

whatever benefits are to be derived, they would be so substantial as to outweigh the adverse consequences which are likely to attend the adoption and implementation of direct access.”¹²⁷

As the following summary indicates, the very factors relied upon by the FCC in its 1984 decision are more valid today, and the current market facts further strengthen the 1984 conclusions.

- **The INTELSAT Utilization Charge (“IUC”) “is not a measure of COMSAT’s cost of providing satellite circuits acquired from INTELSAT to its customers in the United States.”**¹²⁸ Rather, the FCC found that “INTELSAT has a unique financial structure”¹²⁹ and that as a result, the IUC “is not intended to, and does not include any amount to compensate COMSAT for the internal costs which COMSAT incurs making satellite circuits available to U.S. customers” or conducting its duties as U.S. Signatory under the INTELSAT Agreements and the Satellite Act.”¹³⁰ As shown below and in The Brattle Analysis, this conclusion remains just as true today.¹³¹
- “[T]he amount of compensation that COMSAT receives as a return on its INTELSAT investment through the IUC mechanism does not provide COMSAT a full return on its total investment in INTELSAT.”¹³² This 1984 finding also remains true, despite the *Notice*’s tentative (but unsupported) conclusion that IUCs alone could provide COMSAT with a “reasonable opportunity to earn a fair return on its investment from INTELSAT.”¹³³ INTELSAT’s basic financial structure has not changed in

¹²⁷ *Id.* at 298 [emphasis added].

¹²⁸ *Id.* at 311.

¹²⁹ *Id.* at 311.

¹³⁰ *Id.* at 311.

¹³¹ The Brattle Analysis at 23-25.

¹³² *Id.* at 312.

¹³³ *Notice* at ¶ 43.

the intervening years in any way that would modify this determination.¹³⁴ And, as the Commission recognized fourteen years ago, COMSAT's rates to its carrier customers continue to include a number of legitimate expenses that are not recovered via the IUC mechanism.

- **“We find very little to be gained from [direct access] in terms of cost savings or increased efficiency.”**¹³⁵ The FCC determined in 1984 that Level 3-type direct access would be a poor substitute for actual alternative providers of international transmission services. Today, and unlike in 1984, the presence of substantial facilities-based competition in the international marketplace dictates COMSAT's prices. As shown below and in The Brattle Analysis, however, the current proposal for Level 3 direct access is not predicated on true efficiency gains but rather would provide certain U.S. users an opportunity to acquire INTELSAT capacity at below-cost rates, while COMSAT would be saddled with the adverse consequences.¹³⁶
- **Even if any savings might potentially result, “there would be no guarantee that the carriers would flow-through these savings to end users.”**¹³⁷ In 1984, the cost of space segment capacity represents only a fraction of the cost of a basic international telephone call. With the substantial reductions in satellite rates since then, space segment costs today constitute an even smaller portion of the international calls. Any savings would amount to only a fraction of a percentage point of the total end-user charge. Yet absent some way to ensure that COMSAT's U.S. carrier customers flowed-through even these small potential savings to consumers, the FCC found no basis to conclude that end-users would benefit in any cognizable way from direct access.¹³⁸ There is no basis for a different conclusion today.

¹³⁴ 1984 Order at 313-15. The Commission concluded that “direct access *in any form* would not appreciably diminish any of the expense elements ... which comprise the space segment portion of COMSAT's tariff. Were we to adopt direct access, at best we would merely be dividing certain fixed space segment-related costs between COMSAT and others.” *Id.* at 318.

¹³⁵ 1984 Order at 318.

¹³⁶ Brattle Analysis at 13-15.

¹³⁷ 1984 Order at 316.

¹³⁸ 1984 Order at 325.

- “[D]irect access ... could also adversely affect COMSAT’s ability to effectively express, promote, and protect the national and foreign policy interests of the United States before INTELSAT.”¹³⁹ This justification has heightened significance today as the United States works to push INTELSAT privatization forward. If the major U.S. carriers are allowed to become direct contractual customers of INTELSAT prior to privatization, their ability to balkanize the U.S. voice within INTELSAT will most certainly emerge, and their competitive agenda as owners of competing fiber-systems and INTELSAT users is liable to jeopardize the most pro-competitive outcome.

2. None of the Events of the Past Fourteen Years cited by the Notice Provides a Rationale Basis for Reversing its Prior Conclusion

Admittedly, much can happen in fourteen years to warrant a reexamination of these conclusions. The *Notice* correctly reports, for instance, that the FCC’s analysis took place before INTELSAT developed its program of Level 3 and 4 direct access to accommodate liberalization in other countries. The *Notice* fails to note, however, that one of the direct access models it evaluated in the *1984 Direct Access Order*—the so-called “capital lease” proposal—is for all intents and purposes identical to INTELSAT’s Level 3 direct access option.¹⁴⁰ Accordingly, this particular “change in circumstances” identified in the *Notice* does not alter, in any respect, the result reached by the Commission in 1984.

Other changed circumstances the *Notice* relies upon consist of user requests for direct access, the fact that COMSAT continues to be regulated as a dominant carrier in some

¹³⁹ 1984 Order at 325.

¹⁴⁰ “Option 1” discussed in the 1984 Order—also known as the “capital lease” option—would have required COMSAT to continue to make capital investments in INTELSAT and to unbundle its tariffs while allowing international carriers to obtain INTELSAT capacity on a “cost-pass-through” basis, with a ministerial fee to be paid to COMSAT for “administrative and maintenance” costs. *1984 Direct Access Order*.

markets, and that other countries have implemented direct access in recent years. These reasons for reversing the 1984 conclusions do not withstand scrutiny. First, customer requests for direct access are hardly new — they were made in the early 1980s as well. The proper question for the FCC is not whether some customers would gain, but whether their gains would reflect genuine efficiencies or simply arise at the expense of others (such as COMSAT or U.S. taxpayers). As demonstrated in the Brattle Analysis, any gains produced by Level 3 direct access would be artificial, and as a result, would distort competition.

Second, COMSAT's lingering classification as a "dominant carrier" for some services on some routes is not a persuasive rationale for direct access. Since COMSAT's "dominance" did not justify direct access in 1984, direct access logically is even less justified today when COMSAT is classified as non-dominant for the major portion of its INTELSAT services.¹⁴¹ Allegations of inflated COMSAT "mark-ups" also reflect a basic misunderstanding both of the IUC charges and COMSAT's true margins — a misunderstanding that the FCC did not have in 1984.

Third, that INTELSAT now offers direct access programs which many countries have adopted is equally unpersuasive. As noted, the direct access options considered and rejected in 1984 were essentially identical to the Level 3 and Level 4 direct access options under consideration now. Moreover, the critical flaw in this rationale is that the situation in other countries differs fundamentally from that in the United States, nor do the vast majority of countries referenced by the FCC implement INTELSAT's program as the FCC proposes to do

¹⁴¹ *COMSAT Non-Dominance Order*, 13 FCC Rcd 14083.

in the United States. This point is elaborated upon more fully in subsection C below, but COMSAT will note here that direct access in other countries is largely a way to spur competition in the face of structural bottleneck problems arising from the presence of a vertically-integrated PTT — a situation that most certainly does not exist in the United States.

3. Other Developments, Including the Tremendous Growth in Competition in International Services Since 1984, Further Compels Rejection of Level 3 Direct Access

The desire for direct access is predicated on the notion that it might somehow lead to appreciably lower prices and/or greater facilities-based competition. But the *Notice* identifies no relevant facts now to support a reasoned justification that Level 3-type direct access is required to accomplish these objectives.¹⁴² Rather, the only facts before the agency today

¹⁴² At a minimum, the Commission must be able to point to facts in the record before it in order to justify a departure from its 1984 rejection of direct access. *See, e.g., National Black Media Coalition v. F.C.C.*, 775 F.2d 342, 355 (D.C. Cir. 1985) (holding that while “an agency does have the right to develop new policies and methodologies . . . it is also a clear tenet of administrative law that if the agency wishes to depart from its consistent precedent, it must provide a principled explanation for its change of direction.”); *Airmark Corp. v. FAA*, 758 F.2d 685, 691-92 (D.C. Cir. 1984); *United States Satellite Broadcasting Co. v. F.C.C.*, 740 F.2d 1177, 1187 (D.C. Cir. 1984). Certainly INTELSAT’s institution of direct access mechanisms is not such a principled explanation. The Commission did not base its 1984 decision on any suggestion that direct access might have been infeasible because it conflicted with INTELSAT’s operational rules and policies. Instead, that decision was solidly founded on U.S. policy and marketplace facts.

The Commission also points to COMSAT’s status as a dominant carrier for a few so-called thin routes and the fact that certain customers are seeking direct access. With respect to the first point, the Brattle Analysis notes that while COMSAT is still deemed “dominant” on some thin routes, the rates charged on those routes reflect competitive, globally averaged rates that are on file with the FCC. *See* Brattle Analysis at 50. Those rates thus are presumptively competitive and deemed lawful. Moreover, the number of thin routes identified by the Commission in the *COMSAT Non-Dominance Order* is already obsolete and continues to decline.

demonstrate—as the Commission has acknowledged in the *Non-Dominance Order*—that *facilities-based competition* in the U.S. international marketplace *has grown significantly in the absence of direct access*, providing consumers with a range of price and service options for international transmission capacity unimaginable in 1984. Specifically, the following pro-competitive changes have occurred since the FCC last rejected direct access:

- The authorization of separate satellite systems in July, 1984.¹⁴³
- The deployment of transoceanic fiber-optic cables beginning in July 1988.
- The end of “balanced loading” guidelines in January, 1989.¹⁴⁴
- The adoption of the so-called *Disco-I* policy in January, 1996.¹⁴⁵
- The reclassification of AT&T as a non-dominant international carrier in May, 1996.¹⁴⁶
- The end of PSTN restrictions on separate systems in December 1996.¹⁴⁷

¹⁴³ See *Establishment of Satellite Systems Providing International Communications*, 101 FCC 2d 1046, 1178-79 (1985) (Report and Order), *recon.*, 61 Rad. Reg. 2d (P&F) 649 (1986).

¹⁴⁴ *Policy for the Distribution of United States International Carrier Circuits Among Available Facilities During the Post-1988 Period*, 3 FCC Rcd 2156, 2160 (1988) (Report and Order) (reviewing history of loading policy).

¹⁴⁵ *Amendment to the Commission’s Regulatory Policies Governing Domestic Fixed Satellites and Separate International Satellite Systems*, 11 FCC Rcd 2429 (1996) (Report and Order) (“*DISCO-I Order*”).

¹⁴⁶ *Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, 11 FCC Rcd 17963 (1996) (Order) (“*AT&T International Non-Dominance Order*”).

¹⁴⁷ See *Permissible Services of U.S. Licensed International Communications Satellite Systems Separate from the International Telecommunications Satellite Organization (INTELSAT)*, 7 FCC Rcd 2313, 2314 (1992) (Order) (“*Permissible Services Order*”).

- The adoption of the WTO Agreement on Basic Telecommunications in February 1997 and its U.S. implementation beginning in February, 1998.¹⁴⁸
- The Hughes-PanAmSat merger in April 1997.¹⁴⁹
- The Loral-Orion merger in February 1998.¹⁵⁰
- The reclassification of COMSAT as a non-dominant international carrier in April 1998.¹⁵¹
- The Teleglobe-Excel merger in September 1998.¹⁵²
- The MCI-WorldCom merger in September 1998.¹⁵³
- The spin-off of New Skies Satellites, N.V., from INTELSAT in November 1998.¹⁵⁴

¹⁴⁸ World Trade Organization Agreement on Basic Telecommunications Service, February 1997. See "WTO Telecoms Deal Will Ring in the Changes on 5 February 1998," WTO Press Release, 26 January 1998. The WTO Agreement was implemented in the United States by the Commission in the so-called "DISCO II" proceeding. *In the Matter of Amendment of the commission's Regulatory Policies to Allow Non-U.S. Licensed Space Stations to Provide Domestic and International Satellite Services in the United States*, Report and Order, 12 FCC Rcd 24094 (1997) ("DISCO II Order").

¹⁴⁹ *In the Matter of Hughes Communications Group, Inc. and Affiliated Companies and Anselmo Group Voting Trust/PanAmSat Licensee Corp. and Affiliated companies Application for Transfer of Control and/or Assignment of Various Space Station, Earth Station, and Section 214 Authorizations*, Order and Authorization, 12 FCC Rcd 7534 (1997).

¹⁵⁰ *In the Matter of Loral Space & Communication Ltd. And Orion Network Systems, Inc. et al. Application for the Transfer of Control of Various Space Station, Earth Stations, and Section 214 Authorizations*, Order and Authorization, 13 FCC Rcd 4592 (1998).

¹⁵¹ *COMSAT Non-Dominance Order*, 13 FCC Rcd 14083.

¹⁵² *Excel Communications, Inc.*, File No. ITC-T/C-19980717-00495, 13 FCC Rcd 17792 (1998).

¹⁵³ *In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025 (1998) ("MCI/WorldCom Order").

- The enormous expansion of international transmission capacity discussed in the MCI/WorldCom Order.¹⁵⁵
- The pending AT&T/British Telecom joint venture announced in July 1998.¹⁵⁶

These procompetitive developments have all occurred in the absence of direct access. And it is not at all clear how substituting INTELSAT in the U.S. for COMSAT will engender more competition or market pressure for lower prices.

4. The Commission's Recent Findings and Current Marketplace Facts Demonstrate That no Need for Level 3 Direct Access Exists

The *Notice* states that a primary rationale for implementing the Commission's direct access proposal is that the measure "may impede COMSAT's ability to earn monopoly rents."¹⁵⁷ This reasoning is plainly erroneous. The FCC already has determined, as set forth in the *Non-Dominance Order*, that COMSAT lacks market power on routes representing 85-90% of its traffic. COMSAT's rates on these routes are by definition competitive and presumptively lawful—therefore excluding the possibility of unlawful "monopoly rents."

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¹⁵⁴ INTELSAT officially transferred five operational satellites, plus a sixth under construction, to New Skies Satellites, N.V. on November 30, 1998. *See, e.g.*, *Communications Daily*, Dec. 1, 1998.

¹⁵⁵ *See* MCI/WorldCom Order at ¶¶ 86-99.

¹⁵⁶ AT&T and British Telecom announced on July 26, 1998, that they would merge many of their international operations in a \$10 billion joint venture. *See generally*, "AT&T and British Telecom Merge Overseas Operations," *The New York Times*, July 27, 1998 at p. A1. The deal still must be approved by both U.S. and European regulators. The Commission has requested interested parties to file comments on the deal. DA-98-2412 (November 27, 1998).

Furthermore, COMSAT's rates for service on the so-called "thin" routes are the same as those charged on the competitive "thick" routes and remain subject to Commission regulation.¹⁵⁸

Thus, as a matter of both logic and law, there is no factual basis for the agency to contend that COMSAT could earn "monopoly rents." Stated differently, the *Notice* is proposing Level 3 direct access as a way to address a problem which simply does not exist.

Moreover, as discussed above and in the Brattle Analysis, implementing the agency's direct access proposal would afford U.S. customers below-cost access to INTELSAT space segment at COMSAT's expense.¹⁵⁹ The Commission has never before required a carrier to lower its rates to sub-competitive levels, and it has no legal authority to order COMSAT to do so now.

a) The FCC Already Has Found that COMSAT's Rates for 90% of Its INTELSAT Services are Subject to Effective Competition

The FCC's April 1998 *Non-Dominance Order* declares that COMSAT faces effective facilities-based competition for the overwhelming majority of its traffic¹⁶⁰ Consequently, the

¹⁵⁷ (...Continued)
Notice at ¶ ¶ 14, 43.

¹⁵⁸ As noted below, the Commission is currently reviewing COMSAT's proposal in the so-called "incentive-based rate regulation" proceeding to further ensure that all customers on these thin routes enjoy the benefits of competitive thick route pricing. In addition, the FCC's list of thin-route destinations is factually outdated as the number of thin-route countries continues to decline.

¹⁵⁹ See Brattle Analysis at 13-15.

¹⁶⁰ *Notice* at ¶ 1. The Commission held that COMSAT was non-dominant in the provision of full-time video services to all markets and in the provision of switched-voice, private line, and occasional-use video services to so-called "thick route" markets. By the end of 1998,
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corporation's rates on those routes are *a fortiori* competitive and presumptively lawful. Given that the "unprecedented" decline in COMSAT's share of the U.S. international marketplace in recent years—due largely to the soaring increase in new cable and satellite capacity—the FCC could hardly find otherwise.¹⁶¹

The Commission has recognized that COMSAT faces ever-increasing competition from both satellites and from fiber optic cable.¹⁶² As for intermodal competition, the *Non-Dominance Order* notes that fiber-optic cables provided about three times the amount of international circuits offered by all satellite companies, including COMSAT, combined.¹⁶³ The ability and willingness of COMSAT's customers to move their traffic to take advantage of the best price and service options available is not in doubt.¹⁶⁴ This record amply refutes any contention that Level 3 direct access is necessary to guarantee that consumers have choices for international transmission capacity.

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traffic on the routes for which COMSAT is still regulated as dominant will account for only about 8% of COMSAT's INTELSAT-based revenues.

¹⁶¹ COMSAT's share of switched voice and private line traffic to and from the United States decreased from an average of 70% in 1988 to less than 21% in 1996 and its share of the U.S. international video market dropped from 80% in 1994 to less than 45% in 1996. *Non-Dominance Order*, 14 FCC Rcd at 14121, 14131, 14134-5.

¹⁶² See Merrill Lynch, *The Global Satellite Marketplace*, April 1997 (Tables 23 and 31) (showing INTELSAT's shrinking share of total satellite capacity).

¹⁶³ *COMSAT Non-Dominance Order*, 13 FCC Rcd at 14131 (less than 19,000 satellite circuits compared to more than 57,000 cable circuits).

¹⁶⁴ *Id.* at 14120.

b) COMSAT's Rates on the Declining Number of Thin Routes Also are Competitive Market-Driven Rates

Facts concerning COMSAT's services on thin routes provide no more justification for Level 3 direct access than do the facts on thick routes. While the Commission continues to regard COMSAT as a "dominant" carrier for certain services on certain routes—which currently account for less than 8% of COMSAT's INTELSAT-derived revenues—there is no basis for a determination that the corporation's rates on the ever-shrinking number of thin routes are excessive or otherwise unlawful.

Certainly there has been no showing that COMSAT's thin-route rates are anything other than what the corporation has consistently said they are: the very *same* rates afforded to customers on the highly competitive thick-routes for the same services.¹⁶⁵ In short, users are getting the benefit of facilities-based competition without direct access.¹⁶⁶

c) The Latest Marketplace Events Further Undercut the Need for Level 3 Direct Access

If the Commission's own recent findings were not enough to eliminate any factual justification for Level 3 direct access, market-driven events since the issuance of the *Non-Dominance Order* reinforce the point dramatically. All of COMSAT's customers, including

¹⁶⁵ See, e.g., Petition of COMSAT Corporation for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier, File No. 60-SAT-ISP-97 (filed Apr. 24, 1997) [COMSAT Non-Dominance Petition].

¹⁶⁶ See *Policies and Rules for Alternative Incentive-Based Regulation of COMSAT Corporation*, IB Docket No. 98-60, Comments of COMSAT Corporation, filed May 29, 1998 ("Incentive Comments"); Reply Comments of COMSAT Corporation, filed June 12, 1998 ("Incentive Reply Comments").

those on routes still formally classified as non-competitive, now have an even more abundant array of service options from which to choose. Were COMSAT's alleged "mark-ups" out of line with those charged by its rivals, customers could freely switch to other options.¹⁶⁷

Highlights are noted below.

Transoceanic cable competition: Only four months ago, the Commission undertook a detailed analysis of international marketplace developments in approving the MCI/WorldCom merger.¹⁶⁸ Its findings demonstrate that cable capacity continues to expand at an awesome rate—and the FCC therefore can expect that increasing pressures will continue to drive down the rates of all international service providers, without having to impose Level 3 direct access on COMSAT.¹⁶⁹

Satellite competitors: Satellite capacity also continues to experience explosive growth.¹⁷⁰ While there is no question that there is tremendous competition from other satellite

¹⁶⁷ See Brattle Analysis at 41-45.

¹⁶⁸ *In the Matter of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211, FCC 98-225 (released Sept. 14, 1998) ("MCI/WorldCom Order").

¹⁶⁹ For example, in the Atlantic region, the FCC notes that there are now approximately 20,000 E-1 circuits, with that number scheduled to triple by the end of 1999. *Id.* at ¶¶ 86-90. Similarly, cable capacity in the Pacific and Caribbean/Latin American region is also plentiful, with huge increases in capacity planned for the next several years. *Id.* at ¶ 103. As the Commission notes, this figure only includes cables for which a landing license has been granted and a construction contract entered into. Two new projects, TAT-14 and OXYGEN, have announced intentions to construct cables with the equivalent capacity of approximately 500,000 circuits in the next several years. *Id.* at ¶ 106.

¹⁷⁰ For example, COMSAT's primary competitor, Hughes/PanAmSat, operates a fleet of 18 satellites, which will increase to 25 satellites by year 2000. In contrast, INTELSAT now

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providers on COMSAT's "competitive" routes,¹⁷¹ such satellite competition is now extending into COMSAT markets still designated as non-competitive.¹⁷² Countries on the FCC's "thin route" list—but which PanAmSat specifically identifies as countries that it now serves—include Oman, the Dominican Republic, Panama, Paraguay, Nigeria, South Africa, Sudan, and Zambia. This further demonstrates that Level 3 direct access is not needed in order to enjoy lower rates and more service options even in these markets.

Other facilities-based satellite competitors: The Commission may also continue to rely on the entry of new competitors, rather than Level 3 direct access with all its attendant risks, to ensure that consumers enjoy competitive (and declining) prices. A significant number of additional satellite systems are due to come on line in the next several years, including up to 13 Ka-band systems authorized by the Commission in May 1997. Also on the way are a number of non-geostationary satellite systems to provide broadband fixed satellite services, including Skybridge (involving Alcatel and Loral) and Teledesic (involving Boeing, Motorola, and

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has a 19-satellite system, of which the capacity owned by COMSAT for service to and from the United States is the equivalent of about five satellites.

¹⁷¹ *Non-Dominance Order*, 13 FCC Rcd 14083.

¹⁷² For example, PanAmSat last month expanded its Asia-Pacific coverage with, in the company's own words, "the most powerful trans-Pacific C-band coverage available as well as high-power Ku-band beams serving northeast Asia, southeast Asia and Australia, all with access to the United States." PanAmSat News Release, October 7, 1998; *see also* PanAmSat News Release, November 4, 1998 (also noting that the new satellite provides "the highest power C-band beam ever that stretches from Bangladesh to the western United States").

Microsoft).¹⁷³ Even if only a few of the planned systems become operational, they will further increase facilities-based competition.

Teleglobe: A competitive development relevant to direct access and material in the *Notice* has been the emergence of Teleglobe, the Canadian INTELSAT Signatory, as an aggressive player in the U.S. international marketplace. Using its own capacity on INTELSAT and fiber cables, Teleglobe has been authorized by the FCC to provide international facilities-based service in the United States. Thus, COMSAT now faces actual or potential competition from Teleglobe to *every* market COMSAT serves via the INTELSAT system. As the FCC's application files reflect, the Canadian Signatory also uses its extensive North American and international fiber optic network to move traffic beyond U.S. borders, and then uses its own INTELSAT capacity to transmit signals to and from the foreign point.¹⁷⁴

Teleglobe has been particularly aggressive in serving countries in Africa, where most of the Commission's list of thin route countries are located. In one prominent example, Teleglobe provided *all* of the occasional-use video service for the White House Press Pool to cover the U.S. President's visit to sub-Saharan Africa last spring. Teleglobe provided this

¹⁷³ Teledesic was licensed by the Commission in May 1997.

¹⁷⁴ Teleglobe's FCC tariff lists 218 countries that it serves from the United States. This list includes *62 of the 63 so-called thin route countries* for switched voice service (the one exception being Midway Atoll). Teleglobe's U.S. tariff also includes *139 of the 142* countries considered by the Commission to be non-competitive for occasional-use video. (The three exceptions are Brunei, Midway Atoll, and the Chagos Archipelago.) Furthermore, the Canadian company continues to expand its network's reach through acquisitions. In June 1998, Teleglobe announced that it had merged with the Dallas-based long distance carrier Excel Communications, Inc., creating the fourth largest long distance carrier in the United States.

service from Senegal, Ghana, Uganda, Botswana, and South Africa by leasing 18 MHz of capacity on two INTELSAT satellites and downlinking the signals to its Laurentides, Quebec, teleport. The feed was then sent by fiber links to Teleglobe's New York facilities. COMSAT provided *no* occasional use video services for this trip—which demonstrates that COMSAT faces significant competition even in these markets and that U.S. users already *can and do* obtain INTELSAT service from other providers here in the U.S.

All of these recent developments should put to rest the notion that customers have no choice but COMSAT for facilities-based overseas services, even for the now-outdated list of thin route destinations. The dramatic transformation of the international marketplace in recent years renders direct access unnecessary as a means of ensuring that U.S. customers enjoy market-driven price and service choices. No marketplace facts provide any basis for justifying the implementation of Level 3 direct access.¹⁷⁵

* * *

In sum, the factors that led the Commission to reject direct access in 1984 are even stronger today, the "developments" cited by the Notice since 1984 provide no rational basis for a different conclusion today, and the substantial growth in competition in international

¹⁷⁵ It is also important to note that Teleglobe is likely able to offer services at lower rates than COMSAT. Teleglobe's service between the U.S. and third countries is "transit traffic" and is wholly unregulated by Canadian authorities. Transit traffic passes through Canadian facilities but does not originate or terminate within Canada. Canadian policy has sought to promote transit traffic — even though companies like Teleglobe charge Canadian customers higher rates — because it brings Canadian carriers incremental revenue at the expense of foreign carriers, including COMSAT. Because Teleglobe can charge whatever it wants for transit service, it can undercut COMSAT, which cannot discriminate in its provision of U.S. service.

communications militates against direct access still further. On these facts, the Commission cannot rationally reverse its 1984 conclusion that direct access is not in the public interest.

B. The Harms That Would Be Spawned by Level 3 Direct Access Would Greatly Outweigh Any Benefits

In addition to the factors considered by the Commission in 1984, other factors today compel the conclusion that Level 3 direct access today would cause much more harm to the public interest than good. As explained in more detail in the attached analysis by The Brattle Group, Level 3 direct access would directly harm the public interest in the United States in several ways not previously considered by the Commission. These harms would include:

- The distortion to competition that would be caused by allowing a tax-exempt INTELSAT to provide services directly in the United States;
- The market distortion that would be caused by pricing direct access at below-cost levels of the IUCs; and
- The delay or skewing of privatization that would be caused by introducing Level 3 access at this particular point in the process of privatizing INTELSAT.

These harms to the public interest would be significant and immediate, without countervailing gains that would be appreciable or enduring. The harms would greatly outweigh the putative benefits of direct access, particularly in light of the scant likelihood that U.S. consumers would ever even see a reduction in their prices in a direct access regime.

Indeed, the Commission's proposal would not achieve significant cost savings for any party involved in providing or obtaining international communications services—with the possible exception of former COMSAT customers that might enjoy securing INTELSAT-based capacity at below-cost rates. Nor would the proposal spur greater intermodal or intramodal competition, for by definition there are no new facilities at issue. Worse still, allowing

INTELSAT to access the U.S. market now and directly compete against other U.S. service providers would eliminate one of the best incentives available for moving expeditiously toward privatization—direct access into the U.S. marketplace.

1. The Public Interest Would Not Be Served by Allowing Direct Participation in the U.S. Marketplace by an Intergovernmental Organization That Pays No Taxes and Is Not Subject to FCC Jurisdiction

The *Notice* posits that Level 3 direct access might somehow augment the functioning of the U.S. international marketplace but fails to address the clear irony of the proposal: the agency contemplates permitting a tax-exempt entity—INTELSAT—to vie for customers with U.S. rivals lacking the same advantages.¹⁷⁶ It is not clear from the *Notice* that the Commission appreciates the full significance of this outcome for competition.

Unlike COMSAT, INTELSAT is tax-exempt under U.S. law. INTELSAT's tax advantages include exemption from property taxes, payroll taxes, corporate income taxes, and customs duties; the non-U.S. employees working at INTELSAT's Washington, D.C., headquarters also pay no personal income taxes. The exemptions afford INTELSAT a significant cost savings over otherwise similarly-situated U.S. satellite service providers,¹⁷⁷ which it could pass along to direct access customers in the form of artificially low rates. These

¹⁷⁶ See generally Brattle Analysis at 7-8. COMSAT, of course, is a U.S. corporation fully subject to federal, state, and local taxes as well as federal antitrust laws and FCC regulations in its common carrier role.

¹⁷⁷ COMSAT, however, *is* subject to taxation, so the current regime of exclusive access eliminates what would otherwise be a competitive advantage for INTELSAT. In other words, COMSAT's provision of INTELSAT services on a taxable basis directly corresponds to PanAmSat's provision of its services on a taxable basis.

lower rates, however, would, however, reflect economic distortions produced by INTELSAT's tax-exempt status rather than genuine economic efficiencies. For example, because of its artificial cost advantage in offering retail services, INTELSAT would likely capture business from other U.S. carriers, including COMSAT, PanAmSat, Loral and others, irrespective of whether INTELSAT is truly the most efficient service provider.

In addition, INTELSAT's tax-exempt status means that permitting it to compete directly in the U.S. market will result in losses to U.S. taxpayers. This loss is obvious with respect to business that INTELSAT would divert from its tax-paying competitors. However, as The Brattle Group explains, U.S. tax revenues also would be lost even if INTELSAT simply expanded its retail business by growing with the overall market (as opposed to taking business from existing providers) because such expanded services would make use of personnel and other assets on a tax-exempt basis at the expense of other sectors of the U.S. economy. In this manner, the Commission's Level 3 direct access proposal could operate as a direct U.S. government subsidy to INTELSAT.¹⁷⁸

Tax implications aside, INTELSAT's provision of services directly to U.S. customers could distort the operation of the marketplace by virtue of the IGO's total immunity from U.S. antitrust laws and FCC jurisdiction. When COMSAT, as a common carrier, contends for customer in the U.S. market against other providers, it is fully subject to FCC regulation and U.S. competition laws. Nonetheless, in its recent *DISCO-II* decision, the Commission refused to allow COMSAT to serve the U.S. domestic market because of the alleged competitive

¹⁷⁸ See Brattle Analysis at 8-9.

advantages it receives by virtue of its limited Signatory immunity.¹⁷⁹ *It would be truly anomalous (not to mention arbitrary and capricious) if the Commission were now to decide that, despite its much more sweeping immunities, INTELSAT should be allowed to access the U.S. market directly.*

For these reasons, Level 3 direct access could distort competition in U.S. international services by allowing INTELSAT to provide services directly.¹⁸⁰ These distortions do not arise under the exclusive access regime established by the Satellite Act, in which INTELSAT services are provided by an entity – COMSAT – that is fully subject to U.S. taxation and competition laws.

2. Because the Commission Misapprehends the Nature of INTELSAT Utilization Charges, Level 3 Direct Access Would Force COMSAT to Subsidize Service for the Large International Carriers at Below-Cost Rates

The Brattle Analysis demonstrates that the IUC mechanism employed by INTELSAT remains one of the most misunderstood elements of international telecommunications policy—even though the Commission itself recognized the truth of the matter in 1984.¹⁸¹ As explained therein, if Level 3 direct access were introduced in the United States, there would be a

¹⁷⁹ *DISCO II Order*, 12 FCC Rcd 24094 (COMSAT petition for review pending in D.C. Circuit). Of course, it is COMSAT's position that its limited immunity does not confer any such competitive advantage.

¹⁸⁰ Other entities, particularly PanAmSat, have argued before the Commission that direct access must be contingent upon a waiver of these immunities by INTELSAT. However, the Commission has no authority to direct INTELSAT to waive them.

¹⁸¹ Brattle Analysis at 23-26.

considerable risk that the handful of large U.S. carriers — absent an accurately derived surcharge — would obtain access at below-cost prices.¹⁸² This, in turn, would deprive COMSAT the opportunity to earn a fair return on its statutorily mandated investment in INTELSAT. The end result would be a Commission-ordered subsidy for the large international carriers at the expense of COMSAT's shareholders.

a) **The INTELSAT Utilization Charge is Not a Marginal or “Wholesale” Cost of INTELSAT Capacity**

The *Notice's* proposal to allow Level 3 direct access at “the IUC” contains several incorrect assumptions. First, there is no one “IUC” – rather, there are a series of IUCs relating to different INTELSAT capacity configurations. The Commission's use of the term “IUC” can only mean an average based upon some combination of IUC capacity arrangements.

Second, and of fundamental importance to a proper understanding of this issue, IUCs are not the “cost” or “price” of INTELSAT space segment service to Signatories.¹⁸³ Thus, the *Notice's* reference to COMSAT's purported “68%” markup of the IUC (implicitly suggesting that this is a profit margin) is extremely misleading. Indeed, the Commission has acknowledged in Congressional testimony that it is incorrect to regard the differences between COMSAT's prices and the IUC as a true markup.

As the Brattle Analysis explains, the IUCs do not include many costs that a commercial private entity would reflect in its charges. In particular, the IUC does not reflect: Signatories'

¹⁸² Brattle Analysis at 33-38.

¹⁸³ Brattle Analysis at 23-24.

Indeed, the Brattle Analysis demonstrates that COMSAT would be – uniquely among Signatories – vulnerable to below-cost pricing at IUC levels. To most foreign Signatories, actual IUC levels are largely irrelevant because any investment losses from reducing IUCs would be offset by gains associated with “use” of space segment in the provision of retail services. COMSAT, on the other hand, as the largest and only “pure play” investor in INTELSAT (*i.e.*, not itself a retail user of space segment), would be the only Signatory that would stand to be harmed economically from this type of manipulation of the IUCs.¹⁸⁷

The Brattle Analysis further demonstrates that a considerable risk exists that the powerful coalition of U.S. carriers could convince foreign Signatories to outvote COMSAT and manipulate IUC levels to their own advantage.¹⁸⁸ In addition to allowing the large carriers to obtain artificially low rates at the expense of COMSAT, this type of manipulation would have serious distorting effects on the U.S. market. Traffic would tend to flow to INTELSAT whether or not it achieved any real efficiencies. This impact, combined with INTELSAT’s tax exempt status and immunity from antitrust laws, would make it increasingly difficult for other U.S. space segment providers such as COMSAT, PanAmSat and others to compete on a level playing field.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 14-15. The large U.S. carriers have very close links with foreign Signatories as correspondents for completing international calls and as co-owners in international cable systems. This would make it very easy for the U.S. carriers to arrange to compensate these foreign Signatories as they see fit.

c) The “Rate of Return” Under the IUC Mechanism is Not Compensatory to COMSAT

The *Notice* appears to suggest that “the IUC” alone would provide COMSAT with an adequate return on its investment in a Level 3 direct access environment. As demonstrated in the Brattle Analysis, that tentative conclusion is quite incorrect. If Level 3 direct access were implemented under an IUC mechanism, COMSAT would be deprived of a reasonable return on its investment.

The Brattle Analysis shows that the nominal IUC-provided “return” is well below a compensatory return on investment for private, taxable Signatories such as COMSAT.¹⁸⁹ The Brattle Analysis illustrates this conclusion by analyzing the return that COMSAT receives from INTELSAT’s IUC mechanism from three different perspectives: (1) return on signatory equity; (2) return on total capital; and (3) return on net plant. Any one of these perspectives clearly shows an IUC-based mechanism would provide COMSAT with an inadequate return.

Return on Signatory equity, which amounted to approximately 18% under the IUC system in 1997, is the measure most commonly referred to with respect to INTELSAT return rates. However, because this measure only accounts for a pre-tax return on the book value of invested equity, it does not represent what is commonly understood as return on shareholder capital. Indeed, for COMSAT the “18% return” in 1997 translated into a 11.2% post-tax rate of return, significantly lower than the returns of comparable U.S. telecommunications services

¹⁸⁹ Brattle Analysis at 27-33.

companies.¹⁹⁰ Similar results are produced using either a return on total capital analysis¹⁹¹ or a return on net plant to INTELSAT Signatories analysis.¹⁹² Under none of these analyses would COMSAT's return on its INTELSAT investment prove adequately compensatory in a Level 3 environment.

The *Notice* suggests that the fact that COMSAT holds "excess" ownership of INTELSAT above its usage level as evidence that the IUC-based return from INTELSAT on that investment must be compensatory. That is an incorrect interpretation, because that is not the reason that COMSAT has excess ownership. In fact, COMSAT holds these additional shares not to maximize its investment return, but in order to enhance its voting power (and the influence of the United States) within INTELSAT—a factor especially critical to U.S. efforts to achieve full privatization.¹⁹³ As the Commission is well aware, the difference of a few percentage points in voting power can make a key difference during INTELSAT deliberations.

¹⁹⁰ *Id.* at 27-29.

¹⁹¹ This ratio generally is calculated as the total payments to investors divided by the sum of invested equity and debt capital. The use of an IUC mechanism would have afforded COMSAT only a 10.1 percent return under a return on total capital measure in 1997, far lower than returns for mature U.S. telecommunications companies. *Id.* at 29-30.

¹⁹² Under this analysis, the IUC mechanism provided only a 9.2 percent in 1997. This measure of return provides is closely related to the regulatory concept of "return on rate base." Brattle Analysis at 30-31.

¹⁹³ Brattle Analysis at 40.41.

Second, Level 3 direct access would likely create a powerful new constituency in the United States that could delay or skew the optimal privatization outcome: the large U.S. carriers who own the competing transoceanic cable systems and who could access INTELSAT at below-cost rates. In this regard, the *Notice* questions whether such Level 3 direct access customers could affect INTELSAT policies without a formal role in the IGO's governance.¹⁹⁵ But this legalistic focus on form is overly narrow because it ignores the many ways in which these customers could exert considerable influence over INTELSAT's affairs.

For example, while Level 3 would not make these users formal participants in government of INTELSAT, the reality is that the large U.S. carriers would be among INTELSAT's largest customers. No business ignores the desires of its best customers. It is therefore highly likely that the major U.S. carriers will be able to wield significant bargaining power with INTELSAT, and thus directly influence privatization or other restructuring outcomes that might affect the profitability of their competing cable facilities.¹⁹⁶ Such influence is considerably more attenuated today because the Satellite Act requires U.S. users to purchase INTELSAT capacity from COMSAT—a scheme that lawmakers devised specifically to ensure that intermodal competition developed and flourished.

Privatization prospects could suffer for yet another reason: non-compensatory prices to direct access customers could make it too costly for COMSAT to maintain its investment share

¹⁹⁵ *Notice* ¶ 56.

¹⁹⁶ Brattle Analysis at 18-19 (stating that "U.S. direct access customers would hold considerable sway over foreign signatories because... they have close business relationships, share ownership of alternative facilities to INTELSAT, and therefore could share with them the gains from underpaying for COMSAT's past investment").

in INTELSAT. While Level 3 direct access does not automatically trigger a reduction in COMSAT's ownership share, the Brattle Analysis explains that the company might be forced to reduce its ownership because of the significant costs associated with access to the system at a rate below the cost of providing service, with significant financial consequences for COMSAT.¹⁹⁷

This scenario should bring home to the Commission an appreciation for COMSAT's pivotal role in bringing about efficient privatization. The corporation today is a leader in the IGO reform effort, often against strong opposition from other Signatories and competitors.¹⁹⁸ COMSAT plays this critical role because it owns the largest share, and because it is the only "pure-play" INTELSAT investor. Its interests therefore are intimately aligned with a successfully privatized INTELSAT. By contrast, foreign Signatories' motives are more mixed, given their dual role as owners and retail carriers as well as their large financial interest in competing international transmission facilities. The role of large, non-conflicted investors is widely recognized as critical to monitoring management and to effecting organizational change, and INTELSAT's case is no exception.¹⁹⁹

If, therefore, COMSAT were to lose its influence in INTELSAT as a result of the implementation of direct access, the prospects for rapid and neutral privatization would suffer.

¹⁹⁷ Brattle Analysis at 19-20.

¹⁹⁸ One need only look to the Inmarsat privatization process for a clear indication of the way in which COMSAT has taken the lead in IGO reform.

¹⁹⁹ Brattle Analysis at 20 (citing Andri Shleifn and Robert W. Vishny, "Large Shareholders and Corporate Control, *Journal of Political Economy*, 1986, vol. 94, No. 3, PP. 461-88).

Indeed, under this scenario, COMSAT could be reduced from a leader in the INTELSAT reform effort to a weakened bystander. Thus, Commission action that would decrease COMSAT's real-world influence, whether or not accompanied by a decrease in ownership share, would open the door for those who oppose INTELSAT privatization to thwart U.S. government goals for the IGO. This would be a concrete harm to the public interest.

4. Any Potential Benefit of Direct Access to End Users Would be *de Minimis*

Even if the Commission's proposal for Level 3 direct access somehow could avoid creating the harms identified above, the benefits that direct access might bring to end users would be minimal at best. Of course, since the harms identified above would surely occur, they would greatly outweigh the comparatively insignificant – even undetectable – “benefits” that, under the theory advanced in the Notice, would follow from Level 3 direct access.

As the FCC first acknowledged in 1984, the cost of COMSAT-provided space segment accounts for only a small fraction of what U.S. end users pay for international carrier services.²⁰⁰ Moreover, whatever cost reductions would accrue to U.S. carriers as a result of the implementation of direct access, it is unlikely that even these savings would be fully passed on to end users.

As explained in the Brattle Analysis, it is unlikely that end-users will reap all the benefits of whatever savings carriers may gain as a result of the implementation of direct

²⁰⁰ 1984 Order at & 67. The Commission stated then that, even if passed through to end users, savings would represent only a few percentage points of the total end-user charge. The Brattle Group estimates that today such savings would amount to only 1.3 percent of total end user charges, even if INTELSAT services were provided *free*.

providing service are decreasing.”²⁰⁴ The United States Telephone Association recently released the results of two major studies finding “‘incontrovertible’ evidence supporting the ... charge that the three major interexchange carriers (IXCs) are not flowing through their interstate access charge reduction to residential customers.”²⁰⁵ These developments comport with COMSAT’s own experience; while its rates to AT&T, MCI, and Sprint have declined since 1992, the basic rates that those carriers charge for international calls have risen in the same period.

The facts before the Commission in this and related proceedings prove that COMSAT has been substantially lowering rates to its major carrier customers (and other users) without the so-called “incentive” of Level 3 direct access. Those rates represent only a pittance of the average basic rate that the retail carriers charge their end-user subscribers—and it is not at all clear that the carriers have passed through the price breaks they already have enjoyed to subscribers. These facts provide the Commission no basis to find that end users would benefit from the implementation of Level 3 direct access now.

²⁰⁴ Brattle Analysis at 59. (citing Letter from Chairman William Kennard to Michael C. Armstrong, Chairman & CEO of AT&T, February 26, 1998).

²⁰⁵ *Id.* (citing USTA Studies Say IXCs Pocket Access Charge Cuts, " *TeleCompetition Report*, October 29, 1998, at. 14). COMSAT also speaks from its own experience. As COMSAT discussed in its recent Thin Route Reply Comments, COMSAT has continually lowered its space segment rates to AT&T since 1992. Yet AT&T has continually *increased* its rates for basic Dial 1 outbound services. Thin Route Reply Comments at 6, n.11

5. Given the Pending Privatization of INTELSAT, Any Potential Benefits of Direct Access Would Be of Short Duration and Not Worth the Significant Costs

The privatization of INTELSAT, which has gained significant momentum in the last year, likely will supersede any action that the Commission could take to allow for Level 3 direct access in the United States. Privatization will eliminate exclusive Signatory access to INTELSAT; indeed, it will eliminate the role of Signatory altogether. Thus, privatization will accomplish the goals of direct access (and bring about substantial efficiency gains) while avoiding the major harms that would occur if direct access is imposed while INTELSAT is still an intergovernmental organization.

As the Commission knows, the first phase of INTELSAT privatization recently was completed with the spin-off of five INTELSAT satellites (and another currently under construction) into a new, fully private global satellite company, New Skies Satellites N.V., licensed by and incorporated in the Netherlands.²⁰⁶ Therefore, because COMSAT has no exclusive right to sell New Skies space segment to U.S. customers, direct access effectively has arrived already for approximately 25% of the prior INTELSAT satellite fleet.

When the INTELSAT Assembly of Parties approved New Skies, it also made clear that it was just the first step in the restructuring process. The next phase is progressing under the guidance of INTELSAT's new Director General, Conny Kullman, who assumed his position in

²⁰⁶ New Skies is expected to place its greatest emphasis on video services; thus, customers now have yet another choice for this type of service.

October 1998 on a platform strongly supportive of full privatization. Director General Kullman has announced a target date of March 2001 for the process to be concluded.²⁰⁷

Given the normal time it takes to complete complex FCC rulemaking proceedings, it is reasonable to assume that a decision to implement Level 3 direct access and adopt a reasonable surcharge could not occur in less than 9-12 months. Thus, even if Level 3 access might produce some benefits, and assuming that such benefits actually flowed through to end users, this whole new FCC regulatory program would be in effect only for a very short time unless, as discussed above, such direct access causes the privatization process to founder. This is prodigious regulatory effort for a program that even direct access proponents concede has far less benefits than full privatization. Limited Commission resources could therefore be more wisely expended by prioritizing the achievement of INTELSAT privatization rather than pursuing private direct access as a fix (and a temporary one at that) to the exclusive-Signatory structure that will soon disappear.

C. Direct Access in Other Countries Occurs in Factually Inapposite Settings and Therefore Is Not Relevant to the Competitive U.S. Marketplace

The *Notice* cites the existence of some form of direct access in other nations as a justification for implementing Level 3 direct access here.²⁰⁸ In fact, direct access abroad rarely operates in the fully nondiscriminatory fashion that the *Notice* envisions. Moreover, direct access has never been implemented in a nation in which the Signatory was specifically created

²⁰⁷ Telecomm Reports, Nov. 16, 1998, p. 14.

²⁰⁸ *Notice* ¶ 23.

solely to invest in INTELSAT, and whose main profit-making function was to offer INTELSAT's capacity to all domestic users on a nondiscriminatory basis. To the contrary, with the exception of COMSAT, INTELSAT's signatories are virtually all vertically-integrated national carriers.

Put succinctly, direct access abroad has been implemented in recent years to foster facilities-based competition to a Signatory which also operates the local and/or long-distance telephone system within the given country. In other words, direct access abroad today serves the same purpose for which Congress specifically, and successfully, designed COMSAT thirty-six years ago!

As the Commission is aware, until relatively recently most foreign countries chose to participate in INTELSAT through a combination of the postal, telephone and telegraph authority ("PTT") and the dominant national carrier, which itself was intertwined with the PTT. This practice restricted access to the INTELSAT system in foreign countries and artificially constrained marketplace forces.²⁰⁹ While recently a number of these countries have been moving towards increased competition, these efforts have shown mixed success.²¹⁰ Level 3 or Level 4 direct access in these settings functions as an overlay, to one degree or another,

²⁰⁹ The national experience in other countries is also a product of historical forces. For example, in the past, PTTs in Africa had to rely on a communications infrastructure that was established by the European nations that colonized them. Thus, at one time, a call to Mali from Senegal might have had to go through France.

²¹⁰ For example, while Chile enjoys one of the most liberalized telecommunications markets in the world, Chile does not afford resale opportunities equivalent to those available under U.S. law. *See Americatel Corp.*, DA 98-1589 (rel. Aug. 7, 1998).

on top of a market system dominated either by the government or by one or two well-entrenched carriers that dwarf their direct access competitors.²¹¹

To determine how such experience might possibly be relevant to the U.S. setting, COMSAT examined the 93 countries that the *Notice* identifies as allowing some noteworthy form of direct access. As an initial matter, 19 of these 93 countries are non-member users—which INTELSAT treats as equivalent to direct access status, even though many in fact have only one national point of access (and, of course, no Signatory).

Of the remaining 74 Signatory nations that actually permit direct access in some form, 69 permit such access only on a case-by-case basis, not as a blanket policy (*i.e.*, the approach being taken in the *Notice*). This means that they may afford access to one non-Signatory entity but not to others, or they may permit access on differing terms and conditions. Thus, categorizing these nations as affording Level 3 or Level 4 direct access may not, in fact, reflect reality for any particular user in that country.²¹² The access determination is made by the Signatory. This does not appear to be the regime envisioned in the *Notice*, and it certainly

²¹¹ Looking again at Chile, we note that the Signatory, ENTEL-Chile, is a domestic and long distance carrier in Chile, and as recently as 1992, ENTEL-Chile provided nearly 100% of Chile's international telephone service. *Bell Atlantic Communications, Inc.* 12 FCC Rcd 1880, 1888, n. 38 (1997).

²¹² For example, of the 57 Signatory countries listed in Appendix A to the *Notice* as permitting Level 3 direct access, seven allow only the Regional African Satellite Communication Organization ("RASCUM") as a direct access user. RASCUM, an association of more than 40 African countries, is a unique entity that has a special arrangement with INTELSAT for the use one of INTELSAT's satellites for intra-African telecommunications. Of the remaining 50 countries, 22 permit direct access for one or *no* entities other than RASCUM. In several cases, the one other entity is the broadcasting arm of the government. For example, in Spain, the direct access user is Retevision, and in Namibia it is the Namibian Broadcasting Corporation.

conflicts with the U.S. goals for privatizing INTELSAT and thereby eliminating the Signatory role.

Current facts indicate that *only four* countries provide blanket direct access permitting the same level of access to each company in its country or territory, *i.e.*, direct access on a nondiscriminatory basis. The development of competition in those nations—Austria, France, the United Kingdom, and Finland (that latter of which is not listed in the *Notice*)—is completely distinct from that of the United States. Unlike the U.S., each of these four countries permits end-user service provision to be vertically integrated with INTELSAT space segment ownership. The Signatory in each case continues to serve as a principal, if not the dominant, provider of local and/or long-distance telephone service:

- The 1997 market shares of Finland's Signatory, Sonera Ltd. (formerly Telecom Finland), for various service markets ranged from about 32% of the local exchange market to almost 75% of the mobile communications market, with long distance and international market shares falling between the two extremes.²¹³
- The French Signatory, France Telecom, has faced full competition in the provision of telecommunications services only since the beginning of 1998, and it remains one of the world's leading providers of telecommunications services, with 33.7 million telephone lines in service and operations in over 50 countries.²¹⁴

²¹³ Sonera had a 41.6 percent share of the long distance market and a 65.9 percent share of the international telecommunications market in Finland in 1997. Espicom Business Intelligence, Communications Companies Analysis 1998. The ownership of the Finnish government in Sonera Group, Plc, the parent company of Sonera Ltd. is 77.8 percent. Sonera Group Plc, Press Release, Nov. 11, 1998 (<http://www.sonera.com>.)

²¹⁴ France Telecom home page, <http://www.francetelecom.com>.

- Post & Telekom Austria (“PTA”) has been a stock corporation only since May 1996; its telecommunications division had a 98% share of its market in 1997.²¹⁵
- The INTELSAT Signatory in the United Kingdom, British Telecommunications (“BT”), is a multi-billion dollar dominant of the facilities-based carrier. Originally an arm of the government’s post office, BT underwent the first phase of its privatization in the mid-1980s but retained a duopoly position in the provision of international communications until 1996. BT continues to enjoy a dominant position in Britain; as of September 1997, it maintained a 87% share of the local exchange market, a 77% share of the long distance market, and a 52% shares of the market for outgoing international calls.²¹⁶

COMSAT’s interest in providing INTELSAT access is much different than the interest of these carriers for two reasons. First, unlike COMSAT, these four Signatories earn substantial revenue through the provision of end-user telecommunications services. None depends on the wholesale provision of INTELSAT access to other carriers as their primary source of income; their vertical integration ensures that, despite the implementation of direct access within their domestic markets, these Signatories have reason and opportunity to make significant use of INTELSAT capacity to fulfill their own “downstream” traffic requirements.

Second, each of these countries has a relatively small investment stake in INTELSAT. In stark contrast, COMSAT’s ownership stake in INTELSAT is 18%, BT as INTELSAT’s next largest investor has only a 5.7% interest.

Third, these Signatories’ position as leading retail-level telecommunications service providers casts exclusive access to INTELSAT capacity in a different light. For foreign

²¹⁵ PTA home page, <http://www.pta.at/en/ag/index.html>

²¹⁶ BT Annual Report and Accounts 1998.

policymakers seeking to introduce facilities-based competition and move toward free-market systems in their telecommunications sectors, direct access is one answer. But direct access overseas represents a solution to a problem that has never existed in the United States: the existence of a PTT/dominant carrier bottleneck for accessing INTELSAT capacity. As shown above and in the attached statutory analysis, Congress created COMSAT as an independent supplier of INTELSAT space segment precisely to avoid putting control of the first satellite system into the hands of a vertically-integrated entity primarily interested in protecting its market position. Instead, U.S. lawmakers guaranteed access to the system for all users by requiring COMSAT to offer its compacity on a non-discriminatory basis, and the corporation continues to successfully fulfill that obligation.²¹⁷

V. IF LEVEL 3 DIRECT ACCESS WERE IMPLEMENTED, A SUBSTANTIAL SURCHARGE WOULD BE NECESSARY TO ENSURE THAT COMSAT IS COMPENSATED AS REQUIRED BY LAW

If Level 3 direct access were implemented, “a surcharge for direct access over and above the IUCs would be necessary to give COMSAT a fair chance to recover all direct-access

²¹⁷ The Commission also correctly notes that COMSAT subsidiaries in Argentina and Britain are permitted direct access to INTELSAT. *Notice* ¶ 10. Unlike other countries in which the Signatory is a telecommunications service provider, the Signatory in Argentina is the Comision Nacional de Telecomunicaciones, Argentina’s telecommunications regulatory authority. Because the Signatory is not a service provider, there is no other way in Argentina to obtain space segment capacity to INTELSAT except through direct access.

In the United Kingdom, INTELSAT has been given blanket authorization to allow all entities operating under a license in the U.K. direct access to INTELSAT. COMSAT’s access is routine procedure in Britain, where direct access has been permitted since 1994. As noted in the text, the factual setting in which the United Kingdom’s direct access policy developed does not exist in the United States.

related costs, including investment costs.”²¹⁸ If such a surcharge were not adopted, the U.S. government would be liable for damages to COMSAT.²¹⁹ The mere act of setting that surcharge, however, would be a complex endeavor that would itself undermine the alleged benefits of direct access. Moreover, the surcharges would need to be revisited periodically to ensure their continued reasonableness. This would require the type of complex rate regulation that the Commission recently determined was unnecessary in the *Non-Dominance Order*. Given that this regime would remain in place only until privatization, implementing Level 3 direct access—with all of its attendant regulatory procedures—would be an unwise as well as unwarranted allocation of agency resources.

COMSAT has *not* attempted to replicate the complicated analysis that would be legally required in order to ensure that a direct access surcharge regime was fully compensatory. However, based on some initial calculations, COMSAT has determined that the appropriate surcharge could range, on average, from a low of 28.67% (based on outdated rate-of-return regulatory policies) to as much as 45.88% (based on a comparison to price cap carriers) of the applicable IUC. The results of COMSAT’s analysis are set forth below and in the attachment to these comments prepared by COMSAT’s Director of Financial Planning and Analysis.

That attachment shows that, if Level 3 direct access had been in effect in 1997, a surcharge of about 18.2% of INTELSAT’s operating revenues would have been necessary

²¹⁸ Brattle Analysis at 35.

²¹⁹ Of course, for the reasons discussed above, the FCC lacks the authority to mandate direct access at all. The point is that, even if the FCC had such authority – and indeed even if Congress were to amend the Satellite Act to permit direct access – the Constitution would require full compensation for COMSAT.

merely to bring COMSAT's return on its INTELSAT investment to the 12.48% after-tax level then allowed by the Commission under rate-base, rate of return regulation. Moreover, a second surcharge of approximately 10.4% would have been necessary to cover COMSAT's estimated costs attributable to performing its statutorily-required functions as U.S. Signatory.

Because COMSAT is no longer subject to rate-base, rate of return regulation for the vast majority of its traffic, COMSAT is no longer restricted to a 12.48% after-tax return. Accordingly, the attachment also shows what a compensatory surcharge could be using, as a proxy for COMSAT's actual competitive return, the weighted average return for price-cap regulated carriers. This analysis demonstrates that the appropriate average surcharge could in fact be in the neighborhood of 46% of the applicable IUC. However, perhaps still another more appropriate comparison would be to non-rate regulated carriers, since price-cap carriers (unlike COMSAT) are dominant. In any event, it would not be appropriate to rely on such proxies as a substitute for full-blown analyses of COMSAT's actual damages in 1999 and all subsequent years under a direct access regime.

As a matter of takings jurisprudence, it is clear that COMSAT must be able to recover the full costs of its activity. This would include direct expenditures, the time cost of money expended for capital investment, and any opportunity costs—*i.e.*, the net benefit forgone from the best alternative activity. Thus, in pressing a takings claim or a claim for breach of contract, COMSAT's measure of damages would be for its lost expectation. That expectation consisted of the reasonable opportunity to earn recovery of its investment in INTELSAT. It also includes a competitive, risk-adjusted return on that capital, less any costs that COMSAT would avoid by virtue of no longer making retail sales of space segment on the INTELSAT system.

Courts have recognized that opportunity cost is the proper economic definition of cost. “[A]gencies that regulate utility rates have recognized ‘opportunity costs’ as a factor to be considered in setting rates designed to cover the actual costs incurred to provide a particular service.”²²⁰ Acting on that view, the D.C. Circuit rejected “the view that an opportunity cost is not an ‘actual cost,’ in law or economics, because it does not appear as a cash expenditure in the account books of the [regulated firm].”²²¹ In fact, the FCC has also embraced the idea that a price for mandatory access to a facility should include opportunity cost.²²² Thus, if the Commission were to mandate Level 3 direct access without establishing an adequate surcharge, COMSAT would have a valid claim against the United States for reimbursement of both its historic and opportunity costs.

²²⁰ *City of Los Angeles*, 103 F.3d 1027, 1032 (D.C. Cir. 1997).

²²¹ *City of Los Angeles, Dep’t of Airports v. U.S. Dep’t of Transportation*, 103 F.3d 1027, 1032 (D.C. Cir. 1997) (citing *Pennsylvania Electric Co.*, 60 F.E.R.C. ¶ 61, 034, 61, 120 & n. 1(1992), aff’d sub nom. *Pennsylvania Elec. Co. v. FERC*, 11 F.3d 207 (D.C. Cir. 1993); William Baumol & J. Gregory Sidak, *Transmission Pricing and Stranded Costs in the Electric Power Industry* 139 et seq. (AEI Press 1995)).

²²² *See, e.g., Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation Leased Commercial Access*, 11 F.C.C. Rcd. 16,958-59 (1996) (“We generally agree with Time Warner that the value of leased access channels ‘is the opportunity cost imposed on the operator from the lost chance to program these channels.’”) (quoting Time Warner Comments); *see also Implementation of Section 302 of the Telecommunications Act of 1996; Open Video Systems*, 11 F.C.C. Rcd. 18,223 (1996).

VI. CONCLUSION

For the foregoing reasons, COMSAT Corporation respectfully urges the Commission to reject, once again, implementation of Level 3 direct access to INTELSAT in the United States.

Respectfully submitted,

COMSAT Corporation

By:  (Red)

Warren Y. Zeger
Howard D. Polsky
Keith H. Fagan
Bruce A. Henoch

Richard E. Wiley
Lawrence W. Secrest, III
William B. Baker
Rosemary C. Harold

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202)429-7000

COMSAT CORPORATION
6560 Rock Spring Drive
Bethesda, Maryland 20817
(301) 214-3000