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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	IB Docket No. 96-261
International Settlement Rates	)	

REPORT AND ORDER ON RECONSIDERATION AND ORDER LIFTING STAY

Adopted: May 28, 1999 **Released: June 11, 1999**

By the Commission:

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I. INTRODUCTION

1. In this *Report and Order on Reconsideration*, we deny the petitions for reconsideration of the *Benchmarks Order*[1] filed by AT&T Corp. and a coalition of private and public sector Philippines parties, and grant in part the petition for clarification or reconsideration filed by MCI Telecommunications Corp. (MCI).

2. Specifically, we affirm the Commission's previous finding that it possesses authority to regulate international settlement payments by U.S. carriers for the termination of traffic originating in the United States. We also affirm the Commission's decision to require compliance with the benchmark settlement rates, rather than "best practice rates," as a condition in certain Section 214 authorizations. In addition, we affirm the Commission's decision to use a proxy for variable costs for purposes of applying a bright line test to detect anticompetitive behavior. However, on reconsideration we conclude that the condition for facilities-based service to affiliated markets should apply only to U.S. affiliates of carriers that have market power in the destination market.

II. BACKGROUND

3. In the *Benchmarks Order*, the Commission established benchmarks that govern the international settlement rates that U.S. carriers may pay foreign carriers to terminate international traffic originating in the United States.[2] The Commission concluded that the benchmark rates are necessary because, under the current international accounting rate system, the settlement rates U.S. carriers pay foreign carriers to terminate U.S.-originated traffic are in most cases substantially above the costs foreign carriers incur to terminate that traffic.

4. Above-cost settlement rates raise two concerns which the Commission sought to address in its *Benchmarks Order*. First, above-cost settlement rates contribute to the inflated prices paid by U.S. consumers for international services. As accounting rates are reduced, the cost to U.S. carriers of providing international service will decrease. U.S. consumers should see the benefits of such cost reductions in the form of lower prices for international service. The second concern is that the above-cost margins in settlement rates can be used to finance strategies that create competitive distortions in the market for U.S.

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1 *International Settlement Rates*, IB Docket No. 96-261, *Report and Order*, 12 FCC Rcd 19,806 (1997), *aff'd sub. nom.*, Cable & Wireless et al. v. FCC, No. 97-1612 (D.C. Cir., Jan. 12, 1999) (*Benchmarks Order*).

2 An accounting rate is the price a U.S. facilities-based carrier negotiates with a foreign carrier for handling one minute of international telephone service. Each carrier's portion of the accounting rate is referred to as the settlement rate. In almost all cases, the settlement rate is equal to one-half of the negotiated accounting rate.

international services. The potential for competitive distortions is a pressing concern as the United States implements the commitments it made in the World Trade Organization (WTO) Basic Telecom Agreement reached on February 15, 1997. These commitments, and the Commission's rules implementing them, make it much easier for foreign carriers to enter and invest in all U.S. markets for basic telecommunications services, and therefore it is critical that the Commission adopt safeguards against anticompetitive behavior.[3]

5. The Commission calculated the benchmark rates using foreign carriers' publicly available tariff rates and information published by the International Telecommunication Union (ITU). The Commission developed a methodology for calculating the benchmarks called the "tariffed component price" (TCP) methodology.[4] It grouped countries by their level of economic development, using a World Bank and ITU classification scheme, and calculated benchmarks using the TCP methodology for each category. The benchmarks are: 15¢ for upper income countries; 19¢ for upper-middle and lower-middle income countries; and 23¢ for lower income countries.

6. The Commission established a transition schedule for U.S. carriers to negotiate settlement rates that comply with the benchmarks. The transition schedule is also based on level of economic development, with an additional category for countries with very low levels of telecommunications network development. Under the transition schedule, U.S. carriers are required to negotiate settlement rates that comply with the benchmarks according to the following schedule: one year from implementation of the *Benchmarks Order*[5] for carriers in upper income countries; two years for carriers in upper-middle income countries; three years for carriers in lower-middle income countries; four years for carriers in lower income

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3 *See, e.g., Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, Market Entry and Regulation of Foreign-Affiliated Entities*, IB Docket Nos. 97-142 and 95-22, *Report and Order and Order on Reconsideration*, 12 FCC Rcd 23,891 (1997) *recon. pending*, (*Foreign Participation Order*).

4 The Commission's benchmark methodology is based on a framework adopted by the ITU that identifies the three components of the international telecommunications network that are necessary to provide international telephone service: international transmission facilities, international switching facilities, and national extension (domestic transport and termination). The Commission developed the benchmarks using foreign carriers' tariffed prices to calculate, on a country-by-country basis, a price for the international transmission and national extension network components and using ITU information to calculate a price for the international switching component. The Commission aggregated the prices for each of the three network components to calculate a "tariffed components price" (TCP) for each country. The Commission established three benchmark rates by grouping countries by their level of economic development and averaging the TCPs for the countries in each category. *See Benchmarks Order* at ¶¶ 100-111.

5 The implementation date of the *Benchmarks Order* was January 1, 1998.

countries; and five years for carriers in countries with teledensity (lines per 100 inhabitants) less than one.

7. To address the Commission's concern about potential distortions in the U.S. market created by above-cost settlement rates, the Commission adopted conditions for certain types of Section 214 authorizations. First, it adopted a condition that applies to authorizations to provide international facilities-based switched or private line service from the United States to an affiliated market. Such authorizations will be conditioned on the U.S. carrier's foreign affiliate offering U.S.-licensed international carriers a settlement rate at or below the relevant benchmark. If, after the carrier has commenced service to the affiliated market, the Commission learns that the carrier's service offering has led to distortions in market performance, the Commission will take enforcement action. That enforcement action may include a requirement that the rates of the U.S.-licensed carrier's foreign affiliate be reduced to a "best practice rate" of 8 cents or a revocation of the carrier's authorization to provide service.

8. Second, the Commission adopted a condition that applies to all authorizations to provide switched services over facilities-based or resold international private lines, also known as international simple resale (ISR). Such authorizations will be subject to the condition that at least half of the settled traffic on the route in question is being settled at rates that are at or below the relevant benchmark. Again, if the Commission learns that competition on a route has been distorted by activities of the authorized carrier, the Commission will take enforcement action. That enforcement action may include a requirement that carriers be prohibited from using their authorizations to provide switched services over private lines on a given route until settlement rates for at least half of the traffic on that route are at or below a "best practice" rate of 8 cents. It could also include a revocation of carriers' authorizations.

III. DISCUSSION

9. The Philippines Parties,[6] AT&T and MCI filed petitions requesting reconsideration or clarification of various aspects of our *Benchmarks Order*. The Philippines Parties' Petition for Reconsideration requests the Commission to reconsider its benchmarks policy. The Philippines Parties contend that our benchmarks contravene domestic and international law and will make accounting rate reform more difficult, not easier.[7] AT&T's Petition for Partial Reconsideration and MCI's Petition for Clarification or Reconsideration

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[6] The Philippines parties are the National Telecommunications Commission of the Republic of the Philippines, Philippines Long Distance Telephone Company, and Capitol Wireless, Inc.

[7] Petition for Reconsideration of the Philippines Parties (Philippines Petition), filed Sept. 29, 1997.

address solely the Section 214 authorization conditions. AT&T requests that the Commission condition Section 214 authorizations on compliance with a "best practice rate" instead of the benchmark rates. AT&T further requests that the Commission revise its test for determining whether market distortion has occurred in the facilities-based market.[8] MCI requests that the Commission apply its facilities-based authorization condition solely to carriers that are providing service on a route where they have an affiliate with market power or where traffic between the U.S. carrier and its affiliate is greater than 25% of the overall traffic on the route.[9] We address each of the requests below.

A. The Benchmarks Are Consistent With Domestic and International Law.

10. The Commission concluded in the *Benchmarks Order* that it has jurisdiction to adopt settlement rate benchmarks under the Communications Act and relevant case law. The Commission determined that above-cost settlement rates paid by U.S. carriers to terminate international traffic are neither just nor reasonable, and it acted pursuant to its statutory authority in Section 201(b) of the Communications Act to prohibit U.S. carriers from continuing to pay such charges.[10] The Commission also concluded in the *Benchmarks Order* that its benchmarks are consistent with international obligations of the United States.

11. The Philippines Parties request the Commission to reconsider its conclusions that the Commission has jurisdiction to adopt the settlement rate benchmarks. They contend that the benchmarks policy is tantamount to an assertion of jurisdiction over foreign carriers by the Commission. They argue that such an assertion of authority is not contemplated by the Communications Act and violates international law. AT&T[11] and MCI[12] oppose the Philippines Parties Petition, arguing that the Commission's benchmarks are consistent with domestic and international law. We address each of the Philippines Parties' arguments below.

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8 AT&T Petition for Partial Reconsideration (AT&T Petition), filed Sept. 29, 1997.

9 MCI Telecommunications Corp. Petition for Clarification or Reconsideration (MCI Petition), filed Sept. 29, 1997. In its Petition, MCI requests this modification of the condition for facilities-based service to affiliated markets only for carriers that were already authorized to provide service on the implementation date of the *Benchmarks Order*. In its Reply, MCI states that this modification should apply to both existing and future authorizations. Reply of MCI Telecommunications Corp. (MCI Reply), filed Nov. 6, 1997, at 3.

10 47 U.S.C. § 201(b) provides that "[a]ll charges [and] practices . . . *shall* be just and reasonable" (emphasis added).

11 AT&T Opposition to Petitions for Reconsideration, filed Oct. 24, 1997.

12 Opposition of MCI Telecommunications Corp. to the Philippines Parties' Petition for Reconsideration, filed Oct. 24, 1997.

1. The Benchmarks Order Applies to U.S. Carriers Only.

12. The Philippines Parties argue first that the benchmarks policy exceeds the Commission's statutory authority and violates the sovereignty of the Philippines by asserting jurisdiction over foreign carriers.[13] They contend that, by requiring U.S. carriers to comply with the benchmarks, the Commission is "vest[ing] itself with authority over how Philippines carriers allocate joint and common costs as well as support universal service in their nation."[14]

13. In its order affirming the Commission's *Benchmarks Order*, the D.C. Circuit rejected the argument that the benchmarks policy unlawfully asserts regulatory authority over foreign telecommunications services and foreign carriers. The court noted that "the Commission does not exceed its authority simply because a regulatory action has extraterritorial consequences."[15] The court thus found that the *Benchmarks Order* "does not regulate foreign carriers or foreign telecommunications services and therefore does not violate the Communications Act."[16]

14. The Philippines Parties also argue that the *Benchmarks Order* will interfere unlawfully with and have negative consequences for the Philippines national telecommunications policy of universal service. In essence, the Philippines Parties argue that the Philippines and other developing countries have an entitlement to subsidies paid by U.S. consumers and that the *Benchmarks Order* interferes with that right. Foreign governments are free to choose their own policies, but international law does not require U.S. consumers to subsidize those policies. Moreover, the Commission did not ignore the fact that it may be difficult for some developing countries to transition to a more cost-based system of settlement rates without undue disruption to their telecommunications networks. To provide time for carriers to make the adjustments necessary to transition to a more cost-based system, the Commission adopted a transition schedule for U.S. carriers to negotiate settlement rates that comply with the benchmarks.[17]

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13 Philippines Petition at 6-9.

14 *Id.* at 8.

15 Cable & Wireless et al. v. FCC, No. 97-1612, slip op. at 10 (D.C. Cir., Jan. 12, 1999) (*Cable and Wireless*).

16 *Id.*

17 *Benchmarks Order* at ¶ 165.

2. The Commission Has Authority Under Section 201 of the Communications Act to Require U.S. Carriers to Comply With the Settlement Rate Benchmarks.

15. The Philippines Parties argue that the language of Section 201(b) only grants the Commission authority to regulate the rates charged to customers, not to regulate what carriers may pay to unaffiliated entities for components of communications services.[18] They contend that no precedent supports Commission authority over international settlement payments made by U.S. carriers and that to permit such authority would logically permit the Commission to extend its jurisdiction to any practices of foreign carriers.

16. The D.C. Circuit rejected similar arguments raised in *Cable and Wireless* and found that "at least three provisions of the Communications Act authorize the [Commission] to regulate the settlement rates that U.S. carriers pay to foreign carriers," including Sections 201, 205(a), and 211(a).[19] Specifically, the court found that the reference in Section 201 to "all charges, practices, classifications, and regulations for and in connection with" interstate and foreign communications, encompasses the negotiation and payment of settlement rates by U.S. carriers.[20] The court also found that the Commission lawfully exercised its authority under Section 205(a) to declare that it would be an unjust and unreasonable practice for a U.S. carrier to pay settlement rates above the relevant benchmark rate.[21]

3. The *Benchmarks Order* Satisfies Section 205's Procedural Requirements.

17. The Philippines Parties further argue that the Commission violated procedural safeguards in its adoption of benchmark settlement rates. They assert that the Commission violated Section 205 of the Communications Act, first by acting without receiving a complaint or issuing an order of investigation, and then by engaging in rulemaking through a public notice and comment proceeding rather than a full agency hearing as defined in Section 556 of the Administrative Procedures Act (APA).[22]

18. The Philippines Parties' procedural arguments are without basis. Section 205 requires that a rate prescription take place "after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission on its

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18 *See* Philippines Petition at 10.

19 *Cable and Wireless*, slip op. at 12-13.

20 *Id.* at 12.

21 *Id.* at 13.

22 5 U.S.C. § 556. Philippines Petition at 14-15.

own initiative."[23] As the Commission noted in the *Benchmarks Order*, the Supreme Court has held that such language does not trigger the detailed oral hearing requirements of Sections 556 and 557 of the APA. Instead, the Court held that the notice and comment provisions of Section 553 of the APA satisfy a general hearing requirement such as that contained in Section 205.[24] The Philippines Parties further argue that the *Benchmarks Order* is procedurally flawed because Section 205 requires that, as a precondition for convening a hearing, the Commission receive a complaint or issue an order of investigation on its own initiative.[25] This requirement, however, was satisfied by our *Notice of Proposed Rulemaking* in this proceeding which gave all interested parties ample opportunity to present their views.[26]

4. The *Benchmarks Order* Comports with Due Process Requirements.

19. The Philippines Parties further assert that the rules articulated in the *Benchmarks Order* violate the Due Process Clause of the Fifth Amendment. They cite the fact that the complaint procedure established in the *Benchmarks Order* permits foreign carriers to file comments, but not to become a party, in proceedings that could reduce their settlement revenues. The Philippines Parties contend that this procedure is flawed because if foreign carriers were found "to be engaged in an activity regulatable by U.S. law," they would "be entitled to procedural and substantive due process."[27]

20. We disagree that the complaint procedure denies foreign carriers due process. As the Philippines Parties recognize, foreign carriers may file comments or an opposition to a U.S. carrier's petition requesting the Commission to take enforcement measures under the enforcement procedures the Commission adopted in the *Benchmarks Order*.[28] The complaint procedures thus satisfy whatever process rights a foreign correspondent may have by affording them an opportunity to participate in the proceedings.

21. The Philippines Parties also argue that the benchmark rates are not sufficiently clear to place carriers on notice as to what rates are unlawful. They state that it is unclear,

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23 47 U.S.C. § 205.

24 *U.S. v. Florida East Coast Railway*, 410 U.S. 224, 227 (1973); *see also United States v. Allegheny-Ludlum Steel*, 406 U.S. 742 (1972).

25 *See* Philippines Petition at 15.

26 *See International Settlement Rates*, IB Docket No. 96-261, *Notice of Proposed Rulemaking*, FCC No. 96-484 (rel. December 19, 1996).

27 Philippines Petition at 15.

28 *Benchmarks Order* at ¶ 186.

for example, whether the benchmark rates apply to peak traffic rates or to average rates.[29] We believe the settlement rates are sufficiently clear to provide notice to U.S. carriers. The Commission adopted a single benchmark rate for each category of countries because, in most cases, U.S. carriers negotiate a single settlement rate with each foreign correspondent. Thus, in almost all cases, there will be no question as to how the benchmark rates apply. If a U.S. carrier desires to negotiate a more complicated settlement rate structure involving, for example, different rates for peak and off-peak traffic or volume discounts, it may seek guidance from the Commission as to how to apply the benchmark rates.

5. The Benchmarks Order Comports With International Obligations and Does Not Violate the Principle of Comity.

22. The Philippines Parties also contend that the Commission's benchmarks policy violates the provision in the ITU's International Telecommunication Regulations (ITR) that requires accounting rates to be negotiated "pursuant to mutual agreement" and "by mutual consent."[30] The D.C. Circuit rejected this argument in *Cable and Wireless*. The court noted that the Preamble to the ITR explicitly recognizes "the sovereign right of each country to regulate its telecommunications."[31] The court also noted that Article 1.7 (a) of the ITR provides that the ITR "recognize the right of any member to require that administrations and private operating agencies, which operate in its territory and provide an international telecommunication service to the public, be authorized by that member."[32] The court agreed with the Commission that the right to authorize a carrier to provide service necessarily includes the right to attach reasonable conditions to the authorization to safeguard the public interest.[33]

23. The Philippines Parties concede that the ITR do not require the United States to cede sovereignty over its own carriers, but argue that the ITR "likewise does not grant the United States hegemony over other nations' carriers, as the reach of the [*Benchmarks*] *Order*

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29 Philippines Petition at 15-16.

30 The Philippines Parties cite ITR, § 1.5 ("Within the framework of the present regulations, the provision and operation of international telecommunication services is pursuant to mutual agreement between administrations"); and § 6.2.1 ("For each applicable service in a given relation, administrations (or recognized private operating agencies) shall by mutual agreement establish and revise accounting rates to be applied between them . . . taking into account relevant CCITT [currently ITU-T] recommendations and relevant cost trends").

31 ITR, Preamble.

32 ITR, Article 1.7(a).

33 *Cable and Wireless*, slip op. at 11.

attempts to do."[34] The Commission does not, through its benchmarks, attempt to assert hegemony over foreign carriers. As the Commission has stated, the benchmarks are a constraint on U.S. carriers only.

24. The Philippines Parties further assert that the benchmarks violate the international law principle of comity between nations because they are "equivalent to dictating what foreign carriers may charge for terminating international traffic in their own countries."[35] We believe that the Philippines Parties interpret the principle of comity too broadly. The Commission adopted the benchmarks pursuant to its authority to enact regulations that ensure U.S. consumers pay charges for international service that are just and reasonable. The benchmarks, as with all regulations that affect international commerce, will by necessity have an indirect effect on foreign entities. If this type of indirect effect were considered to run afoul of the principle of international comity, no nation would be able to adopt regulations that apply to international commerce.

B. Section 214 Authorization Conditions

25. The Commission adopted two authorization conditions in the *Benchmarks Order*, one that applies to authorizations to provide facilities-based service to affiliated markets and one that applies to all authorizations to provide switched services over facilities-based or resold international private lines. These two authorization conditions are intended to address different competitive concerns.

26. The condition for facilities-based service to affiliated markets addresses the potential for a carrier to engage in a predatory price squeeze, *i.e.*, to price below the level of its imputed costs when providing service from the United States to a foreign market where it has an affiliate.[36] A price squeeze is a predatory tactic by which a U.S. affiliate of a foreign carrier would set its prices so close to the international settlement rates charged by the foreign carrier that the other carriers in the U.S. market could not match the prices without losing money, even if they are more efficient than the U.S. affiliate. Such a strategy would be made possible by the fact that the foreign carrier controls an essential input for providing service in the U.S. international message telephone service (IMTS) market, and the price charged for that input -- the international settlement rate -- is substantially above the economic cost of providing the service. Although the U.S. affiliate may pay the same settlement rate paid by its competitors, it would take into account the actual economic cost incurred by the foreign

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[34] Philippines Petition at 18.

[35] *Id.* at 20-21.

[36] For a more detailed discussion of the ability of a foreign-affiliated facilities based carrier to execute a predatory price squeeze, *see Benchmarks Order* ¶¶ 195-231.

carrier rather than the above-cost rates when setting its IMTS prices. In the *Benchmarks Order*, the Commission found that a U.S.-licensed carrier has both the ability and incentive to engage in a price squeeze when it provides facilities-based service to a market in which its affiliated foreign carrier provides the terminating service and collects above-cost settlement rates.

27. Our facilities-based condition addresses our concern about price squeeze behavior by requiring that a carrier's settlement rates be at or below the relevant benchmark before its U.S.-licensed affiliate may provide facilities-based service on the affiliated route.[37] This condition substantially reduces the above-cost settlement rates that could be used to execute a price squeeze on affiliated routes. However, the Commission recognized in the *Benchmarks Order* that the facilities-based condition does not completely eliminate the incentives or the ability of a carrier to execute a price squeeze because the settlement rate benchmarks are still above-cost. The Commission therefore decided that it will take enforcement action if, after the U.S.-licensed carrier has commenced service to the affiliated market, the Commission discovers that the carrier has attempted to execute a predatory price squeeze or engaged in other anticompetitive behavior that distorts market performance. That action may include a requirement that the foreign affiliate reduce its settlement rate for the route to a level at or below the best practices rate the Commission adopted in the *Benchmarks Order*, 8 cents,[38] or a revocation of the U.S.-licensed carrier's authorization to serve the affiliated market. The Commission adopted a rebuttable presumption that a carrier has distorted market performance if any of the carrier's tariffed collection rates on the affiliated route are less than the carrier's average variable costs on that route. For purposes of this presumption, the Commission adopted a proxy for average variable costs that is equal to the carrier's net settlement rate plus any originating access charges.

28. The Commission decided in the *Benchmarks Order* to apply the facilities-based condition to existing Section 214 authorization holders that serve affiliated markets (*i.e.*, those that were authorized to provide service prior to the January 1, 1998 effective date of the *Benchmarks Order*). The Commission required that existing authorization holders comply with the condition by having their foreign affiliates negotiate with U.S. international carriers a settlement rate for affiliated routes that complies with the appropriate benchmark and is in effect within ninety days of the January 1, 1998 effective date. MCI's petition in this proceeding requested reconsideration of this decision. As the ninety day deadline for

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[37] The Commission's rules provide, *inter alia*, that a U.S. carrier is considered to be affiliated with a foreign carrier when a foreign carrier owns a greater than twenty-five percent interest in, or controls, the U.S. carrier. *See* 47 C.F.R. § 63.18(h)(1)(i).

[38] This 8 cent rate is the lowest commercially viable settlement rate that existed between the United States and a foreign country at the time the Commission issued the *Benchmarks Order*. It is the rate that existed between the United States and Sweden at that time. *Benchmarks Order* at ¶ 134.

complying with the condition approached, the Commission was still considering MCI's petition. The Commission, therefore, issued a temporary stay of the effectiveness of the condition for facilities-based service to affiliated markets as it applies to existing Section 214 authorization holders in a March 30, 1998 *Stay Order* pending our action on MCI's petition.[39]

29. The condition for provision of switched services over private lines, also known as ISR, addresses the potential for "one-way bypass" of the settlements system to occur. One-way bypass could occur if a foreign carrier can send international calls to the United States over less expensive private lines and avoid paying settlement rates, and, at the same time, receive international calls from the United States that are subject to the accounting rate system. U.S. carriers would thus continue to make above-cost settlement payments to the foreign carrier. One-way bypass could seriously exacerbate the U.S. settlements outpayment, which would ultimately be reflected in higher consumer rates for international service as U.S. carriers pass the increased costs through to their customers.

30. To address the concern about one-way bypass, the Commission adopted an authorization condition that requires that at least 50 percent of the traffic on a route be settled at rates at or below the appropriate benchmark level before carriers may provide switched services over private lines. The Commission reasoned that, if settlement rates are closer to cost, the impact of one-way bypass on the level of U.S. settlement payments will be diminished. As with our condition for facilities-based service to affiliated markets, the Commission recognized that our condition for provision of switched services over private lines does not completely eliminate the potential for one-way bypass to occur. The Commission, therefore, decided that it will take enforcement action if the Commission learns that one-way bypass has occurred. That enforcement action may include a requirement that carriers be prohibited from using their authorizations to provide switched services over private lines on a given route until settlement rates for at least half of the traffic on that route are at or below the best practice rate of 8 cents. It could also include a revocation of carriers' authorizations. The Commission adopted a test for determining when one-way bypass has occurred. Pursuant to that test, the Commission will presume that one-way bypass has occurred if the ratio of outbound to inbound settled traffic increases more than 10 percent in two successive quarterly traffic measurement periods.

1. <u>The Section 214 Authorization Conditions Are Sufficient to Prevent Anticompetitive Conduct.</u>

31. AT&T argues that the Commission's Section 214 authorization conditions are not sufficient to prevent anticompetitive behavior in the U.S. market for IMTS. It urges the Commission to modify the conditions to require compliance with the best practice rate, rather

[39] *International Settlement Rates*, IB Docket No. 96-261, *Order*, FCC 98-49 (rel. March 30, 1998) (*Stay Order*).

than the benchmark rates.[40] AT&T asserts that this modification is necessary because our benchmarks are above-cost and thus do not entirely eliminate the ability and incentive of carriers to engage in price squeeze behavior and one-way bypass.

32. GTE Service Corporation (GTE), Sprint Communications Company L.P. (Sprint) and Telefónica Internacional de España, S.A. (Telefónica) all oppose this proposal. Telefónica argues that AT&T's proposal is not necessary, and indeed, no condition is necessary, to prevent price squeeze behavior. Telefónica contends that there are sufficient legal and economic deterrents to prevent price squeeze behavior and that the conditions proposed by AT&T would limit entry and be contrary to the GATS commitments made by the United States.[41] Sprint, GTE and the Philippines Parties also argue that AT&T's proposed conditions would limit entry.[42] Sprint further objects to AT&T's proposed conditions on the ground that there is no evidence the best practice rate reflects costs for all carriers.[43]

33. We decline to modify the benchmark conditions to require compliance with the best practice rate rather than the benchmark rates, as AT&T requests. As AT&T correctly states, the settlement rate benchmarks are above-cost. As a result, the Commission's requirement that rates be at or below the benchmarks as a condition of providing service does not completely eliminate the ability of carriers to engage in anticompetitive behavior that may arise as a result of the above-cost accounting rates. However, we believe that the combination of this requirement and the tests to detect one-way bypass and price squeeze behavior is sufficient to prevent anticompetitive distortions in the U.S. market. The requirement that rates be at or below the benchmarks substantially reduces the ability to engage in anticompetitive behavior and the tests to detect one-way bypass and price squeeze behavior provide an administratively efficient means to detect anticompetitive behavior, should it occur. In addition, the tests to detect anticompetitive behavior provide a strong deterrent because they enable the Commission to take quick action to address price squeeze behavior and one-way bypass.

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40 AT&T Petition for Partial Reconsideration (AT&T Petition) at 3.

41 Opposition of Telefónica Internacional de España, S.A. to AT&T Petition for Reconsideration, filed Oct. 24, 1997, (Telefónica Opposition) at 2-12. Telefónica, however, does not seek reconsideration of our Section 214 authorization conditions. For the Commission's response to Telefónica's criticisms of the authorization conditions, *see Benchmarks Order* at ¶¶ 207-231; ¶¶ 264-267.

42 Sprint Communications Co. L.P. Opposition to AT&T's Petition for Reconsideration (Sprint Opposition), filed Oct. 24, 1997, at 4-5; Opposition of GTE to AT&T's Petition for Reconsideration, filed Oct. 24, 1997, at 3-4, Philippines Opposition, filed Oct. 24, 1997, at 5.

43 Sprint Opposition at 4-5.

34. We believe that the benchmark conditions effectively balance our desire to prevent competitive distortions in the U.S. market for IMTS with our desire to encourage competitive entry and put downward pressure on accounting rates. The authorization conditions proposed by AT&T could unnecessarily deter many carriers from providing facilities-based service from the United States and could unduly limit the number of routes on which carriers could provide switched services over private lines, to the detriment of U.S. consumers. Given that the Commission's tests to detect price squeeze behavior and one-way bypass enable us to take immediate action in response to anticompetitive behavior, we believe AT&T's proposed authorization conditions are not necessary to prevent competitive distortions in the U.S. market.

2. The Test for Detecting Price Squeeze Behavior is Reasonable.

35. AT&T also requests that we modify the test the Commission adopted for purposes of detecting whether price squeeze behavior or other market distortion has occurred. AT&T contends that our proxy for average variable costs would understate a carrier's actual variable costs and therefore "allow prices to be reduced far below the costs that should be considered for this purpose."[44] AT&T further contends that our proxy for average variable costs is at odds with Commission precedent and antitrust jurisprudence. AT&T urges that the Commission adopt a specific definition of average variable costs that includes "all variable or incremental costs that would not be incurred if the service were not offered."[45]

36. We decline to revise the proxy for average variable costs for purposes of the Commission's test to detect price squeeze behavior. We believe that the more complex test AT&T urges us to adopt is not necessary for purposes of the test. The Commission's intent was to adopt a "bright line" test with a proxy for average variable costs that would allow either the Commission or other interested parties to identify readily whether a carrier is pricing its services at a predatory level. The Commission thus adopted a proxy for average variable costs that is based on publicly available data. The data necessary to calculate a U.S. carrier's net settlement rate are included in carrier's quarterly traffic reports[46] and information on U.S. carrier's access charges is available in tariffs filed with the Commission and in the Commission's annual Monitoring Report in CC Docket No. 87-339. In contrast, the data necessary to identify all possible average variable costs will be in the hands of the carrier whose prices are at issue. Including all variable costs in the test, as AT&T requests, would defeat the purpose of applying a bright line test.

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[44] AT&T Petition at 9.

[45] *Id.* at 12.

[46] *See* 47 C.F.R. § 43.61.

37. We recognize that the proxy for average variable costs does not include all variable costs. Nonetheless, originating access charges and net settlement payments represent the two primary expenses that a carrier would not incur in the short term if it stopped providing IMTS from the United States to its affiliated market. The Commission's intention was not to create a comprehensive test for precisely determining average variable costs, but to create a proxy for average variable costs as part of an easily administrable test to determine whether a carrier is pricing its services at a predatory level. We believe that identifying the primary variable expenses is appropriate for purposes of establishing an easily administrable bright line test.

38. We emphasize that the test to detect price squeeze behavior does not preclude the Commission or any other interested party from filing a complaint under Section 201 of the Communications Act charging predatory pricing where a carrier's prices exceed its originating access charges and net settlement payments. As AT&T correctly points out, the Commission would take into account all variable costs in reviewing a formal complaint alleging predatory pricing.[47] AT&T states that filing a complaint "would not provide any easy or timely remedy" to price squeeze.[48] We believe, however, that the Section 214 authorization condition will substantially reduce the threat of price squeeze behavior. As a result, it is not likely that the Commission or an interested party would have to invoke the Section 201 complaint process.

3. Application of the Section 214 Authorization Conditions to Carriers with Foreign Affiliates that Lack Market Power is Not Necessary.

39. MCI requests that we modify the authorization condition for facilities-based service to affiliated markets so that it applies solely to carriers that are providing service on a route where they have an affiliate with market power or where traffic between the U.S. carrier and its foreign affiliate is greater than 25 percent or more of the total inbound or outbound traffic on that route.[49] MCI argues that most non-dominant foreign affiliates "lack the incentive or ability to act anticompetitively against unaffiliated U.S. carriers."[50] SBC

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47 *See, e.g., PanAmSat Corp. v. Comsat Corp.*, File No. E-96-21, *Memorandum Opinion and Order* (released May 20, 1997) at ¶ 17.

48 AT&T Petition at 12.

49 In its Petition, MCI requested this modification of the facilities-based authorization condition only for carriers that were already authorized to provide service on the implementation date of the *Benchmarks Order*. In its Reply, MCI states that this modification should apply to both existing and future authorizations. MCI Reply at 3.

50 *Id.* at 2.

Communications supports MCI's Petition.[51] AT&T opposes MCI's petition on the grounds that the incentive and ability for anticompetitive behavior exist regardless of whether the foreign affiliate has market power in the destination market.[52]

40. We are persuaded that we should modify the condition for facilities-based service to affiliated markets to apply solely to U.S. carriers that are providing service on a route where they have an affiliate with market power. Upon review of the record, we conclude that there is not a substantial threat of price squeeze behavior by an integrated carrier that lacks market power in the foreign market. As the Commission stated in the *Benchmarks Order*, a price squeeze strategy by a U.S. carrier serving an affiliated market is made possible by the fact that the U.S. carrier's foreign affiliate controls an essential input for providing service in the U.S. IMTS market, and the price charged for that input -- the international settlement rate -- is substantially above the economic cost of providing the service. The U.S. carrier would take into account the actual economic cost incurred by its foreign affiliate carrier rather than the above-cost settlement rates when setting its IMTS prices. However, this advantage exists for the U.S. carrier only if its foreign affiliate is terminating the U.S. carrier's traffic. Otherwise, the U.S. carrier would have to pay an unaffiliated carrier to terminate its traffic.

41. A predation strategy would therefore only make sense for a U.S. carrier if its foreign affiliate had sufficient terminating facilities in the foreign market to terminate all the traffic generated by the U.S. carrier, including additional traffic generated by the price squeeze strategy. A foreign carrier that lacks market power in the foreign market is, however, unlikely to have sufficient facilities to terminate a substantial amount of additional traffic. If the U.S. carrier were to engage in price squeeze behavior, it would suffer substantial losses until its foreign affiliate was able to obtain additional terminating facilities. These losses would serve as a substantial disincentive to engage in price squeeze behavior. We thus conclude that there is not a sufficient danger of anticompetitive effects resulting from the ability of a U.S. carrier to execute a price squeeze on a route where it has an affiliate that does not have market power in the foreign market to warrant application of the benchmarks condition on those routes. As a result, we will apply the condition for facilities-based service

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51 SBC Reply to AT&T Opposition to Petitions for Reconsideration (SBC Reply) filed Nov. 6, 1997, at 1-2. SBC states that MCI's proposal should also apply to the condition for switched services over facilities-based or resold international private lines. SBC Reply at 2-3. However, that condition has no relation to foreign affiliation; it is a general condition that applies on all routes.

52 AT&T Opposition to Petitions for Reconsideration (AT&T Opposition) at 8. In subsequent comments filed in Docket No. IB 98-118, AT&T changed its position on this issue. *See* Reply Comments of AT&T Corp., IB 98-118 (August 28, 1998), at 8 ("Although the Commission's benchmark safeguards against market-distorting price squeeze behavior presently apply to all facilities-based carriers providing service on affiliated routes, AT&T believes that these safeguards are necessary only where the affiliate has market power in the foreign market.").

to affiliated markets solely to carriers that are providing service on a route where they have a foreign affiliate with market power.

42. Our decision to apply the condition for facilities-based service to affiliated markets solely to carriers that are providing service on a route where they have an affiliate with market power is consistent with the regulatory framework the Commission adopted in the *Foreign Participation Order*. That framework establishes narrowly tailored safeguards to protect competition and consumers in the U.S. market from anticompetitive behavior that results from the ability to exercise foreign market power in the U.S. market.[53] Price squeeze is one form of such anticompetitive behavior.

43. The Commission did not codify the condition for facilities-based service to affiliated markets in the *Benchmarks Order*. We believe, however, that it would serve to clarify carriers' general obligations to include the condition in the Commission's rules. Given our decision to apply the condition solely to carriers that are providing service on a route where they have an affiliate with market power, we will include the condition in the section of the Commission's rules that contains the dominant carrier safeguards, Section 63.10.[54]

44. In the *Foreign Participation Order*, the Commission concluded that it would streamline the Section 214 application of any applicant not otherwise eligible for streamlined processing so long as the applicant's affiliate is a foreign carrier in a WTO Member country and the applicant certifies that it will comply with the Commission's dominant carrier regulations. By our action in this *Order*, those regulations now include the condition for facilities-based service to affiliated markets.

45. For purposes of determining which carriers must comply with the condition, we will apply the rebuttable presumption the Commission adopted in our *Foreign Participation Order* that foreign carriers with less than 50 percent market share in each relevant market on the foreign end lack sufficient market power to affect competition adversely in the U.S. market.[55] For purposes of the condition for facilities-based service to an affiliated market, the relevant market is international transport and facilities, including cable landing station access and backhaul facilities.[56]

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53 *See Foreign Participation Order* at ¶¶ 143-149.

54 47 C.F.R. § 63.10.

55 *Foreign Participation Order* at ¶ 161. *See* 63 C.F.R. § 63.14.

56 *See Id.* at ¶ 145.

46. We lift here the Commission's stay of the effectiveness of the condition for facilities-based service to affiliated markets as it applies to Section 214 authorization holders that were authorized to provide service prior to January 1, 1998.[57] Pursuant to the *Benchmarks Order*, existing Section 214 authorization holders that serve affiliated markets would have been required to negotiate with U.S. international carriers a settlement rate for affiliated routes that complies with the appropriate benchmark within ninety days of January 1, 1998, if the Commission had not issued the *Stay Order*. In accordance with our decision here, only Section 214 authorization holders that are affiliated with a carrier that has market power in the foreign market must comply with the condition for facilities-based service to affiliated markets. We will require such existing Section 214 authorization holders to negotiate with U.S. international carriers a rate for terminating traffic[58] for affiliated routes that complies with the appropriate benchmark and is in effect within thirty days of the effective date of this order. Existing Section 214 authorization holders have been on notice since the Commission adopted the *Benchmarks Order* that they would have to comply with the condition for facilities-based service to affiliated markets. We thus believe that allowing thirty days for compliance with the condition provides sufficient notice to existing Section 214 authorization holders.

IV. Conclusion

47. We affirm the Commission's previous finding it has authority under the Communications Act to establish settlement rate benchmarks and to require U.S. carriers to negotiate settlement rates that comply with those benchmarks. We also affirm the Commission's previous finding that the settlement rate benchmarks do not violate the international law obligations of the United States. With respect to the settlement rate benchmarks conditions, we affirm the Commission's decision to require compliance with the benchmark settlement rates, rather than the best practice rate, as a condition of providing facilities-based service to affiliated markets and switched services over facilities based or resold international private lines. In addition, we affirm the Commission's decision to use a proxy for variable costs for purposes of applying a bright-line test to detect anticompetitive behavior. Finally, we amend the condition for facilities-based service so that it applies solely to U.S. affiliates of carriers that have market power in the destination market.

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57 *See Stay Order* at ¶ 5 (effectiveness of the condition is stayed "pending Commission action on MCI's Petition for Clarification or Reconsideration").

58 In some cases, the rate for terminating traffic may not be as settlement rate, but some other type of financial arrangement. For that reason, we use the phrase, "rate for terminating traffic."

V. Ordering Clauses

48. Accordingly, IT IS ORDERED, pursuant to Sections 1, 2, 4(i), 5(c), 201, 211, 214 and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 155(c)(5), 201, 211, 214, and 303(r), and Section 1.106 of the Commission's Rules, 47 C.F.R. § 1.106, that the AT&T Petition for Partial Reconsideration and the Petition for Reconsideration of the Philippines Parties ARE DENIED.

49. IT IS FURTHER ORDERED that the MCI Telecommunication Corp. Petition for Clarification or Reconsideration IS GRANTED in part and DENIED in part.

50. IT IS FURTHER ORDERED, pursuant to Sections 1 and 4(i) of the Communications Act, 47 U.S.C. §§ 151 and 154(i), that the stay of the effectiveness of the condition for facilities-based service to affiliated markets as it applies to Section 214 authorization holders that were authorized to provide service prior to January 1, 1998, is LIFTED.

51. IT IS FURTHER ORDERED, pursuant to Sections 1, 2, 4(i), 5(c)(5), 201, 211, 214 and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 155(c)(5), 201, 211, 214, and 303(r), that Part 63 of the Commission's rules, 47 C.F.R., pt. 63, IS AMENDED as set forth in Appendix A.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas

Magalie Roman Salas
Secretary

APPENDIX A
Final Rules

Part 63 of The Commission's Rules and Regulations (Chapter 1 of Title 47 of the Code of Federal Regulations) is amended as follows:

PART 63 -- EXTENSION OF LINES AND DISCONTINUANCE, REDUCTION, OUTAGE AND IMPAIRMENT OF SERVICE BY COMMON CARRIERS; AND GRANTS OF RECOGNIZED PRIVATE OPERATING AGENCY STATUS

1. The authority citation for Part 63 continues to read as follows:

Authority: Sections 1, 4(i), 4(j), 201-205, 218 and 403 of the Communications Act of 1934, as amended, and Section 613 of the Cable Communications Policy Act of 1984, 47 U.S.C. 151-154(i), 154(j), 201-205, 218, 403, 533 unless otherwise noted.

2. § 63.10 is amended by adding paragraphs (c)(6) and (e) to read as follows:

§ 63.10 Facilities-based international common carriers.

* * *

(c) (6) If authorized to provide facilities-based service, comply with paragraph (e) of this section.

* * *

(f) Except as otherwise ordered by the Commission, a carrier that is classified as dominant under this section for the provision of facilities-based services on a particular route and that is affiliated with a carrier that collects settlement payments for terminating U.S. international switched traffic at the foreign end of that route may not provide facilities-based service on that route unless the current rates the affiliate charges U.S. international carriers to terminate traffic are at or below the Commission's relevant benchmark adopted in IB Docket No. 96-261. *See* FCC 97-280 (rel. Aug. 18, 1997) (available at the FCC's Reference Operations Division, Washington, D.C. 20554, and on the FCC's World Wide Web Site at http://www.fcc.gov).