("difficult or inconvenient" facts may not be disregarded by the agency); *Farmers Union Cert Exchange Inc. v. FERC*, 734 F. 2d 1486, 1499 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984) (lack of factual basis in the record renders decision arbitrary and capricious); *Arizona Public Service Co. v. U.S.*, 742 F.2d 644, 649 (D.C. Cir. 1984) (judicial review "ensures that the agency has engaged in the reasoned decisionmaking essential to informed and even-handed implementation of public policy").

[15] *See* CompTel at 10 (40 percent); Level 3 at 3 (10 percent). PrimeTEC (p. 7) contends, without explanation, that the combined market shares of U.S. carriers and their foreign affiliates or joint venture partners should trigger the 25 percent flexibility threshold, which would also, in effect, lower the threshold below this level for affiliated U.S. carriers.

Dominance Order, imposing what would be, in effect, a new form of dominant carrier regulation on U.S. carriers that are without market power would harm U.S. consumers by "hinder[ing] competition" in the U.S. market.[16] Dr. Lehr concludes that "the 25% rule tilts what would otherwise be a level playing field, favoring one set of competitors over another, and thereby harming the competitive process and the public interest." Lehr Reply Aff. at 4-5. The Commission should continue to address any potential abuse of foreign market power through regulatory measures like the ISP that promote competition by giving equal treatment to all non-dominant unaffiliated U.S. carriers. It should not attempt to do so through measures unfairly favoring some of those U.S. carriers over others.

Arguments by carriers such as PrimeTEC (p. 5) that the existing and proposed 25 percent thesholds are necessary to protect smaller U.S. carriers also suffer the same fatal flaws as the Commission reasoning that the D.C. Circuit squarely rejected in its 1996 remand of the domestic "Residual Interconnection Charge." *See Competitive Telecommunications Ass'n v. FCC*, 87 F.3d 522 (D.C. Cir. 1996). The Commission argued that this non-cost based charge forcing large long-distance carriers using dedicated access lines to subsidize smaller long-distance carriers using shared lines was necessary to protect the smaller carriers.[17] Observing that "the Commission apparently decided not to risk erring in a manner that might cause irreparable harm by driving smaller IXCs out of

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[16] See also *AT&T International Non-Dominance Reconsideration Order*, ¶ 1 ("We conclude that relieving AT&T of the regulatory burdens associated with dominant carrier regulation will serve the public interest by promoting competition in international telecommunications services.")

[17] *Id.* at 529, 532.

business," the Court instructed the Commission to "move expeditiously on remand to a cost-based alternative to the RIC, or to provide a reasoned explanation of why a departure from cost-based ratemaking is necessary and desirable in this context."[18]

Establishing a 25 percent threshold to protect smaller U.S. international carriers by raising the costs of larger U.S. international carriers would similarly fail to satisfy the requirement for reasoned decisionmaking. As the D.C. Circuit found in *Hawaiian Tel. Co. v. FCC*, 498 F.2d 771, 776 (D.C. Cir. 1974), "thinking about competition, not in terms primarily as to its benefit to the public, but specifically with the objective of equalizing competition among competitors" is "not the objective or role assigned by law to the Federal Communications Commission."

3. Secret '25 Percent or Below' Arrangements Would Also Harm Competition and Unfairly Disadvantage Larger Carriers.

The proposal (Notice, ¶ 33) to remove filing requirements for flexibility arrangements involving less than 25 percent of the traffic on a route would have similar adverse effects and its adoption would be equally improper. AT&T, the largest carrier, would be required to continue to disclose the terms and conditions of its settlement arrangements on approximately half its traffic, while most other U.S. carriers would be able to keep their arrangements entirely secret. This different regulatory treatment would raise AT&T's costs and harm competition, while dominant foreign carriers would cause further competitive harm by using their secret arrangements with U.S. carriers to engage in whipsaw strategies to keep U.S.-outbound settlement rates high and U.S.-inbound rates

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[18] *Id.* at 532.

as low as possible. AT&T at 16-25 & Attachment 1 (Lehr Affidavit).

For example, foreign carriers could avoid present settlement rates on their U.S.-bound traffic by agreeing to separate below 25 percent arrangements with the lowest bidding U.S. carriers. Additionally, "matched minute" arrangements would allow smaller U.S. carriers to raise larger carriers' costs by reducing their proportionate return traffic. The result would be increased U.S. outpayments, reduced proportionate return traffic and reduced pressure to lower settlement rates on U.S.-outbound calls.

The adoption of this proposal is unnecessary to address the concerns raised by Telegroup (p. 3) regarding the need for confidentiality for arrangements with new carriers in foreign markets, which would be fully satisfied by the removal of the ISP and associated filing requirements from arrangements with foreign non-dominant carriers. The only effect of providing secrecy for below-25 percent arrangements with foreign dominant carriers will be to provide even greater whipsaw incentives and opportunities than would be provided by the removal of the ISP at benchmark rates. The threshold requirement for flexibility arrangements in WTO markets is merely the presence of more than one competing facilities-based carrier with the ability to terminate international traffic.[19]

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[19] *Foreign Participation Order*, ¶ 307 (rebuttal of presumption in favor of permitting flexibility in WTO markets requires showing that "the foreign carrier "is not subject to competition in its home market from multiple (more than one) facilities-based carriers that possess the ability to terminate traffic and serve existing customers in the foreign market"). AT&T's comments incorrectly stated (p. 18) that the Commission allows flexibility arrangements in WTO markets with more than one facilities-based carrier. However, AT&T correctly warned (p. 22) about the potential adverse consequences of secret flexibility arrangements with incumbent carriers in the Dominican Republic, Jamaica, Malaysia, Mexico and the Philippines, all of which have more than one competing facilities-based carrier with the ability to terminate international traffic,

(Footnote continued on next page)

Incumbents in such markets with rates above benchmarks would therefore be able to use these whipsaw opportunities to stymie the enforcement of benchmark rates. AT&T at 21-22.

As emphasized by GSA (p. 7), foreign incumbents would be "[t]he primary beneficiaries" of this relaxation of the flexibility rules and there would be "little positive impact in promoting more competition or lower prices." The Commission should rather maintain the prior approval procedures for all flexibility arrangements established by the *Flexibility Order*.[20] Because flexibility arrangements are not limited to countries where the availability of viable ISR arrangements or best practice settlement rates would preclude whipsaw concerns, Commission review will continue to be necessary to ensure that there is no "significant adverse impact on U.S. net settlement payments and resulting traffic volumes."[21]

There is certainly no basis for the secrecy for all below-25 percent arrangements that would be provided under Sprint's proposal (p. 5) to remove the ISP

(Footnote continued from previous page)

settlement rates many times higher than cost, do not allow ISR and will not be subject to benchmark settlement rates until 2000 or 2001.

[20] *See* AT&T at 37; MCI WorldCom at 8; TRA at 6. Thus, contrary to the claim by CompTel (p. 6) the ISP "no longer governs" arrangements with carriers in countries eligible for flexibility only where this prior approval requirement is satisfied.

[21] *Flexibility Order*, 11 FCC Rcd. at 20087. Contrary to the claim by SBC (pp. 11-12), such concerns are hardly "spurious" or "ill-conceived." Moreover, if the ISP is removed for arrangements with non-dominant carriers, the only arrangements subject to such review would be those with foreign dominant carriers.

entirely for such arrangements.[22] Notably, Sprint itself highlights (p. 11) the "disastrous" effects in the U.S. market of any removal of ISR restrictions even for "a portion" of traffic on a route -- increased U.S. outpayments, reduced proportionate return traffic for U.S. carriers and reduced pressure on the foreign carrier to lower settlement rates. Sprint overlooks that the indiscriminate removal of the ISP from '25 percent or below' arrangements would have exactly the same "disastrous" effects in the U.S. market as the indiscriminate removal of restrictions on ISR.[23] Accordingly, the Commission should maintain its present requirement for the prior approval of all flexibility arrangements and reject Sprint's proposal to apply the 25 percent threshold to all routes.

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[22] As noted by AT&T (p. 24), the *Flexibility Order* expressly recognized that the potential adverse effects on the public interest of below-25 percent alternative settlement arrangements by "reserving the right to review and, if need be reject" all such arrangements. *See Flexibility Order*, 11 FCC Rcd. at 20087.

[23] For the same reasons, the Commission should dismiss Sprint's further claim (p. 4) that because the ISP cannot be enforced "on a consistent basis," future enforcement of the ISP should be governed by the "relative ease of detection of large arrangements." Sprint's argument is tantamount to contending that an increase in crime should require the repeal of criminal laws against smaller offenses. Further, to the extent that there is "widespread cheating and non-compliance" with the ISP, as Sprint contends, any smaller carriers that have engaged in such conduct (thus "disadvantag[ing]" carriers obeying the Commission's rules, as Sprint observes) should not be further rewarded with the additional advantages they would enjoy over larger carriers as a result of the exemption of below-25 percent arrangements from the ISP. Such an outcome would be even more unjust if "cheating and non-compliance" is more prevalent in the case of small arrangements, as Sprint's conclusions regarding the greater ease of detection of large arrangements would suggest.

II. THE COMMISSION SHOULD REMOVE THE ISP FROM ARRANGEMENTS WITH FOREIGN DOMINANT CARRIERS ONLY WHERE THE FOREIGN MARKET IS SUFFICIENTLY COMPETITIVE TO PREVENT DISCRIMINATION.

There is wide agreement among U.S. commenters that the ISP should be removed from arrangements with foreign dominant carriers only where competitive conditions or settlement rate levels limit whipsaw risks. Specifically, as shown by AT&T (pp. 2-15), the Commission should at least require the dominant carrier to have lowered settlement rates to "best practice" levels, or that U.S. carriers have the ability to terminate traffic in the foreign market through viable ISR arrangements under reasonable and nondiscriminatory terms and conditions for interconnection. Parties accepting benchmark rates for this purpose ignore the whipsaw opportunities that would continue to exist because of the wide margins by which benchmark rates exceed costs, unless the foreign market provides viable ISR opportunities to U.S. carriers. Moreover, no commenter shows how the mere authorization of ISR by the Commission, rather than its authorization by the foreign country under reasonable terms and conditions, would prevent whipsaw behavior.

Most foreign carriers and their U.S. affiliates mistakenly contend that continuation of the ISP is unnecessary or improper following the WTO Agreement. They are wrong both on the facts and on the law. As the General Services Administration makes clear, most WTO markets remain closed and the ISP remains necessary to prevent the abuse of foreign market power. Further, the Office of the United States Trade Representative, which is responsible for the interpretation of U.S. international trade obligations, has emphasized that the Commission may properly address the potential abuse of foreign market power by examining competitive conditions in the foreign country.

1. Continued Whipsaw Risks Require the Continuation of the ISP With Many Foreign Dominant Carriers.

All commenters support the ISP as a necessary regulatory tool where foreign carriers are able to use their market power to whipsaw competing U.S. carriers. Thus, SBC (p. 5) observes that a monopoly foreign carrier otherwise "could extract stiff concessions from the U.S. carriers, typically in the form of high settlement rates, which would ultimately result in U.S. consumers paying high rates for international telecommunications services."[24] Most commenters further recognize that whipsawing by foreign dominant carriers remains a significant concern after the entry into force of the WTO Agreement and requires the Commission to move cautiously in removing the ISP from such arrangements.

As emphasized by the General Services Administration (p. 5), only about "one-quarter of the total WTO membership" made commitments to introduce competition in 1998 and (p. 6) "it is likely that significant competition is yet to develop for international voice and data services to and from nations with recent commitments." These facts belie the claims by a few commenters such as GTE (p. 7) that whipsawing is now an "empty threat" and the ISP should therefore be removed completely.[25] With

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[24] *See also* ntta.com at 3-4 (ISP "may have been appropriate" in pre-WTO environment); DT at 4 (supporting retention of the ISP with monopoly carriers); GTE at 7 (whipsawing was a "credible threat" from foreign PTTs with exclusive franchises).

[25] GTE's view of the global telecommunications market bears little relationship to the facts. Although the ability to by-pass settlements arrangements with foreign incumbent carriers will potentially remove or at least mitigate whipsaw risks, there is no basis to GTE's assertions (pp. 2-3, 7-8) that these alternatives exist today on all WTO routes. Indeed, they do not even exist today on a majority of WTO routes.

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effective competition established in relatively few WTO markets and monopoly operators still controlling most of these countries, the concerns that gave rise to the ISP continue fully to apply to the large majority of WTO routes. *See also,* AT&T at 6 & n.7.[26]

Because of the lack of true competition in WTO countries and the continued market power of dominant carriers in those countries, GSA (p. 5) "strongly urges the Commission not to change regulations with respect to traffic interchanged with foreign carriers that are dominant in their home markets, even if the market, taken as a whole, is considered somewhat competitive." GSA emphasizes (*id.*) that the elimination of pricing and traffic constraints proposed by the NPRM "hold promise for stimulating more competition if – and only if – there is now a strong competitive base."[27] These

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GTE wrongly claims (p. 7) the existence of a "competing carrier in the destination market" on "most WTO routes" and (p. 8) that "alternatives such as ISR and switched hubbing" exist "even in countries that have not introduced competition in basic switched telephone service." Similarly, GTE fails to realize (p. 4) that most countries with closed markets also prohibit other means of by-passing the settlements process and that U.S. carriers have no ability to "simply by-pass settlement agreements that they find onerous."

[26] Reliance upon the dispute resolution procedures of the WTO Agreement, as proposed by ntta.com (p. 5 & n.8), would not provide effective relief for U.S. carriers subject to whipsaw behavior by foreign carriers. No WTO Member has made a GATS commitment specifically addressing whipsaw behavior. To the extent that relief against such conduct would be available under the WTO Reference Paper, no such claim could be brought against the majority of WTO Member countries that made no commitment to implement the Reference Paper. Further, no timely relief would be available under WTO Dispute Resolution procedures, which may require up to 15 months if the matter is taken to the WTO Appellate Body. *See* WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, Arts. 4, 6, 20, 21, House Document 103-316, Vol. 1, 103d Cong., 2d Sess. (Sept. 27, 1994), 1654.

[27] *See also* TRA at 6 (opposing removal of the ISP from foreign dominant carriers even

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cautions come from the agency with "a major interest in steps that will reduce the prices of international telecommunications services and provide more service alternatives for all end users" (*id.*) as the statutory representative of the customer interests of the Executive Branch. They underscore the critical role played by the ISP in preventing the abuse of foreign market power and the severe potential impact on U.S. consumers of any premature removal of its restraints.

2. The Existence of Best Practices Rates Should be Required to Prevent Harm to Competition From Removal of the ISP.

AT&T shares the concerns expressed by GSA but believes that the ISP may be removed from arrangements with foreign dominant carriers without facilitating anticompetitive behavior provided that settlement rates are at "best practice" levels or the foreign market allows U.S. carriers to terminate traffic through viable ISR arrangements under reasonable and nondiscriminatory terms and conditions for interconnection. *See* AT&T at 10-11. Far from being unduly "restrictive," as some parties mistakenly contend,[28] best practice rates (currently $0.08) provide a reasonable surrogate for the cost-based settlement rates that remove incentives to engage in whipsaws to preserve or increase above-cost settlement profits. The fact that competitive markets like Sweden and the UK have lowered rates below benchmarks and even below the present best practices

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in markets allowing ISR services).

[28] See Telefonica at 6; SBC at 9. The best practices rate is close to the Commission's $0.09 most conservative estimate of foreign termination costs. *See International Settlement Rate Order*, 12 FCC Rcd. at 19866.

level belies the claim by Telefonica (p. 6) that benchmark rates "presumptively approximate market-based rates."

The lesser standard put forward as the primary proposal in the Notice (¶ 27), which is to remove the ISP for all carriers on routes on which the Commission has authorized ISR, would not prevent competitive harm. *See* AT&T at 8-15. Because ISR may be authorized by the Commission where 50 percent of traffic is settled at benchmark rates, this proposal would effectively remove the ISP with foreign dominant carriers that provide benchmark rates.[29] Commenters like Qwest (p. 5) that support this standard put forward no support for their claims that the provision of benchmark rates would preclude whipsaw behavior. Indeed, the Notice (¶ 27) acknowledges otherwise.[30] Foreign dominant carriers would still have the incentive to engage in such conduct to prevent or delay the reduction of settlement rates to the cost-based levels that are under half the middle and lower income benchmarks. Such an approach would frustrate the achievement of the cost-based settlement rates that are a long-standing goal of Commission policy.[31]

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[29] The proposal by Telefonica (p. 5) to remove the ISP for any foreign carrier providing benchmark rates to U.S. carriers is little different from this proposal and would also encourage whipsaws to prevent further settlement rate reductions to cost-based levels.

[30] Bell South (pp. 2-3) supports the removal of the ISP "in liberalized markets and on competitive routes," even for markets that "do not allow ISR" and where "the settlement rate is slightly above the benchmark." Bell South fails to explain how, as it mistakenly contends (p. 3), "any remaining possibility of whipsawing is outweighed by the pro-competitive effects" resulting from the removal of the ISP in such circumstances.

[31] *See International Settlement Rate Order*, 12 FCC Rcd. at 19827 (reaffirming Commission commitment to achieve this goal).

Best practice rates provide the best available measure consistent with this Commission goal that would most effectively prevent further whipsaw behavior by foreign dominant carriers. Indeed, the use of the best practice rate, or a variation thereof, as the appropriate threshold for the removal of the ISP is supported by all three largest U.S. international carriers.[32] Sprint (p. 7) supports the use of the best practices rate rather than benchmark rates for this purpose (together with other requirements), and MCI WorldCom (p. 6) advocates the use of a rate "within 2 cents of the best practices rate."[33] No commenter puts forward any reasoned basis why this alternative proposal set forth in the Notice (¶ 28) would not better serve the public interest.

Contrary to the claim by SBC (p. 9), the acceptance of benchmark rates as the threshold for ISR does not make benchmark rates also the appropriate standard for the removal of the ISP. The authorization of ISR at benchmark rates was premised on the continuation of the ISP for other traffic on the ISR route.[34] The removal of the whipsaw

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[32] Similarly, Ameritech (p. 4) would remove the ISP for all traffic on a route where there are "transparent, nondiscriminatory, cost-based international termination charges" at both ends, a requirement for which best practices rates provide a reasonable surrogate.

[33] While the MCI Worldcom proposal is preferable to the use of benchmark rates as a threshold requirement for the removal of the ISP with foreign dominant carriers, a 2 cent margin above the best practices rate may still encourage whipsaw behavior in markets that do not allow U.S. carriers to engage in viable ISR and obstruct the achievement of cost-based settlement rates. These concerns will remain even if the best practices rate is updated in this proceeding and annually thereafter, as MCI WorldCom propose (p. 6,n.10), a request AT&T fully supports.

[34] The continuation of the ISP for other traffic also ensures that the authorization of ISR by the Commission upon the achievement of benchmark rates does not lead to market distortion in the U.S. if the foreign market itself does not allow ISR. Following removal of the ISP, however, existing reporting safeguards against market distortion

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protections provided by the ISP requires additional safeguards in order to prevent the leveraging of foreign market power and to ensure continued movement toward cost-based rates.

3. No Commenter Shows That the Authorization of ISR by the Commission Would Prevent Competitive Harm.

Similarly, the availability of viable ISR arrangements in the foreign market, in compliance with the *de jure* and interconnection prongs of the equivalency test, provides a competitive termination alternative by-passing the settlements process that would protect U.S. carriers against the leveraging of market power and provide continued pressure on settlement rates. *See* AT&T at 14. The presence of either or both of these key requirements for viable ISR arrangements or best practices rates would provide the "strong competitive base" sought by GSA to ensure that the removal of the ISP would promote rather than harm competition.

The alternative threshold requirement for removal of the ISP with foreign dominant carriers should be whether the foreign market allows U.S. carriers to terminate traffic through viable ISR arrangements under reasonable and nondiscriminatory terms and conditions for interconnection. *See* AT&T at 11-15. MCI (p. 6) advocates a similar approach, requiring compliance with all four requirements of the equivalency test as the alternative threshold, while Sprint (p. 7) would require compliance with the equivalency

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would become unworkable and one-way inbound by-pass from such countries would not be detected. *See* AT&T at 31-32. Thus, CompTel (pp. 6-7) is incorrect in arguing that the retention of the ISP serves "no useful purpose" on routes where ISR

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test in addition to other safeguards before the ISP is removed from above-25 percent arrangements with foreign dominant carriers.[35] BTNA (p. 7) similarly finds that whipsaw risks are sufficiently diminished in markets meeting equivalency requirements to allow the removal of the ISP. At a minimum, as demonstrated by AT&T (p. 14), the Commission should require the existence of the first two requirements of the equivalency test, which are the legal right to provide ISR services in the market together with the bedrock interconnection requirement for the existence of reasonable and nondiscriminatory terms and conditions for interconnection.

There is little support for the use of the primary threshold proposed by the Notice (¶ 27) which is whether the Commission has authorized ISR services on the route. Those few parties that support this specific approach either refuse to recognize the continued whipsaw risks that exist at benchmark rates, as does Qwest (pp. 5-6), or mistakenly assume that the Commission's authorization of ISR would occur only where "competitive alternatives" exist in the foreign market, as does RSL (p. 3).[36] As demonstrated by AT&T (pp. 11-14), because ISR may be authorized where 50 percent or more of traffic is settled at benchmark rates, it is quite possible that the Commission could

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is authorized.

[35] As described in Section I, there is no justification for Sprint's 25 percent threshold and the "no unreasonable discrimination" requirements advocated by MCI WorldCom and Sprint for above-25 percent arrangements.

[36] SBC makes the same erroneous assumption, contending (p. 18) that "the very fact that the Commission authorizes ISR on the route makes it likely that a substantial amount of traffic on the route is already being carried outside the traditional

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authorize ISR services to a country that prohibits these services, such as Israel, which is subject to benchmark rates in 1999, or Mexico, which is subject to benchmark rates in 2000.

Alternatively, the Commission could authorize ISR services to a country that provides the legal right to offer ISR services but does not allow U.S. carriers to do so on a viable basis, as in the case of Chile, which is subject to benchmark rates in 2000, or as would have been the case under the ISR policies originally proposed by Japan. *See* AT&T at 13-14. Unless the Commission looks beyond its own authorization of ISR and requires the existence of viable ISR opportunities in the foreign market, U.S. carriers would be left with no competitive termination alternative to counter whipsaw behavior by dominant foreign carriers following removal of the ISP.[37]

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correspondent system."

[37] Equally unfounded is the proposal by Telefonica (p. 3) to remove the ISP for all carriers on a route as soon as one non-incumbent foreign carrier on the route enters into a settlement agreement with a U.S. carrier. Telefonica wrongly claims (*id.*) that the mere fact that one non-dominant carrier is able to terminate some traffic on the route is sufficient to make that route "competitive" and to preclude whipsawing by a foreign dominant carrier on the route. CompTel (p. 5) is also mistaken in contending that presence of two competing carriers in the foreign market is sufficient for this purpose. The high settlement rates charged by many non-incumbent carriers in foreign markets and the continued market barriers in multi-carrier markets like Mexico show otherwise. *See* FCC Report *IMTS Accounting Rates of the United States, 1985-1998*, Aug. 1, 1998; AT&T at 23. The presence of competitors is also insufficient if they lack "sufficient capacity to accommodate rival U.S. carriers' needs." *See Foreign Participation Order*, ¶ 157. A viable ISR standard requiring the absence of ISR market barriers and the existence of reasonable and nondiscriminatory terms and conditions for interconnection would provide much greater assurance in this regard. Where these conditions exist, U.S. carriers may terminate ISR traffic either with other foreign carriers or on a self-correspondency basis by leasing facilities

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Lastly, there is no basis to the claims by some foreign carriers and their U.S. affiliates that the WTO Agreement prohibits either the use of equivalency criteria for the removal of the ISP or the continuation of the ISP itself.[38] *See* AT&T at 15, n.24. USTR has made clear that the Commission may properly address the potential abuse of foreign market power by examining competitive conditions in the foreign country that facilitate the leveraging of market power to harm U.S. competition.[39] The Executive Branch agency that negotiated the WTO Agreement, that is charged with the statutory

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and negotiating interconnection arrangements in the foreign market. The use of an ISR standard would also avoid limitations, such as those imposed by Mexico, on the amount of traffic that may be terminated with other facilities-based carriers. *See Rules to Render the International Long-Distance Service*, Ministry of Communications and Transport, Mexico, Dec. 4, 1996, at Rules 10, 13, 16. The test proposed by GTE (pp. 9-10) requiring the foreign carrier to provide "nondiscriminatory interconnection facilities of its competitors" would offer no relief in markets where the interconnection offered by the incumbent carrier is at unreasonably high rates. As an example, the Commission need look no further than GTE's wholly owned affiliate Codetel, the former monopoly carrier in the Dominican Republic, which charges interconnection rates of approximately 15 cents per minute to its competitors. *See GTE Telecom Inc.*, 12 FCC Rcd. 15939, 15942, n.13 (1996) (GTE indirectly owns 100 percent of Codetel); *International Settlement Rates*, IB Docket No. 96-261, Comments of Tricom, S.A. (filed Feb. 7, 1997), at 4 (protesting the high level of Codetel's access charges).

[38] *See* C&W at 6; DT at 5; GTE at 10; ntta.com at 9&11, n.25.

[39] *See Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, IB Docket No. 97-142, Comments of the Office of the U.S. Trade Representative, (filed Jul. 9, 1997), at 3; *id.*, Reply Comments of the Office of the United States Trade Representative, (filed Oct. 17, 1997) at 8 ("The GATS telecom agreement does not specify a single mechanism for addressing potential anticompetitive practices in the telecommunications sector. The United States has traditionally relied on a combination of regulatory, government enforcement, and private antitrust mechanisms in this sector, and remains free to do so under the agreement.").

mandate to interpret U.S. international trade obligations, and that would defend the Commission's rules against any future WTO challenge, must be accorded far greater deference in these matters than the foreign carriers that would be the direct beneficiaries of an over-expansive interpretation of U.S. obligations under the GATS. As the Commission concluded in response to similar foreign carrier claims regarding the safeguards adopted in the *Foreign Participation Order*, the measures proposed here are "consistent with U.S. international obligations, including those contained in the GATS."[40]

4. <u>Non-Dominant Carrier Status Should be Subject to Public Notification.</u>

There is general agreement that arrangements with non-dominant carriers in WTO markets, including non-dominant affiliates of U.S. carriers, should not be subject to the ISP. However, to reduce the risk identified by the Notice (¶ 23) of "exclusive dealings with foreign carriers that possess market power" in markets where the ISP has not been removed for all carriers, the non-dominant status of foreign carriers should be a matter of public record. AT&T's concern (p. 5) that the possession of market power will not always be "clear-cut" is shared by MCI WorldCom (p. 4) and SBC (p. 10), both of which anticipate that declaratory rulings will be required to resolve ambiguous circumstances. Unless affirmative findings are required, however, it is likely that many ambiguities requiring such resolution will not be raised with the Commission.

The Commission should provide public notice of the non-dominant status of foreign carriers by establishing a non-dominant carrier list based upon certifications or

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[40] *Foreign Participation Order*, ¶ 375. *See also, id.* at ¶¶ 366-75.

data publicly filed by interested parties and subject to public comment.[41] The list would be updated quarterly on the same basis. Such an approach would allow the non-dominant status of a foreign carrier to be established independently of any particular arrangement with a U.S. carrier and would thus protect the confidentiality of those relationships.

AT&T does not agree with parties proposing the removal of the ISP from arrangements with non-dominant carriers in non-WTO markets. As the Commission found in the *Foreign Participation Order*, it is "not incongruous to apply different standards" to non-WTO markets because they present greater competitive concerns than WTO markets.[42] The provision of additional benefits to countries with membership of the WTO also serves the public interest in encouraging open foreign markets.[43]

5. The No Special Concessions Rule Should Not Apply to Matters Previously Covered by the ISP.

The Commission should approve the tentative conclusion by the Notice (¶ 41) that the No Special Concessions rule does not apply to "the terms and conditions under which traffic is settled, including allocation of return traffic, by a U.S. carrier on an

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[41] This approach should be preferred to the "dominant carrier list" proposed by C&W (p. 14), which may encourage frivolous challenges by foreign dominant carriers contending that the recent opening of their markets to competition has removed their market power. Moreover, a dominant carrier list would be much broader in scope, unless it was limited to markets with competitive carriers. *See* FCC Report *IMTS Accounting Rates of the United States, 1985-1998*, Aug. 1, 1998 (listing 18 WTO markets with more than one carrier).

[42] *Id.*, ¶ 126. For this reason, there is also no basis for the relaxation of flexibility rules on non-WTO routes, as requested by Sprint (p. 9).

[43] *Id.*, ¶¶ 125-27.

ISR route."[44] For the same reason that the No Special Concessions rule does not govern flexibility arrangements, "policy and logic," as emphasized by FT (p. 6), requires the removal of the No Special Concessions rule from the settlement of traffic on an ISR route.[45] Accordingly, the rule should be removed from the settlement of traffic on all routes on which the ISP is removed from arrangements with foreign dominant carriers. In other respects, the No Special Concessions Rule should continue to apply to the interconnection of international facilities, private line provisioning and maintenance and quality of service.

To do otherwise, as proposed by Ameritech (p. 7), and to retain the No Special Concessions rule on ISR routes for "arrangements with foreign carriers with market power" would effectively re-impose the ISP on these arrangements. Sprint's proposed use of the rule to prevent (p. 12) "more favorable rates for interconnection of international private line facilities" would have the same perverse result. The Commission should address the concerns raised by these carriers by ensuring that the ISP is removed from arrangements with foreign dominant carriers only where the existence of viable ISR opportunities or best practices settlement rates would prevent any potential harm from

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[44] Commenters such as BTNA (pp. 9-10) and MCI WorldCom (pp. 9-10) concur with AT&T (pp. 15-16) in supporting this sensible approach. Indeed, there is wide agreement that the No Special Concessions rule should reflect the application of the ISP. *See* GSA (pp. 5, 10); TRA (pp. 5, 8) (seeking retention of both the ISP and the No Special Concessions Rule for arrangements with foreign dominant carriers). *See also* ntta.com (pp. 3, 9) (seeking removal of both the ISP and the No Special Concessions Rule on all WTO routes).

[45] FT correctly observes (p. 6) that any other approach would be "inconsistent with the very existence of an ISR arrangement since ISR is an alternative, non-ISP arrangement."

such arrangements. If the Commission does not believe that these conditions would suffice, it should retain the ISP for all arrangements with foreign dominant carriers. The least desirable approach would be to adopt mutually inconsistent policies that would create confusion and encourage non-compliance.[46]

III. THERE SHOULD BE NO CHANGE IN THE ISR RULES.

Authorizing ISR on routes to countries that prohibit these services would have no effect on settlement rates but would allow dominant foreign carriers still subject to the ISP to avoid settlements payments on their U.S. calls. Most U.S. carriers therefore share AT&T's concern that the modifications in the ISR rules suggested by the Notice (¶ 38) would do nothing to encourage lower settlement rates and encourage one-way by-pass by the foreign carriers in closed markets that have the greatest incentives to engage in this conduct.[47] Accordingly, the Commission should not adopt the suggestions that ISR should be authorized for some traffic on all routes and that ISR restrictions should be removed completely at some future point.[48]

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[46] The Commission should also reject the attempt by SBC (pp. 19-20) to "narrow[] or clarif[y]" the No Special Concessions rule in a way that would nullify its protections. To limit the scope of the rule only to "exclusive arrangements affecting facilities, services, or functions in the particular markets in which the foreign carrier actually has market power" would not prevent the abuse of market power. Even if it was possible to draw SBC's distinctions, the foreign dominant carrier could evade them by cross-subsidizing between different markets.

[47] *See* AT&T at 28-31; MCI WorldCom (pp. 8-9); Sprint (pp. 10-12)

[48] SBC (pp. 15-17) suggests a further proceeding to consider the removal of all ISR restrictions once the Commission has authorized ISR in 50 percent of markets, but acknowledges (p. 17) that the existence of "a significant number of 'closed' markets" at that point would provide continued grounds for concern. In fact, as most WTO markets with open market commitments will be subject to high or upper middle

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As GSA observes (p. 9), a situation "where private lines are used only for inbound traffic and outbound traffic remains subject to the accounting rate system . . . could lead to increased prices for consumers in the U.S." Significantly, the foreign carriers and their U.S. affiliates that request the immediate authorization of ISR on all WTO routes offer no substantive response to these concerns.[49] Moreover, DT (pp. 5-6) makes clear that the Commission's existing policies also have support outside the United States. DT (*id.*) "point[s] out that there is a risk that the proposed modification in favor of non-liberalized countries might result in 'one-way bypass' of the accounting rate system to the disadvantage of the carriers in - not only the United States but - all liberalized countries."

Substantial harm from increased outpayments, reduced proportionate return traffic and reduced pressure on high settlement rates would result from the removal

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income benchmarks, virtually all remaining markets at that point would be closed markets.

[49] Because market barriers to ISR in WTO markets with no WTO commitments would not violate GATS MFN or national treatment requirements, C&W (p. 3) and GTE (p. 12) are mistaken in suggesting that WTO dispute resolution procedures would provide effective recourse against one-way by-pass by carriers in closed markets. ntta.com (p. 12) fails to show how "general Part 43 reporting requirements" would allow one-way by-pass to be addressed on a timely basis, if at all. C&W (p. 3) otherwise fails to show how its requested extension of Section 214 switched resale authorizations to include ISR (and the removal of the ISP) would address by-pass concerns. C&W would also allow facilities-based entry to the U.S. without compliance with benchmarks, contending (pp. 10-11) that the Commission should rely on market forces to reduce settlement rates, although the existence of competition plays no role in its bootstrap logic. In any event, as described by AT&T (p. 5, n.5), the Commission has expressly rejected reliance "entirely on the market to reduce

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of restrictions even on a small amount of ISR traffic, as Sprint describes (p. 11),[50] while it is also unclear how any such "ISR quota" would be allocated and monitored.[51] TRA (p. 8) again advocates similar "size-based criteria" to those rejected by the *Flexibility Order*, under which only U.S. carriers with below-5 percent market shares would be allowed to engage in unrestricted ISR.[52] As the Commission affirmed on that former occasion, departures from ISP requirements should not be limited to "certain categories of carriers, such as . . .'small' carriers."[53] Instead, the treatment of all U.S. carriers on an equal basis should be required by the Commission's "policy of allowing market forces, where possible, to determine the allocation of resources."[54]

Moreover, no commenter shows that the Commission's recently established reporting safeguards would prevent by-pass harm. As demonstrated by AT&T (pp. 31-32), it is much too early to make this determination and, in any event, these safeguards

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settlement rates on a timely basis to a more cost-based level." *International Settlement Rates*, 12 FCC Rcd. at 19824.

50 C&W's request (p. 4) for the allowance of ISR on "subsets" of services would provide a potentially broad exemption from the ISR rules for countries maintaining high settlement rates and ISR restrictions. Because of the impossibility of monitoring the type of traffic carried over inbound international private lines interconnected to the public switched network, the adoption of this approach would encourage widespread inbound settlements by-pass.

51 *See* AT&T at 31; SBC at 15.

52 *See Flexibility Order*, 11 FCC Rcd. at 20076. *See also* PrimeTEC at 10 (supporting below-5 percent proposal).

53 *Flexibility Order*, 11 FCC Rcd. at 20080.

54 *Id.*

will be rendered highly unreliable on routes on which "settled" arrangements are no longer subject to the ISP, and particularly if the removal of Commission restrictions on ISR also triggered the removal of the ISP. Thus, in accordance with its longstanding "commitment to prevent one-way by-pass" (Notice, ¶ 38), the Commission should maintain its existing ISR policies.[55]

IV. BOC INBOUND GROOMING ARRANGEMENTS WOULD HARM COMPETITION.

No commenter shows that the public interest would be served by allowing the Bell Operating Companies to accept geographically "groomed" inbound international traffic for termination within their regions before their access charges are reduced to cost-based levels. As described by AT&T (pp. 33-34), the approval of such practices would enable the BOCs to make anticompetitive use of their regional bottlenecks and above-cost access charges to lower inbound rates below the levels that could be offered by other U.S. carriers.

BOC inbound grooming arrangements would therefore divert return traffic from other U.S. carriers, thus raising their costs and prices, while also raising U.S. settlement outpayments and reducing pressure on above-cost settlement rates. Such allegedly "economically efficient" traffic distribution arrangements, as they are termed by SBC (pp. 20-24), would no doubt serve the interests of the BOCs in raising their U.S. rivals' costs, in addition to furthering the interests of foreign dominant carriers in raising their settlement profits. U.S. consumer benefits, however, as noted by MCI WorldCom

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[55] The Commission should also retain its present accounting rate notification

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(p. 10), would be "small or non-existent."

In sum, any "de-linking" of the outbound and inbound international traffic streams encouraged by flexibility policies and the removal of the ISP will serve competition only if the BOCs are precluded from misusing their regional bottleneck monopolies in this way.[56] Merely requiring non-exclusivity, as proposed by PrimeTEC (p. 9), would not be sufficient when no other carriers can offer the same in-region termination rates.

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procedures. *See* AT&T at 16, n.25; Sprint at 13.

[56] Contrary to the claim by SBC (p. 23), the allowance by the Commission of the BOCs' termination of out-of-region domestic traffic has no relevance here, as domestic long-distance calls involve no return traffic or proportionate return issues. Similarly, the Commission's discussion in the *LEC Regulatory Treatment Order* of the ability of the BOCs to exercise market power against domestic and international competitors did not discuss the specific issues raised by grooming arrangements in connection with return traffic and proportionate return and stated that such an arrangement would require public comment and approval under the flexibility rules. *See id.*; *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 15 FCC Rcd. 15756, 15838 (1997) ("*LEC Regulatory Treatment Order*").

CONCLUSION

For the reasons explained above and in AT&T's Comments, AT&T opposes proposals by some carriers for the expanded use of the 25 percent traffic threshold in connection with the removal of the ISP. The Commission should not provide secrecy for under-25 percent flexibility arrangements, and should remove the ISP with all carriers only in markets where settlement rates are at "best practice" levels, or where U.S. carriers are able to terminate traffic through viable ISR arrangements. The Commission should maintain the existing ISR rules and continue to prohibit grooming arrangements with the Bell Operating Companies.

Respectfully submitted,

AT&T CORP.

By James Talbot.

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James J. R. Talbot

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Dated: October 16, 1998

Attachment I

List of Commenters
IB Docket No. 98-148

Americatel Corportion
Ameritech
AT&T Corp.
BT North America, Inc. ("BTNA")
BellSouth Corporation ("BellSouth")
Cable & Wireless USA, Inc. ("C&W")
Competitive Telecommunications Association ("CompTel")
Deutsche Telekom AG & Deutsche Telekom Inc. ("DT")
France Telecom ("FT")
General Services Administration ("GSA")
GTE Service Corporation ("GTE")
Level 3 Communications ("Level 3")
MCI WorldCom, Inc. ("MCI WorldCom")
ntta.com inc. ("ntta.com")
PrimeTEC International, Inc. ("PrimeTEC")
Qwest Communications Corp. ("Qwest")
RSL Com USA Inc. ("RSL")
SBC Communications, Inc. ("SBC")
Sprint Corporation ("Sprint")
Telecommunications Resellers Association ("TRA")
Telefonica International, S.A. ("Telefonica")
Teleglobe USA Inc. ("Teleglobe")
Telegroup, Inc. ("Telegroup")
Telia North America Inc. ("Telia")
TMI Communications & Co. LP ("TMI").

Attachment II

High Income Countries Subject to Benchmark Settlement Rates on 1/1/99

1996 43.61	Industry US Bill Minutes	AT&T US Bill Minutes	AT&T % of Market US Bill Mins	MCI W/C US Bill Minutes	MCI W/C % of Market US Bill Mins	Sprint US Bill Minutes	Sprint % of Market US Bill Mins	Other Carriers US Bill Minutes	Other Carriers % of Market US Bill Mins
Andorra	462,891	87,728	19%	103,781	22%	189,334	41%	82,048	18%
Aruba	14,399,844	6,382,637	44%	4,998,088	35%	2,997,387	21%	21,732	0%
Australia	282,491,698	104,501,737	37%	73,339,270	26%	49,282,108	17%	55,368,583	20%
Austria	53,912,409	26,109,961	48%	12,560,007	23%	13,200,766	24%	2,041,675	4%
Bahamas, The	61,786,618	36,602,471	59%	17,815,297	29%	6,833,169	11%	535,681	1%
Belgium	113,503,879	50,888,332	45%	37,056,217	33%	23,178,208	20%	2,381,122	2%
Bermuda	35,782,987	19,530,075	55%	10,076,906	28%	192,402	1%	5,983,604	17%
Brunei	1,430,524	732,840	51%	368,908	26%	0	0%	328,776	23%
Canada	3,463,380,909	1,775,124,900	51%	920,679,628	27%	542,370,997	16%	225,205,384	7%
Cayman Islands	19,280,382	11,284,098	59%	4,580,448	24%	3,407,554	18%	8,282	0%
Cyprus	8,973,001	4,873,558	54%	2,327,242	26%	1,284,039	14%	488,162	5%
Denmark	60,706,503	24,424,000	40%	21,631,255	36%	13,066,685	22%	1,584,563	3%
Finland	26,660,995	13,067,902	49%	7,758,803	29%	4,934,894	19%	899,396	3%
France	442,140,244	185,510,304	42%	176,465,361	40%	70,511,587	16%	9,652,992	2%
French Polynesia	6,432,264	1,908,752	30%	4,358,183	68%	44,905	1%	120,424	2%
Germany	781,808,609	396,054,709	51%	283,333,181	36%	89,424,284	11%	12,996,435	2%
Greenland	247,401	110,792	45%	82,906	34%	47,538	19%	6,165	2%
Hong Kong	539,470,995	109,225,202	20%	236,859,628	44%	192,540,478	36%	845,687	0%
Iceland	8,865,912	5,178,796	58%	2,448,160	28%	1,125,939	13%	113,017	1%
Ireland	121,023,244	75,219,455	62%	26,725,176	22%	15,541,869	13%	3,536,744	3%
Israel	238,579,053	131,000,945	55%	75,627,206	32%	30,130,126	13%	1,820,776	1%
Italy	334,063,551	179,654,727	54%	90,139,501	27%	59,938,482	18%	4,330,841	1%
Japan	703,106,667	283,475,487	40%	307,176,380	44%	101,885,932	14%	10,568,868	2%
Kuwait	40,767,445	18,719,341	46%	11,040,750	27%	10,985,023	27%	22,331	0%
Liechtenstein	188,268	179,601	95%	0	0%	0	0%	8,667	5%
Luxembourg	9,227,995	4,332,562	47%	2,489,309	27%	1,962,879	21%	443,245	5%
Macau	3,236,420	1,505,610	47%	921,683	28%	761,492	24%	47,635	1%
Netherlands	207,062,957	85,232,605	41%	57,569,482	28%	38,990,093	19%	25,270,777	12%
Netherlands Antilles	33,922,789	12,443,621	37%	16,963,079	50%	3,814,804	11%	701,285	2%
New Zealand	58,884,758	20,582,042	35%	17,714,715	30%	13,203,219	22%	7,384,782	13%
Norway	50,929,295	24,324,961	48%	15,609,284	31%	8,418,318	17%	2,576,732	5%
Portugal	44,635,609	27,147,465	61%	9,918,119	22%	4,086,844	9%	3,483,181	8%
Qatar	5,965,067	3,130,848	52%	1,461,490	25%	1,356,106	23%	16,623	0%

High Income Countries Subject to Benchmark Settlement Rates on 1/1/99

1996 43.61	Industry US Bill Minutes	AT&T US Bill Minutes	AT&T % of Market US Bill Mins	MCI W/C US Bill Minutes	MCI W/C % of Market US Bill Mins	Sprint US Bill Minutes	Sprint % of Market US Bill Mins	Other Carriers US Bill Minutes	Other Carriers % of Market US Bill Mins
Singapore	148,681,290	51,303,814	35%	71,402,551	48%	25,705,290	17%	269,635	0%
Spain	147,263,334	78,186,320	53%	34,104,979	23%	18,686,847	13%	16,285,188	11%
Sweden	103,214,281	44,719,355	43%	37,239,928	36%	12,364,726	12%	8,890,272	9%
Switzerland	180,963,684	72,275,010	40%	53,300,594	29%	36,730,688	20%	18,657,392	10%
Taiwan	321,684,529	124,652,371	39%	139,199,803	43%	57,130,265	18%	702,090	0%
United Arab Emirates	53,752,567	22,043,195	41%	18,107,574	34%	13,516,521	25%	85,277	0%
United Kingdom	1,226,368,905	613,215,464	50%	324,325,400	26%	170,217,054	14%	118,610,987	10%

Source: 1996 Section 43.61 International Telecommunications Data (filed October 31, 1997)

Countries with Market shares Greater than 25%

AT&T	**38**
MCI WorldCom	**32**
Sprint	**3**

Average Market Share in Countries with Market Shares Greater than 25%

AT&T	**48%**
MCI WorldCom	**32%**
Sprint	**35%**

ATTACHMENT III

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

In the Matter of	)	
	)	
1998 Biennial Regulatory Review --Reform of the International Settlements Policy and Associated Filing Requirements	)	IB Docket No. 98-148
	)	
Regulation of International Accounting Rates	)	CC Docket No. 90-337
	)	

REPLY AFFIDAVIT

OF

WILLIAM H. LEHR

ON BEHALF OF

AT&T CORP.

This reply affidavit supplements and reaffirms my comments submitted earlier in this proceeding[1] in light of the FCC's recent decision[2] reaffirming AT&T's classification as a non-dominant carrier in international telephone services and comments submitted by MCI WorldCom[3] and Sprint[4]. In my earlier statement, I recommended that the FCC eliminate its proposed "25% rule" under which flexible settlements agreements between carriers are treated differently depending on whether the contract concerns more or less than 25% of the inbound or outbound traffic on a route.

The FCC's recent decision affirmed its determination that AT&T lacks market power in international telephone services. The FCC argued that AT&T's substantial loss of market power since 1991, customer's high responsiveness to prices (elastic demand), and the high elasticity of supply confirm that AT&T does not possess market power over

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1 See *Affidavit of William H. Lehr on Behalf of AT&T*, in the Matter of 1998 Biennial Regulatory Review --Reform of the International Settlements Policy and Associated Filing Requirements, Federal Communications Commission, CC Docket No. 90-337 and IB Docket No. 98-148, September 16, 1998.

2 See *Order on Reconsideration in the Matter of Motion of AT&T to be Declared Non-Dominant for International Service*, Federal Communications Commission, CC Docket No. 79-252, adopted September 30, 1998.

3 See *Comments of MCI ~~Worldcom~~WorldCom, Inc.*, in the Matter of 1998 Biennial Regulatory Review --Reform of the International Settlements Policy and Associated Filing Requirements, Federal Communications Commission, CC Docket No. 90-337 and IB Docket No. 98-148, September 16, 1998.

4 See *Comments of Sprint Corporation*, in the Matter of 1998 Biennial Regulatory Review --Reform of the International Settlements Policy and Associated Filing Requirements, Federal Communications Commission, CC Docket No. 90-337 and IB Docket No. 98-148, September 16, 1998.

international services.[5] Therefore, there is no logical or economic basis for singling out larger carriers such as AT&T for special regulatory treatment as occurs with the "25% rule." Moreover, it is worth noting that the FCC's analysis of market power rejected a finding of this on the basis of market shares for AT&T that are significantly above the arbitrary 25% level.

Where the FCC believes that competition is at risk from undue market power on the part of one or more carriers, then the appropriate policy would be to retain the current International Settlements Policy (ISP) in those markets that are at risk. It is both inconsistent and anticompetitive to liberalize regulatory oversight in such a way as to introduce artificial distinctions among carriers that are otherwise believed to be without market power.

Maintenance of the "25% rule" would have this effect, and perversely, would weaken competition among the largest carriers (AT&T, Sprint, and MCI WorldCom). Because AT&T is the most substantial rival for MCI WorldCom and Sprint, it is not surprising that they recommend reforming the policy in ways that would asymmetrically harm AT&T to their potential advantage.

MCI WorldCom recommends extending the 25% rule to all markets where the ISP is relaxed, not just those markets where flexible agreements are currently permitted. MCI WorldCom argues that this liberalization is consistent with the presumption that those markets are adequately competitive. They also argue that carriers with more than the 25%

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[5] See *Order on Reconsideration in the Matter of Motion of AT&T to be Declared Non-Dominant for International Service*, note 2, *supra*, paragraphs 8-10.

share should be able to submit their filings confidentially to the FCC, rather than publicly as recommended by the FCC in its Settlements NPRM.[6]

While I agree that allowing larger carriers to submit their agreements to the FCC confidentially rather than publicly would lessen the regulatory burden imposed by the 25% rule (*i.e.*, by reducing the negative effect of the rule on the ability of larger carriers to negotiate favorable settlements agreements), it would not be appropriate to extend the 25% rule to an even larger subset of markets, and particularly to those that are competitive in nature where neither the ISP nor other protections are required to protect individual U.S. carriers.

Furthermore, although the rule would apply to both AT&T and MCI WorldCom in a significant number of the markets in which both compete, a greater share of AT&T's traffic would be subject to the higher unit costs associated with complying with the 25% rule. This would drive a wedge between AT&T's and MCI WorldCom's costs, reducing AT&T's ability to compete on an equal footing with MCI WorldCom and thereby weakening the forces for effective competition in international telephone services.

Sprint's proposed policy revision, if adopted, would be even more damaging to effective competition. In its comments, Sprint recommends removing the ISP for all contracts affecting less than 25% of the inbound or outbound traffic along a route to all markets. This would unfairly favor Sprint which would be able to take advantage of

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[6] See *Notice of Proposed Rulemaking In the Matter of the 1998 Biennial Regulatory Review Reform of the International Settlements Policy and Associated Filing Requirements*, IB Docket No. 98-148, and Regulation of International Accounting

(Footnote continued on next page)

flexible agreements for all of its traffic along most routes, resulting in a significant regulatory-induced cost advantage relative to AT&T (and MCI WorldCom), which would remain subject to the ISP for contracts affecting 25% or more of the inbound or outbound traffic on a route.

The markets where the FCC proposes that the ISP should be retained are markets where competition is still inadequate and the foreign incumbent's dominant position continues to pose a significant risk of whipsawing for U.S. carriers. Adopting Sprint's recommendation would reduce the effectiveness of the ISP and would strengthen the market power of dominant foreign incumbents.

In summary, therefore, the FCC's finding that AT&T lacks market power over international telephone service, and is therefore, equivalent from a competitive perspective to MCI WorldCom, Sprint, and other competitors in international services eliminates any logical or economic justification for regulating AT&T asymmetrically *vis a vis* other carriers that are similarly deemed to lack market power. Lacking market power, AT&T has no *a priori* economic advantage relative to other U.S. carriers that would allow it to negotiate uniquely favorable deals with the foreign incumbent. Accordingly, the regulatory imposition of higher costs associated with the 25% rule cannot be justified on these grounds. In those markets that are sufficiently competitive to justify relaxation of the ISP, the 25% rule tilts what would otherwise be a level playing field, favoring one set

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(Footnote continued from previous page)

Rates, CC Docket No. 90-337, Federal Communications Commission, Washington, DC, Adopted August 6, 1998 (hereafter, "*Settlements NPRM*").

of competitors over another, and thereby harming the competitive process and the public interest. In recognition of this, the FCC should eliminate the 25% rule.

FCC DOCKET NO. IB 98-148
AFFIDAVIT OF WILLIAM H. LEHR

I hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.

William H. Lehr

Subscribed and sworn before me this 16 day of October, 1998.

Notary Public
Channing L. Entwistle
NOTARY PUBLIC
My commission exp. Dec. 6, 2000

My Commission expires: _____

CERTIFICATE OF SERVICE

I, Karen Kotula, do hereby certify that on this 16th day of October, 1998 a copy of the foregoing "Reply Comments of AT&T Corp." was mailed by U.S. first class mail, postage prepaid, upon the parties on the attached service list.

Karen Kotula

Karen Kotula

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