

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

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

REPORT AND ORDER

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By the Commission: Chairman Hundt and Commissioner Ness issuing separate statements.

Table with 2 columns: Topic and Paragraph Number. Topics include Introduction, Discussion (Benchmarks, Implementation of Benchmarks, Section 214 Authorization Conditions, Effect of Settlement Rate Savings on U.S. Consumers, Legal Basis For Establishing Benchmark Settlement Rates), and sub-topics like Tariffed Components Price Methodology, Benchmarks Based on Tariffed Components Prices, Safeguard in Cases of Market Distortion, etc.

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I. Introduction

1. In this *Order*, we establish benchmarks that will govern the international settlement rates that U.S. carriers may pay foreign carriers to terminate international traffic originating in the United States. The action we take in this *Order*, along with our recent *Accounting Rate Flexibility Order*¹ and our proceedings implementing the World Trade Organization ("WTO") Basic Telecom Agreement, substantially completes our plan to restructure the economics of the market for U.S. international telecommunications services. This restructuring will promote the low cost, technologically innovative interconnectivity serving all the world's consumers that should be the hallmark of a Global Information Infrastructure.

2. The benchmark settlement rates we adopt in this *Order* 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

¹ Regulation of International Accounting Rates, Phase II, *Fourth Report and Order*, 11 FCC Rcd 20063 (1996) ("*Accounting Rate Flexibility Order*").

foreign carriers incur to terminate that traffic.² The significant margins on international termination fees that now prevail cause U.S. consumers to pay artificially high prices for international services and discourage foreign carriers from introducing effective competition and cost-based pricing for all telecommunications services.³ Moreover, the above-cost margins in settlement rates can be used to finance strategies that create competitive distortions in the market for U.S. international services.

3. The potential for competitive distortions in the U.S. market for international services is a pressing concern as we move forward with implementing the commitments the United States made in the WTO Basic Telecom Agreement reached on February 15, 1997. The Commission has proposed new rules to implement these commitments.⁴ These commitments, and our proposed rules, will make it much easier for foreign carriers to enter and invest in all U.S. markets for basic telecommunications services. The benchmarks policy we adopt here reduces the possibility that this more open entry could create competitive distortions in the U.S. market. This approach is fully consistent with our philosophy of using regulatory measures to control the pricing of interconnection by carriers with control over bottleneck facilities.

4. The combination of freer entry into the U.S. market, the market opening commitments of other countries in the WTO Basic Telecom Agreement, and the introduction of our benchmark settlement rates should provide incentives conducive to the introduction of alternative arrangements to the traditional accounting rate system for the termination of international traffic. The Commission has already adopted an *Accounting Rate Flexibility Order*

² The current international accounting rate system was developed as part of a regulatory tradition in which international telecommunications services were supplied through a bilateral correspondent relationship between national monopoly carriers. 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. U.S. carriers are required to file a copy of their settlement agreements with the Commission. See 47 C.F.R. § 43.51(a)(2).

³ See Letter from Tom Bliley, Chairman, John Dingell, Ranking Democratic Member, W.J. "Billy" Tauzin, Chairman, Subcommittee on Telecommunications, Trade and Consumer Protection, Michael G. Oxley, Chairman, Subcommittee on Finance and Hazardous Materials, Committee of Commerce, U.S. House of Representatives, to Reed E. Hundt, Chairman, Federal Communications Commission, dated January 29, 1997 (stating that accounting rate reform "will benefit consumers in the U.S. and around the globe").

⁴ See Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, IB Docket 97-142, *Order and Notice of Proposed Rulemaking*, FCC 97-195 at ¶ 32 (rel. June 4, 1997) ("*Foreign Participation Notice*"). See also Amendment of the Commission's Regulatory Policies to Allow Non-U.S.-Licensed Space Stations to Provide Domestic and International Satellite Service in the United States, IB Docket 96-111, *Further Notice of Proposed Rulemaking*, FCC 97-252 (rel. July 18, 1997) ("*DISCO II Notice*").

that sets forth the conditions under which U.S. carriers⁵ may deviate from the requirements of the Commission's International Settlements Policy ("ISP"). The rules we adopted in the *Accounting Rate Flexibility Order* should allow carriers to create alternative arrangements for pricing and organizing the supply of international services.

5. This *Order* addresses the urgent need for reform of the traditional settlements system on the many routes where more flexible cost-oriented alternative arrangements are not yet contemplated. We conclude that we must reduce the settlement rates paid by carriers in the United States in order to fulfill our duty to ensure reasonable rates for U.S. consumers. We also conclude we would promote competition in the United States market by using settlement rate benchmarks to remedy anticompetitive conditions in the international marketplace. We emphasize, however, that we would prefer to achieve our goals through a multilateral agreement on accounting rate reform. If, in the future, there is multilateral consensus on a substantially equivalent international measure to achieve our goals of a more cost-based and non-discriminatory system of settlements in a timely manner, we will waive enforcement of the benchmark settlement rates. This was precisely our approach when we adopted the effective competitive opportunities ("ECO") test to guide conditions for allowing increased foreign investment.⁶ When the WTO agreement provided substantially comparable conditions, the Commission proposed to abandon the ECO test for WTO Member countries.⁷

6. Our action in this *Order* comes after years of efforts by the U.S. Government to achieve cost-based termination fees internationally by means of discussion and negotiation bilaterally and multilaterally at the International Telecommunication Union ("ITU"), the Organization for Economic Cooperation and Development ("OECD"), and other international organizations. We will continue to work in the ITU and other international organizations to achieve such a multilateral agreement. This *Order* does not take effect until January 1, 1998 -- the same day as the WTO Basic Telecom Agreement. The first target period for U.S. carriers to negotiate rates at or below the settlement rate benchmarks, however, is not until January 1, 1999. We encourage other countries that have expressed interest in an international agreement on reforming the accounting rate system to continue to work with the United States toward achieving that goal.

⁵ References in this *Order* to "U.S. carriers" include any carrier licensed to operate in the United States regardless of its ownership or principal place of business.

⁶ See Market Entry and Regulation of Foreign-Affiliated Entities, *Report and Order*, 11 FCC Rcd 3873 (1995), *recon. pending* ("*Foreign Carrier Entry Order*").

⁷ See *Foreign Participation Notice* at ¶ 32.

7. We believe that accounting rate reform is necessary and will benefit consumers and carriers in all countries, including businesses and others who rely on global telecommunications services. Thus, contrary to the views of some commenters, it is not the case that accounting rate reform will benefit consumers in the United States at the expense of carriers in overseas markets. Accounting rate reform will allow consumers in all countries to receive higher quality service, more service options,⁸ and lower rates as accounting rates are reduced to a more cost-based level.⁹ Accounting rate reform will also benefit every carrier that provides international services by stimulating growth of those services. The current accounting rate system suppresses global demand by contributing to inflated International Message Telephone Service ("IMTS") calling prices. As settlement rates, and in turn calling prices, are reduced, demand for international services will be stimulated.¹⁰

8. It is clear to us that accounting rate reform is essential if carriers that currently benefit from and rely on artificially high settlement rates are to remain viable. As the Secretary-General of the ITU stated recently, the global telecommunications market has undergone changes that will be "little short of revolutionary" for the future of the international accounting rate system.¹¹ In this new market environment, carriers who wish to rely on high settlement rates will likely find that market forces will create incentives for bypass of their high-cost routes.

9. The WTO Basic Telecom Agreement reached on February 15, 1997 will have profound effects on the accounting rate system.¹² Pursuant to that agreement, 69 countries, covering 95 percent of the global market for basic telecommunications services, have agreed to

⁸ As the Coalition for Hemispheric Competitiveness notes, the current system of inflated settlement rates has created incentives for monopoly IMTS providers to restrict or prohibit the provision of other services, such as Internet or VSAT, which could potentially undermine their settlement payments. Coalition for Hemispheric Competitiveness Comments at 4; *see also* ICA Reply at 3 (if monopoly carriers' excess profits from settlements are reduced, those carriers will lose much of their incentive to stifle competition).

⁹ *See, e.g.*, Alexis de Tocqueville Institution Reply at 3 (lower rates will bring benefits to individuals and businesses throughout Latin America); Coalition for Hemispheric Competitiveness Comments at 3 (artificially high settlement rates create increased costs for Latin America and Caribbean users calling from their countries to one another and to the United States).

¹⁰ *See* Alexis de Tocqueville Institution Comments at 3 (many of the concerns expressed by commenters "are based on a static analysis of telecom markets, and fail to take into account the changes that lower rates and greater competition will bring"); Frontier Comments at 1 ("The existence of above-cost accounting rates has artificially depressed demand for international services.")

¹¹ Dr. Pekka Tarjanne, Secretary-General, ITU, "The 1998 Telecommunications Revolution," Study Group 3 Meeting, May 27, 1997 ("Tarjanne May 27 speech"). The full title of Study Group 3 is the Study Group on "Tariff and Accounting Principles including Related Telecommunications Economic and Policy Issues."

¹² In the words of Secretary-General Tarjanne, the agreement on basic telecommunications "changes everything." Tarjanne May 27 speech at 2.

permit competition from foreign suppliers of basic telecommunications services. In addition, 59 of these countries have committed to enforce fair rules of competition for basic telecommunications services by subscribing to the detailed, procompetitive rules contained in the Reference Paper on Regulatory Principles negotiated as part of the WTO Basic Telecom Agreement. As a result, most of the world's major trading nations have made binding commitments to transition rapidly from monopoly provision of basic telecommunications services to open entry and procompetitive regulation of these services.

10. The WTO Basic Telecom Agreement will fundamentally change the nature of relations between international telecommunications carriers. In many markets, the accounting rate system will become largely irrelevant as alternative means for routing traffic become the norm. The traditional bilateral correspondent relationships between national monopoly carriers are breaking down as countries open their markets to competition. For example, in markets that permit competition in international services, carriers will be able to provide end-to-end service without the use of accounting rates. In addition, under the WTO Basic Telecom Agreement, more countries will allow switched traffic to flow over private lines, outside the settlements system. At a minimum, the increased competition in the global IMTS market that will result from this trade agreement will exert downward pressure on accounting rates in competitive markets as new entrants compete to terminate foreign traffic.

11. As a result of these competitive pressures, an increasing amount of international traffic will migrate from the traditional accounting rate system to least cost routes through the use of practices such as hubbing, refile, and reorigination.¹³ These practices are all examples of routing bilateral traffic through a third country to take advantage of a lower accounting rate between the third country and the destination country. As we observed in the *Notice*, such least-cost routing practices already have begun to erode the stability of the accounting rate system. Least-cost traffic routing is an economically rational response to inflated settlement rates, and will continue as long as carriers maintain excessive settlement rates.¹⁴ Carriers are also developing technological means other than these least-cost routing practices to bypass the accounting rate system. For example, internet telephony has the potential to be a significant alternative to the accounting rate system. Calls made over the internet are not subject to the accounting rate system, and as a result, we anticipate that charges for internet telephony will be substantially

¹³ See "Report Of The Informal Expert Group On International Telecommunications Settlements," International Telecommunication Union, April 1997 ("*Informal Expert Group Report*") (the implementation of the WTO Basic Telecom Agreement "may, unless there is adequate price reform, result in an increasing proportion of the world's international traffic flowing outside the traditional international settlements system").

¹⁴ See, e.g., Dr. Pekka Tarjanne, Consultation Document on Accounting Rate Reform, Temporary Document 3-E, ITU-T Study Group 3, Geneva, November 11-15, 1996 ("The ability of regulators to control accounting rate bypass is limited except insofar as the incentive would disappear if accounting rates and collection charges were more symmetric and closer to costs").

closer to the actual cost of providing service, and much lower than most collection rates for international service.¹⁵

12. Above-cost settlement rates pose particular problems for the United States as the largest and most competitive market in the world for facilities-based and resale domestic and international long distance services. Because rates in the United States are lower than in many countries, a substantial amount of world traffic is routed through the United States. The traditional settlement rate system assumes that a customer's physical location determines the place of origin of an international call, with the carrier in the originating country paying a settlement rate to the carrier in the terminating country. However, service innovations such as callback allow customers to change the originating country for settlement purposes. The result is that many more calls are originated for settlement purposes from countries like the United States with vigorous retail and wholesale markets than in monopoly markets that lack similar competition. These traffic routing patterns will only be exacerbated as countries implement their market access commitments under the WTO Basic Telecom Agreement.

13. Partly as a result of these traffic routing patterns, the U.S. settlement deficit continues to grow steeply. In 1996, the U.S. settlement deficit totalled \$5.4 billion, double what it was in 1990. Conservative estimates put at least seventy percent of that total as an above-cost subsidy from U.S. consumers to foreign carriers. It is this subsidy paid by U.S. consumers which is the focus of our concern, not the total settlements deficit. Our goal is to move to a nondiscriminatory and more cost-based rate structure for the termination of global telecommunications services so that market-generated shifts in the traffic balance do not continue to exacerbate the level of the U.S. net settlements deficit. We do not believe it benefits consumers to arbitrarily restrict a carrier's ability to route traffic in the most economically efficient manner or to restrict the development of new technologies and new routing methods.

14. For all these reasons, we find that the global telecommunications market is changing in ways that cannot accommodate the traditional international accounting rate system. We therefore remain committed to achieving accounting rate reform, despite the opposition in the record from many foreign carriers and some governments. We recognize, moreover, that the liberalizing market trends that are undermining the accounting rate system will also make our settlement rate benchmarks moot for competitive countries and carriers. We have already seen that in markets where there is robust competition, settlement rates are usually substantially lower than in monopoly markets.¹⁶ We anticipate that with the increasing market liberalization that will

¹⁵ See "The Model is Extensible," *Telemedia News & Views*, Thursday, May 1, 1997.

¹⁶ For example, U.S. carriers pay a settlement rate of \$0.08 to Sweden; \$0.105/peak and \$0.07/off-peak to the United Kingdom, and \$0.12-\$0.08 to Canada. These settlement rates are substantially below the settlement rate benchmarks we adopt in this *Order*.

result from implementation of countries' commitments in the WTO Basic Telecom Agreement, settlement rates between the United States and many countries will rapidly fall below our settlement rate benchmarks. Nonetheless, the benchmarks are necessary because many countries still will not be open to competition, and in those that have introduced competition, efficient pricing structures take time to develop.

15. As the Commission observed in the *Notice*, there has been substantial agreement in multilateral organizations for several years on the need to reform the accounting rate system. For example, both the OECD and the ITU have been studying accounting rate reform, with the emphasis in both organizations on the principles of transparency, nondiscrimination, and cost-based pricing.¹⁷ The Inter-American Telecommunications Commission ("CITEL") recently formed an ad hoc working group to study the issue of accounting rate reform¹⁸ and many other regional organizations have also committed resources and time to study this issue.¹⁹

16. Many countries have also demonstrated a commitment to achieving accounting rate reform. For example, the United Kingdom and New Zealand recently joined the United States in improving the transparency of the accounting rate system by publishing their accounting rates. It is expected that the European Union countries will eliminate entirely accounting rates for intra-European calls after January 1, 1998, and rely instead on a system of call termination charges based on domestic interconnection rates. The commitment of many countries to accounting rate reform is reflected in the comments filed in this proceeding. Most commenters acknowledge the need for accounting rate reform, even if they disagree with our approach.²⁰

17. A significant multilateral achievement in the realm of accounting rate reform is ITU-T Recommendation D.140, which was adopted by the ITU Telecommunications Standardization Sector Study Group 3 in 1992. ITU-T Recommendation D.140 calls for carriers

¹⁷ See, e.g., "International Telecommunications Pricing Practices and Principles: A Progress Review," OECD, Paris (1995).

¹⁸ See, "Consensus Issues On Accounting Rates: Second Colloquium and First CITEL Ad Hoc Working Group Meeting On Accounting Rates," May 13-15, 1997.

¹⁹ For example, accounting rate reform was the topic of a workshop at the AFCOM '97 Conference held in Swaziland, May 19-23, 1997.

²⁰ See, e.g., European Union Comments at 1 ("The European Community and its Member States [] agree with the end purpose of the NPRM regarding international settlement rates"); United Kingdom Comments at 1 ("The UK will wish to support the US in discussion of benchmarking or other methods of creating greater momentum for rapid cost-orientation of accounting rates as agreed in ITU Recommendation D.140"); Telecom. Authority of Singapore Comments at 1 ("Singapore is in general agreement with the motivation behind the Notice which is to achieve nondiscriminatory 'cost-based' accounting rates"); Japan Comments at 1 (Japan "shares the view" of the United States "that international settlement rates should be reduced and cost-based").

to adopt nondiscriminatory, cost-oriented, and transparent accounting rates within five years. Adoption of ITU-T Recommendation D.140 was an important step forward in accounting rate reform in terms of a multilateral commitment to a set of guiding principles. However, progress on the actual implementation of those principles has been slow, at best. We are committed to the principle of cost-oriented settlement rates adopted in Recommendation D.140 and to achieving implementation of that principle as expeditiously as possible. Our settlement rate benchmarks are consistent with the directive in ITU-T Recommendation D.140 to achieve cost-oriented rates and represent substantial progress in implementing that directive in the United States.²¹ As NTIA states, our benchmarks policy "represent[s] a constructive means of implementing the primary goals of ITU-T Recommendation D.140 -- moving accounting rates closer to cost in an expeditious manner, consistent with transparency and non-discrimination."²²

18. Many commenters urge the Commission to work through multilateral organizations, especially the ITU, to achieve accounting rate reform.²³ We have contributed actively to the work of multilateral organizations and agree that we should continue to work vigorously with these organizations to pursue accounting rate reform.²⁴ We do not, however,

²¹ As we discuss below in Section II.B.1, the methodology for calculating settlement rate benchmarks we adopt in this *Order* relies on the framework for determining cost-oriented rates set forth in Recommendation D.140.

²² NTIA Reply at 8.

²³ See, e.g., Telefónica del Perú Comments at 13 ("supports -- and urges the FCC to participate in -- multilateral negotiations regarding the accounting rate issue"); HKTI Comments at 29 (urging the Commission to work through the ITU); Deutsche Telecom Comments at 9 ("the highest priority should be a global reform of the accounting rate system"); Cable and Wireless Comments at 2 (urging the Commission "to work with the international community to achieve multilateral, managed change"); CANTO Comments at 2 ("ITU-T Study Group 3 is the appropriate multilateral forum for the United States or other countries to pursue global reform of the accounting rate system"); Dept. of Communications of Ministry of Transport of the Republic of Latvia Comments at 1 (supports the work of the ITU); Grenada Comments at 1 (settlement rates are agreed bilaterally under the auspices of the ITU); France Telecom Comments at 7-9; Pakistan Telecom Authority Comments at 1, 2; Suriname Comments at 1; Telefónica de España Comments at 36-37; COMTELCA Reply at 8-10; ITJ Comments at 2, 6-11 (urging the Commission to work through the ITU and expressing concern that the benchmarks policy could be counter-productive); Lattelekom Comments at 4; Indonesia Reply at 2; Brazil Reply at 1-2 (suggests costing principles a multilateral forum could use to establish cost-based settlement rates); Portugal Comments at 1-2 (the ITU is the proper forum to discuss accounting rate reform); St. Vincent and the Grenadines Comments at 1 (considers proposals in the *Notice* to be trade matter that should be dealt with in the WTO); Singapore Comments at 2 (urging the Commission to work through the ITU); Singapore Telecom Comments at 2-3; Solomon Islands Comments at 1; KDD Comments at 22-23 (reform should be pursued through the ITU); CAT Comments at 3 (it would be appropriate to form a special group within the ITU to review the accounting rate system); VSNL Comments at 13; Sonatel Reply at 1; Telekom Malaysia Reply at 2.

²⁴ For example, a United States delegation participated in the recent ITU-T Study Group 3 meetings held in Geneva May 22-30, 1997, and submitted two written contributions on the issue of accounting rate reform for consideration by that group. FCC representatives gave presentations on accounting rate reform at the OECD Working Group on Telecommunications and Information Services Policies held in Paris on April 10-11, 1997, the AFCOM '97 Conference held in Swaziland on May 19-23, 1997, and the CITEL

agree that our contribution to multilateral efforts should be our exclusive means of addressing accounting rate reform. As explained below, we believe we must take action in order to fulfill our statutory mandate to ensure U.S. consumers receive telecommunications services at reasonable rates and to address the potential for competitive distortions in the U.S. market for international services as we move forward with implementation of the commitments made by the United States in the WTO Basic Telecom Agreement. Thus, while we remain committed to pursuing accounting rate reform in multilateral organizations, we must also take action domestically in the interim to reduce settlement rates to a more cost-based level. The action we take here will be concurrent with our continued efforts to achieve reform of the accounting rate system in the ITU and other multilateral organizations.

19. The benchmark rates we adopt in this *Order* are based on foreign carriers' publicly available tariff rates and information published by the ITU. We categorize countries primarily by their level of economic development, as defined by a World Bank and ITU classification scheme. For each category, the benchmark is based on an average of the tariff rates and other data for each country in the category. The three benchmarks we adopt are: \$0.15 per minute for upper income countries; \$0.19 per minute for upper middle income and lower middle income countries; and \$0.23 per minute for lower income countries. Even though these benchmark settlement rates will continue to exceed, usually substantially, any reasonable estimate of the level of foreign carriers' relevant costs of providing international termination service, they will nonetheless substantially reduce the excess in current settlement rates in a manner that treats foreign carriers fairly.

20. We will require that U.S. carriers negotiate with their foreign correspondents settlement rates at or below the appropriate benchmark according to a schedule of target reductions. If U.S. carriers fail to achieve progress in negotiating settlement rates at or below the benchmarks, we will take appropriate enforcement measures to ensure that progress is made and that, ultimately, U.S. carriers achieve rates that comply with the benchmarks.

21. While we are committed to achieving more cost-based settlement rates, we also recognize that an immediate reduction of settlement rates to the benchmark levels could result in undue disruption of foreign carriers' operations and their correspondent relations with U.S. carriers. Disruption of either U.S. carriers' or foreign carriers' networks would not be in the public interest. The policies we adopt here thus take into account the need to ensure a smooth transition from current settlement rates to our benchmarks.

22. To provide an opportunity for all carriers to make appropriate adjustments to enable them to move to more cost-based settlement rates, we adopt five transition periods for

Colloquium on the International Settlement Regime held in Margarita Island, Venezuela on March 11-13, 1997.

U.S. carriers to negotiate settlement rates at or below the benchmarks. The transition periods are based on the same categories used to calculate settlement rate benchmarks, with an additional category for countries with teledensity, or lines per one hundred inhabitants, less than one. We will require that U.S. carriers negotiate settlement rates with foreign carriers according to the following transition schedule: within one year of the effective date of this *Order* with carriers in upper income countries; within two years with carriers in upper middle income countries; within three years with carriers in lower middle income countries; within four years with carriers in low income countries; and within five years with carriers in countries with teledensity less than one.

23. We also adopt conditions for certain types of Section 214 authorizations²⁵ to address potential distortions in the U.S. market for IMTS created by above-cost settlement rates. We adopt two conditions. First, we will condition any carrier's authorization to provide international facilities-based switched service from the United States to an affiliated market on the carrier's foreign affiliate offering U.S. international carriers a settlement rate at or below the relevant benchmark. If, after the carrier has commenced service to the affiliated market, we learn that the carrier's service offering has distorted market performance, we will take enforcement action. That enforcement action may include a requirement that the foreign affiliate's settlement rate on the affiliated route be reduced to a level at or below a "best practice rate," or a revocation of the carrier's authorization. Second, we will grant carriers' applications for authority to provide switched services over facilities-based or resold international private lines on the condition that at least half of the traffic on the route in question is subject to a settlement rate at or below the relevant benchmark. If we learn that competition on the route has been distorted, we will take enforcement action. That enforcement action may include a requirement that at least half of the traffic on the route be subject to a settlement rate at or below the "best practice rate." It could also include revocation of carriers' authorizations.

24. The settlement rate benchmarks we adopt here are consistent with our authority under the Communications Act of 1934 to declare rates and practices to be unjust and unreasonable and to prescribe rates and practices that are just and reasonable. Our settlement rate benchmarks will ensure that a large cost component affecting the end user charges for an international call, the settlement rate, moves closer to the underlying cost of international termination service. By placing a limit on the amount that U.S. carriers can pay for this component, our benchmarks comport with our past ratemaking practices under Sections 201 through 205 of the Communications Act of 1934, as amended ("the Act"). For example, under traditional rate-of-return regulation we prescribed rate components (*i.e.*, allowable rate base items and expenses) or calculation methodologies (*i.e.*, cost of capital, depreciation, cash working

²⁵ Section 214 of the Communications Act of 1934, 47 U.S.C. § 214, requires carriers to obtain authorization from the Commission to construct, acquire or operate, or engage in transmission over any lines.

capital studies) for U.S. carriers to use in setting their interstate and international rates.²⁶ More recently, we have moved away from a rate-of-return regulatory regime to a regime that relies on a price cap methodology for dominant carriers provisioning interstate and international services.²⁷ Even in this new regime, however, we have found it necessary at times to focus regulatory oversight on components that are reflected in the rates charged to end users. We have done this, for example, with regard to the charges that interexchange carriers must pay for access to the exchange access facilities of incumbent local exchange carriers ("LECs") for origination or termination of interstate and international traffic. Because incumbent LECs have little or no competition in the provision of these services, we have taken, and continue to take, action to ensure that the incumbent LEC access rates move toward the underlying cost of providing access services.²⁸

25. Similarly, we seek through adoption of benchmark settlement rates to bring a component that affects end user international rates closer to the underlying cost of providing international termination services. As with the access charges paid by interexchange carriers, U.S. international carriers, for the most part, do not have a competitive international market from which to purchase international termination services. We therefore must take action to ensure that the settlement rate component of an end user rate does not prevent U.S. consumers from having access to telecommunications services at reasonable rates.

26. Commenters raised several issues related to our authority under the Communications Act and ITU regulations to establish settlement rate benchmarks. We respond to these commenters' arguments in detail below in Section II.E. In that section, we demonstrate that the Communications Act provides us with the authority to reform U.S. carrier participation in international settlement rate practices in the manner we adopt in this *Order*. Section 201 of the Act requires that "all charges, practices, classifications, and regulations for and in connection with ['foreign communication' services] be just and reasonable."²⁹ International telecommunications services that are settled under a settlement rate agreed to by a U.S. international carrier and its

²⁶ See, e.g., *Communications Satellite Corp.: Investigation into Charges, Practices, Classifications, Rates and Regulations*, 70 FCC 2d 1449 (rel. Feb. 2, 1979).

²⁷ See *Motion of AT&T Corp. to be Declared Non-Dominant for International Service, Order*, FCC 96-209 (rel. May 14, 1996) ("AT&T International Non-dominance Order"), *recon. pending*; *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 (1995) ("AT&T Domestic Non-dominance Order"), *recon. pending*; *Revisions to Price Cap Rules for AT&T Corp.*, 10 FCC Rcd 3009 (1995); *Competition in the Interstate Interexchange Marketplace, Report and Order*, 6 FCC Rcd 5880 (1991), *recon.*, 6 FCC Rcd 7569 (1991), *further recon.*, 7 FCC Rcd 2677 (1992).

²⁸ *Access Charge Reform*, CC Docket No. 96-262, et al., *First Report and Order*, FCC No. 97-158 (rel. May 16, 1997) ("*Access Charge Reform Order*").

²⁹ 47 U.S.C. § 201.

foreign correspondent fall within the definition of "foreign communication" in the Act and settlement rates are a "charge" or "practice." We thus find that the plain language of Section 201 gives us jurisdiction over settlement rates. To the extent that the above-cost portion of settlement rates paid by U.S. carriers to their foreign correspondents leads to those settlement rates being "unjust or unreasonable," Section 201 requires us to declare such "charges" or "practices" unlawful. We analyze in detail why the benchmark settlement rates we adopt in this *Order* represent the highest amount at which we consider a settlement rate to be presumptively just and reasonable under Section 205 of the Act.

27. We also find that our settlement rate benchmarks are consistent with ITU regulations and general international law principles of comity and national sovereignty. The rules adopted here do not constitute the exercise of jurisdiction over foreign carriers. Instead, we establish in this *Order* the rate at which a settlement rate agreed to by a U.S. international carrier satisfies that carrier's obligation to comply with the "just and reasonable" requirements of Sections 201 and 205. We do not adopt any rules in this *Order* that provide for enforcement action against a foreign carrier for its failure to agree to a settlement rate at or below the relevant benchmark. Obviously, by placing a cap on the level of the rate U.S. carriers may negotiate with their foreign correspondents, our actions will have an indirect effect on foreign carriers. International services, by their very nature, require one end of the communications to be handled outside of the United States, and thus rules regarding the U.S. end of the communication may have an impact on the foreign end as well. An indirect effect on foreign carriers, however, does not militate against the validity of rules that only operate directly on carriers within the United States.

28. We discuss our settlement rate benchmarks and the methodology for calculating them in Section II.A. In Section II.B., we describe the mechanisms we adopt to assist U.S. and foreign carriers in the transition to more cost-based settlement rates and measures we will take to enforce our benchmarks. We discuss the Section 214 authorization conditions we adopt to address the potential market distortions created by above-cost settlement rates in Section II.C. We describe in detail our legal basis for establishing settlement rate benchmarks in Section II.E.

II. Discussion

29. In our *Notice*, we presented proposals for revising our benchmark settlement rates to move them closer to the level of costs incurred by foreign carriers to terminate international traffic.³⁰ The *Notice* solicited comment on four issues: (1) how should settlement rate benchmarks be calculated; (2) how long should the transition to benchmark rates last; (3) what enforcement mechanisms are necessary to ensure carriers make progress in negotiating settlement

³⁰ *International Settlement Rates*, IB Docket No. 96-261, *Notice of Proposed Rulemaking*, FCC No. 96-484 (rel. December 19, 1996) ("*Notice*").

rates within the benchmarks; and (4) can the benchmark rates be used to address competitive problems in the U.S. IMTS market?³¹

30. Initial comments on our *Notice* were filed on February 7, 1997, and reply comments were filed March 31, 1997.³² The Commission received over 120 initial and reply comments, including 90 from foreign carriers and governments. The insights and concerns raised by the commenters have been very valuable to us as we have developed our benchmarks policy. We have taken the concerns raised in the record into account in developing our policy and have modified several of our proposals in the *Notice* in response to them.

31. We believe we must take action to reduce settlement rates toward cost to fulfill our statutory mandate to ensure U.S. consumers receive telecommunications services at reasonable rates. Our mandate under the Communications Act is to make available a rapid, efficient worldwide wire and radio communications service with adequate facilities and reasonable charges.³³ The measures we adopt in this *Order* are intended to ensure that IMTS rates paid by U.S. consumers are reasonable. Moreover, they are intended to reduce the potential for competitive distortions in the U.S. market for IMTS that above-cost settlement rates can produce. These distortions could impede the development of competition in the U.S. market, to the detriment of consumers and service providers.

32. Above-cost settlement rates have a direct and substantial impact on the prices U.S. consumers pay for IMTS. U.S. consumers pay on average 88 cents per minute for international calls and they pay on average 13.5 cents per minute for domestic long distance calls. Yet, the difference in cost of the underlying facilities between the two services is minimal. Indeed, as we stated in the *Notice*, the costs of providing telephony have been decreasing and are becoming virtually distance insensitive due to recent technological advances.³⁴ Above-cost settlement rates paid by U.S. carriers to their foreign correspondents are a significant factor in the difference in calling prices between international and domestic long distance services. As the Coalition for Hemispheric Competitiveness states, monopoly carriers charging inflated settlement rates "in

³¹ *Notice* at ¶ 4.

³² The Commission granted an extension of the reply comment date from March 10, 1997, to March 31, 1997. *See International Settlement Rates*, IB Docket No. 96-261, *Order Granting Extension of Time*, DA 97-440 (rel. Feb. 27, 1997).

³³ *See* 47 U.S.C. § 151.

³⁴ *Notice* at ¶ 9. *See* Tarjanne May 27 speech at 6 (since 1988, "significant cost elements, such as the cost of undersea cable or satellite capacity, have been falling by some 30 percent per year"). *See also* AT&T Comments at 9 (noting that the original capital costs of the TAT-12 and TAT-13 undersea cables brought into service in 1995 and 1996 are one third the capital cost of the TAT-11 cable brought into service in 1993).

effect impose their monopoly pricing on customers located in open markets" such as the United States.³⁵ Therefore, to ensure that the rates paid by U.S. consumers are reasonable, we must reduce the settlement rates paid by U.S. carriers to a more cost-based level.³⁶

33. We recognize that while above-cost settlement rates contribute significantly to the high rates paid by U.S. consumers for IMTS, they are not, as some commenters point out, the sole factor.³⁷ Another important factor is insufficient competition in some sectors of the U.S. market for IMTS. Thus, we must also focus our efforts on encouraging increased competition in the U.S. market if we want to ensure that consumers pay reasonable prices. Our benchmark settlement rates are an important part of that effort because they address the potential market distortions that are created by above-cost settlement rates.

34. There are two such market distortions that could adversely affect competition in the U.S. market for IMTS. One is the potential for one-way bypass. This could occur if a foreign carrier collecting above-cost settlement rates is able to send its switched traffic over resold private lines into the United States, but U.S. carriers are unable to send their traffic over private lines in the reverse direction, and must continue to pay a relatively high settlement rate. The other potential market distortion could arise when a foreign carrier enters the U.S. market to provide facilities-based service to its home market. Any settlement payments made by the U.S. affiliate to its foreign parent for service to the U.S. affiliate's home market would simply be an internal corporate transfer. Because the foreign carrier's U.S. affiliate would not have to pay the above-cost settlement rates that its competitors must pay to the foreign carrier, the U.S. affiliate would be able to price its services in the U.S. market below the level of costs incurred by its competitors. However, if a foreign carrier is paying settlement rates that are closer to cost-based levels than current rates, its incentive and ability to engage in this market distorting behavior are significantly diminished.

³⁵ Coalition for Hemispheric Competitiveness Comments at 4-5; *see also* ICA Reply at 1-3 (noting the high rates its members pay for international telecommunications services and urging the Commission to take action to reduce settlement rates so that calling prices will decrease).

³⁶ Several commenters question whether U.S. consumers will see the benefits of settlement rate reductions. We address this issue in Section II.D., *infra*.

³⁷ *See, e.g.*, European Union Reply at 3 (part of the explanation for high collection rates "would appear to be the lack of effective competition between the U.S. international carriers"); Telefónica del Perú Comments at 9-10 (lack of full competition in the U.S.-outbound international telecommunications market is the primary cause of high collection rates); PBCom Comments at 3-5; 9-10 (high collection rates in relation to settlements payments evidence a need for increased competition in the U.S. market for IMTS and the Commission should grant promptly authority to new competitors to begin providing international service); GTE Comments at 7-8 (noting extent to which AT&T collection rates exceed net settlement rates); HKTI Comments at 10-12 (despite decrease in HKTI accounting rates, U.S. collection rates have increased on the U.S.-Hong Kong route); KDD Comments at 9-10 (despite decreases in KDD accounting rates, U.S. collection rates on the U.S.-Japan route have increased); COMTELCA Reply at 5-6.

35. Some commenters have questioned the need for settlement rate benchmarks and, in many cases, our motive for establishing benchmarks. The problem the Commission is trying to address through its settlement rate benchmarks, as these commenters see it, is the fact that U.S. net settlements payments have been increasing in recent years. These commenters argue that alternative routing services such as callback, country direct services and refile, which the Commission has encouraged, contribute significantly to the U.S. net settlements payments. Therefore, they contend, if the Commission wishes to reduce the U.S. net settlements payment, it should discourage alternative routing services.³⁸ Many commenters also note that demographic factors such as differences in income levels and substantial immigrant populations in the United States contribute to the traffic imbalance between the United States and foreign countries. Based on this observation, they conclude that the Commission is mistaken in its attempts to address the level of U.S. net settlements payments through settlement rate benchmarks.³⁹

36. These commenters are correct in pointing to a number of the causes of the settlements deficit; these arguments, however, fundamentally misconstrue the problem which the Commission seeks to remedy through its settlement rate benchmarks. The rapidly escalating U.S. net settlements deficit is a serious problem, but it is a harmful byproduct of the more basic issue: the fact that the current accounting rate system creates economic inefficiencies in the global market for telecommunications services. We are not, as many commenters contend, concerned with the absolute level of U.S. net settlements payments *per se* or the contribution of settlement payments to the U.S. trade deficit. Rather, we are concerned with the extent to which those payments reflect rates that substantially exceed the underlying costs of providing international

³⁸ See, e.g., Nepal Comments at 2; AHCIET Comments at 6; Cable and Wireless Comments at 22-24; CANTO Comments at 5; HKTI Comments at 5-6; 13-14; KDD comments at 8-9; Telefónica de España Comments at 37-40; VSNL Comments at 4-5; TSTT Comments at 6; Telecom Vanuatu Comments at 2; Solomon Islands Comments at 2; China Telecom Comments at 2; COMTELCA Comments at 10; COMTELCA Reply at 2-6; Deutsche Telecom Comments at 2-3; IDC Comments at 14-16; Korea RPOAs Comments at 4; Lattelekom Comments at 3-4; India Comments at 1; Korea Telecom Reply at 1; New T&T Comments at 1; Taiwan Comments at 2; Telecom Italia Comments at 5-6; Telefónica del Perú Comments at 10; Telekom Malaysia Comments at 3; Telstra Comments at 7-8; CAT Comments at 2; Sri Lanka Telecom Comments at 3-5; Portugal Comments at 3; Singapore Telecom Comments at 3-5; Panama Reply at 10-12; Sonatel Reply at 2. Some commenters also urge us to take into account the revenues of U.S. telecommunications equipment suppliers in considering the level of the U.S. trade balance deficit for telecommunications. See, e.g., ASETA Comments at 3; TSTT Comments at 5; see also Cable and Wireless Comments at 2 (settlements deficit is only "one facet of the complex equation which produces the U.S. balance of trade in communications").

³⁹ See, e.g., Telmex Comments at 15 (large traffic flows to Mexico are due to "a confluence of factors," including the relative levels of economic development and teledensity of the United States and Mexico, and the large number of U.S. citizens and residents of Mexican ancestry); GTE Comments at 5-6 (part of the imbalance is caused by factors such as "United States demographics" and "the calling habits of U.S. consumers," which are beyond the control of the Commission); Pakistan Telecom Comments at 2 (traffic imbalance due to differences in income level and expatriate communities in the United States); see also FT Comments at 6-7; Korea RPOAs Comments at 4-5; Cable and Wireless Comments at 21-22; VSNL Comments at 5; Telekom Malaysia Reply at 2.

termination services.⁴⁰ As discussed throughout the *Notice*, these above-cost settlement rates contribute to the inflated rates paid by U.S. consumers for international services, create the potential for competitive distortions in the U.S. market for IMTS, and produce inefficiencies in the global telecommunications market.

37. We are not persuaded by those opposing our proposals that our settlement rate benchmarks are not necessary to move settlement rates closer to a cost-based level. Our tentative conclusion in the *Notice* that most current settlement rates substantially exceed costs has not been refuted in the record. The majority of commenters acknowledge this fact and agree that reform of the accounting rate system is necessary.⁴¹ The lowest enduring settlement rate between the United States and a competitive overseas destination is currently \$0.08 per minute.⁴² Yet, the average settlement rate U.S. carriers pay their foreign correspondents is approximately \$0.35,⁴³

⁴⁰ We reiterate the support we announced in our *Accounting Rate Policy Statement* for new services that encourage alternatives to the traditional accounting rate system and increase competitive pressures in the global telecommunications market. *Policy Statement on International Accounting Rate Reform*, 11 FCC Rcd 3146 at ¶¶ 21-23 (1996) ("*Accounting Rate Policy Statement*"). These alternative services are not, as many commenters argue, the source of the "problem" in the global market for international services. Rather, they are an economically rational response to the problem of inflated settlement rates and distorted tariffs. *See, e.g.*, ICA Reply at 5 (callback services "are a natural response of the marketplace to global pricing distortions"). As long as settlement rates remain above cost, carriers in competitive markets will find methods to circumvent those rates to provide new services at competitive rates to their customers.

⁴¹ *See, e.g.*, European Union Reply at 1 ("It is clear that settlement rates worldwide are far higher than can be warranted by the full economic cost of an international telecommunications service"); Japan Comments at 1-2 ("It is of course desirable that settlement rates should be more cost-based and be further reduced"); ITJ Comments at 2; Indonesia Reply at 1 (supports efforts to adopt cost-based settlement rates); IDC Reply at 1 ("we generally agree that reform of the current system is desirable"); ASETA Comments at 2 ("We do agree that accounting rates must be cost-oriented"); Portugal Comments at 1 ("agrees that the present accounting rate system should be reformed"); COMTELCA Comments at 1; Deutsche Telecom Comments at 3-5; France Telecom Comments at 3; Brazil Reply at 1 (supports "the FCC position of accounting rate reduction"); Singapore Comments at 1 ("is in general agreement with the motivation behind the *Notice* which is to achieve nondiscriminatory 'cost-based' accounting rates"); Singapore Telecom Comments at 1; New T&T Comments at 1 ("considers that the achievement of settlement rates which more closely resemble the costs of providing international termination services is a noteworthy and essential goal"); HKTI Comments at 1 (the accounting rate system "is increasingly out of step with modern service configurations and multi-carrier markets"); KDD Comments at 1 ("supports establishing cost-oriented settlement rates and moving toward a new system of remuneration"); Telefónica del Perú Comments at 1 ("There is an international consensus -- which Telefónica del Perú shares -- that accounting rates should continue to move toward cost"). Only a few commenters contend that current rates are cost-based. For example, CARICOM states that the rates charged by its member countries "are in fact very closely related to cost." CARICOM Reply at 1.

⁴² This is the current settlement rate between the United States and Sweden. *See* Section II.B.3., *infra*.

⁴³ This average settlement rate is a weighted average based on the total minutes of U.S.-outgoing traffic.

which is more than four times this lowest prevailing settlement rate. Moreover, settlement rates with many countries are several times higher than the average rate of \$0.35.⁴⁴

38. Some commenters contend that we need not take action to reform the accounting rate system and reduce settlement rates to more cost-based levels because settlement rates have been declining recently without government intervention. They also argue that competitive market forces, accelerated by the WTO Basic Telecom Agreement, will ensure that this downward trend continues.⁴⁵ Some commenters also argue that our decision in the *Access Charge Reform Order* to rely upon market forces to generate cost-based access rates in the United States conflicts with our proposal to establish settlement rate benchmarks.⁴⁶

39. It is true that changing market conditions have increased pressure on the accounting rate system and helped to reduce settlement rates. However, settlement rates are still substantially above-cost. Moreover, the costs of providing international services have continued to decrease.⁴⁷ In addition, effective competitive market conditions exist in only a few countries. Monopoly conditions prevail in most.⁴⁸ Our experience suggests that in those countries introducing competition in the near future, it will often take time for vigorous competition to create efficient pricing. Under these circumstances, we do not believe we can rely entirely on the

⁴⁴ For example, U.S. carriers' settlement rate with Colombia is \$0.59 per minute; with India, \$0.79 per minute; with the Syrian Arab Republic, \$1.00 per minute; with Thailand \$0.75 per minute; and with Trinidad and Tobago, \$0.575 per minute. Accounting Rates for International Message Telephone Service of the United States, Federal Communications Commission, International Bureau, Telecommunications Division, June 1, 1997.

⁴⁵ See, e.g., PTI Comments at 3-5; GTE Reply at 3-5; KDD Reply at 2-4; Telefónica de España Comments at 32-35; Singapore Telecom Reply at 4; see also Telecom Italia Comments at 3,4; 6-7 (arguing that market based solutions have worked and the Commission should not seek to impose a regulatory solution); Telefónica de España Reply at 7-10 (urging the Commission to focus on increasing competition consistent with the WTO Basic Telecom Agreement rather than adopting benchmarks). See also Australia Reply at 1 (stating that it prefers "a market-driven, rather than administrative, approach to this issue").

⁴⁶ Letter from Alfred M. Mamlet and Colleen A. Sechrest, counsel to Telefónica de España and Telefónica Larga Distancia de Puerto Rico, to William Caton, Acting Secretary, July 30, 1997 (Telefónica de España and Telefónica Larga Distancia de Puerto Rico July 30 *Ex Parte*); Letter from Robert J. Aamo, counsel for KDD, to William Caton, June 5 1997 (KDD June 5 *Ex Parte*).

⁴⁷ See, e.g., AT&T Comments at 9 (noting reductions in costs of undersea cables brought into service in 1995 and 1996 versus the costs of the TAT-11 cable brought into service in 1993).

⁴⁸ See *infra* Section II.C.1 (distinguishing U.S. interexchange access market from IMTS market). See also *Informal Expert Group Report* at 4 (despite rapid movement toward competitive markets, "there will continue to be a number of relationships between competitive and non-competitive markets"). See also ICA Comments at 4 ("The fact of the matter is . . . most countries continue to sanction monopolies").

market to reduce settlement rates on a timely basis to a more cost-based level.⁴⁹ We thus believe benchmark rates are necessary to ensure that U.S. carriers achieve settlement rate reductions on a timely basis that will benefit U.S. consumers.

A. Benchmarks

40. We would prefer to let competitive market forces determine settlement rates, as that would provide the best assurance that carriers are charging cost-based rates.⁵⁰ But as stated above, competitive market conditions do not exist in many countries at this time. As we stated in the *Notice*, we believe settlement rates in markets where there is effective competition would tend to the level of long run incremental costs plus a reasonable contribution to joint and common costs.⁵¹ More specifically, for international termination services, prices would tend to the level of total service long run incremental cost, or TSLRIC, plus a reasonable contribution to joint and common costs.⁵² As explained in the *Notice*, the TSLRIC of providing international termination services is the additional cost that a firm incurs as a result of providing that service. This cost includes a risk-adjusted return on capital.⁵³ The term "total service," in the context of TSLRIC, indicates that the cost measured is that of providing an entire service, in this case, international termination service.⁵⁴ The term "long run," in the context of TSLRIC, refers to a period long enough so that all of a firm's costs become variable or avoidable.⁵⁵

⁴⁹ See NTIA Reply at 5 ("[i]n a competitive market, settlement rates would naturally move closer to incremental cost, but we cannot rely solely on market forces to achieve timely reform of accounting rates in markets where limited or no competition exists").

⁵⁰ See, e.g., *Access Charge Reform Order* at ¶ 263 ("Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production"). See also Alexis de Tocqueville Institution Comments at 5 ("As more nations create competitive telecommunications markets, the need for governments to involve themselves in the setting of [settlement] rates will diminish and disappear").

⁵¹ Notice at ¶ 41.

⁵² References to incremental cost and long run incremental cost throughout this *Order* are to TSLRIC. In the *Interconnection Order* the Commission adopted a version of the TSLRIC costing methodology called total element long run incremental cost as the basis for pricing interconnection and unbundled elements. See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, *First Report and Order*, 11 FCC Rcd 15499 (1996) ("*Interconnection Order*"), *Order on Reconsideration*, 11 FCC Rcd 13042 (1996), *petition for review pending and partial stay granted, sub nom. Iowa Utilities Bd. v. FCC*, 109 F.3d 418 (8th Cir. 1996), *pricing rules vacated*, 1997 WL 403401 (8th Cir. July 18, 1997).

⁵³ *Interconnection Order* at ¶700.

⁵⁴ *Id.* at ¶ 677.

⁵⁵ *Id.*

41. Most economists generally agree that competitive markets, over the long run, tend to force prices toward incremental costs.⁵⁶ In dynamic, competitive markets, firms take action based not on embedded costs, but on the relationship between market-determined prices and forward-looking costs. If market prices exceed forward-looking economic costs, new competitors will enter the market.⁵⁷ As new competitors enter the market, prices will be driven toward a forward-looking incremental cost level. For services such as international termination services that share some joint and common costs,⁵⁸ incremental costs would include a reasonable contribution to forward-looking joint and common costs. Otherwise, prices based on incremental costs might not permit recovery of forward-looking costs if there were significant joint and common costs among services.

42. Because settlement rates in effectively competitive markets would tend to the level of TSLRIC plus a reasonable contribution to joint and common costs, our settlement rate benchmarks ideally should be set at that level.⁵⁹ However, as we observed in the *Notice*, the data necessary to calculate foreign carriers' incremental costs are not available at this time and no commenter has provided cost data in the record about the costs of providing international termination services.⁶⁰

43. Because data on foreign carriers' costs are not available at this time, we must look to another source of data to establish benchmarks. In this *Report and Order*, we adopt the methodology for establishing benchmarks that we proposed in the *Notice*. The methodology is based on foreign carriers' publicly available tariffed rates and data published by the ITU-T. We describe this methodology, which we refer to as the "tariffed components price" or "TCP"

⁵⁶ See generally Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* 69 (1988). See also Stephen Breyer, *Regulation and Its Reform* 52 (1982); Harold Hotelling, "The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates," 6 *Econometrica* 242 (1938).

⁵⁷ *Interconnection Order* at ¶ 620.

⁵⁸ We use the term "joint costs" to refer to costs incurred when two or more outputs are produced in fixed proportion to the same production process (*i.e.*, when one product is produced, a second product is generated by the same production process at no additional cost). We use the term "common costs" to refer to costs that are incurred in connection with the production of multiple products or services and remain unchanged as the relative proportion of those products or services varies (*e.g.*, the salaries of corporate managers). See *Interconnection Order* at ¶ 676.

⁵⁹ A regional tariff group within the framework of ITU-T Study Group 3, the Regional Group for Asia and Oceania ("TAS") Group, has concluded that settlement rates should be at an incremental cost level. A report to Study Group 3 on the TAS Group's activity noted that "the time is rapidly approaching when a long run incremental costing model would be more appropriate" than a fully distributed costing model. Temporary Document 4-PL at 2, ITU-T Study Group 3, Geneva, May 22-30, 1997.

⁶⁰ The Commission requested comment in the *Notice* on alternative methodologies for calculating benchmarks other than the approach proposed in the *Notice* and on steps it might take to obtain incremental cost data. *Notice* at ¶ 56.

methodology, in more detail in the next section. We categorize countries by their level of economic development, and establish a separate benchmark rate for each category using the TCP methodology. For each category, the benchmark is based on an average of the tariff rates and other data for each country in the category.

44. Even though our goal is cost-based settlement rates, the benchmarks based on the TCP methodology that we adopt here result in settlement rates that we believe still exceed foreign carriers' costs to terminate international traffic because they are based primarily on foreign carriers' tariffed rates. Such tariffed rates include costs which would not be included in cost-based settlement rates, such as costs associated with marketing, allowances for uncollectible billings and other retail communications services to consumers. Nonetheless, the benchmarks are substantially below most prevailing settlement rates and represent progress toward achieving cost-based rates, and we find that they are reasonable given the limited data available to us for calculating benchmarks at this time. While we adopt the TCP methodology as the basis for calculating our settlement rate benchmarks, we are still committed ultimately to achieving settlement rates that reflect incremental costs and believe that rates will reflect incremental costs as IMTS markets become increasingly competitive.

1. Tariffed Components Price Methodology

a. The Notice

45. The TCP methodology proposed by the Commission in the *Notice* relies on the framework described in ITU-T Recommendation D.140.⁶¹ That Recommendation contains cost guidelines that identify the three specific network elements that are used to provide IMTS and the cost components for those elements to be included in cost-oriented settlement rates. The specific network elements are: (1) international transmission facilities; (2) international switching facilities; and (3) national extension (domestic transport and termination).

46. The Commission released with the *Notice* a study by the International Bureau which calculates prices for these three elements.⁶² The prices calculated for the international transmission and national extension network components is based on foreign carriers' tariff rates, and the price for the international gateway element is based on data published by the ITU. The

⁶¹ *ITU-T Recommendation D.140*, "Accounting Rate Principles for International Telephone Services," Geneva (1992).

⁶² "Foreign IMTS Interconnection Costs," A Report Prepared by the International Bureau, Telecommunications Division, Federal Communications Commission, December 1996 ("Bureau Report"). Sixty-five countries were included in the Bureau's study, generally those having the largest traffic volumes with the United States. The Bureau used data collected during the fourth quarter of 1995 through mid-1996 to calculate tariffed components prices for these sixty-five countries.

TCP methodology proposed in the *Notice* uses the sum for each country of these tariffed prices for the international transmission and national network components and the price for the international gateway switching component, which we referred to collectively as a country's "tariffed components price," to calculate settlement rate benchmarks.

47. We noted that the logic of basing benchmarks on a foreign carrier's tariffed prices is that those prices are the same tariff rates charged by a foreign carrier to its domestic customers. Nondiscriminatory treatment of U.S. carriers would require that foreign carriers charge U.S. carriers a rate for terminating service from the United States that is comparable to the rate they assess their own domestic customers. We also noted that tariff rates are publicly available, so benchmarks based on such rates can be revised, if necessary, as the tariff rates change.

48. We stated that benchmark settlement rates based on tariffed components prices will permit foreign carriers to recover more than their incremental cost of terminating international service. This is because the tariff rates used in the calculations presumably reflect foreign carriers' incremental cost plus a significant contribution to common costs. In fact, because the tariff rates used to calculate TCPs include costs associated with providing retail communications service to consumers which would not be included in cost-based settlement rates, settlement rates based on retail rates will substantially exceed incremental cost. For example, tariff rates include an allowance for uncollectible billings, general overhead expenses associated with retail service, and marketing and commercial expenses that would not be included in the cost of providing international termination services.

49. The following is a summary of the methodology for calculating the tariffed price for each network element proposed by the Commission in the *Notice* and detailed in the Bureau Report:

- International facility component

The international facility component consists of international transmission facilities, both cable and satellite, including the link to international switching facilities. This component includes only the half-circuit on the terminating end because originating carriers have traditionally been responsible for the half circuit on the originating end of a call. The Commission proposed to base the price of this component on foreign carriers' private line rates for dedicated circuits because the circuits used for private line service are functionally the same as those used to provide IMTS. Under the Commission's proposed methodology, the private line rates are converted to a per minute charge. This is done by first calculating the number of voice grade circuits derived from a private line half-circuit and then calculating a per minute rate for these voice grade circuits using an estimate of monthly minutes transmitted over international circuits.

- International gateway component

The international gateway component consists of international switching centers and associated transmission and signalling equipment. Foreign carriers generally do not offer a separate tariff rate for the international gateway component. The Commission therefore proposed to calculate the price for this component using information published by the ITU-T in Recommendation D.300R.⁶³ Recommendation D.300R calculates for TEUREM member countries⁶⁴ accounting rate shares for each of the three network elements in ITU-T Recommendation D.140. The rates that are calculated vary according to what percentage of plant capacity is digital; the rates decline as the level of digitalization rises, reflecting the greater efficiency of digital equipment. The Commission proposed to categorize countries by the three levels of digitalization used in Recommendation D.300R and to calculate a price for the international gateway component based on the accounting rate shares calculated in ITU-T Recommendation D.300R.⁶⁵

- National extension component

The national extension component consists of national exchanges, national transmission, and the local loop facilities used to distribute international service within a country. The Commission proposed to use foreign carriers' domestic rates

⁶³ *ITU-T Recommendation D.300R "Determination of Accounting Rate Shares in Telephone Relations between Countries in Europe and the Mediterranean Basin," Geneva (1992) ("ITU-T Recommendation D.300R")*.

⁶⁴ The TEUREM group is a regional tariff group created under the auspices of ITU-T Study Group 3. Its members are: Albania, Algeria, Andorra, Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Gibraltar, Germany, Greece, Greenland, Hungary, Ireland, Israel, Italy, Lebanon, Libya, Liechtenstein, Luxembourg, Malta, Monaco, Morocco, Netherlands, Norway, Poland, Romania, San Marino, Spain, Sweden, Switzerland, Syria, Tunisia, Turkey, United Kingdom, Russia, Vatican City State, and Yugoslavia.

⁶⁵ The digitalization categories used in Recommendation D.300R are: (1) 0-30%, (2) 31-60%, and (3) 61-100%. ITU-T Recommendation D.300R calculates an accounting rate share for the international exchange component of 0.0324 SDR (about \$.048) for the first category, 0.0228 SDR (about \$.034) for the second category, and 0.129 SDR (about \$.019) for the third category. The accounting rate share figures are calculated from data filed by the member countries. The Bureau Report notes that telephone administrations providing service in developing countries are generally more likely to have communications networks that are less technologically advanced and, therefore, have lower levels of digital equipment than those in developed countries. Based on this observation, the Commission proposed to use the highest accounting rate share figure for the international exchange component in Recommendation D.300R for the least developed countries in the study, the lowest figure for the most developed countries, and the middle figure for other countries in the study.

and the distribution of U.S. billed service within a country to compute an average charge per minute for cost of this component.⁶⁶

50. We concluded that a carriers' TCP could provide a sound basis for calculating settlement rate benchmarks in the absence of carrier-specific cost information. We therefore presented and sought comment on several options for calculating benchmarks using the TCPs.

b. Positions of the Parties

51. The majority of commenters recognize the dilemma posed by the Commission that, on the one hand, settlement agreements should contain settlement rates that are cost-based, but on the other, the data necessary to calculate costs for each foreign carrier are not available.⁶⁷ Commenters disagree, however, on whether the Commission's proposed TCP methodology provides a reasonable basis for calculating settlement rate benchmarks in the absence of cost information.

52. U.S.-owned carriers generally support the TCP methodology as an interim solution to achieve settlement rates that more closely approximate costs than current settlement rates. They emphasize, however, that the TCP methodology would result in rates that are substantially above costs and that the Commission's ultimate goal should be to achieve settlement rates that are cost-based. For example, MCI states that it "firmly supports moving settlement rates toward their true cost" but the TCP approach "would be a reasonable compromise as an interim solution for the purpose of negotiating more reasonable settlement rates."⁶⁸ MCI contends that the advantage of the TCP methodology is that settlement rates based on TCPs would be nondiscriminatory because they would represent the same rates charged by foreign carriers to their domestic customers.⁶⁹ WorldCom similarly submits that while TSLRIC-based settlement rates are the ultimate goal, the TCP methodology "is an important step in the right direction toward cost-based

⁶⁶ In certain small markets, *e.g.*, Hong Kong and Kuwait, consumers are charged a monthly subscription rate that includes domestic service.

⁶⁷ *See e.g.*, United Kingdom Comments at 2 (noting "the difficulties the Commission has had in obtaining detailed cost data and interconnection prices for most of the routes examined"); NTIA Reply at 10 ("NTIA appreciates the difficulties the Commission catalogues in assessing the actual costs of terminating traffic").

⁶⁸ MCI Comments at 3.

⁶⁹ *Id.*

rates."⁷⁰ WorldCom states that the TCP methodology provides a reasonable foundation for benchmarks because it is based on the best available information.⁷¹ In addition, WorldCom notes that the TCPs are a "reasonable surrogate" for setting benchmarks because they are based on the actual rates in effect, as established by foreign carriers and reviewed by foreign regulators.⁷² ESI, on the other hand, disagrees that we should set benchmarks based on the TCP methodology. It argues that we should adopt a benchmark ceiling "that is not significantly greater than nine cents."⁷³

53. Several commenters concur with the Commission's conclusion that benchmarks based on TCPs will allow foreign carriers to recover costs in excess of their incremental costs of terminating international traffic. The Alexis de Tocqueville Institution asserts that the proposed TCPs "more than cover incremental cost plus a reasonable return."⁷⁴ AT&T agrees with the Commission's observation that the TCP for the domestic distribution component is substantially above cost because foreign carriers' tariff rates include retail expenses and overhead costs that are not incurred to provide international termination services, and contends that these same deficiencies apply to foreign carriers' tariffs for dedicated international private line service.⁷⁵ WorldCom states that if there is a fault of the proposed benchmarks based on TCPs it is that they "are set too high above true economic costs."⁷⁶

54. Many foreign carriers and some governments oppose the Commission's proposal to use the TCP methodology to calculate settlement rate benchmarks, although they do not offer any specific suggestion for how to achieve cost-based settlement rates in the absence of data on carriers' costs. For example, KDD states that although it "fully supports establishing cost-

⁷⁰ WorldCom Comments at 7-8. *See also*, Sprint Comments at 3 (Commission proposal "would place some modest upper limits on the amount by which U.S. ratepayers must continue to subsidize the rest of the world").

⁷¹ WorldCom Comments at 8; *see also* NTIA Reply at 11 ("applying foreign carrier tariffed prices as surrogates for the three network components cited in ITU Recommendation D.140 offers the best available approach to establishing new (if interim) benchmark rates").

⁷² WorldCom Comments at 8; *see also* NTIA Reply at 11 (concurring with the Commission that a benefit of the TCPs is that they are based on the rates charged by foreign carriers to their domestic customers and that under the principle of nondiscrimination, U.S. carriers should not pay foreign carriers more than the foreign carrier's domestic customers are charged for the same service).

⁷³ ESI Comments at 4.

⁷⁴ Alexis de Tocqueville Institution Reply at 5.

⁷⁵ AT&T Comments at n.29.

⁷⁶ WorldCom Comments at 8.

oriented settlement rates and moving towards a new remunerative system," it opposes the FCC's benchmarking approach.⁷⁷ KDD contends "[o]nce the FCC determined that it lacked the data necessary to apply the TSLRIC methodology, its inquiry should have been at an end."⁷⁸ Telmex objects to the Commission's proposal to establish benchmarks, arguing that only carriers can determine a credible estimate of the costs they incur to engineer a route.⁷⁹

55. Lattelekom objects to the Commission's goal of achieving cost-based settlement rates, arguing that the goal does not take into account the nature of different traffic minutes. Lattelekom argues that "[n]ot all minutes are the same" and accounting rate principles should be different depending on the underlying nature of the product. In particular, it argues that settlement rates for "value added" services such as home country direct should not necessarily be cost-based.⁸⁰

56. Some commenters object to the Commission's proposed use of the TCP methodology to establish settlement rate benchmarks on the ground that the TCPs do not accurately reflect carriers' costs. For example, GTE concludes that "the use of the TCP methodology is inherently flawed because it does not reflect actual cost."⁸¹ Telmex asserts that "TCP data are simply not a good proxy for actual costs"⁸² and the methodology generally "is invalid because it incorrectly assumes that there is a constant relationship between costs and rates across countries."⁸³

⁷⁷ KDD Comments at 12.

⁷⁸ *Id.* at 14.

⁷⁹ Telmex Comments, Statement of Indetec International ("Indetec Statement") at 8.

⁸⁰ Lattelekom Comments at 2-4.

⁸¹ GTE Reply at 27.

⁸² Telmex Comments, Indetec Statement at 2-3; see also Singapore Tel Comments at 8 (The TCP approach "is not an accurate methodology for deriving cost-oriented settlement rates"); Telefónica de España Comments at 49 (proposed benchmarks "bear no relationship whatsoever to the real costs of providing international service").

⁸³ Telmex Comments, Indetec Statement at 7; see also ASETA Comments at 2 (approximations made by the Commission show the limitations of trying to determine other carriers' costs). Tricom states that "[t]he Commission's benchmark rate proceeding, which relies, in part upon average network cost data supplied to the Commission by AT&T, . . . fails to recognize significant differences in costs incurred by carriers in countries with developing telecommunications markets." Tricom Reply at 5. The TCP methodology, however, relies on foreign carriers' tariffed rates and ITU data to calculate settlement rate benchmarks, not AT&T average cost data.

57. To the extent specific concerns about the TCP methodology are raised in the record, they relate primarily to the Commission's claim that benchmarks based on the TCP methodology will fully compensate foreign carriers for the costs they incur in terminating international traffic.⁸⁴ Many commenters dispute this claim, arguing that the TCP methodology could result in an underrecovery of costs in some cases where the domestic tariffs that are used to calculate TCPs reflect cross-subsidies between services. These commenters contend that in cases where domestic tariffs reflect cross-subsidies, tariffs for local service may be below cost and the TCPs based on those tariffs will also be below cost.⁸⁵ IDC, on the other hand, recognizes that the TCP methodology includes a profit component and overhead costs, but argues that additional overhead expenses should be included in the benchmark calculations to account for "the basic costs of doing business in each country."⁸⁶ IDC further argues that the TCP methodology fails to take into account the fact that the cost of doing business can vary widely from country to country. Thus, according to IDC, the TCP methodology could "handicap" high-cost countries such as Japan.⁸⁷ GT&T states that the Commission mistakenly "has focused solely upon the notional settlement rate," instead of the actual per-minute settlement costs of U.S. carriers as determined by net settlement payments.⁸⁸ Thus, according to GT&T, the settlement rate benchmarks could ensure that U.S. carriers pay per minute termination costs that are substantially lower than the benchmarks.

58. Some commenters raise concerns related to the currency conversions used by the Commission to calculate benchmarks using the TCP methodology. KDD notes that the TCP methodology ignores the extent to which some foreign currencies like the Japanese Yen are overvalued compared to the U.S. dollar and argues that this deficiency demonstrates the inherent difficulty of translating foreign costs into U.S. dollars on an accurate and consistent basis. According to KDD, this difficulty should preempt any effort to prescribe settlement rates through

⁸⁴ See Notice at ¶42.

⁸⁵ AHCIET Comments at 4-5; Cable and Wireless Comments, Attachment A at 4; CANTO Comments at 6; Chunghwa Telecom Comments at 2; France Telecom Comments at 10-11; GTE Comments at 23; RPOAs of Korea Comments at 3; Taiwan Comments at 2; TSTT Comments at 4; Telefónica del Perú Comments at 12; Telefónica de España Comments at 55; India Reply at 2; GT&T Reply at 6. Singapore Telecom claims that the Commission's proposed TCP for Singapore is "far beneath" the costs it incurs in connection with U.S.-billed international switched service, but provides no support for this claim. Singapore Telecom Comments at 9. Chunghwa Telecom states that the TCP methodology does not consider "network architecture and wireless telephone call charge," but does not elaborate on this point. Chunghwa Comments at 2.

⁸⁶ IDC Comments at 4-5.

⁸⁷ *Id.* at 5.

⁸⁸ Letter from Robert J. Aamoth, counsel for GT&T, to William Caton, Acting Secretary, June 18, 1997 (GT&T June 18 *Ex Parte*) at 7.

a TCP approach.⁸⁹ France Telecom notes that the TCP methodology does not take into account the effect of currency fluctuations because the TCP estimates are converted into U.S. dollar equivalents on a set date.⁹⁰ France Telecom urges the Commission to consider another relevant economic unit designed to neutralize the effects of currency fluctuations.⁹¹ Telmex states that the period for data analysis chosen by the Commission, the fourth quarter of 1995 through the middle of 1996, does not provide accurate data for Mexico because during that period Mexico faced rapid rates of inflation and a significant devaluation of the peso.⁹²

59. Telefónica de España argues that the Commission's reliance on exchange rates to produce U.S. dollar equivalents overestimates the costs of carriers in high-cost developed countries and underestimates the costs of carriers in developing countries. Telefónica de España urges the Commission to adjust the TCPs for the national extension and international switching components by using the World Bank's Purchasing Power Parity ("PPP") conversion factors rather than exchange rates to convert foreign currencies into U.S. dollars.⁹³ KDD agrees with Telefónica de España that the Commission erroneously ignored PPP in calculating the benchmark settlement rates. However, KDD argues that Telefónica de España misapplied the PPP in urging the Commission to establish lower TCPs for Japan and other developed countries. To the contrary, KDD argues, Japan's TCP is too low because translating the costs it incurs in Japanese yen into U.S. dollars based solely upon the exchange rate would result in KDD receiving less than full compensation for its costs. KDD concludes that the solution is for the Commission to permit U.S. and foreign carriers to allocate exchange rate and PPP risks among themselves through bilateral negotiations.⁹⁴

60. France Telecom, Telefónica de España, and GT&T question our methodology for calculating the international transmission component. France Telecom questions the Commission's use of a multiplication factor of four to convert foreign carriers' private line rates to

⁸⁹ KDD Comments at 16.

⁹⁰ France Telecom Comments at 12-13; *see also* GTE Reply at 27; GT&T Reply at 6 (GT&T's national extension rate has not changed since 1989, but in the past eight years, the exchange rate ratio between Guyana and U.S. dollars has changed from 10:1 to 142:1 due to the devaluation of the Guyana currency).

⁹¹ France Telecom Comments at 13.

⁹² Telmex Comments at 23.

⁹³ Telefónica de España Comments at 59-63. According to Telefónica de España, only the national extension and international switching components require a PPP adjustment because they are the two components which are not internationally-traded services. That is, those services are provided only in a terminating country -- they cannot be "sold" in another country. *Id.* at 61.

⁹⁴ KDD Reply at 13-14.

a per minute charge, claiming that in its experience, the multiplication factor may be significantly lower.⁹⁵ Telefónica de España similarly argues that we cannot assume that a 4:1 multiplication factor is appropriate for all traffic.⁹⁶ Telefónica de España further argues that the Commission's assumption of 8,000 minutes per circuit per month for purposes of converting private line rates to a per minute charge inaccurately reflects usage on developing country routes.⁹⁷ AT&T disagrees with these comments. It states that many smaller carriers use multiplication factors of six and seven.⁹⁸ AT&T further states that its experiences show that the assumption of 8,000 minutes "is in fact very conservative."⁹⁹ Sprint similarly states that the assumption of 8,000 minutes per month is "reasonable and even conservative."¹⁰⁰ It also states that the Commission's assumption of 4:1 multiplexing is reasonable and consistent with its own experience.¹⁰¹

61. GT&T claims that our methodology for calculating TCPs for the international transmission component ignores the fact that carriers use Ramsey pricing to establish rates for dedicated international traffic routing. Thus, according to GT&T, a carrier's retail international private line rate may be less on a per-minute basis than its wholesale costs of terminating international switched traffic. GT&T further argues that the Commission erroneously assumes international private line rates are a meaningful estimate of a carrier's transmission costs. According to GT&T, in developing countries, international private line service may be directed at only a few strategic customers. This is the case in Guyana, where service is directed at two customers.¹⁰² GT&T also objects to the Commission's calculation of Guyana's international

⁹⁵ France Telecom Comments at 10 (France Telecom states that a multiplication factor of four is not common for a major international operator that has a physically diverse network that has been developed over a period of years).

⁹⁶ Telefónica de España Comments at 58.

⁹⁷ Telefónica de España Comments at 59. According to Telefónica de España, the amount of voice traffic between the United States and the Telefónica Group countries, on average, is approximately 7,000 minutes per circuit. *Id.*

⁹⁸ AT&T Reply at 32.

⁹⁹ *Id.*

¹⁰⁰ Sprint Comments at 11.

¹⁰¹ *Id.*

¹⁰² GT&T Reply at 7-8; *see also* Telmex Comments at 23 (reliance on Telmex's private line rates for 1.544 Mbps dedicated circuits to calculate Mexico's TCP for the international transmission component is misplaced because during the period under review, Telmex had few such circuits, used older technology, and offered the lines at very low prices to few customers); C&W Comments, Attachment A at 4 (prices of international private leased circuits are the outcome of commercial decisions by carriers and therefore are not sound basis for establishing benchmarks).

transmission TCP, arguing that because Guyana does not have a tariffed rate for international private line service, the Commission has no basis for calculating a TCP for Guyana.¹⁰³ GT&T further states that because it exchanges traffic with the United States exclusively via international satellite facilities, the Commission cannot calculate a TCP for Guyana without providing evidence that the costs of such facilities are the same as fiber optic submarine cables.¹⁰⁴

62. Telefónica de España also claims that private line rates should not be used to calculate the international facility component. It asserts that the costs of leasing private lines are lower than the costs of operating public lines because switched traffic is more variable than private line traffic and therefore subject to greater risk.¹⁰⁵ AT&T disagrees with this claim. It contends that switched traffic does not carry noticeably greater risks than the leasing of private lines. AT&T further contends that Telefónica de España fails to consider the profits and retail expenses included in private line tariffs.¹⁰⁶

63. ABS-CBN states that the TCP for the national extension component in the Philippines understates the costs of termination in that country because it is based upon data which reflect the heavily urban distribution of the Philippine Long Distance Telephone Company's ("PLDT") historic base of access lines. ABS-CBN states that this data does not accurately reflect the costs of new carriers which have an obligation to serve outlying areas which are more expensive to serve.¹⁰⁷ It further argues that the TCP methodology is defective because it relies upon data concerning the geographic distribution of U.S.-originated calls that is not in the record.¹⁰⁸ It contends that reliance on such data would be contrary to what it states is the precedent established by the Commission in the Universal Service Reform Order¹⁰⁹ that the Commission cannot rely on a model that contains confidential data.¹¹⁰ AT&T disagrees that the Commission's reliance on traffic data not in the record undermines the benchmark settlement

¹⁰³ GT&T Reply at 4-5.

¹⁰⁴ *Id.* at 2-4.

¹⁰⁵ Telefónica de España Comments at 57-58.

¹⁰⁶ AT&T Reply at n. 63.

¹⁰⁷ ABS-CBN Reply at 7.

¹⁰⁸ ABS-CBN Comments at 5-6.

¹⁰⁹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order* (rel. May 8, 1997) ("*Universal Service Reform Order*").

¹¹⁰ ABS-CBN Supplemental Comments at 2-5.

rates. It states that every U.S. carrier has full details of the in-country distribution of its U.S.-originated traffic and every foreign carrier receiving settlement payments has that information for the U.S.-originated traffic that it terminates.¹¹¹

64. GT&T objects to the Commission's proposed use of ITU-T Recommendation D.300 R to calculate TCPs for the international switching component. GT&T argues that the Commission's assumption that a country's level of digitalization corresponds to its level of economic development is not supported in the record and the Commission has not shown that the results of the TEUREM study in Recommendation D.300 R adequately reflect the higher costs of developing countries.¹¹² GT&T further states that the proposed use of a single usage-based amount to estimate switching costs is inconsistent with the Commission's assertion in the access charge reform proceeding that a significant portion of local switching costs likely do not vary with usage.¹¹³ It also states that the TEUREM study cannot be used to calculate a TCP for the international switching component because the underlying data and assumption used to calculate its results have not been made publicly available.¹¹⁴

65. Some carriers raise concerns that the TCP methodology ignores certain costs incurred by carriers. ABS-CBN states that the TCP methodology is flawed because it does not take into account the local interconnection costs paid to incumbent local carriers by competing international carriers. As an example, ABS-CBN cites the Philippine market where international carriers had contracts in 1996 with the dominant Philippine carrier which required a \$.35 per minute payment for international calls terminating in metro-Manila, plus up to \$.15 per minute more for calls terminating elsewhere. ABS-CBN concludes that the Commission's proposed benchmark of \$.19 for the Philippines would drive out competing international carriers that must pay domestic interconnection charges that exceed the benchmark level.¹¹⁵ Similarly, Tricom states that it must pay CODETEL access charges which are nearly three times higher than the Commission's proposed TCP for the national extension component in the Dominican Republic, are higher than the Dominican Republic's overall TCP, and nearly equal to the proposed

¹¹¹ AT&T Reply at 34, n.68; AT&T Supplemental Reply at 3-4.

¹¹² *Id.* at 8. *See also* AHCIET Comments at 4-5 (it is not valid to generalize the results of Recommendation D.300, which correspond to a particular geographic and political region; GNP per capita should be the sole basis for estimating switching costs). Chunghwa Telecom also questions the Commission's TCPs for the international switching component, asserting that the TCP for this component "is lower than the actual cost." However, it provides no basis for this assertion. Chunghwa Telecom Comments at 2.

¹¹³ *Id.* at 8-9 (citing *Access Charge Reform Order* at ¶ 72).

¹¹⁴ *Id.* at 8.

¹¹⁵ ABS-CBN Comments at 4-5. ABS-CBN notes that the dominant Philippine carrier has proposed reducing the metro-Manila call termination charge to \$.28 per minute.

benchmark for the Dominican Republic.¹¹⁶ HKTI states that the delivery fee from international calls required by the Hong Kong regulator serves as a floor below which HKTI cannot fall without incurring an actual loss on international calls.¹¹⁷ Telmex notes that the TCP methodology does not take into account additional costs carriers may incur to satisfy government-mandated service objectives like universal service and infrastructure development.¹¹⁸ Telefónica de España also states that the TCP methodology does not include the costs of providing universal service and urges the Commission, at a minimum, to adjust the methodology to include a universal service component.¹¹⁹

c. Discussion

66. We continue to believe after reviewing the record that the TCP methodology provides a reasonable basis for establishing settlement rate benchmarks in the absence of carrier-specific cost data. Relying on publicly available tariff data and information published by the ITU enables the Commission to make some progress in achieving the goal of cost-oriented settlement rates promised in ITU Recommendation D.140. At the same time, the TCP methodology treats foreign carriers fairly. We do not believe, as some commenters argue, that we should delay taking action to reduce settlement rates until carrier-specific cost data is available. Nor do we believe, as some commenters contend, that we should reject the TCP methodology because it is not a pure cost-based methodology.¹²⁰ Rather, where we have data that enables us to bring rates closer to costs and to treat foreign carriers equitably, we believe we have a reasonable basis upon which to establish benchmarks.¹²¹

¹¹⁶ Tricom Comments at 4.

¹¹⁷ HKTI Comments at 19; *see also* CAT Comments at 2 (TCP methodology does not take into account "local call charge, network investment charges, as well as other concerned charges").

¹¹⁸ Telmex Comments, Indetec Statement at 8.

¹¹⁹ Telefónica de España Comments at 50-54. Telefónica de España suggests that the Commission consider a system of asymmetrical payments which reflects differences in universal service costs. Under such a system, developed countries would be required to pay a higher rate to terminate traffic in a less developed country. *Id.* at 54. *See also* Brazil Reply at ¶ 8 (a fourth cost component for establishing settlement rates should be universal service subsidies).

¹²⁰ *See, e.g.*, Cable and Wireless Reply at 27; Telmex Comments, Indetec Statement at 2-3.

¹²¹ *See* discussion in Section II.E.1. of this *Order* concerning the Commission's authority under the Communications Act to establish benchmarks based on the TCP methodology.

67. A primary benefit of the TCP methodology is that it relies on data that is publicly available: carriers' tariffed rates and information published by the ITU.¹²² Moreover, it is based on a framework that received consensus approval from the members of the ITU.¹²³ Importantly, the TCP methodology is equitable because it relies primarily on the tariffed prices carriers charge to their own domestic customers. As Frontier notes, the data on which the TCP methodology is based "represents rates at which the individual component elements would be available if they are offered on an unbundled basis."¹²⁴ Reliance on tariffed prices also means that U.S. carriers are treated fairly. As we stated in the *Notice*, nondiscriminatory treatment of U.S. carriers would require that foreign carriers assess U.S. carriers a comparable charge for the network elements necessary for international termination services as they charge their own domestic customers.

68. We disagree with Lattelekom that settlement rates should vary with the nature of the traffic. The underlying service provided by the foreign correspondent, international termination, is the same regardless of the nature of the traffic. The network components used and the costs of those components do not vary. Because the underlying service and its costs are the same, we see no reason why the settlement rate should be different based on the nature of the end user service provided.

69. It is true, as some commenters note, that the TCP methodology results in benchmark rates that are still above-cost. Nonetheless, the benchmarks we adopt here will achieve significant reductions in settlement rates, bringing them closer to cost, and place some discipline on a system of inflated settlement rates. We therefore adopt the TCP methodology as the basis for calculating settlement rate benchmarks.¹²⁵ The TCP methodology study procedure, data collection, and estimation methods are described in further detail in Appendix E to this *Order*.

70. We disagree with commenters' arguments that benchmarks based on TCPs will not allow foreign carriers to recover their costs of providing international termination services. The fact that foreign carriers' tariff rates for domestic local service in many cases contain cross-subsidies does not mean that reliance on those tariff rates to calculate benchmarks results in an underrecovery of costs. The TCP methodology relies on tariff rates for both domestic local and

¹²² By contrast, we have no basis upon which to adopt ESI's recommendation that we adopt benchmarks that are no more than \$0.09. There is no record evidence to support ESI's estimate of average cost.

¹²³ See NTIA Reply at 10-11 ("NTIA commends the Commission for relying on the cost guidelines contained in ITU Recommendation D.140, as those guidelines represent consensus at the multilateral level").

¹²⁴ Frontier Comments at 2.

¹²⁵ The benchmark rates we adopt using the TCP methodology are set forth in the next section. See Section II.A.2., *infra*.

long distance service to calculate a price for the national extension element. As described in Appendix E, the national extension element is calculated by distributing international calls from the United States among service classifications, time periods, and the destination of the calls. The appropriate tariff rate is then applied to the minutes in each distribution category. Thus, to the extent domestic local tariff rates are priced below cost, any underrecovery of costs should be offset by traffic that is distributed to service classifications such as long distance or international whose tariff rates are above-cost. Moreover, most international traffic is terminated in major metropolitan areas where network costs are generally lower due to the economies of scope and scale that exist where traffic is concentrated in one geographic area. In many cases, more than 70 percent of calls from the United States terminate in major metropolitan areas.¹²⁶ Moreover, as we stated in the *Notice*, the tariff rates used to calculate TCPs include costs associated with providing retail communications service to consumers which would not be included in cost-based settlement rates. For example, tariff rates include an allowance for uncollectible billings, general overhead expenses associated with retail service, and marketing and commercial expenses that would not be included in the cost of providing international termination services.

71. We also note that our estimation procedures generally are conservative, erring on the side of allowing a higher price in many instances. For example, our categorization of countries by three levels of digitalization for purposes of calculating the TCP for the international gateway component produces a conservative estimate of switching costs. We assigned lower levels of digitalization to developing countries based on the assumption that, generally, those countries' networks are less technologically advanced. In fact, however, some developing countries with recent significant infrastructure development could have more technologically advanced telecommunications equipment. Moreover, evidence in the marketplace suggests that the ITU data used to calculate the TCP for the international gateway switching component is substantially above cost.¹²⁷ For example, Telia, the domestic carrier in Sweden, has an interconnect tariff which allows competing international carriers to interconnect with its domestic network. The tariff has two components: a monthly connection point charge of approximately \$6,000 and fixed monthly charge of approximately \$73.00 per facility, *e.g.*, 2.048 Mbps circuit. These fixed charges are equivalent to a monthly rate of \$0.003 per minute for usage of 8,000 minutes per circuit. In addition, in our *Interconnection Order* we concluded that a range between \$0.002 per minute of use to \$0.004 per minute of use for unbundled local switching is a reasonable proxy for domestic switching service.

72. We find GT&T's argument that our focus on the notional settlement rate instead of the actual per-minute settlement costs of U.S. carriers means that U.S. carriers could pay per

¹²⁶ See *Notice*, Bureau Report at 13. See also WorldCom Comments at 9, n.25.

¹²⁷ *Interconnection Order* at ¶ 811.

minute termination costs that are substantially lower than the benchmarks to be without merit.¹²⁸ GT&T's argument fails to take into account the fact that there are two sides to the netting process for calculating settlement payments. It is true that at settlement U.S. carriers pay less than the notional settlement rate times the total amount of traffic they originate. But that is because the minutes they originate are netted against minutes they terminate for the foreign correspondent. Thus, the net payment from the U.S. carrier to the foreign carrier represents payments the foreign carrier owes to the U.S. carrier for terminating foreign-originated calls. The per minute termination cost paid by U.S. carriers is the same; it is just offset by the per minute termination cost paid by foreign carriers.

73. Some commenters raise concerns about the use of exchange rates to calculate the settlement rate benchmarks. Three concerns are raised: (1) that a country's currency may have been devalued vis-à-vis the dollar at the time the benchmarks were calculated; (2) currency fluctuations in the future may affect the level of compensation a country receives; and (3) using exchange rates to convert foreign currencies into U.S. dollars overestimates the costs of carriers in high-cost countries and underestimates the costs of carriers in low-cost countries. While currency fluctuations do affect the level of compensation a country receives, this concern is common to all goods and services traded internationally and exists for parties negotiating accounting rate agreements regardless of whether we set benchmark settlement rates. When parties to an agreement set a price for an internationally traded good or service, the value of the compensation the parties receive will vary depending on the exchange rate between the relevant currencies. The parties to an accounting rate agreement have no control over the value of other countries' currencies. Nor do we. Some commenters suggest that we denominate our benchmarks in a neutral currency such as SDRs to reduce the impact of currency fluctuations vis-à-vis the dollar. We agree that if parties would prefer to allocate the risk of currency fluctuations by calculating their accounting rate in SDRs rather than in U.S. dollars, they should be free to do so. We believe it is appropriate, however, to leave it up to the parties to an agreement whether to calculate the accounting rate in SDRs or U.S. dollars.

74. We emphasize that any carrier may ask us to reconsider, in a specific case, the benchmarks on the grounds that they do not permit the carrier to recover the incremental costs of providing international termination service.¹²⁹ Thus, if the exchange rate used to calculate the benchmarks does not permit a carrier to recover its costs, either because a country's currency may have been significantly devalued vis-à-vis the U.S. dollar at the time the benchmarks were

¹²⁸ We generally refer to the "notional settlement rate" as the "net settlement rate." In order to calculate the net settlement rate for any particular U.S. carrier, one must subtract the product of the carrier's inbound minutes and the carrier's settlement rate for a particular country from the product of the carrier's outbound minutes to a country and the settlement rate with its foreign correspondent(s) in that country. One must then divide the total by the carrier's total outbound minutes to the country.

¹²⁹ See *supra*, Section II.A.2.

calculated or because a carrier is located in a "low cost" country, the benchmark for that carrier can be adjusted. We also note that the effect of any one country's currency valuation on the benchmark calculations is mitigated by the fact that we use an averaging approach, as described in the next section of this *Order*, to calculate benchmark settlement rates.

75. France Telecom and Telefónica de España raise concerns about the calculation of the international transmission component. Both state that it may not be appropriate for the Commission to use a 4:1 multiplication factor to convert foreign carriers' private lines to a per minute charge, and Telefónica de España states that the Commission's assumption of 8,000 minutes per circuit per month for purposes of converting private line rates to a per minute charge inaccurately reflects usage on developing country routes. Both the 4:1 multiplication factor and the 8,000 minutes per month estimate are based on actual operating results experienced by U.S. facilities-based carriers that provide IMTS. The figures are based on the operations of AT&T, MCI, Sprint, and WorldCom, and thus reflect the experiences of different sized carriers. In addition, the figures reflect service provided over a range of traffic routes to countries with varying levels of economic development. Thus, while the multiplication factor for some routes may be lower, as France Telecom notes, it may be higher on others reflected in the estimate. The same is true of the estimate of 8,000 minutes per circuit. Moreover, contrary to Telefónica de España's claim, the average minutes per circuit in some developing countries may exceed 8,000 minutes because the international transmission circuits are sometimes used to terminate domestic calls where there are inadequate domestic facilities.

76. We find no evidence to support GT&T's claim that carriers use Ramsey pricing to establish rates for dedicated international traffic routing. Ramsey pricing requires precise information about the incremental costs of supplying circuits for private line services and detailed information about the demand elasticities among different classes of international communications users.¹³⁰ There is nothing in the record to suggest that this information is available to carriers. In fact, carriers, including GT&T, have vociferously argued that cost information is not available.¹³¹ We also note that there is no evidence in the record that, even if carriers did use Ramsey pricing to establish rates for dedicated international traffic routing, such a pricing strategy would result in below-cost international private line tariffs. We find it highly unlikely that a monopoly carrier would price any service below the level of costs incurred to provide that service.

¹³⁰ The theory behind Ramsey pricing is that prices to different customer groups are set at varying levels above incremental costs depending upon the demand elasticities of the group. Those customer groups with an inelastic demand are charged higher prices and those with an elastic demand are charged lower prices. Thus, to establish rates based on Ramsey pricing principles, a carrier would need to know the incremental cost of supplying a service, and the demand elasticities of various customer groups. See Ramsey, F., "A Contribution to the Theory of Taxation," *Economic Journal*, Vol. 37, No. 1, pp. 47-61, 1927; see also, William Baumol, *Economic Theory and Operations Analysis*, pp. 513-16, and Kenneth Train, *Optimal Regulation*, Chapter 4.

¹³¹ See, e.g., GT&T Reply at 4-5.

77. We disagree with commenters that argue international private line rates do not provide a reasonable basis for calculating the TCP for the international transmission component. GT&T argues that international private line rates are not a meaningful estimate of a carrier's transmission costs because, in developing countries, international private line service may be directed at only a few strategic customers.¹³² Similarly, Telmex asserts that during the period under review, Telmex had few international private line circuits, used older technology, and offered the lines at very low prices to few customers.¹³³ AHCJET states that it is not valid to use the tariffs of one service, international private lines, to estimate the cost of another service, international termination.¹³⁴ We use carriers' international private line rates to calculate the TCP for the international transmission component because the circuits used for private line service are functionally the same as those used to provide IMTS. Thus, the cost for the underlying facility for both services, the circuits, should be the same. Unless GT&T and Telmex are offering international private line service at below cost rates, their international private line rates would thus recover, at a minimum, their costs of providing the international transmission component of international termination service.

78. We also disagree with GT&T's claim that the Commission has no basis for calculating a TCP for Guyana because Guyana does not have a tariffed rate for international private line service and because Guyana exchanges traffic with the United States exclusively via international satellite facilities. We believe it is reasonable to use the highest available tariff for international private line service in the region, Brazil's rate of \$0.066, to calculate Guyana's international transmission TCP. The international private line rates are not used as a precise estimate of individual country's costs to provide the international transmission component of international termination services. Rather, they are used as the next best source of data to calculate benchmarks. As discussed above, reliance on retail tariff rates produces benchmark settlement rates that are in excess of the costs of providing international termination service. Moreover, as described in the next section of this *Order*, the individual country TCPs are averaged to calculate one benchmark rate for categories of countries. With respect to GT&T's claim that we cannot calculate a TCP for Guyana without providing evidence that the costs of international satellite facilities are the same as fiber optic submarine cables, we note that there is substantial evidence that the cost of international satellite facilities are extremely low. Based on its assumptions about bandwidth, traffic fill factors and financial carrying costs, the ITU cited in its 1996 *Direction of Traffic* estimates that the per minute cost, including operating expenses, on

¹³² GT&T Reply at 7-8.

¹³³ Telmex Comments at 23.

¹³⁴ AHCJET Comments at 5.

international cable and satellite systems is less than \$0.01.¹³⁵ This cost estimate is less than one sixth the rate of \$0.066 we use for Guyana's international transmission TCP.

79. Telefónica de España objects on different grounds to the use of international private line rates to calculate the TCP for the international transmission component. It asserts that the costs of leasing private lines are lower than the costs of operating public lines because switched traffic is more variable than private line traffic and therefore subject to greater risk. We disagree with this argument. Even if switched traffic is subject to greater risk, as Telefónica de España asserts, that greater risk would be more than offset by the margins in international private line tariffs. The tariffed component prices for the international transmission component ranged from \$0.03 to \$0.25, with most in the range of \$0.05 to \$0.07. However, the ITU estimates that the cost of the undersea cable, including operating expenses, used to provide the international transmission component of termination services is less than \$0.01 per minute.¹³⁶

80. We also disagree with GT&T's objections to our use of ITU Recommendation D.300 R to calculate the TCP for the international switching component. GT&T argues that the Commission's assumption that a country's level of digitalization corresponds to its level of economic development is not supported in the record and the Commission has not shown that the results of the TEUREM study in Recommendation D.300 R adequately reflect the higher costs of developing countries. As an initial matter, GT&T provides no support for its statement that international switching costs are higher in developing countries. In addition, our assumptions in calculating the TCP for the international gateway switching component are favorable to developing countries. We assumed that developing countries' networks generally are less technologically advanced. We therefore assigned lower levels of digitalization, and as a result, higher prices for the switching component, to developing countries. In fact, however, as noted above, some developing countries with recent significant infrastructure development may have more technologically advanced telecommunications equipment. Moreover, as discussed above, there is evidence in the marketplace that the estimates in the TEUREM study substantially overestimate international gateway switching costs.

81. GT&T also argues that we cannot rely on the TEUREM study to calculate the TCP for the international switching component because the underlying data and assumptions of that study are not publicly available. However, we do not rely on the underlying data and assumptions of the study to calculate the TCP for the international switching component. Instead, we take the results of that study, the accounting rate shares assigned to the international switching component, and assign them to countries based on their level of economic development. Thus,

¹³⁵ *Direction of Traffic, Trends in International Telephone Tariffs*, ITU and Telegeography, Inc. (1996) at 4-5 (citing *Satellite Communications: Structural Change and Competition*, OECD, Paris (1995)).

¹³⁶ *Id.*

there is no information or data that we relied upon to make our calculations that is not publicly available.

82. GT&T further states that our proposed use of a single usage-based amount to estimate switching costs is inconsistent with the Commission's assertion in the access charge reform proceeding that a significant portion of local switching costs likely do not vary with usage.¹³⁷ There is, however, no inconsistency between our calculation of a per minute price for the international gateway switching component in this *Order* and our statement in the access charge reform proceeding referenced by GT&T. By calculating a per minute price here, we are not saying that switching costs vary with usage. Rather, we are simply taking the total price we estimate and dividing it by minutes to calculate a per minute price. The per minute price we calculate does not vary with usage.

83. ABS-CBN objected in its comments to the fact that data concerning the geographic distribution of U.S.-originated calls used to calculate the national extension component TCP was not in the record. The national extension TCP is calculated by determining the distribution of international calls from the United States within each country and applying the appropriate tariff to the minutes in each distribution category. The distribution of minutes for each country was determined from information collected on AT&T's customers' calls during a three month period that began on January 6, 1996. AT&T filed the data under seal in this proceeding with an accompanying Motion for Confidential Treatment.¹³⁸ Although we believed that foreign carriers would likely have call distribution data on the U.S.-originated traffic that they terminate, we welcomed AT&T's filing of the call distribution data to supplement the record in this proceeding. Recognizing that "AT&T's call distribution data could provide competitors with competitively-sensitive market and cost structure information about AT&T's operations," the International Bureau issued an order on July 23, 1997, granting AT&T's request for confidential treatment.¹³⁹ The Bureau permitted AT&T to make the information available to all parties of record pursuant to a Confidentiality Agreement that AT&T had attached to its motion. ABS-CBN subsequently filed a motion to establish a comment schedule for the AT&T data.¹⁴⁰ The International Bureau denied ABS-CBN's motion, finding that ABS-CBN had not shown good

¹³⁷ GT&T Reply at 8-9 (citing *Access Charge Reform Order* at ¶ 72).

¹³⁸ International Settlement Rates, *Motion for Confidential Treatment*, IB Docket No. 96-261 (filed by AT&T on July 22, 1997).

¹³⁹ International Settlement Rates, *Order Granting Motion for Confidential Treatment*, IB Docket No. 96-261, DA 97-1563 (rel. July 23, 1997).

¹⁴⁰ International Settlement Rates, *Motion to Establish Comment Schedule*, IB Docket No. 96-261 (filed by ABS-CBN Telecom on July 28, 1997 ("*ABS-CBN Telecom's Motion*").

cause for establishing a comment schedule.¹⁴¹ The Bureau concluded that, contrary to ABS-CBN's representation, the AT&T data is not complex and is presented by AT&T in a concise, easy-to-understand manner.¹⁴²

84. After reviewing the data, ABS-CBN complained that it could not verify the national extension TCP calculations.¹⁴³ ABS-CBN complained in particular that it did not understand how time-of-day weighted prices could have been calculated based on the data provided by AT&T. It concluded that there must be a gap in the data and that the Bureau's asserted reliance on the call distribution data "is suspect."¹⁴⁴ We believe that the data placed on the record by AT&T is sufficient to allow parties to verify the national extension TCP calculations. Moreover, contrary to ABS-CBN's claim, the data is complete. There is no further data that the Bureau relied upon to calculate the national extension TCPs that is not in the record. Because of the confidential treatment granted AT&T's call distribution data, we cannot discuss in this *Order* details of the data. However, we can describe the data generally. The data is provided in table format, with tariff category in one column and the percentage of calls distributed to each category in another column. For countries that also have time-of-day or peak/off-peak tariffs, percentage of calls distributed in each of the relevant timeframes is included in a separate table. The traffic data that is aggregated in table format was collected during a three month period. In the Bureau Report attached to the *Notice*, the International Bureau incorrectly stated that the data was collected for the same one hour period during the three months, when in fact, the data was collected throughout the day for three months. For purposes of calculating the national extension TCP, the International Bureau assumed that the percentage of overall traffic to a country distributed among time-of-day or peak/off-peak tariffs was distributed in the same percentage across tariff categories. Thus, for example, if 40% of the traffic was delivered during the off-peak period, it was assumed that 40% of the traffic in each tariff category was delivered during the off-peak period.

¹⁴¹ International Settlement Rates, *Order Denying Motion to Establish Comment Schedule*, IB Docket No. 96-261, DA 97-1613 (rel. July 29, 1997).

¹⁴² ABS-CBN requested a further comment schedule in part because of "the expected scope of the new AT&T data, which . . . cover up to ninety days of telephone call volumes, segmented by calling hour for at least fifty-six countries." *ABS-CBN Telecom's Motion* at 2. ABS-CBN Telecom expressed this concern in its motion without taking the opportunity to review first the information that AT&T had made available.

¹⁴³ Letter from Gregory C. Staple, Counsel to ABS-CBN, to Peter Cowhey, Chief, International Bureau, July 30, 1997 (*ABS-CBN July 30 Ex Parte*); see also *Telefónica de España and Telefónica Larga Distancia de Puerto Rico July 30 Ex Parte* (arguing that "it is not readily apparent . . . how the Commission used this data to calculate the national extension component of the TCP").

¹⁴⁴ *ABS-CBN July 30 Ex Parte* at 3.

85. ABS-CBN further argues, in its comments and its subsequent July 30 *Ex Parte*, that because the traffic distribution data for the Philippines was collected in 1996, it only covers traffic terminated by PLDT. According to ABS-CBN, the data does not accurately reflect the costs of new carriers which have an obligation to serve outlying areas which are more expensive to serve.¹⁴⁵ As we stated in the *Notice*, any interested party may ask us to reconsider, in a specific case, the benchmarks on the grounds that they do not permit recovery of its incremental costs of providing international termination service.¹⁴⁶ Thus, if ABS-CBN believes that the benchmark of \$0.19 for the Philippines does not permit it to recover its costs, it may submit to us the basis for its cost calculations and we will reconsider that benchmark.

86. Some commenters raise concerns that the TCP methodology ignores certain costs incurred by carriers such as local interconnection costs paid to incumbent local carriers by competing international carriers¹⁴⁷ and additional costs carriers may incur to satisfy government-mandated service objectives like universal service and infrastructure development.¹⁴⁸ As discussed in Section II.B.1, most countries, including the United States, have established a subsidy system in which the cost of the domestic network is not borne wholly by the domestic subscribers in all cases. We recognize, as many commenters point out, that such universal service subsidies are legitimate telecommunications policies. However, we disagree that foreign termination services from certain countries should be required to finance a disproportionate share of network costs, or that foreign carriers should have the ability to impose hidden, discriminatory universal service obligations on termination services for foreign-originated calls.

87. The issue of interconnection rates and universal service obligations is specifically addressed in the Reference Paper on Procompetitive Regulatory Principles negotiated as part of the WTO Basic Telecom Agreement. The Reference Paper obligates the governments that have adopted it as part of their schedules of commitments to ensure the availability of interconnection to major suppliers¹⁴⁹ "under non-discriminatory terms, conditions . . . and rates." It further provides that universal service obligations will not be regarded as anticompetitive, "provided they are administered in a transparent, nondiscriminatory and competitively neutral manner." These

¹⁴⁵ ABS-CBN Reply at 7; *ABS-CBN July 30 Ex Parte* at 3.

¹⁴⁶ *Notice* at ¶ 57. *See infra*, Section II.A.2.

¹⁴⁷ ABS-CBN Comments at 4-5; Tricom Comments at 4.

¹⁴⁸ *See, e.g.*, Telmex Comments, Indetec Statement at 8; Telefónica de España Comments at 50-54.

¹⁴⁹ A major supplier is defined in the Reference Paper as "a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of: (a) control over essential facilities; or (b) use of its position in the market."

principles, as well as the others contained in the Reference Paper, are essential to the implementation of full and fair competition. Discriminatory local interconnection charges and universal service obligations that are levied disproportionately on foreign-originated calls clearly violate these principles. Thus, to the extent that commenters argue our TCP methodology should be revised to take into account discriminatory local access charges or universal service subsidies aimed solely or disproportionately at international termination services, we disagree. We note, however, that as a practical matter, the TCP methodology we adopt here results in settlement rate benchmarks that are still above the cost of providing international termination service. As a result, the benchmarks include a generous contribution that could be applied to fund universal service and other social goals.

88. We emphasize, as stated in the *Notice*, that any interested party may ask us to reconsider, in a specific case, the benchmarks we adopt in this *Order* on the grounds that they do not permit the recovery of the incremental costs incurred to receive, transmit, and terminate international service. TSTT requests more detail "regarding the nature of the forum" for such challenges than was provided in the *Notice*.¹⁵⁰ WorldCom states that the Commission should establish a clear-cut procedure to govern challenges and that the burden should be placed on the foreign carrier to demonstrate that it has higher costs.¹⁵¹ We will permit those asking for reconsideration in a specific case to file a written request seeking a determination that the relevant settlement rate benchmark does not permit recovery of incremental costs. In its request, the petitioner must demonstrate that the relevant incremental costs are higher than the established benchmark.

89. KDD objects to this process, arguing that foreign carriers should not be required to provide cost data to the Commission to justify a different benchmark.¹⁵² At the same time, KDD questions the accuracy of the Commission's benchmarks. It is not our purpose to set foreign carrier rates, but rather to ensure that U.S. carriers' rates are just, reasonable and nondiscriminatory. However, if the Commission is to ensure equitable treatment under its benchmarks policy, it must provide an opportunity for justification of a different benchmark level if it is believed that the established benchmarks do not permit recovery of relevant costs. We do not here compel any foreign carrier to provide cost data. Rather, we provide an opportunity to seek revision of a settlement rate benchmark with which U.S. carriers are to adhere by providing cost data. Moreover, we note that under the Commission's rules, a party may request confidential

¹⁵⁰ TSTT Comments at 3.

¹⁵¹ WorldCom Comments at 9.

¹⁵² KDD Comments at 18. Deutsche Telecom does not object to the challenge process, but argues that any cost information supplied by carriers must be accorded confidential treatment. Deutsche Telekom Comments at 11.

treatment of any cost data it submits to justify a different settlement rate benchmark for a U.S. carrier.¹⁵³

2. Benchmarks Based on Tariffed Components Prices

a. The Notice

90. We proposed in the *Notice* to categorize countries by level of economic development and to establish a separate benchmark for each category. We proposed to use the World Bank and ITU's classification of countries based on level of gross national product (GNP) per capita. The four levels of economic development under this classification scheme are: (1) low income, GNP per capita of less than \$726; (2) lower-middle income, \$726-\$2,895 per capita; (3) upper-middle income, \$2,896-\$8,955 per capita; and (4) high income, \$8,956 or more.¹⁵⁴ We proposed to use the simple average of the tariffed components prices for all countries in each economic development category as the upper end of benchmark ranges.¹⁵⁵

91. We proposed to base our benchmarks on TCP averages instead of relying on individual country TCPs because an averaging approach mitigates the effect of carriers' inefficient pricing structures on our benchmark calculations.¹⁵⁶ Because the TCPs rely on foreign carriers' widely divergent tariffs to set prices for two of the three network elements, any inefficiencies in a foreign carrier's tariffs are captured in its tariffed components price. For example, telephone service in many countries is provided by monopoly carriers whose tariff rates may reflect protected market positions and an ability to charge prices not related to underlying costs. Moreover, many countries have rate structures that use high international or domestic long distance charges to offset below-cost local service fees. Averaging the TCPs mitigates the effect of these inefficiencies by averaging the most inefficient rates with those that are less inefficient.

¹⁵³ See 47 C.F.R. § 0.459.

¹⁵⁴ *Social Indicators of Development*, World Bank, Washington, D.C. (1996). Because our proposed methodology for calculating the benchmarks resulted in benchmarks that are almost identical for lower-middle income and upper-middle income countries, we proposed to merge the two middle income countries into one "middle income" group for purposes of calculating and implementing the benchmark settlement rates.

¹⁵⁵ In addition to our proposal to establish benchmarks based on level of economic development, we asked for comment on other options for calculating benchmarks, either using the TCP methodology or some other approach.

¹⁵⁶ We also asked for comment on whether we should adopt country-specific benchmarks where each country's benchmark would be equal to its TCP.

92. We noted, however, that averaging all countries together would result in a benchmark that was substantially below current settlement rates with lower income countries and in many cases, above or equal to current settlement rates with upper income countries. We therefore proposed to categorize countries by level of economic development for purposes of calculating averages rather than calculate one average for all countries to create a less severe differential between current settlement rates and the benchmarks for lower income countries. We noted that establishing separate benchmarks based on level of economic development would mitigate the impact on developing countries of averaging the TCPs while still capturing some of the benefits of using an average. We also noted that economic development level is a logical way to cluster the tariffed components prices for purposes of averaging because there generally is an inverse correlation between the level of tariffed components prices and a country's level of economic development.

b. Positions of the Parties

93. Many commenters that address the Commission's proposal to calculate three benchmarks based on level of economic development express concern about the use of GNP per capita to classify countries. Many of these comments, however, reflect a fundamental misunderstanding about the rationale for the Commission's proposed TCP methodology. They assume that the Commission believes there is a correlation between income level and telecommunications network costs. Based on this misunderstanding, many commenters argue that grouping countries by income level does not capture certain alleged cost differences among countries.

94. For example, Singapore Telecom states that it "objects to the FCC's proposal to use the World Bank classifications as a basis for calibrating the comparative cost levels of individual countries."¹⁵⁷ Singapore Telecom further states that there is not a clear correlation between economic development and telecommunications costs.¹⁵⁸ KDD also erroneously assumes the Commission proposed to establish benchmarks based upon income levels because there is a correlation between income level and telecommunications costs. Accordingly, KDD states that it opposes the Commission's proposal because "whatever relationship may exist between the World Bank classifications and the relevant cost experiences of any country is so tenuous as to be virtually meaningless."¹⁵⁹ Similarly, AHCJET characterizes the Commission's proposal as

¹⁵⁷ Singapore Telecom Comments at 9.

¹⁵⁸ *Id.*

¹⁵⁹ KDD Comments at 15; *see also* IDC Comments at 5 (Country classifications based on GNP "is an oversimplification of a very complex issue of operating costs as seen in Japan"); CANTO Comments at 6 (use of the World Bank classifications is inappropriate because "the range of cost sensitivity varies enormously among all developing countries"); Cable and Wireless Comments, Attachment A at 5 (whether there is

categorizing countries "to determine costs [] based exclusively on the Gross National Product per capita of each country." AHCJET concludes that it is not valid to use GNP per capita as the only basis to estimate costs.¹⁶⁰

95. Other commenters oppose the Commission's proposal to establish benchmarks based on income level on the ground that GNP per capita does not accurately reflect differences in development level between countries. For example, Panama states that the Commission's proposal to classify countries on the basis of GNP per capita fails to recognize fundamental differences between countries such as economic, political, social, and technological development.¹⁶¹ Similarly, TSTT argues that using GNP by itself to categorize countries is inappropriate because it does not take into consideration other social and economic factors such as unemployment, income distribution, and poverty. TSTT states that GNP per capita is not "a true indicator of the level/extent of development of a country's telecommunications infrastructure."¹⁶² Indonesia states that "relevant factors influencing costs such as teledensity, geographical nature, [and] purchasing power parity" should be taken into account in establishing benchmarks.¹⁶³ COMTELCA argues that reliance on GNP per capita to categorize countries is not the most effective means to achieve what it presumes is the Commission's goal of allowing "countries with the least developed communications infrastructure to receive the highest settlements payments."¹⁶⁴ COMTELCA urges the Commission to adopt a single regional benchmark for Central America.¹⁶⁵

96. Some commenters object to the income level classification of specific countries. COMTELCA notes that our grouping of countries by GNP per capita places only two Central American countries in the low income category, while all others are in the middle income category. COMTELCA argues that all of its member countries have underdeveloped

"an inverse relationship between GNP per capita and the unit costs" of countries' networks is a "debatable proposition"); Japan Reply at 1-2.

¹⁶⁰ AHCJET Comments at 5.

¹⁶¹ Panama Comments at 22; Panama Reply at 13.

¹⁶² TSTT Comments at 3; *see also* France Telecom Comments at 14 (categorizing countries by GNP as the sole criterion may be inappropriate because it fails to take into consideration other elements, such as purchasing power parity or the level of development of a country's telecommunications sector); New T&T Comments at 2.

¹⁶³ Indonesia Reply at 2.

¹⁶⁴ COMTELCA Comments at 12.

¹⁶⁵ *Id.* at 13.

telecommunications systems and therefore should be in the benchmarks category designated for the least developed countries.¹⁶⁶ Tricom notes that the Dominican Republic would be at the extreme bottom of the middle income category and contends that it would be more accurate and appropriate to use the four income categories in the World Bank's classification scheme.¹⁶⁷ The Philippines also objects to the Commission's proposal to merge the two middle income groups, arguing that the combined category treats lower middle income countries unfairly.¹⁶⁸

97. AT&T recognizes that using an averaging approach to establish benchmarks has the advantages of averaging the most inefficient foreign carrier tariffs with those that are more efficient and reducing the burden for less developed countries of moving toward more cost-based rates. However, AT&T urges the Commission to combine the averaging and country-specific approaches by setting the upper end of each country's benchmark range at the lower of either that country's TCP or the average of TCPs for countries in the same income category. AT&T states that combining the approaches is necessary because if the Commission's proposed averaging approach is adopted, countries with TCPs below the average will be discriminating against U.S. carriers by charging rates higher than those charged to domestic customers.¹⁶⁹ COMTELCA opposes this suggestion, arguing that it would not allow foreign carriers to recover their costs.¹⁷⁰

98. MCI also suggests a hybrid approach to setting benchmark settlement rates using TCPs. MCI proposes that the Commission set country-specific benchmarks equal to the lower of a country's TCP or a target rate twenty percent above the mean for all countries in the same economic development category. According to MCI, the Commission's proposed averaging approach would apportion the effect of the most excessive tariff regimes across all countries, instead of mitigating the effect of tariff inefficiencies. MCI states that its approach would reduce the impact of tariff inefficiencies on benchmark rates.¹⁷¹

99. TNZL and Telefónica de España oppose the Commission's proposal to average TCPs for countries in the same income category and urge the Commission to adopt country-specific benchmarks. Telefónica de España states that averaging is inappropriate "given that the

¹⁶⁶ COMTELCA Comments at 12-13.

¹⁶⁷ Tricom Comments at 3.

¹⁶⁸ Philippines Comments at 34-36; *see also* GTE Reply at 23-24; TSTT Comments at 3.

¹⁶⁹ AT&T Comments at 16-27.

¹⁷⁰ COMTELCA Reply at 18-19.

¹⁷¹ MCI Comments at 4-5; MCI Reply at 5-6.

costs at issue vary significantly even between countries that are within the same category."¹⁷² TNZL objects to the Commission's averaging proposal on the ground that there is no necessary correlation between costs and income level. TNZL concludes that a country's own TCP is a closer "proxy" for costs than the averages proposed by the Commission.¹⁷³ Sprint urges the Commission to adopt country-specific benchmarks on the ground that the TCPs reflect cost differences among countries. Sprint states that a country's "geography or distance from the U.S., for example, would, all other things being equal, appear to be highly relevant to its TCP."¹⁷⁴ Frontier, on the other hand, states that country-specific benchmarks would be administratively cumbersome and could result in countries that are similarly situated having significantly different benchmarks.¹⁷⁵ Frontier therefore supports the Commission's proposal to establish benchmarks based on countries' level of economic development.

c. Discussion

100. We adopt, with two modifications, our proposal in the *Notice* to establish separate benchmarks based on countries' level of economic development. We believe, contrary to the arguments of commenters who urge us to adopt country-specific settlement rate benchmarks, that it is appropriate to average country's TCPs and establish benchmarks based on level of economic development. We also believe, contrary to the arguments of some commenters, that GNP per capita provides a reasonable basis for grouping countries for purposes of calculating and implementing settlement rate benchmarks.

101. We use tariff data to calculate two of the three elements for settlement rate benchmarks as the best available option in the absence of cost data. As discussed above, using tariff data has several advantages: it is publicly-available data; it would result in nondiscriminatory treatment of international traffic vis-a-vis domestic traffic; and, importantly, relying on tariff data will result in settlement rate benchmarks that allow foreign carriers to recover more than their costs of providing international service.¹⁷⁶ However, there are also

¹⁷² Telefónica de España Comments at 56.

¹⁷³ TNZL Comments at 7-8; *see also* SDN Users Assoc. Reply at 1 (country-specific benchmarks will result in settlement rates that more closely approach cost-based rates); Coalition of Service Industries Reply at 3 (where country specific data exists, the Commission should establish country-specific benchmarks).

¹⁷⁴ Sprint Comments at 16.

¹⁷⁵ Frontier Comments at 3.

¹⁷⁶ We note that establishing settlement rate benchmarks which allow foreign carriers to recover more than their costs of providing international termination service is more appropriately viewed as a shortcoming rather than an advantage of using tariff data. We reiterate that our goal is ultimately to achieve settlement rates that are cost-based. However, in the absence of cost data, the TCP methodology provides a

certain shortcomings of using tariff data that make reliance on each country's TCP to establish individual country benchmarks inappropriate.

102. The primary shortcoming of using tariff data to calculate settlement rate benchmarks is that any inefficiencies in foreign carriers' tariffed prices are captured in its TCP. As many commenters note, carriers' tariffed prices in many cases do not reflect the underlying cost of providing the tariffed service. This is in part because the tariffs reflect social policies such as universal service goals. For example, many countries have rate structures that use high international and domestic long distance charges to offset below-cost local service fees. Extreme examples of the problems of relying on tariff data to calculate benchmarks are markets such as Hong Kong and Kuwait that do not charge consumers on a per minute basis for domestic calls, but rather rely on a monthly subscription rate that includes domestic service. Another reason tariffed rates reflect inefficiencies is that, in many countries, telephone service is provided by monopoly carriers whose tariff rates may reflect protected market positions and an ability to charge prices not related to underlying costs. Because tariffed rates vary widely as a result of these inefficiencies, similarly situated countries could have substantially different individual TCPs.¹⁷⁷ Another shortcoming of using tariff data to calculate settlement rate benchmarks is that a country could attempt to influence the level of its future benchmark rate by changing its carriers' tariff rates.

103. We believe it is appropriate to average the individual country TCPs to calculate settlement rate benchmarks to mitigate the effect of these shortcomings of relying on tariff data. As AT&T notes, averaging individual country TCPs mitigates the effect of carriers' inefficient pricing structures on our benchmark calculations by averaging the most inefficient rates with those that are less inefficient. In addition, an average figure is beyond the ability of any one country or carrier to alter significantly, so a carrier would have no incentive to change its tariff rates to affect the level of its benchmark.¹⁷⁸ Telefónica de España argues that this concern "can be readily solved by an FCC decision not to recognize significant increases in the underlying TCPs if it finds that those increases are solely intended to raise the benchmark."¹⁷⁹ Such a solution would

reasonable alternative for achieving substantial reductions in the level of current settlement rates.

¹⁷⁷ See, e.g., Telefónica del Perú Comments at 12 (noting that Peru's TCP of \$0.16 is lower than that of France at \$0.175, Germany at \$0.198, and Switzerland at \$0.206).

¹⁷⁸ See, e.g., France Telecom Comments at 11 (agreeing that TCP methodology "could encourage some countries to retain high domestic tariffs in order to justify a high benchmark"); Cable and Wireless Comments, Attachment A at 5 ("use of individual country observations may lead to opportunistic distortions in tariff structures"); United Kingdom Comments at 2 (agrees that an averaging approach could diminish the ability of an individual carrier to affect the level of its benchmark by setting inflated tariffs).

¹⁷⁹ Telefónica de España Comments at 56.

put us in the position of determining whether another country's tariff policies are valid and justified. We do not believe that would be an appropriate role for the Commission.

104. We believe, however, that averaging all individual country TCPs to calculate one benchmark for all countries would ignore important differences among countries. Specifically, we are concerned that calculating one benchmark that applies to all countries would disproportionately affect lower income countries and would not adequately take into account the difficulty many lower income countries will encounter in reducing settlement rates to a more cost-based level. As we observed in the *Notice*, the TCPs are generally significantly higher in lower income countries than in upper income countries. If the TCPs of lower income countries were averaged with those of higher income countries to establish one benchmark, the differential between the new benchmark rate and current settlement rates would be much greater for lower income countries than for higher income countries. Indeed, for many higher income countries, there would be little difference between an average benchmark and current settlement rates. Establishing separate benchmarks based on level of economic development would mitigate the impact of averaging on lower income countries while still capturing some of the benefits of averaging.¹⁸⁰

105. Many commenters urge the Commission to heed in particular the effect of significant reductions in settlements revenues on telecommunications network development in lower income countries trying to develop their infrastructure.¹⁸¹ We agree with these commenters that calculation and implementation of our benchmarks should take into account the impact on lower income countries of moving to more cost-based settlement rates. As many commenters note, investment in network infrastructure in lower income countries benefits not only the

¹⁸⁰ The reason the TCPs are generally higher in lower income countries is that the inefficiencies embedded in the underlying tariff data are generally more pronounced in lower income countries. Several commenters argue that the costs of providing international termination service are higher in developing countries. See, e.g., CANTO Comments at 3; Indonesia Reply at 2; TSTT Comments at 4 (economies of scale are lower in developing countries; Telekom Malaysia Comments at 3 (costs are greater where networks have not reached maturity); Pakistan Telecom Comments at 1 (economies of scale are lower in developing countries and cost of equipment is higher because it is all imported); Telefónica del Perú Comments at 15 (incremental cost of terminating traffic in a country like Peru which is in process of updating poor infrastructure is likely to be far higher than in industrialized nations); Sonatel Reply at 1 (costs incurred in developing countries are two or more times higher than in industrialized countries). We are not convinced that there are substantial differences in costs based solely on a country's level of economic development. Level of economic development may have an effect on certain costs, but that effect is not always negative. For example, lower income countries generally have lower labor costs than higher income countries but higher capital costs. The ITU also has expressed skepticism that the costs of providing telecommunications service is higher in developing countries, noting that "an analysis of recent data contradicts the theory about higher operating costs in developing countries." *Direction of Traffic: Trends in International Telephone Tariffs*, ITU/Telegeography (1996) at 13.

¹⁸¹ See, e.g., GT&T Reply at 13; CANTO Comments at 5; Cable and Wireless Comments at 10-15.

economies of lower income countries, but also the economies of other countries.¹⁸² Poor network development is an infrastructure bottleneck that constrains all levels of economic activity and impedes the development of international commerce and trade.

106. In the *Notice*, we proposed to group countries by level of economic development, using established World Bank and ITU categories based on GNP per capita, for purposes of calculating and implementing our settlement rate benchmarks. Our purpose in using the World Bank and ITU's classification scheme based on GNP per capita was to provide a reasonable indicator of a country's ability to transition to a more cost-based system of settlement rates without undue disruption to its telecommunications network. We believe that the level of development of a country's telecommunications network is an important indicator of that country's ability to transition to a more cost-based system without undue disruption of its network. This is because many carriers with poor telecommunications infrastructure state that they rely on settlement revenues to finance that network development. Thus, a rapid curtailment of settlement revenues could have a negative impact on network development in countries with poor telecommunications infrastructure. We also believe, however, that other social indicators of economic development are relevant to determining the impact of the benchmark settlement rates on a county's telecommunications network. As some commenters point out, a negative impact on a county's overall economic welfare from implementation of the benchmark settlement rates can create an indirect, but substantial, effect on a country's telecommunications network.¹⁸³

107. After reviewing the record, we continue to believe that the categories we proposed in the *Notice* provide a reasonable basis for establishing and implementing settlement rate benchmarks. The World Bank's classification of countries by GNP per capita is an objective, internationally accepted measurement of countries' level of economic development. While, as some commenters point out, there are many other indicators of economic development level, GNP per capita provides an objective and administrable basis for classifying countries. Moreover, we believe that economic development level is generally a good indicator of the level of

¹⁸² See, e.g., CANTO Comments at 2-3 (noting the negative effect on U.S. consumers of policies that could undermine network development in developing countries); ITJ Comments at 17 ("Clearly the use of settlement payments to develop infrastructure and to increase penetration in lesser-developed correspondent countries ultimately redounds to the benefit of not only their citizens but also of carriers from developed countries."); Cable and Wireless Comments at 12-13; Pakistan Telecom Comments at 2; Telefónica del Perú Comments at 4 (improvements in Peruvian telecommunications infrastructure have directly benefitted U.S. consumers through, for example, an increase in call completion); United Kingdom Comments at 2; Sonatel Reply at 1 (noting the importance of developing a network "which can meet the international standards and thus can better support and serve the interests of international business, United Nations' offices, embassies, etc."); TSTT Comments at 5 ("benefits will redound to the USA" from improvements in developing countries' telecommunications infrastructure).

¹⁸³ See, e.g., TSTT Comments at 3 ("social and economic factors such as unemployment, income distribution and poverty" are relevant indicators of the "level/extent of development of a country's telecommunications infrastructure").

development of a country's telecommunications network, and as such, provides a reasonable measure for determining a country's ability to transition to more cost-based settlement rates. As the ITU has observed, "[t]here is generally a close relationship between the level of economic development and telecommunications development."¹⁸⁴ In a study of 164 economies comparing level of GDP per capita and teledensity, the ITU found the strength of this relationship to be significant.¹⁸⁵

108. Some commenters disagree with economic development as a basis for grouping countries on the ground that GNP per capita is not an accurate indicator of the level of development of a country's telecommunications infrastructure.¹⁸⁶ TSTT suggests that teledensity would be a better basis for categorizing countries.¹⁸⁷ For the most part, we disagree with these commenters.¹⁸⁸ As noted above, there is generally a strong correlation between level of economic development and telecommunications development. As such, we believe economic development provides a reasonable lowest common denominator for determining a country's ability to transition to a more cost-based system of settlement rates without undue disruption to its telecommunications network. Moreover, in providing transition periods, we are also concerned about the effect of our benchmark settlement rates on a country's general economic welfare. GNP per capita provides a more general indicator of a country's level of economic development than factors that focus solely on telecommunications infrastructure.

109. Some commenters argue that our proposal to group countries on the basis of economic development level for purposes of calculating and implementing our settlement rate benchmarks violates our MFN obligations under the WTO Basic Telecom Agreement.¹⁸⁹ We disagree with these commenters. MFN is essentially a nondiscrimination rule that requires each WTO Member to treat like services and service suppliers from all other WTO Members

¹⁸⁴ See Telecommunications Indicators for the Least Developed Countries, First Edition, 1995, ITU at 4 ("*ITU Telecommunications Indicators*").

¹⁸⁵ *Id.* The ITU found a correlation co-efficient of 0.85, where 1.0 would equal perfect correlation.

¹⁸⁶ See, e.g., TSTT Comments at 3; France Telecom Comments at 14; Panama Comments at 22.

¹⁸⁷ TSTT Comments at 3.

¹⁸⁸ As discussed below, we agree that GNP per capita may not adequately reflect the level of telecommunications network development, and consequently the ability to transition to more cost-based settlement rates, in the poorest countries.

¹⁸⁹ See, e.g., Japan Comments at 4; EU Comments at 4; GTE Comments at 33; KDD Comments at 25-26; Telefónica de España Reply at 13-14.

similarly.¹⁹⁰ Our MFN obligation does not affect our ability to calculate and implement our settlement rate benchmarks in a manner that recognizes legitimate differences among countries. As discussed above, we group countries by economic development level to provide a reasonable indicator of a country's ability to transition to a more cost-based system of settlement rates without undue disruption to its telecommunications network. Moreover, calculating one benchmark that applies to all countries would disproportionately affect lower income countries. This is because the TCPs are generally significantly higher in lower income countries than in upper income countries. As a result, if the TCPs of lower income countries were averaged with those of higher income countries to establish one benchmark, the differential between the new benchmark rate and current settlement rates would be much greater for lower income countries than for higher income countries. Thus, carriers in lower income countries would be required to make substantially greater reductions in settlement rates than in upper income countries.

110. We agree generally with commenters who argue that we should maintain separate categories for upper middle and lower middle income countries, rather than combine the two categories as we proposed in the *Notice*.¹⁹¹ We proposed in the *Notice* to merge the two middle income categories because our method of calculating benchmark rates results in benchmarks that are almost identical for lower middle and upper middle income countries. But as some commenters point out, there are often substantial differences in the level of network development between countries at the high end of the upper middle income category and countries at the bottom end of the lower middle income category.¹⁹² These differences are particularly significant in determining a reasonable transition period for U.S. carriers to negotiate settlement rates within the benchmarks.¹⁹³ We will continue to merge the two middle income categories for purposes of calculating a settlement rate benchmark, for the simple reason that our method of calculating the benchmark results in a benchmark that is almost identical for the two categories. However, we will maintain the separate categories for lower middle and upper middle income countries that are set forth in the World Bank and ITU's classification scheme for purposes of the transition periods we adopt in Section II.B.2. of this *Order*.

¹⁹⁰ Article II of the GATS requires WTO Member countries to accord "service and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country."

¹⁹¹ See, e.g., COMTELCA Comments at 2; Cable and Wireless Comments, Attachment A at 5; Tricom Comments at 3.

¹⁹² See, e.g., GTE Comments at 18; Tricom Comments at 3; TSTT Comments at 3; see also AHCIET Comments at 6 (proposal to treat all middle income countries the same disregards the approach stated in the *Accounting Rate Flexibility Order* to adopt policies to reflect conditions in developing countries).

¹⁹³ The transition periods we adopt for implementation of the benchmark settlement rates are discussed in Section II.B.2., *supra*.

111. As proposed in the *Notice*, we will base our benchmarks on the simple average of the TCPs for all countries in each category. This results in benchmarks of:

upper income countries	\$0.15
upper-middle income countries	\$0.19
lower-middle income countries	\$0.19
lower income countries	\$0.23

112. We will adopt our proposal in the *Notice* to revise and update our benchmarks periodically as necessary. As we stated in the *Notice*, periodic revisions are necessary to avoid the problem in the future of our benchmarks not keeping pace with cost reductions, and to encourage further movement toward cost-based settlement rates.¹⁹⁴ However, if a U.S. carrier has obtained a commitment from a foreign correspondent to reduce its settlement rate to a level at or below the relevant benchmark within a specified timeframe, we will not require the U.S. carrier to achieve further reductions if the relevant benchmark is revised within the timeframe specified by the U.S. carrier and its foreign correspondent. This will ensure that carriers that have committed to achieving settlement rates within the benchmarks are not adversely affected by any revisions to the benchmarks.

113. We sought comment in the *Notice* on whether it would be appropriate to forbear from applying our settlement rate benchmarks where there is effective competition for international services on a route and where substantial progress has been made toward achieving rates that represent the incremental cost of terminating international service.¹⁹⁵ Several commenters argue that such forbearance would be appropriate. The European Union agrees with the Commission's statement in the *Notice* that the most effective way to ensure settlement rates are at cost-based levels is through the development of competitive markets for IMTS. The European Union thus argues that our benchmarks should not be applied to liberalized markets.¹⁹⁶ TNZL argues that there is no need to adopt benchmarks for routes where there is effective

¹⁹⁴ *Notice* at ¶ 28. Deutsche Telekom urges us to revise the settlement rate benchmarks in the future to reflect tariff changes. Deutsche Telekom Comments at 9-10.

¹⁹⁵ *Notice* at 69.

¹⁹⁶ European Union Reply at 2; *see also* ASETA Comments at 2 (settlement rate negotiations must be conducted "under the principles of free competition").

competition in the international services market.¹⁹⁷ The United Kingdom also urges that benchmarks not be applied on competitive routes. It states that benchmarks could act as an "upward target for rates in such markets."¹⁹⁸ ABS-CBN states that where non-dominant carriers exist at both ends of a route, the Commission should first rely on commercial negotiations, not regulations, to achieve cost-based rates.¹⁹⁹ Americatel and Entel-Chile request that we forbear from applying our benchmarks to the U.S.-Chile route because, they argue, competition in the Chilean long distance and international markets is already vigorous.²⁰⁰ IDC contends that the "urgency" of our benchmarks proposals is lessened considerably in many upper income countries such as Japan where, it states, settlement rates have been declining steadily.²⁰¹

114. We continue to believe, as we stated in the *Notice*, that the best way to achieve cost-based rates is through effective competition. However, we conclude that we should not forbear from applying our settlement rate benchmarks on any route, including routes where competition has been introduced. While we expect, and experience has shown, that settlement rates on routes where there is effective competition will move toward cost-based levels, it will take time for vigorous competition to create efficient pricing. We thus believe that we cannot rely entirely on the development of competitive markets to reduce settlement rates to more cost-based levels in a timely manner. Also, as Japan notes, the standards for determining where effective competition exists and when substantial progress has been made in negotiating cost-based settlement rates could be difficult to establish objectively.²⁰² Moreover, we are concerned that a policy which would create an exemption based on the existence of competition in the destination market from our requirement that U.S. carriers negotiate settlement rates within our benchmarks may not be consistent with our MFN obligations under the GATS.²⁰³

¹⁹⁷ TNZL Comments at 5; *see also* Telefónica de España Comments at 67-69 (the Commission should not apply benchmarks to countries which satisfy the ECO test).

¹⁹⁸ United Kingdom Comments at 2.

¹⁹⁹ ABS-CBN Comments at 1-2. ABS-CBN also argues that our benchmark settlement rate policy will expand our international settlements policy ("ISP") on many routes where it should be relaxed. ABS-CBN submits that where a non-dominant U.S. carrier is corresponding with a non-dominant foreign carrier, regulatory forbearance will best serve the public interest. ABS-CBN Comments at 2. We agree that in many cases involving non-dominant carriers, our ISP may not be necessary. The rules governing flexible settlement arrangements that deviate from the ISP are set forth in our *Accounting Rate Flexibility Order*.

²⁰⁰ Entel-Chile Comments at 1-2; Americatel Comments at 1-2.

²⁰¹ IDC Comments at 13.

²⁰² Japan Reply at 3.

²⁰³ *See* Section II.C.3, *supra*. Some commenters also raise this concern. *See, e.g.*, GTE Comments at 31-32.

115. We note, however, that in markets where there is fully developed competition, settlement rates will likely be below the benchmarks we adopt in this *Order*. Thus, whether the settlement rate benchmarks should be implemented on those routes would be a moot question. As a practical matter, the benchmarks we adopt here will only affect those markets where competition has not been introduced or has not yet fully developed. We anticipate that with the increasing market liberalization that will result from implementation of countries' commitments made in the WTO Basic Telecom Agreement, our benchmarks policy will have minimal impact on most WTO Member countries. We disagree with the United Kingdom that, in competitive markets, our benchmark settlement rates will serve as upward targets. We expect that competition will force rates to competitive levels, which would clearly be below the level of the benchmarks. In addition, in competitive markets, we expect to see much greater reliance on alternatives to settlement rates as permitted under our *Accounting Rate Flexibility Order*. These alternatives will help encourage termination rates to drop even closer to costs than the benchmarks we set today.

116. Americatel and Entel-Chile seek confirmation that alternative settlement arrangements approved by the Commission pursuant to the policies adopted in the *Accounting Rate Flexibility Order* are not subject to the benchmarks.²⁰⁴ ABS-CBN raises a related issue, arguing that our benchmarks policy is inconsistent with our flexibility policy.²⁰⁵ We disagree that there is an inconsistency between our benchmarks policy and our flexibility policy. Our flexibility policy establishes a more flexible regulatory framework that permits carriers to take their international traffic off the traditional settlement system where effective competitive conditions permit and to negotiate alternatives for terminating international calls that do not comply with the Commission's ISP. The focus of our ISP is on preventing foreign carriers from discriminating among U.S. carriers.²⁰⁶ By contrast, the goal of our benchmarks policy is to reduce settlement rates where market forces have not led to more cost-based settlement rates. To the extent we may in the future need to consider the application of the two policies in individual circumstances, we will examine those situations at the time they arise, on a case-by-case basis.²⁰⁷

²⁰⁴ Americatel Comments at 2; Entel-Chile Comments at 2.

²⁰⁵ ABS-CBN Supplemental Comments at 6-7.

²⁰⁶ The ISP requires (1) the equal division of accounting rates; (2) nondiscriminatory treatment of U.S. carriers; and (3) proportionate return of inbound traffic. See *Implementation and Scope of the International Settlements Policy for Parallel Routes*, CC Docket No. 85-204, *Report and Order*, 51 Fed. Reg. 4736 (Feb. 7, 1986) (*ISP Order*), *modified in part on recon.*, 2 FCC Rcd 1118 (1987) (*ISP Reconsideration*), *further recon.*, 3 FCC Rcd 1614 (1988). See also *Regulation of International Accounting Rates*, 6 FCC Rcd 3552 (1991), *on recon.*, 7 FCC Rcd 8049 (1992).

²⁰⁷ We note that in its comments TNZL seeks a modification of the approval process for alternative arrangements pursuant to the *Accounting Rate Flexibility Order*. This issue is not properly raised in this proceeding, however. It is an untimely request for reconsideration of the *Accounting Rate Flexibility Order*. We therefore will not address the merits of TNZL's argument here.

117. KDD notes that under our benchmark proposal, carriers providing service from the United States would have the same benchmark settlement rate as their foreign correspondents, despite the fact that foreign correspondents' benchmarks will vary according to the level of economic development of the country in which the correspondent is located. It concludes that carriers providing service from the United States will therefore be charging their foreign correspondents above-cost rates.²⁰⁸ CANTO states that Commission acknowledgement that there may be a cost disparity between carriers providing service from the United States and their correspondents in developing countries demonstrates that the symmetrical division of the accounting rate deprives foreign carriers of settlement revenues to which they are entitled under cost-oriented accounting arrangements.²⁰⁹ Other commenters similarly note that a system of symmetrical settlement rates is inconsistent with our goal of achieving cost-based settlement rates.²¹⁰ We agree that in a system where settlement rates are truly cost-based, rates will not be symmetric in all cases. As commenters point out, costs may vary among some countries, although we believe that the variation is minimal in most cases. However, as we have noted, we lack the cost data to determine whether, and to what extent, costs vary from one end of a call to the other. The crux of these commenters' objections is that the Commission should reconsider the 50/50 division of accounting rates required by the ISP. We continue to believe that, in most cases, our ISP is necessary to prevent the "whipsawing" of U.S. carriers by dominant foreign carriers.

118. We decline to adopt AT&T and MCI's proposed alternative approaches to calculating benchmarks. AT&T's proposes to set the upper end of each country's benchmark range at the lower of either that country's TCP or the average of TCPs for countries in the same income category, and MCI proposes to set country-specific benchmarks equal to the lower of a country's TCP or a target rate twenty percent above the mean for all countries in the same economic development category. We believe these proposals are inconsistent with the principle of using averages. We use an average to mitigate the effect of tariff inefficiencies by averaging the most inefficient tariffs with those that are less inefficient. AT&T and MCI's proposals are essentially attempts to guarantee lower settlement rate benchmarks by ignoring the effect of averaging for countries with relatively lower TCPs. We believe that their proposals are theoretically inconsistent with our approach and we decline to adopt them.

²⁰⁸ KDD Comments at 16-18; *see also* ITJ Reply at 1 (concurring with KDD's argument); European Union Reply at 2 (urging the Commission to reconsider the symmetrical division of accounting rates); Cable and Wireless Comments at 21; VSNL Comments at 6.

²⁰⁹ CANTO Comments at 3; *see also* COMTELCA Comments at 15 (in light of the fact that developing countries' costs are higher, it may be appropriate to implement a system of asymmetric settlements); India Reply at 2 (arguing that accounting rates should be split unequally with developing countries).

²¹⁰ VSNL Comments at 6; Telstra Comments at 6; Korea RPOAs Comments at 3-4; GTE Comments at 9; Japan Comments at 4; Portugal Comments at 3-4; GTE Comments at 9; Telstra Comments at 6.

119. We disagree with TNZL and Telefónica de España that we should adopt country-specific benchmarks. They urge us to adopt country-specific benchmarks because, they contend, each country's TCP is a closer proxy for costs than an average. However, the TCPs themselves are not a proxy for costs. Rather, they are based on what we believe is the best available information for assessing the reasonableness of settlement rates in the absence of cost information. Moreover, as discussed above, we believe that averaging is appropriate to mitigate the impact of tariff inefficiencies on our benchmark calculations and to eliminate the incentive of carriers to attempt to influence the level of the benchmark rate that applies to their country by raising tariff prices.

120. In summary, we categorize countries by their level of economic development, as defined by GNP per capita, and adopt a separate settlement rate benchmark for each category. The benchmark for each category is calculated using the average of the TCPs for all countries for which we have data in each category. The country categories and their corresponding benchmark are: \$0.15 per minute for high income countries (GNP per capita of \$8,956 or more); \$0.19 per minute for upper-middle income countries (GNP per capita of \$2,896-\$8,955); \$0.19 per minute for lower-middle income countries (GNP per capita of \$726-\$2,895); and \$0.23 for lower income countries (GNP per capita of less than \$726).

3. Safeguard in Cases of Market Distortion

a. The Notice

121. We proposed in the *Notice* to establish a separate benchmark range for each economic development category. We proposed to base the upper end of the ranges on the TCP methodology and for each category, to use an estimate of the incremental cost of terminating international traffic for the lower end of the range. We proposed to use an estimate of the incremental cost for the lower end of the range because it is our goal ultimately to achieve settlement rates that are more closely cost-based than are current settlement rates. We recognized, however, that we do not have sufficient data at this time to calculate a precise estimate of incremental cost. We therefore proposed to use an estimate provided by AT&T of its "average network cost" for termination of inbound international calls as the starting point to derive a preliminary estimate of incremental cost.²¹¹ We also encouraged both U.S. and foreign carriers to submit incremental cost data.

122. AT&T provided an estimate of \$0.075 per minute for the costs of the international half-channel, gateway switching, domestic interexchange carrier distribution, and local

²¹¹ Letter from R. Gerard Saleme, Vice President - Government Affairs, AT&T to Donald Gips, Chief, International Bureau, Federal Communications Commission, December 16, 1996 ("*AT&T December 16 Ex Parte*").

distribution. To get closer to an estimate of incremental cost, we removed the common costs that we could identify and quantify in AT&T's estimate of average network costs -- the common costs included in the access charges. Removing the access charges from AT&T's \$0.075 estimate results in an estimate of \$0.06 for the incremental cost of terminating international traffic.²¹² We noted that while our estimate is based on the costs of a U.S. carrier, the incremental cost in foreign countries is not likely to vary from our estimate by more than a few cents and likely does not exceed \$0.09 per minute.

b. Positions of the Parties

123. Commenters express different views on whether the Commission should use an estimate of TSLRIC for the lower end of the benchmark ranges. Several commenters agree with the Commission that it is appropriate to use an estimate of the TSLRIC of terminating international traffic for the lower end of the benchmark ranges because that is the level to which rates would tend in a competitive market. Frontier agrees with the Commission that "pricing based upon incremental costs is economically efficient and, in a competitive environment, rates would tend to move toward incremental costs."²¹³ WorldCom notes that "economists generally agree that a forward-looking, incremental costing standard is the best reflection of the actual cost of terminating telecommunications traffic."²¹⁴ AT&T fully agrees that reducing settlement rates to a TSLRIC-based level "should be the Commission's overall policy objective." AT&T states that TSLRIC pricing is necessary to encourage efficiency and to prevent competitive distortions in the U.S. IMTS market.²¹⁵

124. Those who disagree with the Commission's proposal generally object to the Commission's conclusion that TSLRIC is the appropriate measure of costs for establishing cost-based settlement rates. However, some commenters also object specifically to the Commission's estimate of TSLRIC.

²¹² We noted this estimate is greater than incremental cost because it includes some contributions to the common costs of AT&T's network that we cannot identify on the basis of the data provided by AT&T.

²¹³ Frontier Comments at 2-3; *see also* NTIA Reply at 4-5 ("In a competitive market, settlement rates would naturally move closer to incremental cost"); Alexis de Tocqueville Institute Reply at 5 (in evaluating actual cost data provided by foreign carriers, Commission should "bear in mind the rates that obtain in truly competitive markets as the best proxies for actual incremental cost plus a market-based rate of return").

²¹⁴ WorldCom Comments at 6 (noting that five former Chief Economists of the United States Department of Justice, Antitrust Division, support forward-looking costing of local interconnection rates).

²¹⁵ AT&T Comments at 21.

125. Many commenters that object to the application of a TSLRIC methodology to determine cost-based settlement rates do so on the grounds that the methodology has not been accepted by all countries. These commenters object to what they see as an attempt by the Commission to impose the TSLRIC methodology on other countries.²¹⁶ GTE and Telmex disagree with the economic theory upon which the TSLRIC methodology is based. They oppose the use of a TSLRIC methodology for setting any rates, including settlement rates.²¹⁷

126. Some commenters disagree not only with the use of a TSLRIC costing methodology to determine cost-based settlement rates generally, but also with the Commission's estimate in the *Notice* of the TSLRIC of terminating international traffic. For the most part, these commenters argue that the Commission's reliance on AT&T's estimate of its average network cost to calculate a TSLRIC estimate is inappropriate because other carriers' costs are likely to differ from AT&T's.²¹⁸ Some commenters cite to our recent *Access Charge Reform Order* and *Universal Service Order* as confirmation that the Commission lacks a reliable methodology for estimating the TSLRIC of providing international termination service.²¹⁹

127. AT&T, on the other hand, contends that its average cost data provide a reasonable, and in fact, generous estimate for all carriers of the TSLRIC of providing international termination service. This is because, according to AT&T, there are no material differences between the costs of U.S. and foreign carriers for the termination of international calls.²²⁰ AT&T

²¹⁶ See, e.g., Chunghwa Telecom Comments at 2; France Telecom Comments at 11; KDD Comments at 12; Philippines Comments at 29-30; Singapore Telecom Comments at 8; Japan Reply at 1.

²¹⁷ GTE Reply at 26; Telmex, Indetec Statement at 9; see also COMTELCA Comments at 14.

²¹⁸ Deutsche Telekom Comments at 10; see also HKTI Comments at 28 (AT&T estimates "should be considered with the greatest skepticism"); GTE Reply at 25 (AT&T cost data is not a proper measure of other carriers' costs and "is a particularly poor proxy for the costs faced by operators in developing countries"); Japan Reply at 2-3 (use of AT&T data inappropriate because AT&T economies of scale far exceed any other carrier in the world); CANTO Comments at 3 (the difference in costs for foreign carriers "is far greater than the FCC's estimate of \$0.3/minute"); GT&T Reply at 11-12 (carriers in developing countries have higher costs than AT&T); France Telecom Comments at 12; KDD Comments at 13-14 (Commission lacks data necessary to implement TSLRIC methodology); Singapore Telecom Comments at 8 (data necessary to implement TSLRIC methodology do not exist); Telintar Comments at 10 ("AT&T's estimate of its domestic cost structure plainly has no relevance to the costs incurred by carriers in other countries").

²¹⁹ See *KDD June 5 Ex Parte* at 6; *Telefónica de España and Telefónica Larga Distancia de Puerto Rico July 30 Ex Parte* at 2-3.

²²⁰ AT&T Comments at 29. AT&T states that for the international transmission component of providing termination service, both U.S. and foreign carriers generally acquire undersea cable capacity under similar consortium cable system agreements and satellite capacity from independent satellite providers. For the international switching component, switching equipment is purchased by both U.S. and foreign carriers from the same equipment providers in a competitive, global market. *Id.*

argues that to the extent cost differences do exist, they should result in foreign carriers having lower costs than U.S. carriers.²²¹

c. Discussion

128. We have stated many times that the most effective way to ensure that consumers pay economically efficient, cost-based rates is through the development of effectively competitive markets.²²² We therefore believe that where markets are not effectively competitive, and we must seek through regulation to ensure that rates are reasonable, we should attempt to the greatest extent possible to duplicate prices that exist in competitive markets. Our goal in this proceeding thus is to establish settlement rate benchmarks that reflect rates that would prevail if the originating and terminating markets for international services were competitive.

129. We believe settlement rates in markets where there is effective competition would tend to the level of total service long run incremental costs, or TSLRIC.²²³ In dynamic, competitive markets, firms take action based not on embedded costs, but on the relationship between market-determined prices and forward-looking costs. If market prices exceed forward-looking economic costs, new competitors will enter the market and prices will be driven toward a forward-looking incremental cost level. For services such as international termination services that share some joint and common costs, incremental costs would include a reasonable contribution to forward-looking joint and common costs. Because rates in competitive markets will tend towards the level of forward-looking incremental costs plus a reasonable contribution to joint and common costs, we conclude that an incremental costing methodology is the appropriate basis for determining cost-based settlement rates.

130. We agree, however, with commenters who contend that we do not have the incremental cost data or a costing methodology necessary to calculate a precise estimate of carriers' incremental cost of terminating international traffic. We noted this lack of data in the *Notice*. It was for that reason we proposed to use the TCP methodology to calculate the top end

²²¹ *Id.* at 28. AT&T states that foreign carriers' satellite transmission costs may be significantly lower than U.S. satellite transmission costs because foreign carriers may purchase directly from Intelsat, while U.S. carriers are required to use Comsat as an intermediary. AT&T further states that vertically integrated foreign carriers that own and operate national networks may experience lower costs for domestic transport and termination than U.S. interexchange companies that must pay access charges to LECs. *Id.* at 29-30.

²²² *See, e.g., Notice* at ¶ 20; *Access Charge Reform Order* at ¶ 263 ("Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production"). *See also* Coalition for Hemispheric Competitiveness Comments at 7 (competition in local and international communications services is the best method to provide reasonably priced, cost-based telecommunications services).

²²³ The term TSLRIC is defined in more detail in Section II.A, *supra*.

of the benchmark ranges. We nonetheless proposed to use an estimate of the incremental cost of terminating international traffic for the lower end of the benchmarks because it is our goal ultimately to achieve settlement rates at an incremental cost level. We calculated a "preliminary estimate of incremental cost" using data supplied by AT&T as a starting point. In making this preliminary estimate, we sought to generate comments and incremental cost data that would enable us to calculate a more accurate estimate of incremental costs. However, we received no comments that help us with this task.²²⁴ AT&T argues that its average cost data provide a reasonable estimate for all carriers of the TSLRIC of providing international termination service, but it submitted no evidence in its comments on what TSLRIC prices would be.

131. We also agree with commenters that argue we should not adopt a TSLRIC estimate based solely on the data supplied by AT&T. While there is no evidence on the record to show that AT&T's costs differ from other carriers, as some commenters assert,²²⁵ we agree that we need more information before we can adopt a TSLRIC estimate. We therefore decline at this time to adopt a TSLRIC estimate for the low end of the benchmark range. Instead, we will adopt one benchmark rate for each economic development category. This benchmark rate will be based, as discussed in Section II.A, on the TCP methodology.

132. Instead of establishing settlement rate benchmark ranges with the low end based on an estimate of the TSLRIC of providing international termination services, as proposed in the *Notice*, we will adopt a rate that we will enforce as a safeguard when we detect distortion in the U.S. market for IMTS. As discussed in the *Notice*, and in Section II.C. of this *Order*, above-cost settlement rates create certain distortions in the U.S. market for IMTS. However, if settlement rates are at cost-based levels, carriers will not have the ability to engage in market distorting behavior. We thus adopt a "best practice" rate that is closer to a cost-based level than our settlement rate benchmarks that we can apply to prevent market distorting behavior. This rate will be applied only to the extent carriers seek authorization to provide facilities-based service from the United States to affiliated markets and to provide private line resale service, as discussed in Sec. II.C., *infra*. In those cases, the rate will be enforced only if the Commission detects market distortion on the route or routes in question.

133. Because we do not have data to establish an accurate cost-based rate, we will use a market-based rate as a substitute. Rates in competitive markets would tend to an incremental cost level. We thus look to competitive markets to find a rate that can be applied in cases of market distortion in lieu of a TSLRIC estimate. As the Alexis de Tocqueville Institution states, rates that exist "in truly competitive markets [are] the best proxies for actual incremental cost plus

²²⁴ We encouraged both U.S. and foreign carriers to submit incremental cost data, but received none. *Notice* at ¶ 50.

²²⁵ *See, e.g.*, Deutsche Telekom Comments at 10; France Telecom Comments at 12.

a market-based rate of return."²²⁶ We adopt a "best practice" rate that is based on the lowest, commercially viable, settlement rate paid today by U.S. carriers to an overseas carrier from a competitive market. We will revisit this rate in the future, as market conditions warrant. We recognize that there could be instances where this rate does not accurately reflect a carrier's costs of providing international termination service. We will therefore consider, on a case-by-case basis, other factors that may influence the level of the best practices rate as applied to individual carriers. However, the best practice rate we adopt here, as revised in the future, will be a presumptive rate that will apply in cases of market distortion until evidence is presented that other factors should be taken into consideration.

134. As the first step in choosing the current best practices rate, we identify the lowest settlement rate that U.S. carriers pay on average for traffic to any country. The lowest settlement rate that U.S. carriers currently pay on average is with Sweden, at 0.06 SDR (\$0.08).²²⁷ The next step in choosing the rate is to determine whether the rate is commercially viable. We conclude that it is. This rate has been in effect since March 1996 and during that time, Sweden has experienced sustainable, vibrant, procompetitive development of its telecommunications industry. We have previously found that Sweden offers effective competitive opportunities ("ECO") for U.S. carriers to offer facilities-based switched and private line services. In making this determination, we found that there are no legal restrictions on competitive entry in Sweden and that the actual conditions, including the terms and conditions of interconnection, competitive safeguards, and the regulatory framework, are conducive to entry.²²⁸ We also noted the actual entry of multiple facilities-based international carriers into the Swedish market.²²⁹ The vibrant

²²⁶ Alexis de Tocqueville Institution Reply at 5. The Coalition for Hemispheric Competitiveness urges us to look exclusively to pricing which exists in competitive markets to set benchmarks, rather than using the TCP methodology. Coalition for Hemispheric Competitiveness Comments at 8.

²²⁷ We note that U.S. carriers have a growth-based rate of 0.15 SDR and 0.1 SDR (this translates into a settlement rate of \$0.105 and \$0.07) with British Telecom for service to the United Kingdom. While the rate is structured so that all U.S. carriers currently pay the \$0.07 rate, we do not believe it is appropriate to choose only the lower rate in a growth-based rate structure for our best practice rate. We also note that TeleNordia and MCI have reached an agreement for a \$0.06 settlement rate. However, that agreement has not yet gone into effect, so there is no evidence that it is a commercially viable rate.

²²⁸ Telia North America, Inc., Application for Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, to Acquire and Operate Facilities to Provide International Services Between the United States and Sweden, *Order, Authorization and Certificate*, I-T-C-96-545, DA 97-511 (International Bur., rel. March 11, 1997) ("*Telia NA Order*").

²²⁹ *Id.* at ¶ 23. See also "Modern Telecommunications for Everybody: Green Paper on a revised Swedish telecommunications regulation," Ministry of Transport and Communications (Aug. 15, 1996) at 13-14 (discussing competitive trends in the Swedish market for international services). The Swedish National Post and Telecom Agency does not distinguish between facilities-based and resellers in licensing and does not publish a list of the facilities-based operators providing service in Sweden. Telia NA, however, estimates that there are eleven facilities-based operators in Sweden that either own their own facilities or lease facilities. See *Telia NA Order* at n. 21.

procompetitive development of the Swedish telecommunications sectors indicates that its settlement rate with the United States is economically feasible and sustainable. We thus adopt U.S. carriers' current settlement rate with Sweden, \$0.08 cents, as our "best practice" rate to be applied in cases of competitive distortion.

135. We emphasize that the "best practice" rate we adopt in this *Order* will apply only in cases of competitive distortion. We also emphasize that we will consider other factors that may make application of the best practice rate inappropriate for a particular carrier. Finally, we reiterate that, as with our benchmark rates, at such time as we find it necessary to require a carrier or carriers to comply with this rate, any affected carrier that believes such a requirement would prove unjustified may follow the procedures discussed in Section II.A.2 of this *Order* to request an individualized settlement rate determination.

B. Implementation of Benchmarks

136. We are committed to achieving as soon as possible settlement rates that are at or below the benchmarks we adopt in this *Order*. However, we are also cognizant of the adjustment problems a rapid transition to more cost-based settlement rates could cause for U.S. carriers' foreign correspondents. These problems are particularly pronounced for carriers in lower income countries. We therefore adopt a transition schedule for U.S. carriers to negotiate settlement rates within the benchmarks that takes into account the level of economic development of the country in which a foreign carrier is located. We also adopt additional measures to ensure a smooth transition from current settlement rates to our benchmarks for those foreign carriers facing the most severe adjustment problems. We discuss these transition measures and the schedule we adopt below in Section III.B.2.

1. Impact of Benchmark Settlement Rates on Developing Countries

a. The Notice

137. In the *Notice*, we acknowledged the argument of some that substantially above-cost settlement rates may be justified because they are used to subsidize network development in lower income countries. We noted, however, that settlement rate reductions would not necessarily result in a significant loss of revenues for foreign carriers, even those with very high settlement rates. This is because, we stated, bringing settlement rates closer to costs will, in the long run, lead to lower calling prices. Lower calling prices, in turn, will stimulate traffic flows. We also noted that the growing capabilities and incentives to bypass the traditional accounting rate system mean that settlement revenues no longer provide secure financing for investment in telecommunications infrastructure. We concluded that open and competitive markets that welcome private capital offer a more reliable and sustainable means to finance infrastructure development than the traditional monopoly-based accounting rate system.

b. Positions of the Parties

138. Many developing countries and their carriers express concern that our settlement rate benchmarks will eliminate an important source of revenue for developing countries' telecommunications markets.²³⁰ These commenters argue that in many developing countries, settlements revenues are used to fund universal service programs and network infrastructure development. For example, the Government of St. Vincent and the Grenadines states that our benchmarks will "effectively cripple" telecommunications network development in its country.²³¹ Similarly, Telekom Malaysia states that the benchmarks will have "dire economic ramifications" for developing countries.²³² Panama states that it relies on revenues from international operations to attract investors for modernization and development of its telecommunications infrastructure.²³³ Telmex similarly argues that a precipitous drop in settlement rates could undermine the procompetitive results that its regulator has achieved to date.²³⁴ CANTO notes that settlement revenues are used as collateral to obtain access to capital and argues that as a result, reduced settlement revenues will have a negative impact on the ability of carriers in developing countries to obtain capital for network development.²³⁵ Some commenters assert an entitlement to maintain excessive settlement rates to fund universal service requirements and network buildout.²³⁶ For

²³⁰ See, e.g., India Reply at 2; Pakistan Tel. Reply at 3; Saint Vincent and the Grenadines Comments at 1; Latvia Comments at 1; Suriname Comments at 1.

²³¹ Government of St. Vincent and the Grenadines Comments at 1. See also CANTO Comments at 4 (loss of significant settlement revenues "would have a substantial, adverse impact" on telecommunications infrastructures in Caribbean countries).

²³² Telekom Malaysia Comments at 3.

²³³ Panama Comments at 26. See also Philippines Comments at 24; CARICOM Reply at 1 (a stream of income, premised on existing settlement rates, was factored into many member country's decisions to modernize their networks).

²³⁴ Telmex Comments at 12; see also CANTO Comments at 5 (settlement rate benchmarks would have a detrimental impact on privatization and infrastructure development plans that are premised upon gradual settlement rate reductions). Although classified as an upper income country, Israel also argues that benchmark settlement rates could harm the competitive process underway in that country. See Israel Comments at 1-3.

²³⁵ CANTO Comments at 4; see also Poland Comments at 1 (positive settlements balance is used as a base for obtaining credit for telecommunications development); Sri Lanka Telecom Comments at 1 (equipment purchases have been financed under agreements committing future settlement revenues for payments); COMTELCA Comments at 12.

²³⁶ See, e.g., GT&T Reply at 12-16; Telintar Comments at 9; Telmex Comments, Indetec Statement at 8; CANTO Comments at 5; Indonesia Reply at 2; Solomon Islands Comments at 2; Telecom Vanuatu Comments at 2.

example, GT&T asserts that "foreign countries are entitled to support universal service through settlement revenues."²³⁷

139. MCI, however, states that there is no evidence in the record that above-cost settlement rates result in any increase in infrastructure development or connectivity to the international telecommunications network.²³⁸ The European Union expresses concern about the potential impact of the benchmark settlement rates on developing countries, noting that some countries "have traditionally seen settlements in-payments as a form of foreign aid."²³⁹ However, it notes that as a form of aid, settlement payments are not transparent and do not permit accountability. The European Union suggests the World Bank's adjustment program may be a useful form of assistance as settlements revenues decrease.²⁴⁰

140. AT&T also argues that the settlement rates paid by U.S. carriers to their foreign correspondents should not include any universal service subsidies. AT&T asserts that U.S. carriers should pay only the cost of international termination, not "the cost incurred by foreign carriers to use the domestic network for purely domestic services, or for international calling between the foreign carrier and a country other than the United States."²⁴¹ Brazil notes that all countries have subsidized network development and many still do. It states that in light of this fact, it is important to identify the level of subsidy and then work to reduce it to a "fair" level.²⁴²

141. Some commenters disagree with our statement in the *Notice* that "reductions in the price of international telephone service would significantly stimulate traffic flows, thereby increasing revenues for U.S. and foreign carriers."²⁴³ Telefónica del Perú and COMTELCA argue that elasticities of demand do not remain constant across all cultures and levels of economic development. They contend that the demand for telecommunications services has significantly

²³⁷ GT&T Reply at 12. *See also* Solomon Islands Comments at 2 ("we as the Government of the Solomon Islands have a legitimate right to impose a large proportion of the cost of the social telecommunications policy objectives on the international sector"); CANTO Comments at 5; India Reply at 2; Cable and Wireless Comments at 12.

²³⁸ MCI Reply at 4.

²³⁹ European Union Reply at 3.

²⁴⁰ *Id.*

²⁴¹ AT&T Reply at 35 (*citing* Regulation of International Accounting Rates, Phase II, *Order on Reconsideration*, 11 FCC Rcd. 6332, 6335 (1996)).

²⁴² Brazil Reply at 2.

²⁴³ *See Notice* at ¶ 10.

less price elasticity in developing countries than it does in industrialized countries. As a result, they argue that carriers in developing countries will not see enough of a revenue increase from traffic stimulation to offset the loss they believe they will incur from reductions in settlement rates.²⁴⁴

c. Discussion

142. We agree with commenters that the transition to more cost-based settlement rates will be difficult for countries and carriers that currently rely on excessive settlement rates to generate revenues. We disagree, however, that this difficulty should be avoided by allowing U.S. carriers to maintain the status quo in the international accounting rate system. As discussed in Section I, *supra*, the global telecommunications market is changing in ways that cannot accommodate the outmoded, monopoly-based, accounting rate system.²⁴⁵

143. We acknowledge the concerns of many commenters that settlement revenues are necessary to fund network development and universal service requirements. However, we also recognize that settlement revenues are no longer a stable source of funding for network infrastructure development as a result of changes in the global telecommunications market. Thus, to the extent that settlement payments have been used for telecommunications infrastructure development, alternative funding mechanisms, from both public and private sources, must be identified.

144. Because of the changing nature of the international telecommunications market, we believe that open and competitive markets that welcome private capital offer a more reliable and sustainable means to finance infrastructure development than the traditional accounting rate system. There is widespread agreement on this principle. For example, ITU Secretary-General Tarjanne has stated that "[t]here is now overwhelming evidence from developing and developed economies alike to support the contention that competition and private enterprise, tempered by regulation, provide the best recipe for telecommunications development. Procompetitive policies and market mechanisms should be favoured wherever feasible."²⁴⁶ Moreover, there is ample

²⁴⁴ COMTELCA Comments at 11-12; Telefónica del Perú Comments at 11-12. *See also* HKTI Comments at 16-17 (even if it were true that international services are price elastic in the U.S. market, it does not necessarily follow that international services are similarly elastic in foreign markets where other factors, including demographics and disposable income, come into play).

²⁴⁵ As ITU Secretary-General Tarjanne recently stated, "[t]here is clear danger that the existing accounting rate system could collapse, or simply be by-passed, if there is no orderly transition to new systems." Tarjanne May 27 Speech at 2.

²⁴⁶ Dr. Pekka Tarjanne, Consultation Document on Accounting Rate Reform, Temporary Document 3-E, ITU-T Study Group 3, Geneva, November 11-15, 1996. *See also* Alexis de Tocqueville Institution Reply at 2 ("There is ample evidence that the single-carrier model of telecommunications service is obsolete and

evidence that allowing additional carriers to compete with an incumbent carrier leads to greater network penetration. For example, a recent study of the implications of competition on universal service and employment shows an increase in network and service availability with the introduction of competition.²⁴⁷ That study notes that in China, after the announcement of the entry of a second carrier in 1993, network growth skyrocketed to 58.9 percent in one year and the waiting period for new wireline connections dropped for both business and residential customers by as much as 50 percent.²⁴⁸ In the Philippines, the announcement of competition in 1993 led to a 1,530 percent increase in the annual installation of main lines.²⁴⁹

145. We also recognize, as the European Union suggests, that there are other public sources of funding and technical assistance to which countries may turn. The World Bank, for example, has indicated a willingness to strengthen its existing assistance mechanisms. Specifically, the World Bank has stated that it would be prepared to provide assistance at the following three levels within the framework of its Country Assistance Strategy discussion with national governments: (1) advice and assistance in handling the transition to economically rational settlement rates, financed either directly through technical assistance loans or grants, or through the World Bank's *infoDev* Program²⁵⁰; (2) assistance in offsetting the macro-economic costs of transition in those countries hardest hit, as part of the World Bank's regular macro adjustment programs; and (3) assistance with network development through loans and guarantees, within the framework of the World Bank's current telecommunications sector policies which promote private investment.²⁵¹

that competition-based systems offer the widest array of services at the lowest cost to the broadest possible segment of the public.").

²⁴⁷ Ben A. Petrazzini, "Competition in Telecoms - Implications for Universal Service and Employment," *Public Policy For The Private Sector*, Note No. 96 (World Bank 1996).

²⁴⁸ *Id.* at 2.

²⁴⁹ *Id.*

²⁵⁰ The *infoDev* Program is managed by the World Bank and funded by outside donors. The program is designed to help developing countries benefit from innovations in information technologies and fully participate in the global information society. The program shares worldwide experience with, and disseminates best practices to, governments and key decision makers on the economic and social development potential of communications and information technologies; facilitates contact between relevant parties (governments, non-governmental organizations, private sector, and individuals); and channels policy advice and other technical assistance to governments on privatization, private entry and competition in the communications and information sectors, and on improving the policy, regulatory and business environment for investment.

²⁵¹ See Informal Expert Group Report at 7.

146. Other multilateral lending agencies such as the Inter-American Development Bank and organizations such as the ITU also have programs to provide governments that make a commitment to competition with technical assistance on critical issues such as the establishment of independent regulatory agencies, interconnection policies, tariff rebalancing, and universal service policies.²⁵² These public sector sources of revenue and assistance provide an important mechanism for easing the transition away from the current international accounting rate system toward a system where prices are more closely related to costs.

147. Panama and Mexico concur with the need for competitive reforms and both countries have embarked on steps to introduce competition in their telecommunications markets. They argue, however, that our benchmarks could impede the further development of competition in their markets by restricting an important source of revenue for new entrants.²⁵³ ABS-CBN also argues that "the status quo should be maintained until competitive telecommunication carriers in the Philippines are more firmly established."²⁵⁴ Bolivia requests the Commission to take into account its needs as it introduces competition.²⁵⁵ We recognize, as these commenters urge, that the adjustments necessary for the successful introduction of competition cannot be made overnight. Especially difficult is the process of rebalancing rates so that services are priced in accordance with the underlying costs of providing them. For these reasons, we think it is appropriate to adopt a transition period for U.S. carriers to negotiate settlement rates at or below the benchmarks.²⁵⁶

148. We disagree with commenters who argue foreign carriers are entitled to require that universal service requirements be financed disproportionately through settlement revenues. As discussed above in response to commenters' claims that the TCP methodology should be adjusted to include an additional universal service component,²⁵⁷ we believe that universal service subsidies must be nondiscriminatory and transparent. Moreover, the Reference Paper on

²⁵² We note that a significant advantage of the World Bank and other funding programs is that they ensure the funding is used for specifically stated objectives, *i.e.*, infrastructure development. Despite the assertions by many commenters, there is no guarantee that settlement revenues are used for network development.

²⁵³ Panama Comments at 26; Mexico Comments at 9-12; *see also* Poland Comments at 2.

²⁵⁴ ABS-CBN Comments at 8; *see also* ABS-CBN Reply at 3-4 (competing carriers receive a small portion of settlement revenues and a reduction would only impair their ability to compete). PTI also requests that the Commission forbear from applying the settlement rate benchmarks on routes where competition is being introduced, such as the U.S.-Portugal route. PTI Comments at 9-10.

²⁵⁵ Bolivia Comments at 1-2.

²⁵⁶ We discuss the transition periods we adopt in Section II.B.2., *infra*.

²⁵⁷ *See* Section II.A., *supra*.

Procompetitive Regulatory Principles negotiated as part of the WTO Basic Telecom Agreement states that universal service obligations must be "administered in a transparent, non-discriminatory and competitively neutral manner." Hidden subsidies such as those contained in settlement rates and subsidies borne disproportionately by one service, or in the case of settlement rates, by consumers from net payer countries, are not consistent with these principles and cannot be sustained in a competitive global market. We also disagree with those commenters that compare the hidden subsidies in settlement rates to domestic universal service policies in the United States, which rely on explicit and transparent funding mechanisms.²⁶⁰ Universal service in the U.S. market is based on and uses end user telecommunications revenues in the United States, not settlements revenues paid by foreign carriers.

149. There is no doubt that reform of the international accounting rate system will require many carriers, especially those in developing countries, to make painful adjustments. However, we believe that the effect of lower settlement rates will be at least partially, if not fully, offset by growth in the market for international services. The current system of inflated accounting rates artificially restricts growth in the global IMTS market. As settlement rates are decreased, international calling prices should decrease. In turn, reduced calling prices for international telephone service should significantly stimulate traffic flows. This would provide increased revenues from two sources: collection revenues from outgoing calls and settlements revenues from incoming calls.²⁶¹ We disagree with commenters that express doubt that demand for international services in developing countries is price elastic. As the United Kingdom states, while it may be difficult to calculate reliably the price elasticity of international traffic, it is "clear that such elasticity is present in the market."²⁶² In fact, there is evidence from both industrialized and developing countries that calling volumes would increase with reductions in IMTS collection rates. In Chile, for example, prices for international calls declined by about 30% after competition was introduced in 1994 and demand grew in one year from about 70 million minutes to 140

²⁶⁰ Cable and Wireless Comments at 12. *See also* Solomon Islands Comments at 2 (asserting that it has "a similar right" to cross-subsidize network development as the United States, the United Kingdom, and other industrialized countries). GT&T similarly states that the "FCC is in no position to criticize foreign countries who may wish to impose a heavier universal service obligation upon international traffic when the FCC itself imposed more burdensome universal service obligations upon international traffic than upon intrastate and local traffic." GT&T Reply at 15-16. GT&T is referring in particular to the access charges paid by interexchange carriers.

²⁶¹ As explained in the Informal Experts Group Report, any revenue shortfall from accounting rate reform "is mainly a transitional problem. Any potential loss in settlement payments should, over time, be replaced by increased local revenue generation, as national tariffs move toward more efficient levels, as new customers are added, as new services and ways of pricing are developed, and as steps are taken to increase the efficiency of the network." Informal Experts Group Report at 5-6.

²⁶² United Kingdom Comments at 3.

million minutes.²⁶³ On the Chile-U.S. route alone, traffic from Chile to the United States increased from 17.3 million minutes in 1993 to 45.6 million minutes in 1995.²⁶⁴ Telefónica de España notes that a recent 43 percent reduction in international rates in Argentina has resulted in "more calls being placed to the United States."²⁶⁵

150. All players in the global telecommunications market must work together to ensure a smooth transition from the current accounting rate system to a system in which prices are more closely related to costs. Carriers and countries that currently rely on above-cost settlement rates do not deny that reform of the accounting rate system is necessary. At the same time, we cannot deny that reform will require difficult adjustments in many countries, especially lower income countries. We therefore adopt policies that take into account the impact of our settlement rate benchmarks on other countries. We believe that such policies are appropriate and are consistent with our statutory authority. As many commenters point out,²⁶⁶ it is in the public interest to take measures to ensure that the networks of U.S. carriers' foreign correspondents are not unduly disrupted by the implementation of our benchmark settlement rates.

151. To address the adjustment concerns articulated in the record by many developing countries, we take into account the impact on developing countries of moving to a more cost-based system in calculating and implementing our settlement rate benchmarks. As discussed in Section II.A.2., *supra*, one of the ways in which we take into account the impact of our benchmarks on lower income countries is by establishing separate benchmarks based on countries' level of economic development. As discussed in the next section of this *Order*, we also adopt a transition schedule for U.S. carriers to negotiate settlement rates at or below the benchmarks we adopt here. This schedule will provide additional time for countries and carriers to make the adjustments necessary to transition to a more cost-based system of settlement rates.

2. Transition to Benchmarks

a. The Notice

²⁶³ U.S. Dep't of State, *Response to the Secretary-General's Consultative Document on Accounting Rate Reform*, ITU Telecommunication Standardization Sector Study Group 3, COM 3-15, at 4 (Mar. 1997).

²⁶⁴ See 1993 Section 43.61 International Telecommunications Data and 1995 Section 43.61 International Telecommunications Data, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission.

²⁶⁵ Telefónica de España Reply at 41.

²⁶⁶ See, e.g., CANTO Comments at 3 (noting the negative effect on U.S. consumers of policies that could undermine network development in developing countries).

152. In the *Notice*, we proposed a transition schedule for U.S. carriers to negotiate settlement rates within the benchmarks. We proposed a transition schedule based on countries' level of economic development because we believe that a U.S. carrier's ability to negotiate a charge that complies with our benchmarks without undue disruption of its or its foreign correspondent's operations diminishes as the level of economic development decreases. We noted, for example, that carriers in many developing countries have significantly distorted rate schedules involving cross-subsidies from users of international services to those using domestic services and that many of these carriers also may have substandard telecommunications infrastructure. We concluded that an immediate shift to cost-oriented settlement rates could create adjustment problems for carriers in these countries while they are trying to rebalance rates and upgrade their network. We further noted that implementation of the benchmarks will require greater reductions in current settlement rates for developing countries than for upper income countries.

153. We proposed a transition schedule that will enable U.S. carriers to achieve rates at or below the benchmarks with all foreign carriers in a four to five year period. Specifically, we proposed to require that U.S. carriers' settlement rates with foreign carriers from high income countries be at or below our benchmarks within one year of the effective date of our order in this proceeding; for upper middle income and lower middle income countries, within two years; and for low income countries, within four years. Alternatively, we requested comment on whether the transition schedule for upper, middle, and lower income countries should be two, three, and five years, respectively, or whether the transition schedule for lower middle income countries should be three years and for upper middle income countries, two years.

154. We also sought comment on whether we should provide an additional period of transition in negotiations with foreign carriers for which annual reductions in the spread between their current settlement rate and their benchmark will exceed a certain percentage, such as twenty-five percent. Alternatively, we sought comment on whether we should provide additional transition time for negotiations with foreign carriers for which transition to the relevant benchmark would entail a loss of greater than a certain percentage of their annual revenue.

155. Finally, we sought comment on whether U.S. carriers should be asked to make reasonable progress in negotiating settlement rates at or below the benchmarks throughout the transition periods. We noted, for example, that carriers could be asked to negotiate a certain percentage reduction annually of the spread between current settlement rates and the relevant benchmark.

b. Positions of the Parties

156. Commenters generally support the Commission's proposed approach of providing a transition schedule based on countries' level of economic development, but they disagree on

what the duration of the transitions should be.²⁶⁷ MCI and Sprint both agree with the Commission's proposed transition schedules, although MCI urges the Commission to adopt the shortest of the proposed transition periods.²⁶⁸ The Alexis de Tocqueville Institution states that the Commission's proposals allow "time for countries to plan and adjust" and give "ample opportunity for countries to accelerate the introduction of competition to their markets."²⁶⁹ Sprint states that a waiver from compliance with the schedule should be allowed where extraordinary hardship is shown.

157. AT&T, Coalition of Service Industries, and WorldCom argue that the proposed transition periods are too long. AT&T urges the Commission to require that U.S. carriers negotiate rates within the benchmarks with carriers in upper income countries by June 1, 1998, with carriers in middle income countries by January 1, 1999, and with carriers in lower income countries by January 1, 2000.²⁷⁰ WorldCom supports a transition schedule of 18 months for upper income countries, two years for upper middle income countries, 30 months for lower middle income countries, and three years for lower income countries.²⁷¹ Coalition of Service Industries argues that the benchmark settlement rates should be implemented by January 1, 1998 for upper income countries and by January 1, 2000 for middle and low income countries.²⁷² Both WorldCom and AT&T oppose any exceptions to the transition schedules such as providing longer transition periods for negotiations with foreign carriers most severely affected by the benchmarks.²⁷³

158. On the other hand, several commenters contend that the proposed transition periods are unrealistic for developing countries and should be lengthened for lower and middle

²⁶⁷ Singapore Telecom, however, states that settlement rate reform cannot work fairly unless implemented in a reasonable and nondiscriminatory fashion for all countries according to the same timetable. Singapore Telecom Comments at 3.

²⁶⁸ MCI Comments at 6.

²⁶⁹ Alexis de Tocqueville Institution Reply at 3; *see also* Frontier Comments at 4 (arguing that a four to five year transition period for developing countries is reasonable).

²⁷⁰ AT&T Comments at 19.

²⁷¹ WorldCom Comments at 10-11.

²⁷² Coalition of Service Industries Comments at 3.

²⁷³ WorldCom Comments at 12 (Commission "must adhere to a black line deadline, and not adopt any exceptions that will all but swallow the rule itself); AT&T Comments at 20 (only exceptions from transition periods should be for "temporary emergencies" such as war, famine or natural disasters).

income countries.²⁷⁴ GTE argues that for almost all developing countries, the transition periods must be longer than the proposed 2 to 4 years. It further argues that, at a minimum, the transition period for middle income countries should be four years.²⁷⁵ Tricom argues that the transition period for lower middle income countries should be at least 4 to 5 years. COMTELCA argues for even longer transition periods, 7 to 10 years.²⁷⁶ France Telecom argues that some flexibility should be retained to allow longer transition periods where "reasonably necessary."²⁷⁷ CANTO and GTE contend that transition periods should be tailored to individual countries' needs. GTE suggests that the gap between current settlement rates and a country's benchmark could be the basis for establishing transition periods, while CANTO argues that a country's transition should not end before a rate rebalancing plan has been enacted and completed.²⁷⁸ GTE also contends that countries committed to lowering accounting rates and rebalancing tariffs should be given a longer transition period.²⁷⁹ Telefónica de España also argues that the transition periods must be tied to rate rebalancing.²⁸⁰ It further states that if the transition periods are not adjusted in this manner, the Commission should double the transition schedule for upper income countries and even further lengthen the transition schedule for other countries.²⁸¹ Israel argues that the transition periods can be unreasonable for upper income countries, depending on their economic situation.²⁸²

159. Several commenters urge the Commission to require U.S. carriers to negotiate proportionate annual reductions in settlement rates during the transition periods.²⁸³ Sprint states that a 4 to 5 year transition for low income countries would be too long unless the Commission

²⁷⁴ See, e.g., Cable and Wireless Comments at 14; GTE Comments at 15-22; TSTT Comments at 3; COMTELCA Comments at 15; Telefónica de España Comments at 63-65.

²⁷⁵ GTE Comments at 15-16, 18.

²⁷⁶ COMTELCA Comments at 15.

²⁷⁷ France Telecom Comments at 13.

²⁷⁸ CANTO Comments at 6. COMTELCA agrees with this proposal and states that AT&T's suggestion to shorten the transition periods "should be rejected out of hand." COMTELCA Reply at 19.

²⁷⁹ GTE Comments at 21-22.

²⁸⁰ Telefónica de España Comments at 40-48. See also India Reply at 2; Telefónica del Perú Comments at 15 (transition periods should take into account progress being made in rate rebalancing).

²⁸¹ *Id.* at 65.

²⁸² Israel Comments at 1.

²⁸³ AT&T Comments at 20; MCI Comments at 7; Sprint Comments at 17; WorldCom Comments at 8.

requires U.S. carriers to negotiate proportionate annual reductions during the transition period.²⁸⁴ WorldCom states that the Commission should consider mandating a "glide path" for negotiations with any country eligible for a transition period of two or more years.²⁸⁵ KDD, on the other hand, urges the Commission to reject a glidepath approach because "it would be inherently arbitrary as well as a nightmare for the FCC and carriers to monitor and administer."²⁸⁶

160. MCI, WorldCom, and AT&T oppose providing an additional transition period for negotiations with foreign carriers for which annual reductions in the spread between their current settlement rate and their benchmark will exceed a certain percentage. AT&T notes that the beneficiaries of any such measure would be the carriers that have been most resistant to reducing their accounting rates to comply with Commission and ITU policies.²⁸⁷ WorldCom similarly notes that additional transition time would benefit carriers that maintain the highest rates.²⁸⁸ MCI, however, states that a waiver should be available if a U.S. carrier can show that the carrier with whom it is corresponding would be subject to extraordinary hardship due to the benchmark settlement rates.²⁸⁹

c. Discussion

161. The substantial discussion in the record about the potential negative impact of our settlement rate benchmarks on lower income countries supports the need for a transition schedule for implementation of the benchmarks.²⁹⁰ Nonetheless, we remain committed to achieving settlement rates within the benchmarks as soon as feasible without forcing undue disruption of both U.S. and foreign carriers' operations. Therefore, we adopt transition periods and other adjustment mechanisms that balance these competing concerns of providing time for carriers to make adjustments and expeditiously reducing rates to a more cost-based level.

162. We adopt a transition schedule that is based primarily on the categorization of countries we use to calculate our settlement rate benchmarks, the World Bank and ITU's GNP per

²⁸⁴ Sprint Comments at 17.

²⁸⁵ WorldCom Comments at 11.

²⁸⁶ KDD Reply at 25.

²⁸⁷ AT&T Comments at 20.

²⁸⁸ WorldCom Comments at 12.

²⁸⁹ MCI Comments at 7.

²⁹⁰ *See generally Rural Telephone Coalition v. FCC*, 838 F.2d at 1314-15.

capita classifications. As discussed in Section II.A.2, *supra*, we believe this classification scheme provides a reasonable basis for determining a country's ability to transition to a more cost-based system of settlement rates without undue disruption to its telecommunications network.

163. We agree with commenters who argue that basing our transition periods solely on the World Bank and ITU's GNP per capita categories may not provide sufficient consideration of the adjustment problems that the poorest countries will encounter.²⁹¹ In most of the poorest countries, telecommunications infrastructure is severely underdeveloped. We agree with commenters that the transition to a more cost-based system could be most severe for those countries with very low levels of telecommunications network development. We therefore establish a separate category for the "least telecommunications developed" countries for purposes of transitioning to our settlement rate benchmarks.²⁹²

164. We base this additional category on countries' level of teledensity as measured by lines per one hundred inhabitants, rather than GNP per capita. We believe that GNP per capita is generally an accurate indicator of a country's level of telecommunications network development. However, GNP per capita may not adequately reflect the level of telecommunications network development for the least developed countries. The ITU has also observed that the generally strong correlation between level of economic development, as measured by GNP per capita, and telecommunications development, as measured by level of teledensity, is substantially weaker among the poorest countries.²⁹³ For this reason, we will consider countries' level of teledensity, as suggested by some commenters,²⁹⁴ for purposes of determining which countries are the "least telecommunications developed." We will include countries with a teledensity of less than one in this "least telecommunications developed" category. As the ITU has noted, a level of teledensity less than one is generally a strong indication that a country's telecommunications infrastructure is severely underdeveloped.²⁹⁵

165. We will require U.S. carriers to negotiate settlement rates with their foreign correspondents in accordance with the following schedule:

²⁹¹ TSTT Comments at 3; Panama Comments at 22.

²⁹² See Appendix C. We note that countries that fall into this category for the transition schedule also appear in one of the four economic development categories based on income per capita for purposes of establishing the relevant benchmark.

²⁹³ The ITU plotted the relationship between GDP per capita and teledensity for the 48 "Least Developed Countries" as recognized by the United Nations General Assembly, and found a correlation coefficient of 0.5. ITU Telecommunications Indicators at 4.

²⁹⁴ See, e.g., TSTT Comments at 3; France Telecom Comments at 14.

²⁹⁵ ITU Telecommunications Indicators at 4.

carriers in upper income countries	1 year from implementation of this <i>Order</i> ²⁹⁶
carriers in upper-middle income countries	2 years from implementation of this <i>Order</i>
carriers in lower-middle income countries	3 years from implementation of this <i>Order</i>
carriers in lower income countries	4 years from implementation of this <i>Order</i>
carriers in countries with teledensity less than 1	5 years from implementation of this <i>Order</i>

166. AT&T, Coalition of Service Industries, and WorldCom urge the Commission to adopt shorter transition periods than those proposed in the *Notice* -- AT&T and Coalition of Service Industries for all countries and WorldCom for lower income countries. We are sensitive to the concerns raised by these commenters that the transition periods proposed in the *Notice* are too long. We also would like to see settlement rates within the benchmarks as soon as possible. In fact, we fully expect that for many countries, market forces unleashed by the WTO Basic Telecom Agreement will bring settlement rates within the benchmarks before the end of the transitions periods we adopt here. U.S. carriers already have settlement rates at or below the benchmarks with several countries, including the United Kingdom, Sweden, and Canada. However, for many countries, we do not believe it is feasible to expect U.S. carriers to negotiate rates within the benchmarks in a shorter time frame than the transition periods proposed in the *Notice*. As the record demonstrates, a rapid shift to more cost-based rates could create adjustment problems for carriers in countries with significantly distorted rate schedules.²⁹⁷ A rapid shift to more cost-based rates could also have a short-term impact on telecommunications network development in those limited cases where settlement revenues are a major source of funding for network development. We note that it is in the best interest of U.S. carriers and consumers to avoid undue disruption of foreign carriers' operations.²⁹⁸ A well developed global telecommunications network provides the telecommunications infrastructure necessary to support international commerce and trade.

167. GTE and Tricom urge the Commission to adopt longer transition periods -- GTE for middle income countries and Tricom for lower middle income countries. Other commenters

²⁹⁶ The effective date of this *Order* is January 1, 1998.

²⁹⁷ See, e.g., GTE Comments at 21-22; Telefónica de España Comments at 65; Telefónica del Perú Comments at 15.

²⁹⁸ See CANTO Comments at 2-3 (noting that the benchmark settlement rates could undermine the Commission's statutory mandate to make available a rapid and efficient worldwide communications service with adequate facilities by negatively affecting the ability of carriers in developing countries to maintain and expand their networks).

express concern that the transition periods proposed in the *Notice* are unrealistic for developing countries. We have lengthened the transition periods for lower middle income countries and those with teledensity less than one in response to the concerns in the record. We believe that the schedule we adopt here, with additional transition time for lower middle income countries and countries with teledensity less than one, provides a reasonable balance between the need to achieve settlement rates that are more cost-based as soon as feasible and the need to ensure that accounting rate reform does not unduly disrupt both U.S. and foreign carriers' operations.

168. Cable and Wireless and GTE argue that the transition periods are unrealistic and do not take into account the experience to date of countries introducing competition, including the United States. Cable and Wireless cites the examples of the United States where, it states, the introduction of competition took 15 years, the United Kingdom, which had a similar timeframe, and the European Union, with timeframes of 12-17 years.²⁹⁹ We recognize that the transition to competition takes time and requires difficult adjustments. However, the transition periods we adopt here are not intended to be schedules for implementation of competition in other countries. Rather, they are intended to provide some time for carriers in all countries, even those that have not introduced competition, to make the adjustments necessary to transition to a more cost-based system of accounting rates.

169. GTE suggests that the gap between current settlement rates and a country's benchmark could be the basis for establishing transition periods.³⁰⁰ We disagree. Such a policy would be unfair and tend to favor carriers with the highest settlement rates. GTE further contends that countries committed to lowering settlement rates and rebalancing tariffs should be given a longer transition period. Telefónica de España also urges us to tie the transition periods to rate rebalancing. Telefónica de España goes on to argue that, if we do not tie transition schedules to the rebalancing of tariffs, we should double the transition schedule for upper income countries and even further lengthen the transition schedule for other countries. The transition periods we adopt, however, are intended to address the concern of GTE and Telefónica de España by balancing the need for providing carriers time to make adjustments with the need for reducing rates expeditiously to a more cost-based level.

170. Telefónica de España, Telefónica Larga Distancia de Puerto Rico, and KDD argue that the transition periods are inconsistent with the five year transition period in our *Access Charge Reform Order* for independent local exchange carriers to reduce their interstate access

²⁹⁹ Cable and Wireless Comments at 14. GTE similarly cites the experience of the United States in introducing competition. GTE Comments at 16.

³⁰⁰ GTE Comments at 18.

rates to reflect forward-looking costs.³⁰¹ KDD further states that the Commission should adopt a transition period of at least five years beginning from the effective date of the WTO Basic Telecom Agreement.³⁰² We do not find our decision with regard to transition periods here inconsistent with our *Access Charge Reform Order*. In the *Access Charge Reform Order* we provided for a five year transition period to give competition in the local market sufficient time to develop. In this proceeding, however, the transition periods for settlement rate benchmarks have a different intent -- to ease the transition to a more cost-based system of settlement rates where competitive forces cannot achieve this goal. As discussed throughout this *Order*, we believe that we cannot rely on the market in all instances to reduce settlement rates to more cost-based levels. Moreover, we note that the transition schedule we adopt today provides additional time to reach more cost-based accounting rates after the end of the transition set forth in ITU Recommendation D.140, which had called for more cost-based rates by this year.

171. GT&T cites our *Universal Service Order* in arguing that the proposed transition periods are inconsistent with the Commission's domestic policy. Specifically, GT&T cites to our decision not to require U.S. incumbent local exchange carriers serving rural and/or insular environments to calculate their costs based upon forward-looking economic costs for a period of at least three years. It states that this decision "repudiates [our] proposal to require foreign carriers serving rural and/or insular countries to comply with FCC-prescribed settlement rates subject to a one- to four-year transition period."³⁰³ We are not, however, basing our benchmarks on a TSLRIC methodology. Rather, the benchmarks are calculated using the TCP methodology, which, as shown in Section II.A.1. of this *Order*, results in benchmarks that are substantially above any reasonable measure of incremental costs.

172. We agree with commenters who contend that a schedule of annual percentage reductions is necessary to ensure that progress is made in negotiating settlement rates within the benchmarks. As these commenters note, annual percentage reductions would avoid a situation where U.S. carriers are unable to negotiate settlement rate reductions until the end of the applicable transition period.³⁰⁴ This situation would delay any benefits from the settlement rate benchmarks until several years from the effective date of this *Order*. We therefore expect U.S. carriers to negotiate proportional annual reductions in settlement rates. Under this schedule of reductions, U.S. carriers should negotiate twenty percent reductions annually of the spread

³⁰¹ *Telefónica de España and Telefónica Larga Distancia de Puerto Rico July 30 Ex Parte* at 3; *KDD June 5 Ex Parte* at 3.

³⁰² *KDD June 5 Ex Parte* at 3.

³⁰³ *GT&T June 18 Ex Parte* at 4.

³⁰⁴ *See, e.g., WorldCom Comments* at 11.

between a carrier's current settlement rates and the relevant benchmark for carriers with a five year transition period. For carriers with a four year transition period, the difference should be reduced by 25 percent annually; for carriers with a three year transition period, the difference should be reduced by thirty-three percent annually; and for carriers with a two year transition period, the difference should be reduced by fifty percent per year.

173. We will not, however, mandate that U.S. carriers meet these annual reduction targets. We believe such a requirement would place unnecessary restrictions on the ability of U.S. carriers to negotiate settlement rate arrangements with their foreign correspondents that take into account the needs of both parties and, as KDD notes, would be difficult to administer and monitor. U.S. carriers should retain some flexibility in their negotiations during the transition period. For example, if a U.S. carrier negotiates an accounting rate agreement that would achieve a settlement rate within the relevant benchmark by the end of the transition period, we would be less concerned about whether progress is made in negotiating annual reductions. We emphasize, however, that we may take enforcement action if a U.S. carrier is unable to make any progress in negotiating settlement rate reductions during the transition periods and settlement rates remain well in excess of our benchmarks.

174. In addition to the transition schedules, we will consider providing additional transition time for negotiations with foreign carriers in countries for which annual reductions in settlement rates, according to our transition schedule, would entail a loss of greater than 20 percent of the country's annual telecommunications revenue.³⁰⁵ In considering the need for additional transition time, we will assume U.S. carriers negotiate proportionate annual reductions in the difference between the current settlement rate and the applicable benchmark rate. Thus, for example, if a U.S. carrier is negotiating with a carrier in a country with a four year transition period, we will look at whether a reduction of 25 percent of the difference between the current settlement rate and the applicable benchmark will entail a loss of greater than 20 percent of the country's annual telecommunications revenue. A U.S. carrier providing service to a country that meets this standard may file a request with the International Bureau seeking a waiver of the applicable transition period. Allowing additional transition time for countries that meet this standard will prevent countries facing significant declines in their telecommunications revenues as a result of our benchmarks from experiencing undue disruptions in their networks.

175. We proposed in the *Notice* to provide additional flexibility in implementation of the benchmarks beyond our transition periods for U.S. carriers and their correspondents in developing countries that have demonstrated an actual commitment to fostering entry and promoting

³⁰⁵ We sought comment on this proposal in the *Notice* at ¶ 67.

competitive market environments.³⁰⁶ We stated that such additional flexibility would serve two purposes: it would recognize the challenges to developing countries posed by the introduction of cost-based rates and encourage the development of competitive markets necessary to achieve cost-based settlement rates. Telefónica de España agrees with this proposal, arguing that we should not apply benchmarks to developing countries that have set a date certain for introducing competition.³⁰⁷ AT&T, on the other hand, opposes this proposal, arguing that the proposed transition periods already take into account the needs of developing countries by providing those countries higher benchmarks and longer transition periods.³⁰⁸ WorldCom also opposes this proposal, arguing that it is inherently contradictory. It states that if a route is competitive, settlement rates will drop below the benchmarks, and if a route is not competitive, the settlement rate benchmarks are necessary.³⁰⁹

176. We agree with AT&T that our transition periods adequately take into account the challenges faced by developing countries in moving to more cost-based rates, especially given the longer transition periods we adopt here for lower-middle income countries and countries with teledensity lower than one. The transition periods are intended to provide carriers an opportunity to make necessary adjustments, such as rate rebalancing, to move to a more cost-based settlement system. These same adjustments are required to implement competitive reforms successfully. We also note that the WTO Basic Telecom Agreement significantly advances our goal of encouraging the development of competitive markets.³¹⁰ Moreover, we are concerned that a policy which would create an exemption based on market conditions in the destination market from our requirement that U.S. carriers negotiate settlement rates within our benchmarks may not be consistent with our MFN obligations under the GATS.³¹¹ We thus decline to adopt our proposal in the *Notice* to permit additional flexibility in the application of our benchmarks beyond the transition periods for U.S. carriers serving developing countries that have committed to introducing competitive reforms.

³⁰⁶ *Notice* at ¶ 70.

³⁰⁷ Telefónica de España Comments at 70-72.

³⁰⁸ AT&T Comments at 18-19. Some commenters urge us to take into account the concerns of countries introducing competition in implementing our benchmarks. *See, e.g.*, Panama Comments at 26; Mexico Comments at 9-12; Poland Comments at 2; PTI Comments at 9-10; Israel Comments at 1-3. Taiwan suggests that we adopt transition schedules based on liberalization schedules committed to by WTO Member countries. Taiwan Comments at 2.

³⁰⁹ WorldCom Comments at 13.

³¹⁰ *See, e.g., Foreign Participation Notice* at ¶ 30.

³¹¹ *See* Section II.C.3, *infra*.

3. Enforcement of Benchmarks

a. The Notice

177. We stated in the *Notice* that we would consider taking enforcement measures to ensure that U.S. carriers make adequate progress in negotiating settlement rates at or below the benchmarks.³¹² We proposed, as an initial measure, to identify foreign carriers that are reluctant to engage in meaningful progress toward negotiating settlement rates at or below the relevant benchmark and to convey to the responsible government authorities our concern about continued high settlement rates and the lack of meaningful progress, and to seek their support in lowering settlement rates.³¹³

178. We also proposed stronger steps that we would consider in those cases where a foreign carrier fails to respond to a U.S. carrier's efforts to achieve settlement rate progress. We emphasized that in each case our actions would apply to U.S. carriers within our jurisdiction, not to their foreign correspondents. Specifically, we sought comment on the following measures: (i) directing U.S. carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions aimed at reaching the benchmark level; (ii) directing U.S. carriers to settle at a rate that is no higher than the transition rate goals until a foreign carrier agrees to a reasonable schedule of reductions aimed at reaching the benchmark level; (iii) directing U.S. carriers to settle at or below the benchmark rate and to continue paying at that rate until we determine that meaningful progress in the form of accounting rate reductions is being made; and (iv) directing U.S. carriers to pay a settlement rate no higher than the benchmark rate.³¹⁴

b. Positions of the Parties

179. Several commenters urge us to adopt clear and effective mechanisms to achieve the benchmark settlement rates.³¹⁵ AT&T argues that only through active enforcement can we obtain compliance with the benchmarks adopted in this *Order*.³¹⁶ MCI states that if a U.S. carrier makes a showing that it has been unable to reach an agreement that meets the relevant benchmark

³¹² *Notice* at ¶¶ 87-90.

³¹³ *Id.* at ¶¶ 87-88.

³¹⁴ *Id.* at ¶ 89.

³¹⁵ *See, e.g.*, CSI Reply at 4; SDN Reply at 1.

³¹⁶ AT&T Comments at 31; *see also* WorldCom Comments at 13.

within a reasonable time frame, a U.S. carrier could request us to use our statutory authority to facilitate compliance with this *Order*.³¹⁷ Frontier asserts that we can, and should, utilize each of the enforcement options proposed in the *Notice* as individual circumstances dictate.

180. AT&T recommends that we establish a "complaint" process with expedited procedures, including a time frame for our decision.³¹⁸ AT&T argues that we should require such filings to show "only that the foreign carrier has not complied with the applicable benchmark rate, or has not made the necessary interim step toward that rate during the transition period."³¹⁹ Upon such a showing, AT&T contends that we should prescribe the settlement rate to be paid to that foreign carrier by all U.S. carriers.³²⁰ Both WorldCom and AT&T argue that the remedy we order should be a prescription of rates, rather than agreements to schedules of reductions or determinations of adequate progress.³²¹

181. A number of commenters oppose the enforcement of our settlement rate benchmarks.³²² Indonesia argues that we should use benchmarks only, if at all, as "guidelines for U.S. carriers as their initial offered-rates to negotiate with their corresponding relations, subject to bilateral agreements between the parties involved."³²³ KDD contends that we cannot adopt an enforcement procedure because Section 208 of the Act, which governs complaints, applies only to acts or omissions of a "common carrier subject to this Act." KDD asserts that because a foreign carrier would not qualify as a "common carrier subject to this Act" it cannot be subject to a

³¹⁷ MCI Reply at 8.

³¹⁸ AT&T Comments at 33. AT&T proposes a procedure that requires comments to be filed on a complaint within 28 days from the date of the public notice. AT&T requests 10 additional days for the complaining U.S. carrier to file reply comments. WorldCom argues that we should issue an order responding to a complaint no later than three months after the filing of the complaint. WorldCom Comments at 13.

³¹⁹ AT&T Reply at 17.

³²⁰ *Id.* at 18.

³²¹ AT&T Reply at 18; WorldCom Comments at 14 (*citing* AT&T Corp., MCI Telecommunications Corp., Sprint and LDDS WorldCom Petitions for Waiver of the International Settlements Policy to Change the Accounting Rate for Switched Voice Service with Peru, *Order and Authorization*, 11 FCC Rcd. 12107 (1996); AT&T Corp. and MCI Telecommunications Corp., Petition for Waiver of the International Settlements Policy to Change the Accounting Rate for Switched Voice Service with Bolivia, *Order and Authorization*, 11 FCC Rcd. 13799 (1996)).

³²² *See, e.g.*, Indonesia Reply at 2; SBC Comments at 6; ASETA Comments at 2; Deutsche Telekom Comments at 11; Korea RPOAs Comments at 2, 4; European Union Reply at 1-2, New T&T Comments at 3.

³²³ Indonesia Reply at 2.

Section 208 complaint.³²⁴ SBC argues that our enforcement proposals will likely prove harmful to relationships between U.S. international carriers and their foreign correspondents. SBC argues that "directing U.S. carriers to take certain actions -- some of which are likely to appear hostile from the foreign carriers' perspectives -- . . . would potentially undermine the ability of U.S. carriers to continue negotiations and to develop creative, potentially beneficial solutions to any international accounting disputes."³²⁵ France Telecom expresses concern that the proposed enforcement measures could have a "chilling effect" on multilateral discussions of accounting rate reform.³²⁶

182. ACC asserts that if we decide to adopt our benchmarks proposals, we must protect smaller carriers from foreign carriers' reprisals so that the larger U.S. carriers are not the only beneficiaries of our action.³²⁷ Justice Technology also expresses concern about a potential backlash against new international carriers as a result of our benchmark settlement rates.³²⁸ TRA argues that we should not require "small to mid-sized" carriers to abrogate an existing operating agreement in order to protect them from retaliation by foreign carriers.³²⁹ TRA states that, while adoption of our benchmarks proposals may "serve a broad public policy purpose, the global benefits will be lost on small to mid-sized carriers whose businesses are lost or damaged during the process."³³⁰ For enforcement to be effective, though, AT&T argues that our exercise of prescription authority must apply to all U.S. facilities-based carriers.³³¹

183. We also note that in our *Accounting Rate Flexibility Proceeding*, AT&T suggested that carriers would be assisted in their accounting rate negotiations if we required all accounting rate agreements to have annual expiration dates. Several parties -- including MCI, WorldCom and TRA -- opposed AT&T's proposal of time-bounded rate agreements, arguing that

³²⁴ KDD Reply at 24.

³²⁵ SBC Comments at 6; *see also* Lattelekom Comments at 2 (requiring U.S. carriers to breach contracts will undermine U.S. carriers' credibility and ultimately prove counterproductive).

³²⁶ France Telecom Comments at 14.

³²⁷ ACC Comments at 9.

³²⁸ Justice Technology Comments at 2-3.

³²⁹ TRA Comments at 6.

³³⁰ *Id.* at 7.

³³¹ AT&T Reply at 18.

it would harm small carriers or could be disruptive to carrier negotiations. We stated that we would consider that issue in this *Order*.

184. Some commenters have raised the issue of time-bounded agreements in their comments filed in this proceeding. To protect "small to mid-sized" carriers from foreign carrier retaliation, TRA argues that we should not require such carriers to enter only into short-term settlement rate agreements.³³² WorldCom also opposes our proposal to require U.S. carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions. WorldCom contends that certain foreign administrations would be unwilling to renew such operating agreements with all but the one or two largest U.S. carriers.³³³

c. Discussion

185. Because we have found that settlement rates above the relevant benchmarks after the relevant transition period will not produce just and reasonable rates, we will take appropriate enforcement measures as may be necessary to ensure that U.S. carriers satisfy our benchmark requirements. As an initial measure, we will identify foreign carriers that are reluctant to engage in meaningful progress toward negotiating settlement rates at or below the relevant benchmark. We will convey to the responsible government authorities our concern about continued high settlement rates and the lack of meaningful progress, and seek their support in lowering settlement rates. In our contacts with the responsible government authorities, we will emphasize the need for cooperation in achieving the goal of cost-based rates, enlist their active support in achieving that goal, cite relevant ITU recommendations such as Recommendation D.140, and suggest further discussions that may be necessary.

186. When a foreign correspondent fails to respond to a U.S. international carrier's efforts to achieve a settlement rate that complies with the requirements of this *Order*, we will allow the U.S. international carrier to ask us to consider stronger steps. As it is clearly within the interest of a U.S. international carrier to negotiate rates at or below the relevant benchmark, we believe that we can rely primarily on such a carrier-initiated enforcement process.³³⁴ Pursuant to the procedures we adopt in this *Order*, a U.S. international carrier may file a petition that:

³³² TRA Comments at 6.

³³³ WorldCom Comments at 14.

³³⁴ We agree with KDD that Section 208 does not provide for complaints to be filed pursuant to that section against a common carrier not subject to the Act. We do not here, though, rely on Section 208. Our enforcement mechanism merely allows carriers to alert us to the fact the settlement rates being paid by U.S. international carriers to their foreign correspondents are inconsistent with the rules and policies we adopt in this *Order*.

- (1) demonstrates that it has been unable to negotiate a settlement rate with its foreign correspondent that complies with the rules and policies we adopt in this *Order*; and
- (2) requests enforcement measures be taken to ensure that no U.S. carrier pays that foreign correspondent an amount exceeding the lawful settlement rate benchmark.

The U.S. international carrier should file its petition with the Office of the Secretary, Federal Communications Commission, 1919 M Street, NW, Room 222, Washington, DC 20554. The petitioning carrier must serve the foreign correspondent with a copy of the petition and a copy of the procedural rules governing replies to the petition.³³⁵ The foreign correspondent or other interested party will have thirty-five days from the date on which we place the petition on public notice to file comments or an opposition to the U.S. international carrier's petition. We will allow ten additional days for replies to any comments or oppositions.

187. We will ensure compliance with our settlement rate benchmarks. We believe that we have the authority to use any of the enforcement measures proposed in the *Notice* to respond to a carrier's petition. As we discuss in Section II.E. of this *Order*, our authority includes the ability to prescribe a change in settlement rates whenever we determine such rates to be unlawful. We do not at this time adopt any set enforcement mechanism, but will instead consider the individual circumstances surrounding each carrier-initiated petition to determine the appropriate enforcement action to take. We agree with AT&T that whatever enforcement action we take with regard to a complaint about a foreign correspondent's unwillingness to negotiate a settlement rate at or below the relevant benchmark must apply to all U.S. international carriers' dealings with that foreign correspondent in order for enforcement of our benchmarks to be effective.³³⁶

188. Some commenters express concern that enforcement of the benchmark settlement rates will lead to reprisals against smaller carriers.³³⁷ We will continue to safeguard U.S. carriers against discriminatory treatment by foreign carriers by vigorously enforcing our ISP.³³⁸

³³⁵ See 47 C.F.R. § 1.47.

³³⁶ See AT&T Reply at 18.

³³⁷ See, e.g., TRA Comments at 6-7; ACC Comments at 9; Justice Technology Comments at 2-3.

³³⁸ See *Accounting Rate Flexibility Order* at ¶ 71. The European Union suggests we reconsider the efficacy of our proportionate return and symmetrical settlement rate requirements in light of the increasingly liberalized world market conditions. The European Union states that changing world market conditions result in a situation where these requirements could actually impede competition. European Union Reply at 3. As we stated in our *Accounting Rate Flexibility Order*, we agree that our ISP could impede the development of competition in some circumstances. We thus adopted rules to permit U.S. carriers to deviate from the ISP where appropriate market conditions exist.

189. Although we decline at this time to anticipate exactly which enforcement measure would be appropriate in a given situation, we do agree with those commenters that argue that we should refrain from using one particular proposed enforcement mechanism.³³⁹ We believe that requiring U.S. international carriers to negotiate settlement rate agreements that provide for a fixed expiration date until a foreign carrier agrees to a reasonable schedule of reductions would impose unnecessary financial burdens on U.S. international carriers. Such an action by us would require carriers to be continually engaged in negotiations for short-term agreements. We find that the other proposed enforcement mechanisms will provide us with the ability to ensure compliance with our benchmarks.

190. The benchmark requirements we adopt in this *Order* will become effective on January 1, 1998.³⁴⁰ The transition periods for U.S. carriers to negotiate settlement rates at or below the benchmark rates will begin on that date. However, we will consider, on a case-by-case basis, grandfathering settlement rate agreements that were negotiated prior to the effective date of this *Order* that do not comply strictly with the benchmark requirements we adopt here. Our standard for grandfathering such agreements will be whether approval of the agreement is in the public interest. We will find an agreement to be in the public interest if it serves the same goals we have set forth in this *Order* and if it achieves settlement rates at or below the relevant benchmark within a reasonable period of time. We reiterate that if, in the future, there is a multilateral consensus on a substantially equivalent international measure to achieve our goals of a cost-based system of settlements in a timely manner, we will waive enforcement of the benchmark settlement rates.

C. Section 214 Authorization Conditions

191. We proposed in the *Notice* to apply the settlement rate benchmarks to address potential distortions in the U.S. market for IMTS that could be created by the current system of above-cost settlement rates. We proposed to address these potential market distortions because they impede our policy of creating greater competition in the IMTS market in order to lower international calling prices for U.S. consumers.

192. We identified in the *Notice* two types of market distortions that could be created by above-cost settlement rates. The first is the potential for a foreign carrier and its U.S. affiliate to execute a "price squeeze" against other carriers in the U.S. IMTS market. A price squeeze is a predatory tactic in which the U.S. affiliate sets its prices so close to the international settlement

³³⁹ See, e.g., TRA Comments at 7; WorldCom Comments at 14.

³⁴⁰ Except those matters subject to OMB approval, pursuant to the Paperwork Reduction Act of 1995, Pub. L. No. 104-13, which will become effective upon such approval.

rates charged by the foreign carrier that the other carriers cannot 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. 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 might pay the same settlement rate paid by its competitors, it would consider the actual economic cost incurred by the foreign carrier rather than the above-cost settlement rates when setting its IMTS prices.

193. The second type of market distorting behavior that could be created by above-cost settlement rates is one-way bypass of the settlements system. This could occur if a foreign carrier collecting above-cost settlement rates is able to send its switched traffic over private lines into the United States, but U.S. carriers are unable to send their traffic over private lines in the reverse direction, and must continue to pay a relatively high settlement rate. We have stated on several occasions that such one-way bypass of the settlements system is not in the public interest because it would greatly exacerbate the traffic imbalance, and, therefore, the U.S. net settlements deficit on the route where it is occurring.³⁴¹ An increase in the U.S. net settlements deficit would ultimately lead to higher collection rates for IMTS on the affected route as carriers pass through to consumers increased settlement costs.

194. To address these potential market distortions that could result from above-cost settlement rates, we proposed to condition various types of authorizations to provide international services from the United States on compliance with the benchmark settlement rates. We adopt the proposed conditions with certain modifications in response to the record, as described in the next two sections. We address separately our conditions for carriers that seek to serve affiliated markets as facilities-based switched or private line carriers and our rules that will govern all U.S. carriers in their use of facilities-based or resold private lines for the provision of switched services.

1. Condition for Service to Affiliated Markets

a. Notice

195. We proposed in the *Notice* to condition the facilities-based switched and private line authorizations of carriers seeking to serve affiliated foreign markets from the United States on the affiliated foreign carrier offering U.S. international carriers a settlement rate for terminating U.S.-originated traffic on the affiliated route that is at or below the appropriate benchmark. We further proposed that if, after the foreign-affiliated carrier has commenced service to the affiliated

³⁴¹ See *Notice* at ¶ 11. See also Regulation of International Accounting Rates, *First Report and Order*, 7 FCC Rcd 559, 561, ¶¶ 17-20 (1991).

market, we learn that the carrier's service offering has caused a distortion of competition on the affiliated route, we would order that the affiliated foreign carriers' settlement rates on that route be reduced to the bottom of the range or revoke the authorization of the carrier to serve the affiliated market. An authorization granted to a facilities-based carrier would thus be granted subject to a condition to this effect.

196. We sought comment on what mechanism or approach we should use to determine when there has been a distortion of competition in the IMTS market and the lower settlement rate should be applied. We also requested comment on how our proposal would affect the effective competitive opportunities test ("ECO") we adopted in the *Foreign Carrier Entry Order*.³⁴²

b. Positions of the Parties

197. Commenters disagree about our proposal to use the settlement rate benchmarks to condition authorizations to provide international facilities-based service from the United States to an affiliated foreign market. Some commenters support our proposal, some oppose it on the ground that it is not necessary, and others seek to modify it because it is not stringent enough.

198. WorldCom supports our proposal "because it is a narrowly-tailored remedy that addresses potential competitive distortions without limiting the ability of foreign carriers to enter the U.S. market."³⁴³ WorldCom states that in addition to the proposed authorization condition, we should continue vigorously to enforce the ISP on all routes. The Alexis de Tocqueville Institution concurs that revenues from artificially high settlement rates could be used to subsidize a facilities-based affiliate competing in the U.S. market. It states that such a subsidy could be used "to unfair competitive advantage through marketing efforts or predatory pricing."³⁴⁴

³⁴² *Foreign Carrier Entry Order*, 11 FCC Rcd 3873 (1995). The ECO test considers: (i) whether U.S. carriers are permitted, as a matter of law, to offer international facilities-based services in the foreign country; (ii) whether there exist reasonable and nondiscriminatory charges, terms and conditions for interconnection to a foreign carrier's domestic facilities for termination and origination of international services, and whether there are adequate means to monitor and enforce these conditions; (iii) whether competitive safeguards exist in the foreign country to protect against anticompetitive practices; and (iv) whether there is an effective regulatory framework in the destination country to develop, implement and enforce legal requirements, interconnection arrangements and other competitive safeguards. 47 C.F.R. §63.18(h)(6); *Foreign Carrier Entry Order* at ¶¶ 42-55. In our *Foreign Participation Notice*, we tentatively concluded that we should eliminate the ECO test as part of our public interest analysis of pending and future Section 214 applications filed by foreign carriers from WTO Member countries that seek to provide facilities-based, resold switched, or resold non-interconnected private line services. See *Foreign Participation Notice* at ¶ 32.

³⁴³ WorldCom Comments at 15.

³⁴⁴ Alexis de Tocqueville Institution Reply at 4-5.

199. AT&T supports the concept of using settlement rate benchmarks to condition authorizations, but argues that, as proposed by the Commission, the conditions are not sufficient to prevent anticompetitive behavior in the U.S. market for IMTS. AT&T argues that foreign carriers are able to impose a price squeeze on U.S. carriers by cutting their U.S. prices potentially as low as the foreign carriers' TSLRIC of U.S. origination and foreign market termination. AT&T states that such conduct would harm competition by limiting the participation of existing carriers and by discouraging further market entry.³⁴⁵ AT&T also expresses concern about the ability of foreign carriers to use a U.S. affiliate to lower prices in the U.S. market for IMTS. According to AT&T, this price-cutting strategy would enable a foreign carrier to earn additional settlements revenue by stimulating additional U.S.-outbound traffic to its home market from all carriers from the United States to its home market.³⁴⁶

200. AT&T argues that because the proposed benchmark ranges still exceed economic cost, our proposed condition would not remove the "strategic pricing advantages" enjoyed by carriers serving affiliated foreign markets from the United States.³⁴⁷ Thus, AT&T argues, we should condition a carrier's authorization to provide facilities-based service to an affiliate on that carrier's offering U.S. carriers settlement rates at or below the low end of the benchmark range. ICA also supports such a condition.³⁴⁸ AT&T opposes any attempt to identify anticompetitive behavior through regulatory monitoring, as proposed in the *Notice*, on the ground that it would require the reimposition of burdensome reporting requirements recently removed by the Commission.³⁴⁹ AT&T concludes that the only viable alternative to its proposal is to continue to limit U.S. market entry for the provision of facilities-based and switched resale services to foreign carriers meeting the ECO test.³⁵⁰

201. In contrast to AT&T, HKTI and GTE argue that the proposed condition is not necessary. HKTI asserts that the potential relationship between above-cost accounting rates and any anticompetitive behavior in the U.S. market for IMTS is "totally attenuated."³⁵¹ HKTI asserts that there has been no demonstration that foreign carriers are in fact receiving significant "transfer

³⁴⁵ AT&T Comments at 43.

³⁴⁶ *Id.* at 41-42.

³⁴⁷ *Id.* at 40.

³⁴⁸ ICA Reply at 5-6.

³⁴⁹ AT&T Comments at 44.

³⁵⁰ *Id.* at 40-41; 46.

³⁵¹ HKTI Comments at 17.

payments" through settlements. HKTII further asserts that "a proper calculation of net settlements, correcting for the diversion of direct revenues to U.S. carriers as a result of refile, callback and other reverse charge services, may show that deficits are actually incurred by foreign carriers. HKTII also states that any company can cross-subsidize an affiliate through profits and there is no way the Commission could effectively separate out the specific effects of above-cost accounting rates from profits.³⁵²

202. GTE states that it is implausible that a foreign carrier would cross-subsidize a U.S. affiliate in order to offer below-cost prices in the U.S. market because it will never be able to recoup, in the form of later monopoly profits, the losses it suffered. GTE contends that increasing competition in the U.S. market for IMTS means that it would be impossible for a foreign carrier to gain a monopoly position, much less retain that monopoly long enough to recoup excess profits. GTE concludes that it would be irrational under these circumstances for a foreign carrier to offer below-cost service offerings in an attempt to monopolize a segment of the U.S. market for IMTS.³⁵³

203. ABS-CBN states that the condition is not necessary in all circumstances. ABS-CBN cites its own situation, where according to ABS-CBN, it could not cross-subsidize a foreign affiliate with settlement payments from U.S. international carriers because per minute U.S. settlement rates are barely enough to cover its per minute payout to the incumbent Philippine carrier for local termination services.³⁵⁴ It further states that the "subsidies" most likely to frustrate competition in the U.S. market are those which major U.S. carriers obtain by virtue of their domestic long-distance businesses. ABS-CBN states that major U.S. carriers have a cost structure that is hard to match because they can spread their joint costs over more customers and have more pricing flexibility on individual rates.³⁵⁵

204. The United Kingdom suggests that the Commission make a distinction between liberalized and monopoly markets for purposes of applying the authorization condition. It states that the real anticompetitive behavior to be avoided would involve the ability of a foreign carrier terminating its own traffic to charge its affiliate a lower or no settlement rate. The United

³⁵² *Id.* at 18.

³⁵³ GTE Comments at 25-26; *see also* Telefónica de España Reply at 49 (agreeing with GTE's argument).

³⁵⁴ ABS-CBN Reply at 4-5.

³⁵⁵ *Id.* at 5.

Kingdom states that such behavior is not a concern where the foreign market is open and other carriers on the route can self-terminate.³⁵⁶

205. Sprint also opposes our proposed condition for authorizations to provide facilities-based switched service to affiliated markets on the ground that it is not necessary. Sprint states that "the Commission can under all circumstances rely on its benchmarks as a basis for exchanging traffic for any foreign carrier."³⁵⁷ It further argues that foreign carrier entry and investment in the U.S. market generally should be encouraged. With respect to the question of mechanisms to detect distortion in the U.S. market, Sprint urges us to approach this question "with great care," as one party's perception of competition distortion may be viewed as robust competition by another party.³⁵⁸

206. MCI disagrees with our proposal to condition carriers' authorizations to provide facilities-based service to affiliated markets as proposed in the *Notice*. Instead, MCI urges us to retain the ECO test to address potential distortion concerns.³⁵⁹

c. Discussion

207. We are not convinced by commenters who argue that our proposed authorization condition is unnecessary. We believe it is appropriate to prevent potential anticompetitive distortions in the U.S. market for IMTS by conditioning a carrier's authorization to provide facilities-based switched or private line services to a market in which its affiliated foreign carrier provides service on that foreign carrier offering U.S. carriers a settlement rate to terminate U.S.-originated traffic on the affiliated route that is at or below the relevant benchmark. We are also not convinced by AT&T's arguments that the condition should be more stringent. We therefore adopt the conditions for facilities-based switched and private line service to affiliated markets as proposed in the *Notice*. We also adopt a rebuttable presumption to determine when there has been a distortion of competition in the U.S. market for IMTS and we should take enforcement action.

208. Before we address foreign carriers' incentives to engage in price squeeze behavior, we conclude that a U.S.-licensed carrier does have the *ability* to engage in price squeezes that create distortions in the U.S. market for IMTS when it provides facilities-based service to a

³⁵⁶ United Kingdom Comments at 4.

³⁵⁷ Sprint Comments at 22.

³⁵⁸ *Id.* at 22-23.

³⁵⁹ MCI Comments at 9-10.

market in which its affiliated foreign carrier provides the terminating service and collects above-cost settlement rates.³⁶⁰ We refer to such markets as "affiliated markets." A price squeeze refers to a particular, well-defined strategy of predation that would involve the foreign carrier setting "high" (above-cost) international settlement rates while its U.S. affiliate offers "low" prices for domestic IMTS services in competition with the other carriers. Because the foreign carrier's international termination services are a necessary input for providing IMTS services, the foreign carrier can create a situation where the relationship between its "high" international settlement rates and its U.S. affiliate's "low" prices for IMTS services forces competing carriers either to lose money or to lose customers even if they are more efficient than that affiliate at providing international services. This unprofitable relationship between the input prices and the affiliate's prices, not the absolute levels of those prices, defines a price squeeze.

209. A U.S. affiliate of a foreign carrier will still set its own prices based on the foreign carrier's economic cost of providing international termination services because this will maximize their combined profits. In this sense, a price squeeze would have much the same effect as price discrimination in which the foreign carrier charged its U.S. affiliate lower settlement rates than it charged all other carriers. The affiliate will also take into account the effect of its prices on the settlement revenues earned by the foreign carrier.

210. We sought comment in the *Notice* on whether a foreign carrier has the *incentive* to use revenues from above-cost settlement rates to subsidize an affiliate providing international services in the U.S. market. We noted that a foreign carrier may not have this incentive because in serving its home market directly through a U.S. affiliate, the foreign parent would no longer receive the settlement payment it formerly received from other U.S. carriers to terminate traffic to that market. In its comments, AT&T asserts that foreign carriers collecting above-cost accounting rates do have an incentive to enter the U.S. market and undercut competitors. According to AT&T, the incentives lie in three additional sources of profit for a U.S. affiliate of a foreign carrier: (1) the foreign carrier may earn profits from terminating U.S.-inbound traffic; (2) to the extent that its U.S. collection rate exceeds costs, the foreign carrier may use its affiliate to earn profits on U.S.-outbound traffic; and (3) by using its affiliate to lower price in the U.S. market, the foreign carrier may earn additional settlements revenue for the foreign carrier by stimulating additional U.S.-outbound traffic to its home market from all carriers.³⁶¹ GTE, on the other hand, argues that it would be irrational for a foreign-affiliated carrier to offer below-cost service offerings in the U.S. market because it would be impossible for a foreign carrier to gain a

³⁶⁰ 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 *Foreign Carrier Entry Order* at ¶ 73; 47 C.F.R. § 63.18(h)(1)(i).

³⁶¹ AT&T Comments at 41. See also ESI Comments at 9 (A foreign carrier would have an incentive to subsidize a U.S. affiliate in order to build a competitive force in the U.S. market.).

monopoly position in the U.S. market, much less retain that monopoly long enough to recoup excess profits lost by offering below-cost service. GTE thus concludes that our benchmark conditions are not necessary.³⁶²

211. We agree with AT&T that in markets that are not fully competitive and are characterized by substantial margins between costs and prices, such as some segments of the U.S. market for IMTS, a foreign carrier collecting above-cost settlement rates would have the ability and incentive to enter the U.S. market and charge lower prices for IMTS. As AT&T notes, such a strategy could generate additional revenue for the foreign carrier by stimulating additional U.S.-outbound traffic to its home market from all carriers. To the extent that its U.S. affiliate's prices remain above its costs, the lower prices are consistent with increased competition or more efficient operation, and consumers clearly benefit from the development. On the other hand, where the U.S. affiliate sets its prices below its own costs of providing service, the lower prices may be the result of a predatory price squeeze and distort competition. Nonetheless, we do not agree with GTE that our benchmark conditions are unnecessary. The consequences of carriers opting to engage in a price squeeze strategy are serious enough for us to take preventive measures. As long as foreign carriers are possibly able to engage in predatory price squeeze behavior, we find that the public interest is best served by adopting the Section 214 authorization condition we proposed in the *Notice* to prevent such behavior and protect competition in the U.S. market for IMTS.

212. ABS-CBN states that the condition for provision of facilities-based service to affiliated markets is not necessary for carriers like itself whose settlement revenues barely cover local termination costs.³⁶³ While it may be true that some carriers have greater ability than others to engage in anticompetitive behavior, we believe a rule of general applicability is more administratively efficient, and more importantly, would result in greater regulatory certainty for Section 214 applicants than a case-by-case determination. In addition, case-by-case determinations of the need for competitive conditions could lead to long delays in processing Section 214 applications.

213. We note that in our recent *Access Charge Reform Order* and *Classification of LEC Long Distance Service Order*, we addressed the potential for BOCs to engage in price squeeze behavior when providing in-region interLATA services. In the *Access Charge Reform Order*, we concluded, following analysis similar to that here, that an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. In the *Access Charge Reform Order*, however, we

³⁶² GTE Comments at 25-26.

³⁶³ ABS-CBN Reply at 5.

concluded that we have in place adequate safeguards against such conduct,³⁶⁴ and in the *Classification of LEC Long Distance Service Order*, we concluded that imposing advance tariffing and cost support data requirements on BOC interLATA affiliates would not be an efficient means of preventing the BOCs from engaging in a price squeeze strategy.³⁶⁵ In the *Access Charge Reform Order*, we also took comfort from current market conditions and regulatory developments. In particular, we noted that: (1) interexchange carriers could respond to an incumbent LEC's attempted price squeeze by entering the local market through the use of unbundled network elements priced at cost-based rates; (2) it is unlikely, given the presence of excess sunk network capacity, that an incumbent LEC could successfully engage in predatory conduct aimed at gaining market power in markets for interexchange services; and (3) domestic antitrust laws offer a measure of protection against a predatory price squeeze.

214. The conditions we adopt today are consistent with our recent treatment of price squeeze concerns in other contexts. For example, our requirement that a foreign carrier's settlement rates be at or below the relevant benchmark as a condition of Section 214 authorization for a carrier to provide IMTS service on an affiliated route is analogous to the approach we adopted with respect to an incumbent LEC's interstate exchange access rate -- an important component reflected in the rates charged to end users. In the *Access Charge Reform Order*, we concluded that rates preferably should be set by competition, not regulation.³⁶⁶ If access markets were competitive, predatory price squeezes could not be used profitably to distort competition in interexchange markets. Because incumbent LECs currently have little or no competition in the provision of access to their exchange access facilities, however, we have taken, and continue to take, action to ensure that the incumbent LEC access rates continue to move toward the underlying cost of providing access services. In that *Order*, we determined that where competition does not develop over the next several years, we will require carriers to file cost studies that will enable us to ensure that all customers receive the benefit of more efficient prices.

215. Settlement rates similarly represent a cost component that is reflected in the rates charged to end users. As with access charges, U.S.-owned carriers do not, for the most part, have a competitive international market from which to purchase international termination services. While we believe that the WTO Basic Telecom Agreement will lead to the development of increased competition in foreign carriers' markets, this process has just begun, and competitive alternatives are not currently available. Consequently, international settlement rates generally

³⁶⁴ *Access Charge Reform Order* at ¶ 278.

³⁶⁵ *See* Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, *Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, FCC 97-142 (rel. April 18, 1997), *recon.* FCC 97-229 (rel. June 27, 1997).

³⁶⁶ *Access Charge Reform Order* at ¶¶ 258-84.

remain far above competitive levels. Moreover, unlike in the domestic interexchange market, we have no jurisdiction over the foreign provider of termination services, and we do not have the same range of regulatory tools available as we have in the domestic context to address competitive distortions. We thus have only a limited ability to affect the development of competition in the international termination services market.

216. We believe there are several factors that suggest that predatory price squeezes may be potentially a greater problem on international routes than they are in the domestic interexchange context. First, on many international routes, the margin of settlement rates above cost is greater than the margin for interexchange access charges. At the same time, there may be less competition for end users than in the domestic interexchange context. On such routes, the potential for distortion is higher. Second, in the domestic interexchange context, interexchange carriers can mitigate the effects of a price squeeze and avoid access charges by winning local customers and serving them by means of unbundled network elements set at cost-based rates. No comparable mechanism is available on international routes. Third, in the *Access Charge Reform Order*, we recognized that the existence of four established interexchange networks made it unlikely that predatory price squeezes could be successful. In contrast, on certain international routes, there is little excess capacity available to competitors. Moreover, if an international carrier were forced to exit, the foreign carrier's affiliate might be able to take control of the other carrier's facilities, which would make new entry less likely and thus increase the likelihood that predation would be successful. For these reasons, we believe predatory price squeezes pose a potentially more serious threat on international routes than in the interexchange context. Our benchmarks will help to protect competition in U.S. IMTS markets by reducing the extent to which foreign carriers and their U.S. affiliates can manipulate price-cost margins (the margin between the price of the good and the price of the inputs needed to produce the good) in ways that distort markets.

217. Our assessment of the need to adopt a Section 214 authorization condition to address the potential for price squeezes has changed since we first reviewed this issue in the *Foreign Carrier Entry* proceeding.³⁶⁷ We there concluded that it was unnecessary to impose such a condition. We did not find on that record persuasive evidence that foreign carriers that entered our market pursuant to our ECO framework could successfully engage in a price squeeze. We reasoned that foreign carriers could not unilaterally set settlement rates because they are established through negotiation with U.S. carriers; that high settlement rates could be offset by lower prices for other inputs or by carrier efficiencies; and that the benefits of additional price and service competition from foreign carriers entering our market after an ECO finding offset the possibility of economic harm to unaffiliated U.S. carriers. We also stated our belief that increased global competition itself would encourage foreign carriers to move toward cost-based levels.

³⁶⁷ See *Foreign Carrier Entry Order* at ¶¶ 68-70.

218. The balance of considerations has changed significantly since the *Foreign Carrier Entry Order*. As we stated earlier in this *Order*, our action here comes after the time period for implementation of ITU Recommendation D.140 has concluded, yet settlement rates remain far above cost-based levels. Against this backdrop, the prospect of freer entry into the U.S. market after January 1, 1998 pursuant to our rulemaking proposals implementing the WTO Basic Telecom Agreement increases our concern that foreign carrier entry could create competitive distortions in the U.S. market. We find on this record that foreign carriers have the ability to engage in a price squeeze and that the consequences of carriers opting to engage in such a strategy are serious enough for us to take the preventive measure of adopting a Section 214 authorization condition at this time.

219. We disagree with HKTI that the potential relationship between above-cost settlement rates and anticompetitive behavior in the U.S. market is attenuated. The relationship is in fact straightforward. Settlement rates are an essential input for international termination services. The rates charged for that essential input are in most cases substantially above-cost. When a provider of that above-cost essential input enters the retail market that uses that input (the market for IMTS), it has the ability to price its retail services so that the relationship between "high" input prices and "low" retail prices forces competing retail providers either to lose money or to lose customers even if they are more efficient. HKTI states that there is no way the Commission could separate out the specific effects of above-cost settlement rates from other intracorporate cross subsidies. But, as discussed here, our concern is specifically with the potential market-distorting impact of above-cost settlement rates as an essential input for international termination services. HKTI further states that we cannot determine "distortion" in the international marketplace solely based on the level of settlement rates. It thus concludes that the Section 214 authorizations could not be applied in a nondiscriminatory and fair way and would be arbitrary and capricious as a result.³⁶⁸ We disagree. We have specifically defined the competitive harm we seek to address through the authorization conditions: that a foreign-affiliated carrier can engage in price squeeze behavior on the affiliated route by virtue of its dual role as a provider of an above-cost essential input and a competitor in the retail market using that input.³⁶⁹

³⁶⁸ HKTI Comments at 25-26.

³⁶⁹ HKTI states that there is no evidence that foreign carriers are in fact receiving significant "transfer payments" through settlements. HKTI states that in fact, "a proper calculation of net settlements, correcting for the diversion of direct revenues to U.S. carriers as a result of refile, callback and other reverse charge services, may show that deficits are actually incurred by foreign carriers." HKTI has provided no evidence, however, to support its claim that foreign carriers incur "deficits" as a result of these services. Moreover, contrary to HKTI's claim, we have shown that settlement rates are in almost all cases substantially above the level of costs incurred by foreign carriers to terminate international traffic.

220. We note that AT&T expresses a broader concern about the effect a foreign-affiliated carrier providing service to its home market will have on the U.S. market. AT&T is concerned not only about predatory price squeezes, but also has a more general concern about all price-cutting behavior of foreign-affiliated carriers. AT&T believes that foreign carriers have an "unbeatable cost advantage" due to their parent's collection of above-cost settlement rates.³⁷⁰ To the extent that AT&T argues that all price-cutting by U.S. affiliates of foreign carriers is anticompetitive, we disagree. Such pricing behavior becomes detrimental to U.S. consumers' interests only when it could ultimately reduce the level of competition on particular international routes. A pricing strategy that undercuts competitors' prices but that is neither discriminatory nor potentially harmful to competition may be deemed unfair by some commenters since it would increase the profits of foreign carriers and reduce the profits of carriers in the domestic IMTS market. It does not, however, create distortions in the U.S. market for IMTS that require us to impose conditions.³⁷⁶

221. While we believe that carriers serving affiliated markets have the ability to engage in market-distorting price squeeze behavior by pricing below cost, we do not agree with AT&T that the only way to prevent such behavior is by conditioning a carrier's authorization to provide facilities-based service to an affiliated market on the affiliated foreign carrier offering U.S. carriers settlement rates on the affiliated route at or below a TSLRIC-based rate. Such a condition is not necessary to prevent distortions in the U.S. market for IMTS services, and in fact, it could harm the development of further competition in that market. We believe AT&T's proposed condition could effectively deter many carriers from providing facilities-based service from the United States to affiliated markets. This result would impede our goal of increasing competition in the U.S. market for IMTS to the detriment of U.S. consumers.³⁷⁷

222. We agree with AT&T's assertion that because settlement rate benchmarks based on the TCP methodology are above-cost, the facilities-based condition as proposed in the *Notice* does not completely eliminate the ability for foreign-affiliated carriers to execute a price squeeze. Requiring that a carrier's settlement rates be at or below the relevant benchmark before it may provide facilities-based service to an affiliated market, however, substantially reduces the above-

³⁷⁰ AT&T Comments at 42-43.

³⁷⁶ To the extent that AT&T has concerns that foreign-affiliated carriers may get an unfair advantage over other competitors in the U.S. market, we note that the Section 214 authorization conditions we adopt in this *Order* to address the potential for market-distorting behavior essentially require foreign carriers to forego a substantial portion of the monopoly rents in their settlement rates before using an authorization to provide service to an affiliated market. Thus, the unfair advantage AT&T fears will be substantially mitigated by our conditions to address anticompetitive behavior.

³⁷⁷ As Sprint asserts, foreign carrier entry and investment in the U.S. market generally should be encouraged. Sprint Comments at 22.

cost termination charges that could be used to execute a price squeeze.³⁷⁸ We also note our conclusion that foreign carriers collecting above-cost settlement rates are potentially able to engage in anticompetitive price squeeze behavior. We conclude that AT&T's proposal would be an overreaction to the potential for price squeeze. Moreover, to the extent carriers retain the ability to execute a predatory price squeeze, our authority to take enforcement action, including ordering that a carrier's settlement rates on an affiliated route be reduced to the level of our best practice rate, \$0.08, or revoking a carrier's authorization will be a strong deterrent. We also note that in our *Foreign Participation Notice* we questioned whether we should impose certain competitive safeguards, including structural separation, to guard against anticompetitive behavior in the U.S. market for IMTS. Any such safeguards would be applied in addition to the Section 214 authorization conditions we adopt here.

223. AT&T asserts that, if we do not adopt its proposal to strengthen the condition for the provision of facilities-based switched service to affiliated markets, then we should retain the ECO test.³⁷⁹ MCI also argues in favor of retaining the ECO test.³⁸⁰ We will consider these arguments in our *Foreign Participation* proceeding, where we have sought comment on whether to apply the ECO test in light of the WTO Basic Telecom Agreement. In that *Notice*, we tentatively concluded that we should eliminate the ECO test as part of our public interest analysis of pending and future Section 214 applications filed by foreign carriers from WTO Member countries.³⁸¹

224. We adopt a trigger to determine when market distortion has occurred, at which time we will take enforcement action. Such enforcement action may include requiring a carrier to lower its settlement rates on an affiliated route to the level of our best practice rate or revoking its authorization to provide service on the affiliated route. We establish a rebuttable presumption that a carrier has engaged in price squeeze behavior that creates distortions in the U.S. market for IMTS if the conditions of our bright line test are met. The bright line test we adopt is whether any of a carrier's tariffed collection rates on an affiliated route are less than the carrier's average variable costs on that route. For purposes of this bright line test, we define a carrier's average variable costs on the affiliated route as the carrier's net settlement rate plus any originating access

³⁷⁸ As WorldCom asserts, the benchmark conditions proposed by the Commission are "not a perfect economic solution because the proposed benchmarks are still well above economic cost," but the approach "deserves support because it attacks the crux of the problem: above-cost settlement rates." WorldCom Comments at 15.

³⁷⁹ AT&T Comments at 40-41; 46.

³⁸⁰ MCI Comments at 9-10.

³⁸¹ *Foreign Participation Notice* at ¶32.

charges.³⁸² These are 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.³⁸³ Most other expenses are fixed in the short term, and would be incurred regardless of whether the carrier provided service. If any tariffed collection rate is less than average variable costs, we will presume that the carrier is engaging in anticompetitive price squeeze behavior and we will take enforcement action. Such enforcement action may include a requirement that the carrier reduce its settlement rates on the affiliated route. Alternatively, we could revoke the carrier's authorization to serve the affiliated market.³⁸⁴

225. We believe that recovery of average variable costs is an appropriate threshold standard for determining the existence of price squeeze behavior because in the short run carriers can increase their profits (or minimize their losses) by offering service at a price at or above average variable costs. Thus, any price below that floor would indicate that the carrier is losing money by providing service. Alternatively, in the case of a U.S. affiliate of a foreign carrier, any price below the floor could indicate that the U.S. affiliate is attempting a price squeeze. Because the U.S. affiliate's net settlement payments are an intracorporate transfer and not a true cost, the U.S. affiliate could price its service in the U.S. market below average variable costs. We therefore believe that any price below average variable costs is suspect and that we should establish a rebuttable presumption of market distorting behavior. The presumption of market distortion can be rebutted by a showing that there is an economically justifiable reason for pricing below average variable costs. For example, a carrier could show that its pricing strategy is a time limited promotion in order to gain market share.

226. Data from which a U.S. carrier's net settlement rate can be calculated will be filed as part of the quarterly traffic reports we adopt in this *Order*. As discussed in Section II.C.2., the quarterly reports will contain the same data that are required in the existing Section 43.61 reports, including actual traffic and revenue data, but for facilities-based switched services and facilities-based switched resale services only.³⁸⁵ Information on U.S. carriers' access charges is available in

³⁸² See note 128, *supra*, for an explanation of "net settlement rate."

³⁸³ We acknowledge that there are other long run variable costs that a carrier must recover to remain profitable. However, competitive markets often force firms to price at short run variable costs. We thus focus on short run variable costs for purposes of establishing a presumption of the existence of market distorting behavior.

³⁸⁴ We note that the Commission eliminated the lower pricing bands for LEC price cap services. We believe, however, that because foreign-affiliated carriers have the ability to engage in a predatory price squeeze on affiliated routes, it is appropriate to establish a trigger for presuming that a foreign-affiliated carrier is engaging in price squeeze.

³⁸⁵ See 47 C.F.R. §43.61. The data currently filed by carriers pursuant to the annual reporting requirement in Section 43.61 is compiled in an annual report prepared by the Industry Analysis Division of the Common Carrier Bureau.

tariffs filed with the Commission and in the Commission's annual Monitoring Report in CC Docket No. 87-339. We believe these reporting requirements will be sufficient to enable us to detect market-distorting price squeeze behavior. However, we will develop additional monitoring mechanisms in the future if necessary.

227. We may make a finding that the trigger for determining the existence of market distortion has been met on our own initiative or pursuant to a written request by any carrier providing IMTS on the route in question. Such written requests must provide evidence that any of a carrier's tariffed collection rates on an affiliated route is less than the carrier's average variable costs (average net settlement rate payments plus access charge payments) on the route. Such evidence may be based on the data filed pursuant to the Section 43.61 quarterly traffic report filing requirement that we adopt here, the annual Monitoring Report in CC Docket No. 87-339, a carrier's tariffs, or other sources. If we find, either on our own initiative or by request, that the presumption of market distortion has been met on an affiliated route, we will issue a public notice and notify the carrier providing service to the affiliated route. Once we make a finding, the carrier providing service to the affiliated route will be prohibited from using its authorization to provide switched services until it complies with our enforcement action or successfully presents evidence sufficient to rebut the presumption of market distortion.

228. In the *Notice*, we sought comment on whether we should impose the conditions for facilities-based service to affiliated markets on existing Section 214 certificate holders that serve affiliated markets.³⁸⁶ We conclude that we should apply the conditions to existing Section 214 certificate holders. We see no reason to exempt carriers with existing authorizations from complying with conditions that will apply to all other carriers providing facilities-based service to affiliated markets. The same concerns about anticompetitive behavior we seek to address through our conditions apply equally to carriers with existing authorizations. We will therefore require existing Section 214 certificate holders that serve affiliated markets to negotiate with all U.S. international carriers a settlement rate for the affiliated route that is at or below the appropriate benchmark. The settlement rate must be negotiated and in effect within ninety days of the effective date of this *Order*.

229. We also sought comment in the *Notice* on a proposal to establish a presumption that carriers from countries that have opened their markets to meaningful competition have fulfilled our Section 214 conditions. We reasoned that our conditions would not be necessary under these circumstances because effective competition will best ensure that settlement rates are set at cost-based levels and thereby eliminate the potential for anticompetitive behavior from

³⁸⁶ *Notice* at ¶ 85.

above-cost rates.³⁸⁷ We conclude, however, that we should apply the Section 214 conditions to all carriers, including those from countries that have opened their markets to competition. The conditions are necessary to address the potential for market distorting behavior created by the existence of above-cost settlement rates. Even in countries which have meaningful competition, the potential exists for a carrier with a significant market share to create distortions in the U.S. market for IMTS if it is collecting above-cost settlement rates. We thus conclude that the Section 214 conditions should be applied to all carriers, including those from countries that have introduced competition. We note, however, that in markets where there is fully developed competition, settlement rates will likely be at or below the benchmarks we adopt in this *Order*. Thus, foreign-affiliated carriers providing service to those markets will not have to take any further action to comply with our conditions unless they engage in anticompetitive behavior.³⁸⁸

230. AT&T argues in an *ex parte* communication that we should apply the same condition we proposed in the *Notice* for authorizations to provide facilities-based switched service from the United States to an affiliated market to authorizations to provide switched resale service from the United States to an affiliated market.³⁸⁹ AT&T first raised this argument in an *Ex Parte* dated July 10, 1997, to which it attached its comments in the *Foreign Participation* proceeding. We believe that AT&T's argument is better addressed in the *Foreign Participation* proceeding, where we will have a more complete record on the issue of applying the benchmark condition to facilities-based switched service. AT&T raised the issue in its initial comments in that proceeding, and parties will have an opportunity to comment in their reply comments, which are not due until after the adoption date of this *Order*.

231. In summary, we will condition authorizations to provide international facilities-based switched or private line service from the United States to an affiliated market in order to restrain the ability of foreign-affiliated carriers to engage in anticompetitive price squeeze behavior in the U.S. market. Specifically, we will condition any such authorization to serve an affiliated market on the affiliated carrier offering U.S. international carriers a settlement rate for the affiliated market at or below the relevant benchmark adopted in this *Order*. If, after the carrier has commenced service to the affiliated market, we learn that the carrier's service offering has distorted market performance on the route in question, as determined by the rebuttable

³⁸⁷ *Id.*

³⁸⁸ The United Kingdom has noted that cost-based alternatives for terminating traffic should be available in markets that permit foreign carriers to self-correspond. United Kingdom Comments at 4. There is no need, however, as the United Kingdom suggests, to distinguish between liberalized and monopoly markets in applying our benchmark conditions. While the condition may apply to liberalized markets, if rates are at or below the benchmarks, carriers will not have to take any further action unless they engage in market distorting behavior.

³⁸⁹ Letter from James Talbot, AT&T, to William Caton, Acting Secretary, July 10, 1997.

presumption we adopt here, we will take enforcement action. That action may include a requirement that the settlement rate of the affiliated carrier for the route be at a level equal to or below the best practices rate we adopt in this *Order*, \$0.08, or a revocation of the authorization of the carrier to serve the affiliated market. We adopt a rebuttable presumption that a carrier's service offering 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.

2. Condition for Provision of Switched Services over Private Lines

a. Notice

232. We also proposed in the *Notice* a competitive safeguard to address the potential market distortions resulting from one-way bypass of the accounting rate system. Specifically, we proposed to grant carriers' applications for authority to resell international private lines to provide switched services on the condition that settlement rates on the route or routes in question are at or below the appropriate settlement rate benchmark. Under the proposed condition, if any settlement rate on the route in question is higher than the appropriate benchmark, a resale carrier would not be permitted to use its private line resale authorization to provide switched, basic services until such time as all settlement rates on the route are at or below the benchmark. We noted that this condition would apply to any U.S. carrier seeking to provide switched, basic services via resold private lines regardless of whether the carrier is operating on a particular route in correspondence with an affiliated foreign carrier. We reasoned that even an unaffiliated U.S. carrier would have the ability to distort competition on the route to the extent it accepted one-way bypass traffic from a foreign carrier. We also proposed to order all U.S. international carriers to pay a cost-based settlement rate if, after a carrier has commenced switched service via a resold private line, we learn that competition on the route has been distorted -- *i.e.*, that one-way bypass is occurring. We asked for comment on what mechanism or approach we should use to determine when competition has been distorted. We also sought comment on whether these proposed conditions should replace our current private line resale policy³⁹⁰ or whether that policy should be modified to ensure that it is compatible with the proposed conditions.

233. In our recent *Foreign Participation Notice*, we concluded that it might be necessary to supplement the condition that we proposed in the *Notice* to cover facilities-based

³⁹⁰ Our private line resale policy permits U.S. carriers to resell international private lines to provide switched services to countries that afford resale opportunities equivalent to those available under U.S. law as an alternative to terminating traffic via the traditional settlement rate system. This policy is referred to as the "equivalency test." See Regulation of International Accounting Rates, CC Docket No. 90-337, Phase II, *First Report and Order*, 7 FCC Rcd 559 (1991) (*International Resale Order*). In our *Foreign Participation Notice*, we tentatively concluded that it is no longer necessary, or desirable from an administrative standpoint, to continue to apply the equivalency test to pending or future Section 214 applications to provide switched, basic services over private lines between the United States and WTO Member countries. *Foreign Participation Notice* at ¶ 50.

carriers' use of their authorized private lines to route U.S. inbound and outbound switched traffic. We noted that facilities-based private line carriers also have the ability to distort competition on a particular route to the extent they terminate one-way bypass traffic from a foreign carrier. We therefore proposed to prohibit a U.S.-licensed facilities-based private line carrier from originating or terminating U.S. switched traffic over its facilities-based private lines until all U.S. carriers' settlement rates for the country or location at the foreign end of the private line are at or below the appropriate benchmark.³⁹¹ In a Public Notice accompanying our *Foreign Participation Notice*, we invited interested parties to file supplemental comments on this proposal in this proceeding.³⁹²

b. Positions of the Parties

234. Many commenters agree that the settlement rate benchmarks should be used to condition authorizations to provide switched services over facilities-based or resold international private lines. They agree that such conditions are necessary to address possible distortions in the U.S. market from one-way bypass. Some commenters, however, urge us to strengthen the proposed conditions, while others urge us to loosen restrictions on the provision of international simple resale ("ISR").

235. ACC and Primus, for example, state that they would prefer us to permit ISR on all routes immediately because encouraging carriers to engage in ISR will enhance competition in the global IMTS market. However, they support the proposed conditions as a way to address our concern about one-way bypass.³⁹³ ACC agrees with us that the proposed conditions address the concern that one-way bypass could distort competition.³⁹⁴

236. TNZL opposes our proposed conditions on the basis of a similar concern to that raised by ACC and Primus, that the proposed conditions could undermine our objective of exerting downward pressure on the level of settlement rates. TNZL notes that the logical effect of the provision of switched services over resold international private lines is to put pressure on settlement rates. TNZL concludes that we "should not require that the effect exist before the cause."³⁹⁵ The United Kingdom also cites the procompetitive benefits of ISR and urges us to

³⁹¹ *Foreign Participation Notice* at ¶ 121.

³⁹² Public Notice DA 97-1173 (rel. June 4, 1997).

³⁹³ Primus Comments at 3-5; ACC Comments at 6-7.

³⁹⁴ ACC Comments at 6-7.

³⁹⁵ TNZL Comments at 9; *see also Viatel July 11, 1997 Ex Parte* at 4-5.

consider extending the ability to provide ISR services to as many routes as possible. The United Kingdom suggests that we consider permitting ISR on routes where the benchmarks have not been reached, provided other safeguards against one-way bypass are in place.³⁹⁶ Viatel also cites the procompetitive benefits of ISR services and further argues that the proposed condition is not necessary because there has been no evidence to date of one-way bypass in the U.S. market.³⁹⁷

237. Japan recognizes there is a possibility of "trade distortion caused by monopolist carriers bypassing the international settlement rate system in non-liberalized countries."³⁹⁸ Nonetheless, Japan objects to the proposed condition on resale of private lines to provide switched service. Japan notes in particular that the proposal that all settlement rates must be within the benchmark range before a carrier can use its authorization to provide switched services over private lines is too restrictive and means that market entry for some carriers would be contingent upon the level of accounting rates over which they have no control. TNZL is concerned that this aspect of our proposed conditions could give U.S. carriers' foreign correspondents effective control over whether they will face competition in switched services from international private line resellers. TNZL notes that any foreign carrier could block the entry of a competitor providing ISR simply by refusing to reduce the settlement rate on the route.³⁹⁹

238. GTE objects to our proposal to apply the resale condition to the provision of switched services over facilities-based private lines. GTE states that the proposal is unnecessary in light of the fact that market forces created by the WTO Basic Telecom Agreement will drive down settlement rates.⁴⁰⁰ GTE further argues that there is no demonstrated link between above-cost settlement rates and competitive distortion. GTE notes that we claim only that one-way bypass could occur, not that it has or will.⁴⁰¹

239. AT&T and MCI, on the other hand, urge us to strengthen the proposed condition by requiring that settlement rates on the route or routes in question be at the low end of the benchmark range as a condition of carriers' authorizations to resell international private lines to

³⁹⁶ United Kingdom Comments at 5.

³⁹⁷ Viatel July 11, 1997 *Ex Parte* at 5-6.

³⁹⁸ Japan Comments at 2.

³⁹⁹ TNZL Comments at 9-10.

⁴⁰⁰ GTE Comments at 1-3.

⁴⁰¹ GTE Supplemental Comments at 5-6.

provide switched service to the United States.⁴⁰² AT&T also argues that this more stringent condition should apply to the provision of switched services over facilities-based private lines.⁴⁰³ AT&T argues that this more stringent condition is necessary because the settlement rate benchmarks exceed the incremental costs of providing international service. As a result, foreign carriers would still have an incentive to send their traffic to the United States over private lines while continuing to collect above-cost benchmark rates. According to AT&T, this is problematic because the difference between ISR rates a carrier would pay to terminate traffic in the United States and the benchmark settlement rates a carrier would receive to terminate traffic from the United States "would provide significant margins for foreign carriers on every minute delivered to the U.S."⁴⁰⁴ AT&T concludes that if we adopt the conditions as proposed, it would be necessary to retain the present equivalency test to protect against one-way bypass.⁴⁰⁵

240. WorldCom agrees generally with our proposed conditions. However, it suggests some modifications to the proposals. Specifically, WorldCom proposes a three-prong test where ISR would be allowed on a route if any one prong is satisfied. Under WorldCom's proposed test, ISR would be allowed under any one of the following circumstances: (1) where ISR is already authorized on the route as of the effective date of the *Order*; (2) where the settlement rate for more than 50% of outbound traffic on a particular route is within the benchmark; or (3) where the Commission determines that the foreign market offers equivalent opportunities for ISR.⁴⁰⁶ WorldCom states that the second prong of its proposed test is a clarification of our proposed conditions to address situations where there are multiple foreign correspondents on a route. With respect to the third prong, WorldCom states that there could be situations where the prevailing settlement rate is not within the benchmark, but the country offers equivalent opportunities for U.S. carriers to engage in ISR. In those situations, WorldCom submits, permitting ISR would put additional pressure on high settlement rates and should be allowed.⁴⁰⁷

241. WorldCom also suggests a mechanism for detecting competitive distortion, *i.e.*, one-way bypass, that is based on the aggregate inbound/outbound ratio of settled traffic on a

⁴⁰² AT&T Comments at 35-36; MCI Reply at 8-9.

⁴⁰³ AT&T Supplemental Comments at 2-3. In its Supplemental Comments, MCI states that it supports the Commission's proposal to prohibit U.S. facilities-based private line carriers from originating or terminating U.S. switched traffic over their private lines until all U.S. carriers' settlement rates on the route in question are within the relevant benchmark range. MCI Supplemental Comments at 1-2.

⁴⁰⁴ AT&T Comments at 36.

⁴⁰⁵ *Id.* at 35-36.

⁴⁰⁶ WorldCom Comments at 18.

⁴⁰⁷ *Id.* at 19.

route. WorldCom suggests that if the percentage of outbound traffic relative to inbound increases by a 10 or more percent across two measurement periods, there should be a presumption that inbound traffic is being disproportionately diverted from the settlement process to ISR routing. WorldCom states that the 10 percent threshold should provide sufficient leeway for routine traffic shifts.⁴⁰⁸ AT&T, however, is skeptical that such monitoring procedures would provide an effective remedy for market distortions. AT&T is concerned that reliance upon the Commission's only existing monitoring activities, the annual Section 43.61 reporting process, would delay action for at least nine months after the end of the calendar year in which bypass occurred. The introduction of more frequent reports would, according to AT&T, impose costly compliance burdens and could disclose competitively sensitive information. AT&T also notes that existing Commission reporting requirements for carriers authorized to provide switched services over international private lines have been widely ignored. Finally, AT&T questions how the Commission could distinguish traffic shifts resulting from one-way bypass from those resulting from callback, refile, or other procompetitive market changes.⁴⁰⁹

c. Discussion

242. The comments reflect the dilemma faced by the Commission. The provision of switched services over private lines has strong procompetitive effects in the marketplace. As we stated in the *International Resale Order*, a more liberal policy with respect to resale of international private lines will allow new entities to enter the market and offer services such as IMTS. This new entry will compel carriers at both ends of the circuit to bring their prices closer to cost to avoid losing their current customers to resale providers.⁴¹⁰ But at the same time, the procompetitive effects of private line resale must be weighed against the market distorting effects of one-way bypass.⁴¹¹ The threat of one-way bypass of the accounting rate system cannot be ignored. It has significant implications for competition in the U.S. market for IMTS, and consequently, for U.S. consumers. One-way bypass exacerbates the U.S. net settlements deficit and ultimately increases the burden on U.S. ratepayers through higher rates for IMTS. Contrary to Viatel's claim, the fact that we have not had to take action against carriers for one-way bypass in the past does not mean the concern about one-way bypass is speculative. The reason we have been able to avoid one-way bypass in the past is our equivalency policy. That policy permits private line resale only to countries that afford resale opportunities equivalent to those available

⁴⁰⁸ *Id.* at 20.

⁴⁰⁹ AT&T Reply at 49-50; *see also* KDD Reply at 8.

⁴¹⁰ *International Resale Order*, 7 FCC Rcd at 560.

⁴¹¹ Telia states that it has the same concern about one-way bypass in the Swedish market. Telia Comments at 3-4.

under U.S. law. However, in our recent *Foreign Participation Notice*, we tentatively concluded that it is no longer necessary to continue to apply the equivalency test to applications to provide such service to WTO Member countries.⁴¹²

243. We believe the condition we proposed in the *Notice*, with some modifications, balances our desires to encourage ISR and at the same time limit the potential for one-way bypass. Accordingly, we adopt the condition as proposed in the *Notice* with two modifications. The first modification is that we will authorize carriers to provide switched services over resold international private lines between the United States and foreign destination countries on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes are at or below the appropriate benchmark, as proposed by WorldCom. If we learn that competition on the route in question has been distorted, *i.e.*, carriers are engaging in one-way bypass, we will take enforcement action. Such enforcement action may include a requirement prohibiting carriers from using their authorizations to provide switched services over private lines on that route until settlement rates for at least 50 percent of the settled U.S. billed traffic on the route are at or below the level of our best practice rate of \$0.08, or revocation of a carrier's authorization.

244. In the *Notice*, we proposed to require that all settlement rates on the route in question be within the benchmarks. Our proposal to require that all settlement rates on the route be at the appropriate benchmark levels, rather than only the resale applicant's settlement rates, was intended to address the situation where the Section 214 applicant was a pure reseller. In that case, it would be meaningless to require a pure reseller to comply with settlement rate benchmark conditions because a pure reseller would not have established a settlement rate with any U.S. correspondent. Upon further consideration, however, we do not believe it is necessary to require *all* settlement rates on the route in question to be within the benchmarks. Our concern, as discussed above, is with the potential for one-way bypass and its effects on the U.S. net settlements payment and U.S. consumers. To the extent carriers providing service outbound from the United States have low cost alternatives to terminate their traffic on the route in question, one-way bypass would not have a significant effect on the U.S. net settlements payment and prices paid by U.S. consumers. We believe that any carrier or combination of carriers with 50 percent of the market for termination of outbound traffic from the United States would have sufficient capacity to handle all traffic from U.S. carriers. Thus, even if no other carrier on the route had settlement rates at or below the relevant benchmark, U.S. carriers would be able to terminate all of their outbound traffic on the route with a carrier whose rates are at or below the benchmark. Moreover, it is likely that if the settlement rates for 50 percent of the settled U.S. billed traffic were at or below the relevant benchmark, the rates for the rest of the traffic would be at that level also. We note that requiring settlement rates for only 50 percent of the settled U.S.

⁴¹² *Foreign Participation Notice* at ¶ 50.

billed traffic on the route in question to be at or below the benchmarks will alleviate the concerns stated by TNZL and Japan that facilities-based carriers could control resellers' ability to provide services.

245. The second modification we make to the proposed condition is to apply it to U.S. *facilities-based* carriers' use of their authorized private lines for the provision of switched, basic services. As we stated in the *Foreign Participation Notice*, facilities-based private line carriers also have the ability to distort competition on a particular route to the extent they terminate one-way bypass traffic from a foreign carrier. Because the same concerns exist for both facilities-based private line carriers and carriers that provide service over resold private lines, the same condition should apply to both services. We therefore will permit carriers to use their authorized facilities-based private lines to originate or terminate U.S. switched traffic on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes in question are at or below the appropriate benchmark. If we learn that competition on the route in question has been distorted, *i.e.*, carriers are using their authorized private lines to engage in one-way bypass of the accounting rate system, we will take enforcement action as described in this *Order*.

246. We disagree with GTE that there is no link between above-cost settlement rates and competitive distortion from one-way bypass over facilities-based private lines. Above-cost settlement rates create the financial incentive for carriers to avoid the settlements system by sending traffic over private lines. We also disagree that the condition for the provision of switched services over facilities-based or resold private lines is not necessary because market forces are creating downward pressure on settlement rates. GTE is correct in asserting that competitive market forces, driven in large part by the WTO Basic Telecom Agreement, are creating downward pressure on settlement rates. However, even where there are competitive pressures, rates are not always at cost-based levels. Moreover, many markets are still dominated by monopoly providers.

247. We disagree with AT&T and MCI that we should require accounting rates to be at the low end of the benchmark before carriers may use their authorizations to provide switched services over facilities-based or resold private lines. Such a condition is not necessary to prevent distortions in the U.S. market for IMTS services, and in fact, it could harm the development of further competition in that market. We believe that AT&T and MCI's proposed conditions could effectively deter many carriers from providing switched services over facilities-based or resold private lines. As discussed above, and as many commenters note, these services exert downward price pressure on both ends of a route. We should therefore encourage the development of these services to the greatest extent possible consistent with our goal of preventing the market distortions that result from one-way bypass.

248. AT&T and MCI are correct in asserting that because the settlement rate benchmarks are above-cost, the condition as proposed in the *Notice* does not completely eliminate the incentive for carriers to engage in one-way bypass. However, the requirement that settlement rates be at or below the relevant benchmark before carriers may use their authorizations substantially reduces the financial incentive to engage in one-way bypass. In addition, we believe that our authority to take enforcement action if we detect market distortion will be an effective deterrent to one-way bypass. Finally, to the extent incentives to engage in one-way bypass remain, the mechanism we adopt in this *Order* for detecting market distortion will provide a timely remedy. We discuss this mechanism below.

249. We adopt WorldCom's proposal that the mechanism for detecting whether there has been competitive distortion on a particular route be based on the aggregate outbound/inbound ratio of settled traffic on the route. Similar to WorldCom's suggestion, we will adopt a presumption that market distortion exists, *i.e.*, inbound switched traffic is being diverted from the accounting rate system to facilities-based or resold private lines, if the ratio of outbound (U.S.-billed) to inbound (foreign-billed) settled traffic increases 10 or more percent in two successive quarterly measurement periods. For example, the presumption of market distortion would be met if the traffic ratio at the beginning of a quarterly measurement period was 60 percent outbound traffic and 40 percent inbound traffic and the traffic ratio at the end of the subsequent quarterly measurement period (*i.e.*, six months later) had changed to 65 percent outbound traffic and 35 percent inbound traffic.

250. We agree with WorldCom that a 10 percent threshold should provide sufficient leeway in most cases for routine traffic shifts. We also believe, contrary to the concerns raised by AT&T and KDD, that increases in the traffic imbalance due to callback, refile, or other procompetitive market changes generally will not trigger the 10 percent threshold. In most cases, these services would not contribute to a 10 or more percent increase in the traffic imbalance over the course of two reporting periods. Moreover, the presumption of market distortion can be rebutted by a showing that 10 or more percent increase in the traffic imbalance is due to factors other than one-way bypass, such as callback.

251. We amend our reporting requirements in Section 43.61 of our rules to enable us to detect market distortion.⁴¹³ Section 43.61 requires each common carrier that provides international service between the United States and any foreign country to file an annual report. The annual report includes actual traffic and revenue data for each service provided by a common carrier, divided among service billed in the United States, service billed outside the United States, and service transiting the United States. We will amend this reporting requirement to require that quarterly traffic reports be filed by certain common carriers in addition to the annual report.

⁴¹³ See 47 C.F.R. § 43.61.

Specifically, we will require common carriers subject to the existing Section 43.61 requirements to file traffic reports for each quarter in which their traffic meets any of the following thresholds: (i) their aggregate U.S.-billed minutes of switched telephone traffic exceeds 1 percent of the total of such minutes of international traffic for all U.S. carriers (as published in the most recent Section 43.61 traffic data report);⁴¹⁴ (ii) their aggregate foreign-billed minutes of switched telephone traffic exceeds 1 percent of the total of such minutes of international traffic for all U.S. carriers; (iii) their aggregate U.S.-billed minutes of switched telephone traffic for any country exceeds 2.5 percent of the total of such minutes for that country for all U.S. carriers; or (iv) their aggregate foreign-billed minutes of switched telephone traffic for any foreign country exceeds 2.5 percent of the total of such minutes for that country for all U.S. carriers. Limiting the quarterly filing requirement to carriers that meet these criteria will reduce the burden on small carriers, while enabling us to identify distortions in the balance of payments. The filing of these reports also makes unnecessary the filing of the semi-annual reports we have required to be filed by carriers providing switched services over resold private lines for the first three years following an equivalency determination.⁴¹⁵

252. We will require carriers that are subject to this quarterly reporting requirement to provide the same data called for in the existing Section 43.61 reports. However, we will require that carriers file this data only for switched facilities-based telephone services and switched facilities resale telephone services.⁴¹⁶ This data will enable us to detect whether one-way bypass is occurring. We note that some carriers may be carrying non-settled switched traffic over their private line facilities and reporting this traffic as facilities-based switched traffic in their Section 43.61 reports. We take this opportunity to clarify that only settled traffic should be included in the Section 43.61 reports as facilities-based switched service. We define settled traffic for purposes of these reports as all traffic settled under an arrangement that meets the requirements of our ISP⁴¹⁷ or has been approved as an alternative settlement arrangement under our *Accounting Rate Flexibility Order*. Carriers that are carrying non-settled traffic over their private line facilities should report that traffic as switched facilities resale service.

⁴¹⁴ Section 43.61 International Telecommunications Data, Industry Analysis Division, Common Carrier Bureau.

⁴¹⁵ See generally Streamlining the International Section 214 Authorization Process and Tariff Requirements, *Report and Order*, 11 FCC Rcd 12,884 (1996); *Foreign Carrier Entry Order* at ¶ 170.

⁴¹⁶ Data for service classified as Service Code 1 including data categorized as billing codes 1-14, as set forth in the Section 43.61 reporting manual. Carriers need not file data for Telegraph, Telex or miscellaneous services, Service Codes 2, 3, and 99, respectively.

⁴¹⁷ For background on the Commission's ISP, see Implementation and Scope of the International Settlements Policy for Parallel Routes, CC Docket No. 85-204, *Report and Order*, 51 Fed. Reg. 4736 (Feb. 7, 1986) (*ISP Order*), modified in part on recon., 2 FCC Rcd 1118 (1987), further recon., 3 FCC Rcd 1614 (1988). See also Regulation of International Accounting Rates, CC Docket 90-337, *Report and Order*, 6 FCC Rcd 3552 (1991), on recon., 7 FCC Rcd 8049 (1992).

253. Each carrier covered by this new quarterly filing requirement shall file a quarterly traffic report with the Commission no later than April 30 for the prior January through March quarter; no later than July 31 for the prior April through June quarter; no later than October 31 for the prior July through September quarter; and no later than January 31 for the prior October through December quarter.⁴¹⁸

254. Contrary to the concerns raised by AT&T, we do not believe these quarterly reports will be unduly burdensome. We are not changing the substance of our current Section 43.61 reporting requirement. We are simply increasing the frequency with which a subset of the data must be consolidated and reported. Carriers subject to our Section 43.61 annual reporting requirement should already be collecting the data on an ongoing basis. Moreover, we believe these traffic reporting requirements enable us to strike a reasonable balance between encouraging entry and competition and preventing one-way bypass. With these reporting requirements, we believe it is not necessary to adopt AT&T's proposed alternative that we grant authorizations to provide switched services over facilities-based or resold private lines on the condition that all accounting rates on the route in question are at or below the low end of the benchmarks. We note AT&T's concern that more frequent traffic reporting could disclose commercially sensitive information. We find such concerns outweighed, however, by the compelling public interest benefits of permitting ISR once settlement rates for at least 50 percent of the settled U.S.-billed traffic on a particular route are at or below the level of the appropriate benchmark. We also note AT&T's concern that many carriers do not comply with the Commission's current reporting requirements. We emphasize that we have authority to issue fines to those carriers that do not comply with our reporting requirements.⁴¹⁹ We intend to enforce these requirements and will take all action necessary to ensure that the quarterly traffic reports are filed in a timely manner.

255. The presumption of market distortion can be rebutted by any carrier whose authorization to provide switched services over facilities-based or resold private lines is affected by the determination that there is market distortion. The presumption can be rebutted by a showing that the change in the inbound/outbound ratio is caused by factors other than one-way bypass, such as an increase in callback traffic.

256. We may make a finding that the rebuttable presumption of market distortion we adopt in this *Order* has been met on our own initiative, or pursuant to a written request by any carrier providing IMTS on the route in question. Such written requests must provide evidence

⁴¹⁸ AT&T contends that our existing Section 43.61 traffic reports would not provide timely data to detect market distortion because there is a considerable lag between the end of the reporting period and the date data are filed. AT&T Comments at 37-38. This concern does not apply to the new quarterly reporting requirement we adopt here, as data will be filed one month after the end of the reporting period.

⁴¹⁹ See 47 C.F.R. § 220.

that the percentage of outbound traffic relative to inbound traffic increased 10 or more percent in two successive measurement periods. If we find, either on our own initiative or by request, that the presumption of market distortion has been met on a particular route, we will issue a public notice and notify all carriers authorized to provide switched services over facilities-based or resold private lines on that route of our finding. Commencing on the date we issue a public notice that the presumption of market distortion has been met, carriers will be prohibited from using their authorizations to provide switched services over facilities-based or resold lines until they comply with our enforcement action or provide evidence sufficient to rebut the presumption of market distortion.

257. We believe that our rebuttable presumption based on a 10 or more percent change in the inbound/outbound ratio in two successive reporting periods will detect most instances of one-way bypass. However, it is possible that there may be instances where this mechanism for detecting one-way bypass is not effective. For instances in which market distortion is not evidenced by the 10 or more percent test, we may need to look at other market or individual carrier trends, similar to our process in determining that the rebuttable presumption has been met. We thus reserve the right to investigate other market or individual carrier trends that could indicate one-way bypass. We may undertake such an investigation either on our own initiative or pursuant to a written request by any carrier providing IMTS on the route in question. If, based on our investigation, we conclude that one-way bypass is occurring, we will issue a public notice and notify all carriers authorized to provide switched services over facilities-based or resold private lines on the route in question of our finding. Once we make a finding of market distortion based on an investigation, carriers must comply with our enforcement action until they submit evidence sufficient to rebut our finding of market distortion.

258. WorldCom and the United Kingdom suggest that we permit carriers to provide ISR where we determine that the foreign market offers equivalent opportunities for ISR, even if settlement rates on the route in question are not within the relevant benchmark.⁴²⁰ TNZL also urges that the Section 214 authorization conditions not apply on routes we have found to be equivalent.⁴²¹ ACC and Primus argue that we should permit ISR on any route where it would result in market-based pricing and enhanced competition, and where it would not result in a carrier abusing its dominant market position. ACC and Primus state that such a policy should replace, not supplement, our equivalency policy.⁴²² GTE, on the other hand, argues that we

⁴²⁰ WorldCom Comments at 19; United Kingdom Comments at 5; *see also* GTE Supplemental Comments at 6-7 ("At an absolute minimum," the benchmark condition "should be limited to those instances where one-way bypass could actually occur." Thus, the condition should not apply if a foreign market would meet the equivalency test.).

⁴²¹ TNZL Comments at 11.

⁴²² ACC Comments at 4-5, 7-8; Primus Comments at 4-6.

should retain the equivalency test instead of adopting the Section 214 conditions we proposed in the *Notice*.⁴²³ We will consider these suggestions about retaining or replacing our equivalency test in our *Foreign Participation* proceeding,⁴²⁴ where we have sought comment on whether we should continue to apply our existing equivalency test in light of the WTO Basic Telecom Agreement.⁴²⁵ We note, however, that the Section 214 conditions we adopt in this *Order* may become effective before we determine in the *Foreign Participation* proceeding whether to eliminate the equivalency test. Therefore, until we issue a decision in the *Foreign Participation* proceeding, carriers seeking authorization to provide switched services over facilities-based or resold private lines must comply with both the Section 214 conditions we adopt in this *Order* and our existing equivalency test. We will amend Section 63.18 of the rules to require that applications for authority to provide switched services over resold or facilities-based international private lines between the United States and a particular country include, in addition to the required equivalency showing, a showing that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route in question are at or below the appropriate benchmark.⁴²⁶ We will also amend Section 63.21 of the rules to set forth the conditions that we adopt in this *Order* for the provision of switched services over resold or facilities-based international private lines.⁴²⁷

259. In summary, we will condition the Section 214 authorizations of carriers to provide switched basic services over international facilities-based or resold private lines in order to prevent one-way bypass of the accounting rate system. Specifically, we will authorize carriers to provide switched services over international facilities-based or resold private lines⁴²⁸ on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes in question are at or below the relevant benchmark adopted in this *Order*. If we learn that the rebuttable presumption of market distortion, *i.e.*, one-way bypass, has been met, we will

⁴²³ GTE Comments at 26-28.

⁴²⁴ For the reasons discussed in this section, however, we decline to adopt GTE's suggestion that we not adopt the benchmarks conditions.

⁴²⁵ *Foreign Participation Notice* at ¶¶ 28-59. We proposed in the *Foreign Participation Notice* to eliminate the equivalency test for the provision of switched, basic services over private lines between the United States and WTO Member countries. *Id.* at ¶50.

⁴²⁶ We note that WorldCom's additional suggestion that facilities-based or resold private lines for the provision of switched basic services also be permitted where it is already authorized as of the effective date of this *Order* is moot. Settlement rates on routes where ISR has already been authorized are, or will be, within the benchmarks we adopt here. (Settlement rates for New Zealand will be within the benchmark range before the end of the one year transition period for upper income countries.) We will not require any further showings from carriers on routes for which we have authorized ISR already.

⁴²⁷ These rule changes are set forth in Appendix B to this *Order*.

⁴²⁸ We note that these are services interconnected to the public switched network on one or both ends.

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 until settlement rates for at least 50 percent of the settled U.S. billed traffic on the route are at a level equal to or below the best practice rate of \$0.08 adopted in this *Order* or a revocation of carriers' authorizations to provide service. We adopt a rebuttable presumption that one-way bypass is occurring if the percentage of outbound traffic relative to inbound traffic increases by 10 or more percent in two successive quarterly measurement periods and reserve the right to investigate other shifts in the inbound/outbound ratio to determine whether one-way bypass is occurring.

3. GATS Obligations

a. Notice

260. In the *Notice*, we invited parties to comment on whether our proposed Section 214 authorization conditions would be consistent with any commitments made by the United States, including most favored nation obligations, in the event the WTO's Group on Basic Telecommunications reached an agreement on liberalizing trade in basic telecommunications service. As noted above, the WTO Basic Telecom Agreement was concluded on February 15, 1997.

b. Positions of the Parties

261. Some commenters contend that the Commission's proposed authorization conditions would constitute barriers to entry, in violation of the U.S. General Agreement on Trade in Services obligations.⁴²⁹ Japan states generally that the proposed conditions will hamper the promotion of competition because they will make entry into the U.S. market for IMTS difficult. In Japan's opinion, the proposed conditions are a practical barrier to entry.⁴³⁰ KDD states that while it is legitimate for a country to have laws against anticompetitive conduct, it must implement those laws on a post-entry, not a pre-entry basis.⁴³¹ HKTI similarly asserts that the proposed conditions are "market entry controls" in that they would have the same effect as conditioning entry.⁴³² The European Union states that the proposed conditions "may well result in

⁴²⁹ See General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex IB, 33 I.L.M. 1167 (1994) (hereinafter "GATS").

⁴³⁰ Japan Comments at 2; *see also* Telefónica de España Reply at 17-18. GTE makes the same claim with respect to the proposed condition for the provision of switched services over resold private lines. GTE Comments at 32.

⁴³¹ KDD Reply at 17; *Viatel July 11, 1997 Ex Parte* at 7.

⁴³² HKTI Reply at 6.

a disguised market access barrier detrimental to competition by imposing constraints more burdensome than necessary on carriers seeking access to the U.S. market."⁴³³ The European Union further states that we have not provided a clear and transparent definition of market distortion that would justify imposing the conditions.⁴³⁴

262. Japan also argues that "only foreign-related carriers are subject to the benchmark condition" for facilities-based service to affiliated markets. Japan thus concludes that the condition could be inconsistent with the national treatment principle of the GATS.⁴³⁵ GTE similarly argues that the condition would treat foreign-affiliated carriers differently and concludes that this would be a violation of the MFN principle of the GATS.⁴³⁶ Telefónica de España contends that both conditions would discriminate among services and service suppliers of different countries in violation of the U.S. MFN obligation because they would restrict IMTS on routes with settlement rates not in compliance with the benchmarks.⁴³⁷

263. Some commenters assert that the Commission's concerns about anticompetitive behavior can be met by less restrictive means. With respect to the proposed conditions for authorizations to provide facilities-based service to affiliated markets, Japan argues that cross-subsidization can be avoided by less restrictive measures such as "proper application of regulations on users' rates."⁴³⁸ Japan further argues that the concern about one-way bypass should only be a temporary problem, if one at all, between liberalized countries. Thus, it argues, "excessive government intervention" should be avoided.⁴³⁹ GTE argues that the concern about one-way bypass could be addressed in a less burdensome manner than the condition we proposed in the *Foreign Participation Notice* for the provision of switched services over facilities-based private lines. GTE proposes that we require U.S. facilities-based carriers to furnish the Commission with sufficient information about traffic volumes and revenues on private lines for switched services and any impact on settlements and prices to permit us to make a judgment

⁴³³ European Union Comments at 4.

⁴³⁴ *Id.* at 5.

⁴³⁵ Japan Comments at 4; *see also* HKTI Reply at 6 (conditions would discriminate among providers of similar services from different countries).

⁴³⁶ GTE Comments at 30; *see also* Telefónica de España Reply at 10-11, 15 (condition would violate both MFN and national treatment obligations because it would be far more likely to apply to foreign-owned carriers than U.S.-owned carriers).

⁴³⁷ Telefónica de España Reply at 10-11.

⁴³⁸ Japan Comments at 3.

⁴³⁹ *Id.*

about actual competitive harm resulting from one-way bypass.⁴⁴⁰ AT&T disagrees, arguing that the traffic reporting requirements advocated by GTE would be unduly burdensome.⁴⁴¹ Viatel asserts that to the extent the Commission is concerned about one-way bypass, it should limit its proposed condition to U.S.-inbound services where the U.S. end is open to the PSTN.⁴⁴²

c. Discussion

264. The GATS imposes a number of obligations on WTO Members. All WTO Members are required to accord MFN treatment to like services and service suppliers of all other WTO Members, no matter what specific commitments a Member has made. MFN is essentially a nondiscrimination rule that requires each WTO Member to treat like services and service suppliers from all other WTO Members similarly.⁴⁴³ As a result of the WTO Basic Telecom Agreement, many Members, including the United States, also took on national treatment obligations. National treatment is a nondiscrimination rule that requires a WTO Member to treat like services and service suppliers from other WTO Members as it treats its own services and service suppliers.⁴⁴⁴ The GATS also requires measures related to domestic regulation to be reasonable, objective, impartial, and transparent.⁴⁴⁵ All WTO Members retain the right under the GATS to maintain laws or regulations to protect competition in their markets, as long as the laws or regulations are applied in a manner consistent with the provisions of the GATS.⁴⁴⁶ Our Section 214 authorization conditions are consistent with these obligations. They are reasonable measures based on objective analysis designed to protect competition in the U.S. market for IMTS, and they apply to all carriers providing service in the United States.

265. The Section 214 authorization conditions apply to all U.S. carriers, whether U.S. or foreign-owned, and apply to all routes. Contrary to the arguments of GTE and Japan, all facilities-based carriers operating in the United States would face the same conditions on service

⁴⁴⁰ GTE Supplemental Comments at 8.

⁴⁴¹ AT&T Supplemental Reply at 3.

⁴⁴² *Viatel July 11, 1997 Ex Parte* at 8.

⁴⁴³ Article II of the GATS requires WTO Member countries to accord "service and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country."

⁴⁴⁴ *See* GATS art. XVII.

⁴⁴⁵ *See* GATS arts. III, VI.

⁴⁴⁶ In this regard, we agree with Telefónica de España that Article VI of the GATS does not provide an exception to other GATS obligations. Telefónica de España Reply at 20.

to routes on which they have affiliation on the foreign end. Similarly, the resale condition applies to all carriers, U.S. or foreign-owned, seeking to provide switched services over resold international facilities-based or private lines. Moreover, contrary to Telefónica de España's argument, the conditions do not discriminate among services and service suppliers of different countries or discriminate in favor of U.S.-owned service suppliers. The conditions apply equally to all routes. The fact that the universally-applied conditions may be met on some routes and not on others does not mean that the conditions are inconsistent with our MFN and national treatment obligation.

266. We disagree with commenters who assert that our benchmarks conditions are more burdensome than necessary and are an effective barrier to entry. We believe that the conditions we adopt in this *Order* are necessary to protect competition in the U.S. market for IMTS. As discussed above, above-cost settlement rates create a potential for distortion in the U.S. market. These are not merely hypothetical distortions. Moreover, contrary to the European Union's assertions, we have clearly defined market distortion in both the facilities-based and resale context.⁴⁴⁷ We have shown that the collection of above-cost settlement rates gives foreign-affiliated carriers the ability to price below the level of its costs on affiliated routes. We have also shown that the above-cost accounting rate system creates the potential for one-way bypass if a carrier outside the United States is able to send its switched traffic over private lines into the United States, but carriers in the United States must continue to send their traffic over the accounting rate system. Consistent with our GATS obligations, we are taking measures to protect competition in the U.S. market by adopting authorization conditions to prevent these market distortions created by above-cost settlement rates.

267. Japan argues that anticompetitive behavior in the market for facilities-based services could be avoided by "less restrictive measures" such as rate regulation.⁴⁴⁸ We disagree. We do not believe that regulation of end-user rates is a less restrictive measure than the conditions we adopt in this *Order*. In fact, rate regulation is extremely burdensome and would require extensive cost data from all carriers providing service in the U.S. market, including foreign-affiliated carriers. Viatel contends that if we believe we must address the concern about one-way bypass, we should limit our Section 214 condition to U.S.-inbound services where the U.S. end is open to the public switched network. We do not believe that such a condition would effectively address the concern about one-way bypass because it would be difficult to monitor carrier's traffic flows with such a limited condition. Once a carrier starts providing service, it is difficult to detect whether the carrier is providing inbound or outbound services only. We also disagree with GTE's claim that harm from one-way bypass can be avoided by requiring U.S. carriers to file information

⁴⁴⁷ See Sections II.C.1 and II.C.2., *supra*.

⁴⁴⁸ Japan Comments at 3.

that would enable us to determine whether such harm has actually occurred. We do not believe this approach would be sufficient to address our concern. One-way bypass can substantially increase the U.S. net settlements deficit in a very short period of time. Thus, to the extent possible, we believe we must eliminate the incentive of carriers to engage in one-way bypass. The Section 214 authorization condition we proposed in the *Notice* substantially reduces foreign carriers' incentive to engage in one-way bypass by eliminating the financial advantages of doing so. We believe it is appropriate, and consistent with our right under the GATS to maintain reasonable measures to prevent market distortions in order to protect competition in the U.S. market. Our condition for the provision of switched services over facilities-based and resold private lines represents a reasonable balance between encouraging private line services and preventing distortions in the U.S. market.

D. Effect of Settlement Rate Savings on U.S. Consumers

1. The Notice

268. We sought comment in the *Notice* on how to encourage U.S. carriers to reflect the reductions they receive in their settlement rates in their prices to consumers. We stated that our goal in reforming the settlement rate system was to provide U.S. consumers with just and reasonable rates for IMTS service. We noted that reductions in U.S. international carriers' rates to reflect settlement rate reductions would stimulate calling volume. We said that not only would this benefit U.S. international carriers by increasing their collection revenues, but also would benefit foreign carriers because they could offset lower settlement rate levels with an increase in the number of minutes terminated.⁴⁴⁹

2. Positions of the Parties

269. Many foreign commenters argue that we should focus on collection rates rather than settlement rates.⁴⁵⁰ They argue that high U.S. collection rates deter outbound calling and reduce the ratio of outbound to inbound calls to the detriment of foreign carriers. Several commenters contend that U.S. international carriers have not passed on settlement rate reductions to consumers in the past and there is no assurance that any reduction in settlement payments that results from adoption and enforcement of benchmarks will be passed on to U.S. consumers.⁴⁵¹

⁴⁴⁹ Notice at ¶ 91.

⁴⁵⁰ See, e.g., Telefónica de España Comments at 29-32; Singapore Tel Comments at 10; Telstra Comments at 5; Telmex Comments at 14; HKTI Reply at 21; Telekom Malaysia Reply at 3.

⁴⁵¹ TSTT Comments at 5; HKTI Comments at 11; GTE Reply at 18-19; Panama Reply at 8-10; Singapore Telecom Reply at 10-11; IDC Comments at 6; see also Letter from Tom Bliley, Chairman, John Dingell, Ranking Democratic Member, W.J. "Billy" Tauzin, Chairman, Subcommittee on Telecommunications,

Many of these commenters urge us to require that U.S. international carriers pass on any reductions in settlement rates to U.S. consumers.⁴⁵² Telstra recommends that we require U.S. international carriers to report to us annually the average tariffed rates for IMTS on July 31 and December 31 for the top fifty routes on which U.S. international carriers have settlement deficits.⁴⁵³ Some carriers argue that we should regulate the level of U.S. carriers' rates for international services. For example, KDD states that we should require U.S. carriers to offer rates for international direct dial service that are no higher than the applicable rates they would charge to their callback customers in a foreign country for calls to the United States.⁴⁵⁴ AT&T states that it will ensure that net savings in settlement costs are passed on to U.S. consumers.⁴⁵⁵ WorldCom argues that a mandatory flow-through requirement is unnecessary in the "highly competitive" U.S. telecommunications market -- especially in the markets for carrier-to-carrier and commercial services.⁴⁵⁶

3. Discussion

270. We agree with those commenters that contend U.S. consumers should benefit from the settlement rate reductions that result from our adoption and enforcement of settlement rate benchmarks. We expect that settlement savings as a result of the rules we adopt here will be substantial and will therefore significantly lower U.S. carriers' cost of providing IMTS. However, we disagree with those commenters that argue that competition in the U.S. market for international services may be insufficient to ensure that settlements savings are fully reflected in reduced collection rates. As we noted in the *AT&T International Nondominance Order*, competition in the U.S. market for IMTS is not as robust as we would like.⁴⁵⁷ However, we

Trade and Consumer Protection, Michael G. Oxley, Chairman, Subcommittee on Finance and Hazardous Materials, Committee of Commerce, U.S. House of Representatives, to Reed E. Hundt, Chairman, Federal Communications Commission, dated January 29, 1997 ("The Commission's work to reduce settlement rates to cost is vitally important to U.S. consumers . . . [t]herefore, we intend to monitor whether settlement rate reductions are resulting in consumer price reductions.").

⁴⁵² See, e.g., HKTII Comments at 21.

⁴⁵³ Telstra Comments at 5 (recommending that the first report to us should include data for the previous five years).

⁴⁵⁴ KDD Comments at 10.

⁴⁵⁵ AT&T "commits to reduce its U.S. international rates to reflect fully AT&T's net settlement cost reductions resulting from the Commission's enforcement of new benchmarks." AT&T Reply at 25.

⁴⁵⁶ WorldCom Reply at 7-8.

⁴⁵⁷ In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service, *Order*, FCC 96-209 at ¶ 85 (rel. May 14, 1996) ("*AT&T International Nondominance Order*").

anticipate that the U.S. market for IMTS will become increasingly competitive as a result of the WTO Basic Telecom Agreement. The Section 214 authorization conditions we adopt here will help promote further competition in the U.S. market for IMTS by addressing potential market distortions created by above-cost settlement rates. Moreover, the eventual entry of new entrants such as the Bell Operating Companies into the international services market will further increase competition. We believe that we should, to the extent possible, preserve the ability of U.S. carriers to make pricing decisions in response to these competitive market forces. We thus find that it is not in the public interest at this time to mandate a particular approach U.S. carriers should take to pass through to consumers reductions in net settlements that occur as a result of the settlement rate benchmarks we adopt in this *Order*.

271. We are committed to ensuring that U.S. consumers receive the full benefits of settlement rate savings. We will therefore monitor closely carriers' prices to ensure that the U.S. market for IMTS is sufficiently competitive and carriers are passing on to U.S. consumers the full extent of savings in net settlements that occur as a result of the benchmarks we adopt here.⁴⁵⁸ If, in the future, there is evidence that U.S. consumers are not receiving the full benefits of settlement rate savings, we will review the performance of the U.S. market for IMTS to determine whether we should revisit our conclusion that the market is sufficiently competitive to ensure that carriers pass settlement savings on to consumers.

272. We expect to see U.S. carriers pass on to consumers the savings in net settlements payments on a route-by-route basis because settlement costs, and consequently, savings, are incurred on a route-by-route basis. U.S. customers that make calls on routes on which foreign carriers lower their settlement rates should enjoy the benefits of such reduced rates. Moreover, a route-by-route pass through of net settlement savings would provide incentives for foreign carriers to reduce their settlement rates. This is because a route-by-route pass through of net settlement savings would ensure that foreign carriers that reduce their settlement rate with U.S. carriers enjoy the benefits of stimulated demand that results from lowered collection rates. Without a flow-through of net settlement savings on a route-by-route basis, traffic on such routes could remain static if U.S. carriers apportion settlement savings from such routes to other routes.

273. In reviewing the experience of the past several years, it appears that competition in the U.S. market for IMTS has caused U.S. carriers to direct the cost savings they have realized from settlement reductions more toward higher-volume residential customers than toward basic rate customers. We are concerned that competition alone will not produce lower rates for low-volume residential customers taking service from basic rate schedules. Therefore, in our

⁴⁵⁸ Telstra suggests that we monitor collection rates for IMTS. Telstra Reply at 3-4. The Commission has moved away from a rate-of-return regulatory regime to a regime that relies on a price cap methodology for dominant carriers provisioning interstate and international services. We thus decline to adopt KDD's suggestion that we regulate the rates charged by U.S. international carriers.

monitoring of U.S. carriers' collection rates, we will pay particular attention to whether U.S. carriers pass on net settlement savings to residential basic rate schedules.

274. Many of the commenters that argue that reductions in settlement rates have not resulted in commensurate reductions in collection rates compare reductions in the nominal settlement rate (*i.e.*, the per minute settlement rate level) to collection rates.⁴⁵⁹ This is, however, an inappropriate comparison because the proper basis for calculating any pass through of savings is the *net* settlement payment.⁴⁶⁰ When a settlement rate is reduced, carriers' settlement savings are not equal to the reduction in the per minute settlement rate times the volume of traffic on the affected route. Rather, because settlement payments are made on a net basis, settlement savings on each route are reflected in the reduction of net settlement payments.⁴⁶¹ Thus, in determining whether U.S. carriers have passed settlement savings on to consumers, we will take into account reductions in net settlements, not reductions in the level of settlement rates.

E. Legal Basis For Establishing Benchmark Settlement Rates

275. As noted above, we conclude that we have the authority under the Act, relevant case law, and international regulations to adopt settlement rate benchmarks. In this section, we respond to the legal arguments of the commenters in detail.

⁴⁵⁹ GTE Reply at 19; KDD Reply at 7-8; Telefónica de España Comments at 27.

⁴⁶⁰ We note that many commenters compare settlement rate reductions to basic collection rate schedules. This is also an inappropriate comparison because all carriers offer discount plans that are not reflected in the basic rate schedule. As AT&T notes, rates under these discount plans have in many cases been reduced.

⁴⁶¹ At settlement, each carrier nets the minutes of service it originated against the minutes the other carrier originated. The carrier that originated more minutes of service pays the other carrier a net settlement payment calculated by multiplying the settlement rate by the number of imbalanced traffic minutes. KDD objects to the characterization of the settlements process as a netting system. It states that on most routes, U.S. and foreign carriers calculate settlement obligations for every minute of traffic, not just the imbalanced minutes. KDD Reply at 5. While this may be true as a matter of pricing strategy, as KDD notes, the actual payment from one carrier to another, and thus any savings from settlement rate reductions, reflects a netting of the respective amounts due between carriers.

1. The Communications Act and Relevant Case Law

a. Jurisdiction Over Foreign Communication that Originates or Terminates in the United States

i. Positions of the Parties

276. U.S. carriers generally agree that the Act gives us the statutory authority to adopt our benchmarks proposals.⁴⁶² Specifically, AT&T and Sprint argue that Section 2(a) of the Act gives us jurisdiction over "all interstate and foreign communication by wire or radio."⁴⁶³ Sprint notes that Section 3(17) of the Act defines "foreign communication" as "communication to or from any place in the United States to or from a foreign country."⁴⁶⁴ Sprint contends that, because traffic settled under accounting rates either originates or terminates in the United States, it squarely falls within the Act's definition of "foreign communication" as that term is used in Section 2(a).⁴⁶⁵

277. Other commenters, including many foreign carriers and governments as well as GTE, argue that, despite the language of the *Notice*, we are attempting to exercise jurisdiction over the foreign end of international telecommunications services.⁴⁶⁶ Telefónica de España argues that Section 2(b) of the Act expressly prohibits us from exercising jurisdiction over a carrier "engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier."⁴⁶⁷ Cable and Wireless notes that we have previously acknowledged that the Act generally limits our jurisdiction over international telecommunications services to the U.S. end of the service only.⁴⁶⁸ It claims our benchmarks proposals would exceed this jurisdiction by effectively dictating the rates a foreign carrier could charge to terminate U.S.-

⁴⁶² See, e.g., AT&T Comments at 46-58; Sprint Reply at 3-5.

⁴⁶³ AT&T Comments at 47; Sprint Comments at 5.

⁴⁶⁴ Sprint Comments at 5.

⁴⁶⁵ *Id.*

⁴⁶⁶ See, e.g., Cable & Wireless Comments at 6; GTE Comments at A-17; HKTII Comments at 21-22; KDD Comments at 2-7; Panama Comments at 18.

⁴⁶⁷ Telefónica de España Comments at 11-12.

⁴⁶⁸ Cable & Wireless Reply at 3-4. See also KDD Comments at 5-6.

billed international switched traffic in its own country.⁴⁶⁹ GTE and Telefónica de España argue that a showing of an affirmative Congressional intent to apply the Act's enforcement provisions extraterritorially is necessary to overcome the presumption against such extraterritorial effects of legislation. They contend that no provision of the Act shows an intent by Congress to do so.⁴⁷⁰ KDD argues that we do not have authority to adopt the benchmark settlement rates because their adoption would not afford a foreign country the same degree of regulatory authority as we would be exercising over settlement rates.⁴⁷¹

ii. Discussion

278. This proceeding continues our more than sixty years of regulatory oversight of international settlement arrangements.⁴⁷² We initially conclude that the Act provides us with the authority to reform U.S. carrier participation in international settlement rate practices in the manner we adopt in this *Order*.⁴⁷³ In Sections 1 and 2(a) of the Act, Congress indicated its affirmative intent to give us jurisdiction over "all interstate and foreign communication by wire or radio . . . which originates and/or is received within the United States" ⁴⁷⁴ Such an affirmative Congressional intent to give us jurisdiction over "foreign communication" overcomes the general presumption against the extraterritorial effect of a statute argued by GTE and

⁴⁶⁹ Cable & Wireless Reply at 3-4. Cable & Wireless argues the basis for our contention that we are directing the benchmarks proposals only at U.S.-licensed carriers is unclear since the cost issues (and possible hearings) relevant to the proposed benchmarks involve foreign rates. *Id.* at 7. *See also* Philippines Comments at 29 (stating that "even in the [U.S.] domestic arena, the ability to secure recovery of joint and common costs from a particular service has been (and remains today) basically a policy decision" outside our jurisdiction); Telefónica del Perú Comments at 6-8 (arguing that there is no way to invalidate the terms of a bilateral settlement rate agreement without exercising jurisdiction over both the U.S. carrier and the foreign correspondent).

⁴⁷⁰ GTE Comments at A-12 (citing *Equal Employment Opportunity Comm'n v. Arabian Am. Oil Co.*, 499 U.S. 244 (1991)). *See also* Telefónica de España Reply at 26.

⁴⁷¹ KDD Reply at 21.

⁴⁷² *See Mackay Radio and Telegraph Company, Inc.*, 2 FCC 592 (1936), *aff'd by the Commission en banc*, 4 FCC 150 (1937); *aff'd sub nom. Mackay Radio and Telegraph Co. v. F.C.C.*, 97 F.2d 641 (D.C. Cir. 1938); Regulation of International Accounting Rates, *Report and Order*, 6 FCC Rcd 3552 (1991); Regulation of International Accounting Rates, *Second Report & Order and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd 8040 (1992).

⁴⁷³ As a general matter, GTE argues that the *Notice* is "procedurally flawed" in that its "conclusory listing" of Sections 1, 4(i), 201-205 and 303(r) of the Act as a basis for our authority to establish and enforce settlement rate benchmarks "is a wholly insufficient discussion of a crucial issue." GTE Reply at 11-12. We disagree. Paragraph 19 of the *Notice* clearly placed GTE and other interested parties on notice that we might, as we in fact do, primarily rely on those sections as the statutory basis to apply settlement rate benchmarks to U.S. international carriers. There is no legal requirement for a more detailed discussion.

⁴⁷⁴ 47 U.S.C. § 152(a); *see also United States v. Weiner*, 701 F. Supp. 14, 17 (D. Mass. 1988), *aff'd*, 887 F.2d 259 (1st Cir. 1989); *RCA Communications, Inc. v. United States*, 43 F. Supp. 851 (S.D.N.Y. 1942).

Telefónica de España.⁴⁷⁵ "[F]oreign communication," as that term is defined in the Act, refers to "communication from or to any place in the United States to or from a foreign country."⁴⁷⁶ International telecommunications services that are settled under a settlement rate agreed to by a U.S. carrier and its foreign correspondent clearly fall within the definition of "foreign communication" used in the Act because such telecommunications services either originate or terminate in the United States.

279. The rules adopted here do not constitute the exercise of jurisdiction over foreign carriers. Instead, we establish in this *Order* the rate at which a settlement rate agreed to by a U.S. carrier satisfies that carrier's obligation to comply with the "just and reasonable" requirements of Sections 201 and 205. As such, it is a direct constraint on our U.S. carriers. Where U.S. carriers and their foreign correspondents cannot agree to a settlement rate that falls at or below the relevant benchmark, we will use our powers under the Act to take enforcement actions that will, as proposed in the *Notice*, "apply to U.S. carriers within our jurisdiction, not to their foreign correspondents."⁴⁷⁷

280. We have taken similar action to ensure that a carrier does not pay excessively for an individual component of an end user rate where one of the parties to the transaction falls outside of our jurisdiction. Under our rate-of-return regulation of AT&T, we made sure that AT&T did not pay an unreasonable amount for goods it purchased from its Western Electric affiliate without ever exercising jurisdiction over the latter.⁴⁷⁸ There, we disallowed "from AT&T's interstate rate base the relevant portions of any excess earnings Western receives from sales to the Bell System."⁴⁷⁹ We have taken a similar approach here by restricting what U.S. international carriers can pay for a service provided by a foreign carrier that falls outside of our jurisdiction. Obviously, in the context of international telecommunications services, our actions will have an indirect effect on foreign carriers. Such services, by their very nature, require one end of the communication to be handled outside of the United States, and thus rules regarding the U.S. end of the communication may have an impact on the foreign end as well.

⁴⁷⁵ See *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 284-85 (1949); see also *Hartford Fire Insurance Co. v. California et al.*, 509 U.S. 764 (1993); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

⁴⁷⁶ 47 U.S.C. § 153(17).

⁴⁷⁷ *Notice* at ¶ 89.

⁴⁷⁸ AT&T, 64 FCC 2d 1, 80 (1977).

⁴⁷⁹ *Id.* We also stated that we would consider disallowances from AT&T's interstate rate base "if price comparisons using competitive benchmarks show 'overpayment' by AT&T for any equipment." *Id.*

281. An indirect effect on foreign carriers does not preclude us from adopting settlement rate benchmarks. In *RCA Communications*, the District Court for the Southern District of New York reviewed a Commission order involving the ratio between the charges for handling "Urgent" and "Ordinary" telegraph messages.⁴⁸⁰ International agreements had established the charges for "Urgent" messages at twice the level of those for "Ordinary" messages. We directed RCA Communications and other telegraph companies to cease and desist from the practice of charging amounts for "Urgent" messages "which bear any greater ratio than 1 1/2 to 1 to the charges for Ordinary . . . messages, respectively."⁴⁸¹ The court held that, although our order indirectly affected foreign carriers, "it operate[d] directly only on persons within the United States and an indirect effect on outsiders d[id] not militate against its validity."⁴⁸² We reach the same conclusion here.

b. Application of Section 201's "Just and Reasonable" Requirement to Accounting Rates

i. Positions of the Parties

282. AT&T argues that U.S. carriers' settlement arrangements with foreign correspondents clearly constitute "practices" and "charges" for and in connection with "foreign communication by wire or radio" subject to Section 201's "just and reasonable" requirement.⁴⁸³ Opponents of our benchmarks proposals contend that, even if we are exercising jurisdiction only over U.S. international carriers as we have stated, the Act does not authorize us to adopt benchmark settlement rates. GTE and Telefónica de España argue that, while Section 201 generally gives us the authority to regulate intercarrier charges where both carriers are subject to our jurisdiction, the second proviso of Section 201(b) limits our authority with regard to international settlement rate agreements. GTE states that this authority is "narrower than the authority to determine whether U.S. carriers' charges or other practices are 'just and reasonable'

⁴⁸⁰ *RCA Communications, Inc. v. United States*, 43 F.Supp. 851, 854 (S.D.N.Y. 1942).

⁴⁸¹ *Id.*

⁴⁸² *Id.* at 854. We note also that in an interdependent world economy, significant national regulations and policies for major markets have substantial indirect effects on other countries. As in this case, those unilateral choices can enhance global welfare. However, as a practical matter, countries look to see if they can find common approaches when possible. This is why we welcome continuing multilateral discussions of reform. The classic economic study of interdependence is Richard Cooper, *The Economics of Interdependence* (New York: McGraw Hill, 1971).

⁴⁸³ AT&T Comments at 46-47 (noting that Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of [the] Act").

under the main body of Section 201(b).⁴⁸⁴ Both GTE and Telefónica de España assert that Section 201(b) limits our authority to determine whether settlement rate agreements are contrary to the public interest and does not extend to the authority to prescribe or otherwise modify contract terms.⁴⁸⁵ Argentina Telintar argues that the second proviso of Section 201(b) does not apply to contractual relations where one carrier compensates another for carrying its traffic in order to complete international calls. Argentina Telintar states that the plain meaning of the term "exchange of services" in Section 201(b) is a "barter arrangement or provision of one service in exchange for another service."⁴⁸⁶

ii. Discussion

283. Section 201 of the Act requires that "all charges, practices, classifications, and regulations for and in connection with [interstate or foreign communication by wire or radio] shall be just and reasonable" We find that, because an accounting rate is the charge negotiated between a U.S. international carrier and its foreign correspondent for handling one minute of international telephone service, the plain language of Section 201 gives us jurisdiction over such charges. "Charges" and "practices," as those terms are used in the Act, refer to more than just the end charges to customers. In *Louisiana Public Service Commission v. FCC*, the United States Supreme Court rejected such a narrow reading of the words "charges," "classifications," and "practices" in Section 2(b) of the Act, finding that such terms encompassed depreciation.⁴⁸⁷ Similarly, we conclude that a U.S. international carrier's agreement to a particular settlement rate constitutes a "practice," as well as perhaps a "charge" subject to the just and reasonable requirement of Section 201. Section 201(b) declares any "charge" or "practice" that is "unjust or unreasonable . . . to be unlawful."⁴⁸⁸

284. We disagree with those commenters that argue that Section 201(b)'s requirement that "[a]ll charges, practices, classifications, and regulations for and in connection with [interstate or foreign communication by wire or radio] be just and reasonable"⁴⁸⁹ excludes "charges" and "practices" agreed to by a U.S. international carrier in the form of an above-cost accounting rate

⁴⁸⁴ GTE Comments at A-12. *See also* Telefónica de España Reply at 26-27.

⁴⁸⁵ GTE Comments at A-15; Telefónica de España Reply at 27-28.

⁴⁸⁶ Argentina Telintar Comments at 27.

⁴⁸⁷ *See Louisiana Public Service Commission v. FCC*, 106 S.Ct. 1890, 1900-01 (1986).

⁴⁸⁸ 47 U.S.C. § 201(b).

⁴⁸⁹ 47 U.S.C. § 201(b) (emphasis added).

just because the other party to the contract is a foreign carrier.⁴⁹⁰ As discussed above, the Act defines "foreign communication" to include international telecommunications services that are settled under an accounting rate where such services either originate or terminate in the United States. "Foreign communication" by its very nature requires one end of the communication to be handled outside of the United States, and thus rules regarding the U.S. end of the communication may have an impact on the foreign end as well. The reading of Section 201 suggested by some commenters would effectively negate Congress' inclusion of "foreign communication" in Section 201.

285. Moreover, we do not believe that the second proviso of Section 201 applies to settlement agreements between a U.S. international carrier and its foreign correspondent.⁴⁹¹ That proviso states that "nothing in this Act . . . shall be construed to prevent a common carrier subject to this Act from entering into or operating under any contract with a common carrier not subject to this Act, *for the exchange of their services*, if [we are] of the opinion that such contract is not contrary to the public interest."⁴⁹² Congress designed the proviso, taken from the Interstate Commerce Act, to legitimize arrangements between telegraph carriers and railroads for the provision of free services to each other. As the Supreme Court has held, "'exchange' is barter and carries with it no implication of reduction to money as a common denominator."⁴⁹³ A settlement agreement between a U.S. carrier and its foreign correspondent does not involve any type of barter arrangement or provision of one service in exchange for another. Instead, the agreed-upon settlement rate sets the monetary amount to be paid each carrier for handling one minute of international telephone service. Thus, we agree with Argentina Telintar that such an agreement does not constitute a "contract . . . for the exchange of services" covered by the second proviso of Section 201(b). Even if that proviso did apply to a settlement rate agreement, the language of the proviso "seems clearly to give us the authority to measure any applicable contract against the public interest and nullify or modify those that are found wanting."⁴⁹⁴

⁴⁹⁰ GTE Comments at A-12. *See also* Telefónica de España Reply at 26-27.

⁴⁹¹ *See* The Western Union Telegraph Co.: New Telex Service Arrangements Via Mexico and Canada, *Memorandum Opinion and Order*, 75 FCC 2d 461, n.13 (1979), *vacated on other grounds sum nom. ITT World Communications v. FCC*, 635 F.2d 32 (2nd Cir. 1980).

⁴⁹² 47 U.S.C. § 201(b)(emphasis added).

⁴⁹³ *See Postal Telegraph-Cable Co. v. Tonopah and Tidewater Railroad Co.*, 248 U.S. 471, 475 (1919). *See also* H.R. Rep. No. 1850, 73d Cong., 2d Sess. 5 (1934). Our Rules also distinguish exchange of services agreements from settlement rate agreements. *See* 47 C.F.R. §§ 43.51(a)(1) & (2).

⁴⁹⁴ *Interconnection Facilities Provided to the International Record Carriers, Final Decision and Order*, 63 FCC 2d 761, 766 (1977) ("*IRC Interconnection Order*").

286. As we note above, in recent years, a multilateral consensus has developed that the traditional accounting rate system must be reformed in part because it results in settlement rates that are substantially above costs.⁴⁹⁵ To the extent that the above-cost portion of settlement rates paid by U.S. international carriers to their foreign correspondents leads to those settlement rates being "unjust or unreasonable," Section 201 requires us to declare such "charges" or "practices" unlawful. Settlement rates are in most cases substantially above cost-based levels because effective competitive market conditions do not exist in many foreign markets at this time. The lowest prevailing settlement rate between the United States and a carrier in a competitive overseas market is \$0.08.⁴⁹⁶ Yet, the average settlement rate U.S. carriers pay their foreign correspondents is approximately \$0.35.⁴⁹⁷ The benchmark settlement rates we adopt in this *Order* place a cap on the amount that U.S. international carriers can pay to their foreign correspondents to terminate U.S.-originated traffic. These benchmarks reduce the above-cost portion of settlement rates, but do not eliminate it entirely. In the discussion of our prescription of our benchmarks settlement rates under Section 205 below, we analyze in detail why the benchmark settlement rates we adopt in this *Order* represent the highest amount at which we consider a settlement rate to be presumptively just and reasonable. We find that any settlement rates that exceed the relevant benchmark constitute an unjust and unreasonable "charge" or "practice" under Section 201. As a result, we declare settlement rates in excess of the relevant benchmark to be unlawful and not in the public interest.

c. Section 205 Authority to Set Settlement Rate Benchmarks

i. Positions of the Parties

287. Finding settlement arrangements subject to our regulation, AT&T and Sprint argue that we have the power under Section 205 "to determine and prescribe what will be the just and reasonable charge . . . and what classification, regulation, or practice is or will be just, fair, and reasonable."⁴⁹⁸ Argentina Telintar, however, argues that Section 205 only authorizes us to

⁴⁹⁵ See, e.g., ITU-T Recommendation D.140, "Accounting Rate Principles for International Telephone Services," Geneva (1992) (calling for cost-based, nondiscriminatory and transparent accounting rates). While we support multilateral efforts to reform the global accounting rate system, we limit our statutory analysis here to those settlement rates paid by U.S. international carriers to their foreign correspondents.

⁴⁹⁶ See Section II.B.3., *supra*.

⁴⁹⁷ This average settlement rate is a weighted average based on the total minutes of U.S.-outgoing traffic.

⁴⁹⁸ AT&T Comments at 47; Sprint Comments at 6-7.

prescribe the rates those domestic carriers subject to our jurisdiction may charge their customers, not the prices that a U.S. carrier charges its foreign supplier.⁴⁹⁹

288. AT&T states that our power under Section 205 includes the authority to order a carrier to "cease and desist" where we find that a charge or practice violates the Act.⁵⁰⁰ Sprint contends that, while we cannot require a foreign carrier to agree to a particular settlement rate, we can find that a foreign carrier's refusal to exchange traffic at that rate renders the service provided by the U.S. carrier contrary to the public interest. In that circumstance, Sprint argues that we can refuse to allow a U.S. carrier to exchange traffic with the foreign carrier.⁵⁰¹

289. Sprint does state, however, that the lack of cost data in the record could make it difficult to sustain a prescription of a particular benchmark rate or range of rates.⁵⁰² Sprint argues that we could use benchmarks as "presumptively reasonable settlement rates and . . . afford the public, including any foreign carriers who might be affected by such a prescription, an opportunity to rebut this presumption of reasonableness."⁵⁰³ Sprint contends that such an approach would be similar to one implemented by the former Federal Power Commission ("FPC") for prescribing natural gas rates based on composite cost data and ultimately upheld by the Supreme Court in the *Permian Basin Area Rate Cases*.⁵⁰⁴ Cable & Wireless and KDD contend that, while the FPC in *Permian Basin* lawfully prescribed natural gas rates based on composite cost data, we do not have any data, composite or otherwise, on the costs incurred by foreign carriers in terminating international switched traffic.⁵⁰⁵

ii. Discussion

290. We find that Section 205 of the Act gives us the authority to require U.S. international carriers to pay settlement rates at or below the relevant benchmark that we adopt in

⁴⁹⁹ Argentina Telintar Comments at 28-29.

⁵⁰⁰ AT&T Comments at 47.

⁵⁰¹ Sprint Comments at 7.

⁵⁰² *Id.* at 13.

⁵⁰³ *Id.* at 19. Sprint goes on to argue that, if an interested party fails to rebut the presumption, then we could prescribe a settlement rate for use by a U.S. carrier or require the use of that settlement rate on an interim basis pending further negotiations. *Id.*

⁵⁰⁴ 390 U.S. 747 (1968).

⁵⁰⁵ Cable & Wireless Reply at 6-7; KDD Comments at 23-24.

this *Order*.⁵⁰⁶ We disagree with Argentina Telintar that Section 205 only gives us authority to prescribe the rates that U.S. international carriers charge their customers and not the charge that a U.S. carrier agrees to pay its foreign correspondent for handling one minute of international telephone service.⁵⁰⁷ For the same reasons discussed in our analysis of Section 201 above, we find that an accounting rate constitutes a "practice" or "charge" under Section 205. As such, we have the authority to "determine and prescribe what will be the just and reasonable charge or the maximum or minimum or maximum and minimum charge or charges to be thereafter observed, and what . . . practice is or will be just, fair, and reasonable, to be thereafter followed . . ." ⁵⁰⁸ Section 205 authorizes such action "under order for investigation and hearing made by [us] on [our] own initiative."⁵⁰⁹ Under the *Sierra-Mobile* doctrine, established by judicial decisions interpreting analogous provisions of the Federal Power Act and the Natural Gas Act, we find that we have the "undoubted power" to prescribe a change in contract rates -- such as settlement rates -- "whenever [we] determine[] such rates to be unlawful."⁵¹⁰

291. We have concluded in this *Order* that it would be an unjust and unreasonable "practice" or "charge" for a U.S. international carrier to pay settlement rates above the relevant benchmark rate. The relevant settlement rate benchmark represents the highest presumptively just and reasonable amount a U.S. international carrier can pay its foreign correspondent for handling one minute of an international call under Sections 201 and 205. Thus, we prescribe under Section 205 that U.S. international carriers adhere to the benchmarks we adopt in this *Order*. As discussed in Section II.B.2. of this *Order*, we have established procedures whereby any affected party can rebut this presumption by demonstrating that the relevant benchmark fails to allow a carrier to collect its incremental costs for providing international termination services.

292. We agree with Sprint that the Supreme Court's decision in *Permian Basin*⁵¹¹ lends support for our approach of using tariffed components prices. In *Permian Basin*, the Court rejected the argument that the FPC had to derive its maximum natural gas rates from prevailing field prices, instead allowing the FPC to rely on "composite cost data, obtained from published

⁵⁰⁶ 47 U.S.C. § 205.

⁵⁰⁷ Argentina Telintar Comments at 28-29.

⁵⁰⁸ 47 U.S.C. § 205.

⁵⁰⁹ *Id.*

⁵¹⁰ *FPC v. Sierra Pac. Power Co.*, 350 U.S. at 353 (1956). See also *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. at 339-41 (1956).

⁵¹¹ 390 U.S. 747 (1968).

sources and from producers through a series of cost questionnaires."⁵¹² Similarly, our TCP methodology uses publicly available tariff and ITU data for the three elements of international termination service identified by the ITU in Recommendation D.140. Thus, the TCP methodology relies in large part on the same rates that foreign correspondents charge their domestic customers. We see no justifiable economic basis for allowing our U.S. international carriers to pay foreign carriers more than those carriers charge their domestic customers for the same service, and thus the relevant benchmark rate represents the maximum reasonable "practice" or "charge" for a U.S. international carrier.

293. We agree with Cable & Wireless, KDD, and Sprint that our TCP data are not pure composite cost data. We do not have such cost data because we do not have the ability to compel foreign correspondent carriers to provide us with data about their costs. We note that, despite our invitation to do so in the *Notice*, foreign correspondent carriers have not submitted such information in this proceeding. We do, however, have an obligation under the Act, because of our oversight of rates charged to U.S. consumers, to ensure that U.S. carriers do not pay unjust and unreasonable settlement rates to their foreign correspondents. We emphasize that we do not attempt to set foreign carriers' costs in this *Order*. Rather, we set a cap on the amount U.S. carriers may pay for a component of providing international service that is directly reflected in U.S. consumer rates for that service. This cap is based primarily on foreign carriers' tariffed rates. Because a foreign carrier's rates in almost all cases reflect a foreign carrier's incremental costs plus a significant contribution to common costs, settlement rate benchmarks based on those rates will still be substantially above the costs incurred by foreign carriers to terminate international traffic. Nonetheless, they will significantly reduce the above-cost portion of most current settlement rates. We thus believe that our use of the publicly-available tariff and ITU data to establish our benchmark rates will produce settlement "charges" or "practices" that satisfy the "just and reasonable" requirement of Section 205.

294. As described in more detail in Section II.B.2. of this *Order*, we adopt an averaging approach for establishing settlement rate benchmarks instead of adopting country-specific benchmarks based on the TCP data. We find that the averaging approach we adopt for our TCP methodology produces a just and reasonable amount for the benchmark rates. We adopt an averaging approach for two reasons. First, because our TCP methodology relies in large part on foreign carriers' tariffs to calculate benchmarks, any inefficiencies captured in those tariffs will be captured in an individual country benchmark. These inefficiencies reflect the fact that many countries use long distance and international rates to cross-subsidize rates for local service and

⁵¹² *Id.* at 761. We also note that in *Permian Basin* the FPC had placed the burden on the gas producer to show that, in an individual case, the maximum natural gas rate that was derived from the composite cost data would cause the producer hardship. *Id.* at 764. The FPC also stated that it would not stay enforcement of the maximum rates pending disposition of individual petitions for special relief. *Id.* at 771. We have instituted a similar mechanism. See discussion in Section II.B.2 above.

because telephone service in many countries is provided by monopoly or dominant carriers whose tariffed rates may reflect protected market positions and an ability to charge prices not related to underlying costs. An averaging approach will mitigate the impact of these inefficiencies on our benchmark settlement rates. Second, an averaging approach is necessary to counter the incentive of a carrier to influence the level of its benchmark by raising its tariffs. Using the average as the basis for our benchmark rates will reduce the above-cost portion of the U.S. international carriers' settlement payments, but still permit all foreign carriers to recover their incremental cost of terminating international traffic plus a substantial contribution to common costs. Thus, we are confident that the benchmark rates come nowhere close to going below the "just and reasonable" level required by Section 205.⁵¹³

295. Courts have recognized that "non-cost" factors may play a legitimate role in the setting of just and reasonable rates.⁵¹⁴ We believe that non-cost factors are relevant in evaluating a carrier's "practices" and "charges" as well. This provides the basis for the actions we take in this *Order* in two areas: (1) establishing benchmark rates based on countries' level of economic development; and (2) establishing different transition periods based on countries' economic development. With regard to the former, we begin by recognizing that lower income countries have on average significantly higher TCPs than upper income countries. Thus, if we averaged the TCPs of lower income countries with those of upper income countries to establish one benchmark rate, lower income countries would experience a much greater differential between the new benchmark rate and current settlement rates than would a higher income country. We believe that such extreme differentials would be unfair and could prove too difficult for some foreign carriers to absorb -- creating a risk of harm to some lower and middle income countries' overall economic welfare as well as increasing the chance of disruptions to their telecommunications networks. Establishing separate benchmark rates based on level of economic development would mitigate this effect. We therefore set different rates based on the World Bank's classification of countries by GNP per capita, which we believe to be an objective and administrable measurement of countries' levels of economic development.

296. In establishing different transition periods for the different economic development categories, we also factored in that adoption of our benchmarks will, in many cases, substantially reduce the amount a U.S. international carrier can pay its foreign correspondent to terminate a call. An immediate move to such a lower rate could produce the same result that we are trying to avoid by establishing different TCPs averages for the benchmark rates depending on a country's economic development category--disruptions to the telecommunications networks in foreign countries. Such disruptions would likely prove harmful to U.S. carriers and consumers. We

⁵¹³ 47 U.S.C. § 205.

⁵¹⁴ *See, e.g., Consumers Union v. FPC*, 510 F.2d 656, 660 (D.C.Cir. 1974) (identifying the need to stimulate additional supplies as one such "non-cost" factor).

conclude that economic development level, as determined by reference to the World Bank categories, provides a reasonable measure of a country's ability to transition to a more cost-based system of accounting rates without undue disruption to its network. Thus, to safeguard against such disruptions, we have established transition periods based on the economic development category of a country. Although this will delay the movement to a settlement rate at or below the relevant benchmark rate, we believe that the use of transition periods will likely serve the public interest more than an immediate move to the relevant benchmark rates.

297. In addition to our settlement rate benchmarks, we adopt a "best practice rate" that is closer to a cost-based level than our settlement rate benchmarks that we will apply to prevent market distorting behavior. As discussed in the *Notice*, and in Section II.C. of this *Order*, above-cost settlement rates create certain distortions in the U.S. market for IMTS. However, if settlement rates are at cost-based levels, carriers will not have the ability to engage in market distorting behavior. The best practice rate will be applied only to the extent carriers seek authorization to provide facilities-based service from the United States to affiliated markets and to provide private line resale service, as discussed in Sec. II.C., *infra*, and only if the Commission detects market distortion on the route or routes in question.

298. The use of our "best practice" rate in cases where we detect market distortions also satisfies the just and reasonable requirement of Section 205. Because we do not have data to establish an accurate cost-based rate, we use a market-based rate as a substitute. We look to competitive markets to find a rate that can be applied in cases of market distortion in lieu of a rate based on an estimate of incremental costs. We adopt a "best practice" rate that is based on the lowest settlement rate paid by U.S. carriers to an overseas carrier from a competitive market. We will consider, on a case-by-case basis, other factors that may influence the level of the best practices rate as applied to individual carriers.

d. Benchmarks Proceeding Satisfies Section 205's Procedural Requirements

i. Positions of the Parties

299. Argentina Telintar and Telefónica de España argue that this proceeding fails to satisfy the procedural requirements of Section 205 that we must afford an opportunity for a hearing and make a finding that a prescribed rate is just and reasonable.⁵¹⁵ Telefónica de España cites the decision of the Court of Appeals for the Second Circuit in *AT&T v. FCC*⁵¹⁶ for the

⁵¹⁵ Telefónica de España Reply at 29; Argentina Telintar Comments at 29 (citing *AT&T v. FCC*, 487 F.2d 865, 874-75 (2d Cir. 1973)).

⁵¹⁶ 487 F.2d 865, 874-75 (2d Cir. 1973).

proposition that we may not "circumvent the statutory hearing requirements on the basis of [our] claimed broad inherent regulatory power."⁵¹⁷

ii. Discussion

300. We disagree with the contentions of Argentina Telintar and Telefónica de España that establishing our settlement rate benchmarks and "best practice" rate in the context of this rulemaking violates the procedural requirements of Section 205 of the Act.⁵¹⁸ 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 [us] on [our] own initiative."⁵¹⁹ In *United States v. Florida East Coast Railway*,⁵²⁰ the Supreme Court held that such language does not trigger the detailed oral hearing requirements of Section 556 and 557 of the Administrative Procedures Act.⁵²¹ 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 205.⁵²² Because this proceeding satisfies the procedural requirements of Section 553 of the APA, we find it to be fully consistent with the Court's decision in *Florida East Coast Railway*.

301. We are also not persuaded by the argument of Telefónica de España that adoption of settlement rate benchmarks and "best practice" rates in this proceeding is inconsistent with the decision of the Second Circuit in *AT&T v. FCC*.⁵²³ The *AT&T* case involved a requirement -- which we based on our inherent regulatory power under Section 4(j) of the Act -- for prior Commission permission to file new rates. The Second Circuit held that such a requirement violated the procedural requirements of Section 205 because it amounted to a Section 205 rate prescription without following the statutory requirements of a full hearing and specific findings.⁵²⁴ We find that case inapplicable to the circumstances here. In the *AT&T* case, our action rested on

⁵¹⁷ Telefónica de España Reply at 29.

⁵¹⁸ Argentina Telintar Comments at 28-29; Telefónica de España Reply at 28-29.

⁵¹⁹ 47 U.S.C. § 205.

⁵²⁰ 410 U.S. 224 (1973).

⁵²¹ 5 U.S.C. §§ 556, 557.

⁵²² *U.S. v. Florida East Coast Railway*, 410 U.S. 224. *See also United States v. Allegheny-Ludlum Steel*, 406 U.S. 742 (1972).

⁵²³ 487 F.2d at 874-75.

⁵²⁴ *Id.*

our inherent regulatory power under Section 4(j) of the Act. We do not in this instance dispute that Section 205 governs our action in this proceeding, but rather find that the notice and comment provisions of Section 553 of the APA, under which this proceeding is conducted, satisfy the hearing requirement of Section 205.

e. Contractual Nature of Settlement Rates Does Not Insulate Them from Requirements of the Act

i. Positions of the Parties

302. AT&T argues that the fact that settlement arrangements are memorialized in inter-carrier contracts does not insulate them from our review.⁵²⁵ AT&T notes that Section 211 of the Act requires "[e]very carrier subject to this chapter [to] file with [us] copies of all contracts, agreements, or arrangements with other carriers, or with common carriers not subject to the provisions of this chapter." Because of that requirement, AT&T asserts that we can review settlement arrangements and, where the public interest requires it, modify them.⁵²⁶

303. According to AT&T, the fact that one party to an agreement establishing an accounting rate is a foreign carrier not subject to our jurisdiction does not diminish our authority to require the other carrier subject to our jurisdiction to comply with the requirements of Section 201 of the Act.⁵²⁷ Sprint notes that we previously exercised our jurisdiction over AT&T to ensure that it did not pay excessive prices for goods it purchased from its Western Electric affiliate without ever exercising jurisdiction over Western Electric itself.⁵²⁸ Both AT&T and Sprint cite *RCA Communications, Inc. v. United States*⁵²⁹ for the proposition that we have the authority to regulate the rates of U.S. carriers even where those rates are established by agreements with foreign correspondents.⁵³⁰

⁵²⁵ AT&T Comments at 48-52. See also Sprint Reply at 3 (citing *MCI v. FCC*, 665 F.2d 1300).

⁵²⁶ AT&T Reply at 40 (citing *American Broadcasting Co. v. FCC*, 643 F.2d 818, 824 (D.C. Cir. 1980)).

⁵²⁷ AT&T Comments at 53. AT&T also argues that our prior orders regulating facilities used for foreign communication do not limit our jurisdiction over contracts with foreign correspondents. AT&T notes that in a case cited by commenters, *AT&T Application for Authority Under Section 214 of the Communications Act to Construct and Operate a Third Florida-St. Thomas Cable*, 88 FCC 2d 1630 (1982), we concluded that we had authority to review the "whole facility," even though part of that facility was outside the physical boundaries of the United States. AT&T Reply at 43-44.

⁵²⁸ *AT&T*, 64 FCC 2d 1, 80 (1977).

⁵²⁹ *RCA Communications, Inc. v. United States*, 43 F.Supp. 851 (S.D.N.Y. 1942).

⁵³⁰ AT&T Comments at 53-54; Sprint Comments at 6.

304. Certain commenters attempt to distinguish the *RCA Communications* case cited by AT&T and Sprint from the proposals made in this proceeding. GTE states that *RCA Communications* cannot be relied on as authority to adopt our benchmarks proposals because that case involved regulations that limited the rates U.S. carriers could charge U.S. consumers, not what they could pay foreign carriers.⁵³¹ Several foreign carriers contend that *RCA Communications* stands for the proposition that if we find that a U.S. carrier has entered into an agreement with a foreign correspondent at an excessive rate, our only recourse is to adopt a prescription lowering the rates a U.S. carrier charges its U.S. customers for the service.⁵³²

305. Several commenters cite to the Supreme Court's decision in *Regents of the University System of Georgia v. Carroll*⁵³³ for the proposition that the Act does not "give authority to [us] to determine the validity of contracts between [entities subject to our jurisdiction] and others."⁵³⁴ AT&T responds by arguing that the Court in *Carroll* actually held that we did not have the authority "to determine the validity of contracts between [Title III] licensees and others," not between Title II common carriers and others.⁵³⁵ AT&T notes that the Court stated that its conclusion "was the inevitable result of the statutory scheme of licensing."⁵³⁶

ii. Discussion

306. We agree with AT&T that the fact the settlement arrangements agreed to by U.S. international carriers are memorialized in inter-carrier contracts does not insulate them from our review.⁵³⁷ Section 211 of the Act requires "[e]very carrier subject to this chapter [to] file with [us] copies of all contracts, agreements, or arrangements with other carriers, or with common carriers not subject to the provisions of this chapter." We find that Section 211's filing requirement gives us the means by which to ensure that the settlement arrangements agreed to by U.S. international carriers serve the public interest--allowing us to review and modify them where

⁵³¹ GTE Reply at 8-9.

⁵³² See, e.g., Cable & Wireless Comments at 8; KDD Comments at 19; Panama Comments at 19; Portugal Telecom International Comments at 6-8; Argentina Telintar Comments at 7-10. Argentina Telintar argues that the court in *RCA Communications* expressly recognized that any change in accounting rates could occur only through bilateral agreements. Argentina Telintar Comments at 29-30.

⁵³³ 338 U.S. 586, 602 (1950).

⁵³⁴ See, e.g., COMTELCA Reply at 15-16; Telefónica del Perú Comments at 7-8.

⁵³⁵ AT&T Reply at 44 (citing *Regents v. Carroll*, 338 U.S. at 602).

⁵³⁶ 338 U.S. at 601.

⁵³⁷ AT&T Comments at 48-52. See also Sprint Reply at 3 (citing *MCI v. FCC*, 665 F.2d 1300).

necessary such as here, where we find that they are in violation of Section 201.⁵³⁸ We have long held that we have the authority to determine whether the terms and conditions of contracts filed pursuant to Section 211's requirement are consistent with other provisions of the Act.⁵³⁹ If we did not have the "authority to pass on the contracts which must be filed . . . , [Section 211's] filing requirement would be a meaningless exercise."⁵⁴⁰

307. With the statutory powers discussed above, it is not surprising that the one court to consider the issue found that the Act allows us to regulate the charges of U.S. carriers even where those charges are established by agreements with foreign correspondents. As we discuss above, the district court in *RCA Communications* recognized that our order in that case had an indirect impact on foreign carriers, but found that such an impact did not preclude us from issuing an order that "operate[d] directly only on persons within the United States."⁵⁴¹

308. We disagree with those commenters that contend that the Supreme Court's decision in *Carroll* in any way limits our ability to take such action. At the time of the Court's decision in *Carroll*, we had no power under Title III of the Act to issue "cease and desist" orders.⁵⁴² Instead, we had "at [our] disposal only the cumbersome weapons of criminal penalties and license refusal and revocation."⁵⁴³ Title II of the Act gives us much more expansive powers than we had over broadcast licensees when the Court decided *Carroll*. These powers include the power to issue "cease and desist" orders found lacking in *Carroll*. As a result, we conclude that the Court's holding that we did not have the authority "to determine the validity of contracts between [Title III] licensees and others" does not apply to our enforcement powers against common carriers under Title II at issue here.⁵⁴⁴

2. International Regulations

⁵³⁸ See, e.g., *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. at 339.

⁵³⁹ See Bell System Tariff Offerings, 46 FCC 2d 413 (1974), *aff'd on other grounds sub nom. Bell Telephone Co. of Pennsylvania v. FCC*, 502 F.2d 1250 (3d Cir. 1974), *cert. denied*, *AT&T v. FCC*, 423 U.S. 886 (1975). See also *Southern Pacific Communications Co.*, 66 FCC 2d 199 (1977).

⁵⁴⁰ *IRC Interconnection Order*, 63 FCC 2d at 766.

⁵⁴¹ *RCA Communications*, 43 F.Supp. at 854. See Section II.E.1.a, *infra*.

⁵⁴² Congress amended Section 312 of the Act in 1952 to give us the power to issue "cease and desist" orders to regulate broadcasting. See *Southwestern Cable Co. v. FCC*, 378 F.2d 118, 121 (9th Cir. 1967).

⁵⁴³ *Carroll*, 338 U.S. at 602.

⁵⁴⁴ *Id.*

a. Positions of the Parties

309. Many foreign commenters argue that our settlement rate benchmark proposals violate the regulations of the International Telecommunication Union ("ITU") as well as general international law principles of comity and national sovereignty.⁵⁴⁵ These parties argue that our proposals represent unilateral action by the United States and contradict ITU regulations, such as Articles 1.5 and 6.2.1 of the International Telecommunication Regulations ("ITR"),⁵⁴⁶ that require accounting rates to be negotiated pursuant to mutual agreement.⁵⁴⁷ Several foreign commenters argue that adoption of benchmarks would amount to an extraterritorial assertion of our jurisdiction.⁵⁴⁸ They urge us to seek a negotiated, multilateral solution to accounting rate reform issues within the framework of the ITU.⁵⁴⁹

310. In contrast, U.S.-owned carriers generally support the Commission's proposal and argue that we possess sufficient authority to review negotiated agreements. They point out that nothing in the obligations of the United States under the ITU precludes us from exercising oversight over agreements negotiated by U.S. carriers to determine whether such agreements are in the public interest.⁵⁵⁰

b. Discussion

311. We find that requiring U.S. carriers to pay no more than a benchmark settlement rate is consistent with international law and the regulations of the ITU. Many foreign governments and carriers argue that adoption of our benchmark proposals would violate sections

⁵⁴⁵ See, e.g., Cable & Wireless Comments at 4; GTE Comments at 12-13, A-4; HKTl Comments at 21-22; Jamaica Comments at 2. See also TSTT Comments at 2 (arguing that adoption of our proposals would be "tantamount to tyranny").

⁵⁴⁶ ITU Regulations, §§ 1.5, 6.2.1. See, e.g., Cable & Wireless Comments at 4-5; GTE Reply at 12-16; Telintar Comments at 13-14.

⁵⁴⁷ Cable & Wireless Comments at 5 (citing Article 6.2.1 of the International Telecommunication Regulations (Melbourne, 1988)). See also Argentina Telintar Comments at 11-17 (discussing ITU-T Recommendation D.140, "Accounting Rate Principles for International Telephone Services" (approved September 28, 1995) ("Recommendation D.140")); GTE Comments at 12-13; Panama Comments at 20-21; Telefónica del Perú Comments at 7-9.

⁵⁴⁸ VSNL Comments at 3; Telmex Comments at 20.

⁵⁴⁹ See, e.g., AHCIET Comments at 6; KDD Comments at 15-17.

⁵⁵⁰ See Sprint Reply at 5-6; AT&T Comments at 56-57.

1.5⁵⁵¹ and 6.2.1⁵⁵² of the ITR.⁵⁵³ We reject these arguments. Although the sections cited require administrations to negotiate accounting rates "pursuant to mutual agreement," the ITR do not suggest that governments cede sovereignty over telecommunication carriers that operate in their markets. The preamble to the ITR recognizes that "it is the sovereign right of each country to regulate its telecommunications." Indeed, Article 1.7(a) of the ITR states "[t]hese regulations recognize the right of any member, subject to national law and should it decide to do so, 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."⁵⁵⁴ The right to authorize a carrier to provide service in a given country necessarily includes the right to attach reasonable conditions to such authorization to ensure that the actions of such carriers are consistent with the public interest. We cannot accept the view of certain foreign governments and carriers that the U.S. government must agree to allow U.S. carriers to settle their traffic at whatever rates the foreign carrier deems appropriate regardless of the impact on the U.S. public interest.⁵⁵⁵

312. Several commenters also argue that our adoption of settlement rate benchmarks would violate national sovereignty by dictating the rate that a foreign carrier may charge for termination of traffic on the foreign network. The Philippines notes that Article 6.1.1 of the ITR recognizes the level of toll charges as a "national matter."⁵⁵⁶ We agree that toll charges are a national matter and note that the rules we adopt here place no constraints on the rates that foreign carriers charge foreign end-user customers. We at no time in this *Order* assert that we have the authority to compel directly a foreign carrier to charge a certain rate for terminating U.S.-

⁵⁵¹ ITU Regulations, § 1.5; "Within the framework of the present regulations, the provision and operation of international telecommunication services is pursuant to mutual agreement between administrations." *Id.*

⁵⁵² ITU Regulations, § 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." *Id.*

⁵⁵³ *See, e.g.,* Argentina Telintar Comments at 13-14; Telefónica del Perú Comments at 8-9; Singapore Telecom Comments at 2-3; Cable & Wireless Comments at 4-5.

⁵⁵⁴ ITU Regulations, § 1.7(a).

⁵⁵⁵ We note that section 3.3.1 of Appendix 1 of the ITU regulations states that "[p]ayment of balances of account shall be effected as promptly as possible, but in no case later than two calendar months after the day on which the settlement statement is dispatched by the creditor administration." Although this section calls for the timely payment of settlements for termination services provided by a correspondent carrier, we find nothing in its language to preclude a member country from directing one of its licensed carriers to cease operation under an existing contract.

⁵⁵⁶ *See, e.g.,* Cable & Wireless Reply at 4-8; GTE Comments at A-4; Philippines Comments at 29. It is important to note that the language of Article 6.1.1. refers not to underlying settlement rates, but to "charges to be collected from . . . customers."

originated traffic. Instead, the rules we adopt here apply only to the settlement rates that carriers subject to our jurisdiction may pay for termination of U.S.-originated traffic. We recognize that our settlement rate benchmarks may over time reduce the settlement revenues that many foreign carriers receive from U.S. carriers, and this could in turn lead some foreign carriers to change the rates they charge their consumers. However, our responsibility must be to address the inequity and inefficiency of an accounting rate system that subsidizes foreign carriers at the expense of U.S. consumers. We believe it is fundamentally unfair and inconsistent with the public interest for U.S. consumers to continue to pay high IMTS rates because of above-cost settlement rate payments to foreign carriers.

313. We note that Article 6.2.1 of the ITR requires carriers to negotiate accounting rates "taking into account relevant CCITT recommendations and relevant cost trends."⁵⁵⁷ ITU Recommendation D.140 goes further to state that "accounting rates for international telephone services should be cost-oriented and should take into account relevant cost trends."⁵⁵⁸ We find that these sections support the action that we take here.

314. Many commenters argue that we should reject our benchmarks proposals and, instead, wait until a negotiated solution to above-cost accounting rates can be reached within the structures established by the ITU.⁵⁵⁹ The U.S. Government has contributed actively to the work of the ITU and other multilateral fora on accounting rate issues for many years. While we have seen some progress in these fora, the movement toward fundamental reform has been very slow. We believe that we must take action now to fulfill our statutory mandate to ensure that U.S. consumers receive telecommunications services at reasonable rates and to address the potential for competitive distortions in the U.S. market for international services as we move forward with implementation of the U.S. commitments made in the WTO Basic Telecom Agreement. We would prefer to achieve a multilateral solution to the problem of above-cost settlement rates. Thus, we will continue our efforts to achieve reform of the accounting rate system in the ITU and other multilateral organizations. We emphasize that if, in the future, meaningful progress is made in a multilateral forum to achieve significant reform of the accounting rate system and reduce settlement rates to a more cost-based level, we will reconsider at that time the need to enforce our settlement rate benchmarks.

III. Conclusion

⁵⁵⁷ Article 6.2.1, ITR.

⁵⁵⁸ "Accounting Rate Principles for International Telephone Services," ITU-T Recommendation D.140.

⁵⁵⁹ *See, e.g.*, Communications Authority of Thailand Comments at 3; GTE Comments at A-4; RPOAs of Korea Comments at 5-6.

315. In this *Order* we establish settlement rate benchmarks that will govern the international settlement rates that U.S. carriers may pay to terminate international traffic originating in the United States. Our action is necessary to reduce the inflated margins on international termination fees that contribute to high international calling prices in the United States and create competitive distortions in the U.S. market for IMTS. We will continue, however, to work in the ITU and other international organizations to achieve multilateral agreement on reforming the international accounting rate system and encourage other countries that have expressed interest in achieving reform to work with the United States toward achieving that goal. We emphasize that if a multilateral agreement is reached that achieves substantially equivalent results as the benchmarks policy we adopt in this *Order*, we could waive enforcement of our benchmark settlement rates.

IV. Procedural Issues

A. Final Regulatory Flexibility Analysis

316. Pursuant to the Regulatory Flexibility Act of 1990, 5 U.S.C. §§ 601-612, the Commission's Final Regulatory Flexibility Analysis with respect to the *Report and Order* is as follows:

317. *Reason for Action:* The Commission issues this *Report and Order* adopting changes in the benchmark settlement rates for international message telephone service between U.S. facilities-based carriers and foreign carriers and related issues. The Commission believes that its benchmark rates should be revised to reflect recent technological improvements, their associated cost reductions, and the market structure changes occurring in the global telecommunications market. We also believe these revisions, and related actions taken here, are necessary to move settlement rates closer to the actual costs of providing international termination services.

318. *Objectives:* The objective of this proceeding is to attain reform in the international accounting rate system and thereby help ensure lower international calling prices for consumers and protect competition in the U.S. IMTS market. The Commission will achieve this objective by revising its benchmark settlement rates so that they more closely resemble the underlying costs of providing international termination services.

319. *Legal basis:* The *Report and Order* is adopted pursuant to §§ 1, 2, 4(i), 201, 205, 214 and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 201, 205, 214, 303(r).

320. *Description, potential impact, and number of small entities affected:* The Commission has not developed a definition of small entities applicable to international common

carriers. We therefore have used as the applicable definition of small entity the definition under the Small Business Administration (SBA) rules applicable to Communications Services, Not Elsewhere Classified. This definition provides that a small entity is expressed as one with \$11.0 million or less in annual receipts.⁵⁶⁰ Based on preliminary 1995 data, at present there are 29 international facilities-based common carriers that qualify as small entities pursuant to the SBA's definition. The number of small international facilities-based common carriers has been growing significantly, and by the end of 1996 that number could increase to approximately 50. The revised benchmark rates will apply to all international facilities-based common carriers, including small entities, that enter into an operating agreement with a foreign carrier that provides for the payment of settlement rates. We note that the revised benchmark rates should result in lower settlement rates for carriers. This *Report and Order* also requires that a foreign carrier's settlement rates be at or below the relevant benchmark as a condition of Section 214 authorization for that carrier, or an affiliate, to provide U.S. international facilities-based services between the United States and the affiliated destination country. This condition will apply to all U.S. international facilities-based carriers, including small entities, that are affiliated with foreign carriers. The Commission has concluded that this condition is necessary to prevent potential anticompetitive distortions in the IMTS market.

321. The *Order* also imposes an additional requirement on carriers that seek to provide switched services using resold or facilities-based private lines. Carriers must demonstrate that settlement rates for 50 percent of the settled traffic between the United States and the country at the foreign end of the private line are at or below the relevant benchmark for that country. The Commission believes that at most 635 small international carriers, both facilities-based and resale carriers, could be affected by this requirement. The Commission has concluded this requirement is necessary to prevent potential anticompetitive distortions in the IMTS market. We base our estimate of the number of small entities potentially affected on the number of toll carriers filing Telecommunications Relay Service Fund (TRS) worksheets. In 1995, 445 toll carriers filed TRS fund worksheets. We believe that between 50 and 200 carriers failed to file TRS fund worksheets. We also believe that fewer than 10 toll carriers were not small entities (based on the SBA's definition of small entity as one with fewer than 1,500 employees). Thus, at most 635 international carriers would be classified as small entities. The Secretary shall send a copy of this *Report and Order* to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. § 601, *et seq.* (1981).

322. *Reporting, recordkeeping and other compliance requirements:* In its Initial Regulatory Flexibility Analysis the Commission did not propose any reporting requirements. The *Notice*, however, raised the issues of possible anticompetitive behavior and market distortions,

⁵⁶⁰ 13 C.F.R. § 121.201, Standard Industrial Classification (SIC) Code 4899.

and sought comment on how the Commission's reporting system could be modified in order to make monitoring and enforcement more effective. To address the concerns of commenters, the *Report and Order* contains certain mechanisms to detect potential market distortions. In this regard, the Commission amends its rules to impose an additional reporting requirement. Section 43.61 of the Commission's rules currently requires that carriers file annual reports that include actual traffic and revenue data. Common carriers subject to the existing Section 43.61 requirements will be required to file traffic reports for each quarter in which their traffic meets any of the following thresholds: (i) their aggregate U.S.-billed minutes of switched telephone traffic exceeds 1% of the total of such minutes of international traffic for all U.S. carriers (as published in the most recent Section 43.61 traffic data report); (ii) their aggregate foreign-billed minutes of switched telephone traffic exceeds 1% of the total of such minutes of international traffic for all U.S. carriers; (iii) their aggregate U.S.-billed minutes of switched telephone traffic for any country exceeds 1.5% of the total of such minutes for that country for all U.S. carriers; or (iv) their aggregate foreign-billed minutes of switched telephone traffic for any foreign country exceeds 2.5% of the total of such minutes for that country for all U.S. carriers. Limiting the quarterly filing requirement to carriers that meet these criteria will reduce the burden on small carriers, while enabling us to identify distortions in the balance of payments. The *Report and Order* only imposes an increase in the frequency with which the report must be filed. It will contain the same data that must be included in the current required annual report. Thus, the reporting requirement should not impose a significant economic burden, and no additional outside professional skills should be required in complying with this requirement.

323. *Federal rules which overlap, duplicate or conflict with the Commission's proposal:* None.

324. *Any significant alternatives minimizing impact on small entities and consistent with stated objectives:* The *Notice* solicited comments on a variety of alternative methodologies for calculating benchmark settlement rates, but these have no impact on small entities. The *Notice* also solicited comments on enforcement mechanisms that may be necessary to support U.S. carriers, including small entities, in their negotiations with foreign carriers and in their provision of international service. We did not receive any comments on the impact of these alternatives on small entities.

325. *Comments solicited:* Written comments were requested on the Initial Regulatory Flexibility Analysis in accordance with the same filing deadlines set for comments on the other issues in the *Notice*, but we did not receive any comments.

B. Paperwork Reduction Act of 1995 Analysis

326. This Report and Order contains either a new or modified information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the

Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this order, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13. Public and agency comments are due 60 days from date of publication of this Order in the Federal Register. Comments should address: (1) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (2) the accuracy of the Commission's burden estimates; (3) ways to enhance the quality, utility, and clarity of the information collected; and (4) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology. Written comments must be submitted on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov. For additional information concerning the information collections contained in the Report and Order contact Judy Boley at 202-418-0214.

V. Ordering Clauses

327. Accordingly, IT IS ORDERED that, pursuant to Sections 1, 2, 4(i), 201, 205, 214 and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 201, 205, 214, 303(r), the rules, requirements and policies discussed in this *Order* ARE ADOPTED and Part 43 and 63 of the Commission's Rules, 47 C.F.R. Parts 43 & 63, ARE AMENDED as set forth in Appendix B.

328. IT IS FURTHER ORDERED that the rules, requirements and policies established in this decision shall take effect on January 1, 1998. The new information collection requirements adopted in this *Order* will become effective following OMB approval. The Commission will publish a document at a later date establishing the effective date.

Federal Communications Commission

William F. Caton
Acting Secretary

August 7, 1997

Separate Statement by Chairman Hundt
on International Settlement Rates Report and Order

Today's actions establishing new benchmarks to guide the prices U.S. carriers pay to terminate international calls will result in billions of dollars in savings for United States consumers and will help promote a more competitive, vibrant international telecommunications market.

Currently, the average price of an international call is 88 cents a minute, compared to a price of 13 cents a minute for a domestic long distance call. This difference stems principally from the monopoly cartel that has long insisted on settlement rate payments that exceed the underlying cost of providing service by a factor often as large as five to ten times. This order and the World Trade Organization Agreement to open the world's telecommunications markets will work together to stimulate greatly the growth and competitiveness of the international market to the benefit of consumers and carriers alike worldwide.

This order will bring extraordinary benefits to consumers here in the United States and worldwide. We estimate in the United States alone that consumers will save over \$17 billion over the next six years, based on current market trends. Along with our access reform order earlier this year, this represents the greatest single consumer benefit ever delivered to American consumers in the history of this agency.

As a result of this order and the WTO Agreement, we predict that the average price of an international call will drop from 88 cents today to 20 cents five years from now -- a decrease of almost 80%.

And, we predict the United States market for international services will more than double over the next four years as a result of this order. The world market should enjoy a similar increase.

Over the last several years, an international consensus has developed on the need to reform the antiquated settlement rate system. This system dates back over 100 years to the age of the telegraph and historically served as the mechanism for national monopoly telecommunications carriers to set international settlement rates. The ITU and other international organizations have devoted considerable effort to studying settlement rate reform. We have worked closely with foreign countries in these efforts and will continue to do so. We encourage our friends overseas to move forward with us to reform the settlement rate system because it is an integral part of a successful transition to the post-WTO world. We are convinced that a multilateral solution is the best way to reform and we have pledged in the Report & Order we adopt today to reconsider these benchmarks should such a satisfactory multilateral solution be reached.

Today, the Commission is saying that the solution to financing the global communications network cannot be an ever escalating subsidy from American consumers to foreign telephone companies. We are also saying that the global network must be built, and the only way to do so is

by following the same laws of competition and market financing that apply everywhere. In 1996, the total net outpayment from US carriers to foreign carriers was \$5.4 billion. Over 70% of this outpayment represents a subsidy from US consumers to foreign telecommunications carriers.

Whether we are talking about termination for domestic or international services, there are certain principles that are constant. The principles governing competition in telecommunications, like the laws of physics, are the same whether one is in South Dakota or South Korea. In last year's Telecommunications Act, Congress set forth a number of principles to guide the introduction of competition for local telephone service. Among these principles was the requirement that prices for competitors to interconnect to the incumbent local exchange companies' networks be cost-based and nondiscriminatory. International settlement rates are simply a specialized form of interconnection involving services that cross national borders. The benchmarks we adopt today provide a framework to foster competition in international services by promoting cost-based and nondiscriminatory pricing for international termination services. They also take into account the needs of developing countries by giving carriers from such countries a higher benchmark and a significantly longer period of time to meet their benchmark.

Consumers around the world will receive higher quality service, more service options, and lower rates as settlement rates are reduced to a more cost-based level. Settlement rate reform will also benefit every carrier that provides international services by stimulating growth for international services. The current accounting rate system suppresses global demand by contributing to inflated international calling prices. As settlement rates, and in turn calling prices, are reduced, demand for international services will be stimulated. More importantly, settlement rate reform is essential if carriers that currently benefit from and rely on artificially high settlement rates are to remain viable. Without settlement rate reform, these carriers face being marginalized by a global telecommunications market that will increasingly bypass artificially high-cost routes, either by least-cost routing practices such as call-back, refile and reorigination, or technological innovation such as Internet telephony (which is not subject to the settlement rate system). Only the discipline of a competitive markets can attract the stores of global capital needed to build the global information infrastructure.

August 7, 1997

Separate Statement by Commissioner Susan Ness
on International Settlement Rates Report and Order

That current settlement rates are significantly higher than the actual cost of terminating international long distance telephone service is widely accepted. Even the foreign carriers who benefit by receiving these large annual subsidies from U.S. carriers -- and ultimately U.S. consumers -- have generally acknowledged that current settlement rates are disproportionate to actual costs. Therefore, a multilateral consensus exists -- and has existed for several years now -- that the settlement rate imbalance should be remedied.

It was in 1992 that the ITU adopted Recommendation D. 140, which called for a reduction in these rates within five years, or by 1997. While progress has been made during that time, the pace of reform in settlement rates thus far has been inadequate. Thus, despite general international agreement that a remedy has long been in order, we have been unable to reach consensus internationally as to how to achieve more cost-based rates in a timely manner.

The need to achieve meaningful accounting rate reform has taken on greater urgency in light of the WTO Basic Telecommunications Services Agreement, which will take effect on January 1 of next year. In the context of the market opening commitments that will soon take effect under the WTO Agreement, the current inflated settlement rate structure has even greater potential for market distortion and anti-competitive effects.

The WTO Telecom Services Agreement is a landmark in trade liberalization, and the international community is to be commended for taking this great leap forward. The time is due, however, for the international community to give full effect to the great promise of this Agreement by remedying the accounting rate imbalance. The ITU is to be commended for its efforts in this regard, and I commend the work of Study Group 3, in which the United States will continue to participate vigorously. But the time to act is upon us and that is why the FCC takes this action today. I would like to point out that the Commission has thoroughly reviewed the comments it has received from over 90 foreign governments and foreign carriers relative to this proceeding, and has taken these comments into account in issuing this Order.

I would emphasize, however, that the Order we adopt today specifically provides that the Commission may forbear from enforcement if a multilateral agreement is reached which achieves substantially equivalent results in a timely manner. So the FCC does not by its action today foreclose a multilateral solution. Rather it invites one -- and it is my personal hope that this Order may spur timely multilateral action to achieve our common goals.

APPENDIX A

List of Commenters

ABS-CBN Telecom, North America, Inc.
ACC Corp.
AHCIENT (Hispanic-American Association of Research Centers and Telecommunications Cos.)
Americatel Corporation
Antigua and Barbuda, Government of
Association of Telecommunications Enterprises of the Andean Subregional Agreement
(ASETA)
AT&T Corp. (and Erratum)
Bolivia, Telecommunications Superintendency of
Cable & Wireless, PLC (C&W)(and Erratum)
Caribbean Association of National Telecommunication Organizations (CANTO)
China, Directorate General of Telecommunications, P&T
Chunghwa Telecom
Coalition for Hemispheric Competitiveness
Coalition of Services Industries (CSI)
Colombia, Comision de Regulacion de Telecomunicaciones (comments in Spanish)
Compañía Teléfonos de Chile--Transmisiones Regionales S.A. (CTC Mundo)
Cooperation Council for the Arab States of the Gulf
Deutsche Telekom AG
Economic Strategy Institute (ESI)
Empresa Estatal de Telecomunicaciones (EMETEL)(comments in Spanish)
Empresa Nacional de Telecomunicaciones S.A. (Entel-Chile)
European Union, Delegation of the European Commission (EU)
France Telecom
Frontier Corporation
Grenada, Ministry of Works, Communications & Public Utilities
GTE Service Corporation
Hong Kong Telecom International (HKTI)(and Erratum)
Indosat
International Digital Communications (IDC)
International Telecom Japan Inc. (ITC)
Israel, State of
Jabatan Telekom Malaysia (JTM)
Jamaica, Ministry of Public Utilities and Transport of
Japan, Government of
Justice Technology Corporation
Kokusai Denshin Denwa Co. Ltd. (KDD)
Korea, Government of the Republic of
Lattelekom SIA

Latvia, Department of Communications of Ministry of Transport of the Republic of
MCI Telecommunications Corporation
Nepal Telecommunications Corporation
New T&T Hong Kong Limited (late filed -- 2/25/97)
Pacific Bell Communications (PBCom)
Pacific Islands Telecommunications Association (PITA)
Pakistan Telecommunication Authority
Pakistan Telecommunications Company
Panama, Republic of
Philippines, National Telecommunications Commission of the Republic of
Poland, Ministry of Communications of the Republic of
Portugal, Instituto das Comunicações de Portugal (ICP)
Portugal Telecom International (PTI)
Primus Telecommunications Group, Inc.
Regional Technical Commission on Telecommunications of Central America (COMTELCA)
RPOAs of the Republic of Korea
Saint Vincent and the Grenadines, Government of
Saudi Arabia, Ministry of P.T.T. of the Kingdom of
SBC Communications Inc.
Singapore, Telecommunication Authority (TAS)
Singapore Telecommunications Limited
Solomon Islands, Ministry of Transport Communications and Works
Sprint Communications Company, L.P.
Sri Lanka Telecom Ltd.
Suriname, Government of the Republic of
Syrian Arab Republic, Syrian Telcommunications Establishment
Taiwan, Directorate General of Telecommunications of the Republic of China
Telecom-Colombia
Telecom Italia
Telecom New Zealand Limited (TNZL)
Telecom Vanuatu Limited
Telecommunications Resellers Association (TRA)
Telecommunications Services of Trinidad and Tobago Limited (TSTT)
Telecomunicaciones Internacionales de Argentina Telintar S.A.
Telefónica Internacional de España, S.A.
Telefónica del Perú, S.A. (and Erratum)
Telekom Malaysia Berhad
Telefonos de Mexico, S.A. de C.V. (Telmex)
Telia AB
Telstra Corporation Limited
Thailand, Communications Authority (CAT)
Thailand, Post and Telegraph Department
TRICOM, S.A.

United Kingdom Government
United States Trade Representative, Department of Commerce, Department of State
Videsh Sanchar Nigam Limited (VSNL)
Worldcom, Inc.
Zephyr Capital Group, Inc.

List of Reply Commenters

ABS-CBN Telecom, North America, Inc.
Alexis de Tocqueville Institution
AT&T Corporation (and Supplemental Reply Comments)
Australia, Government of
Brazil, Ministry of Communications
Cable & Wireless, PLC (C&W)
CARICOM
Chunghwa Telecom
Coalition of Service Industries (CSI)
European Union, Delegation of the European Commission (EU)
GTE Services Corporation
Guyana Telephone & Telegraph Limited (GT&T)
Hong Kong Telecom International (HKTI)
India, Government of
Indonesia, Ministry of Tourism, Posts, and Telecommunications of the Republic of
International Communications Association (ICA)
International Digital Communications, Inc. (IDC)
International Telecom Japan Inc. (ITJ)(and Supplemental Reply Comments)
Jabatan Telekom Malaysia (JTM)
Japan, Government of
Kokusai Denshin Denwa Co. Ltd. (KDD)
Korea Telecom
MacAvoy, Paul W.
MCI Telecommunications Corporation
National Telecommunications and Information Administration (NTIA)
Netherlands Antilles, Bureau Telecommunicatie
Pacific Bell Communications (PBCom)
Pakistan Telecom Company
Panama, Republic of
Regional Technical Commission on Telecommunications of Central America (COMTELCA)
SDN Users Association, Inc.
Singapore Telecommunications Limited
Sonatel, Société Nationale des Télécommunications du Sénégal
Sprint Communications Company, L.P.
Telecommunications Services of Trinidad and Tobago (TSTT)
Telefónica Internacional de España, S.A.
Telstra Corporation Limited
TRICOM, S.A.
United States Trade Representative, Office of (USTR)
Worldcom, Inc.
Zimbabwe Posts and Telecommunications Corp. (ZPTC)

APPENDIX B

FINAL RULES

Parts 43 and 63 of Title 47 of the Code of Federal Regulations are amended as follows:

PART 43 -- REPORTS OF COMMUNICATION COMMON CARRIERS AND CERTAIN AFFILIATES

1. The authority citation for Part 43 continues to read as follows:

Authority: Section 4 of the Communications Act of 1934, as amended, 47 U.S.C. § 154.

2. In § 43.61, paragraphs (b) through (d) are redesignated paragraphs (a)(1) through (a)(3) and new paragraph (b) is added to read as follows:

§ 43.61 Reports of International Telecommunications Traffic.

(b) Quarterly Traffic Reports. (1) Each common carrier engaged in providing international telecommunications service between the area comprising the continental United States, Alaska, Hawaii, and off-shore U.S. points and any country or point outside that area shall file with the Commission, in addition to the report required by paragraph (a) of this section, actual traffic and revenue data for each calendar quarter in which the carrier's quarterly minutes exceed the corresponding minutes for all carriers by one or more of the following tests:

(i) The carrier's aggregate minutes of facilities-based or facilities resale switched telephone traffic for service billed in the United States are greater than 1.0 percent of the total of such minutes of international traffic for all U.S. carriers published in the Commission's most recent § 43.61 annual report of international telecommunications traffic;

(ii) The carrier's aggregate minutes of facilities-based or facilities resale switched telephone traffic for service billed outside the United States are greater than 1.0 percent of the total of such minutes of international traffic for all U.S. carriers published in the Commission's most recent § 43.61 annual report of international telecommunications traffic;

(iii) The carrier's aggregate minutes of facilities-based or facilities resale switched telephone traffic for service billed in the United States for any foreign country are greater than 2.5 percent of the total of such minutes of international traffic for that country for all U.S. carriers published in the Commission's most recent § 43.61 annual report of international telecommunications traffic; or

(iv) The carrier's aggregate minutes of facilities-based or facilities resale switched telephone traffic for service billed outside the United States for any foreign country are greater than 2.5 percent of the total of such minutes of international traffic for that country for all U.S. carriers published in the Commission's most recent § 43.61 annual report of international telecommunications traffic.

(2) Except as provided in this paragraph, the quarterly reports required by paragraph (b)(1) of this section shall be filed in the same format as, and in conformance with, the filing procedures for the annual reports required by paragraph (a) of this section.

(i) Carriers filing quarterly reports shall include in those reports only their provision of switched, facilities-based telephone service and switched, facilities resale telephone service.

(ii) The quarterly reports required by paragraph (b)(1) of this section shall be filed with the Commission no later than April 30 for the prior January through March quarter; no later than July 31 for the prior April through June quarter; no later than October 31 for the prior July through September quarter; and no later than January 31 for the prior October through December period.

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. secs. 151, 154(i), 154(j), 201-205, 218, 403 and 533 unless otherwise noted.

2. Section 63.18 is amended by redesignating paragraph (e)(4)(ii) as paragraph (e)(4)(ii)(B) and by revising paragraphs (e)(2)(B)-(C), (e)(3), and (e)(4) to read as follows:

§ 63.18 Contents of applications for international common carriers.

(e) ***

(2) ***

(B) The applicant may resell private line services for the provision of international switched basic services only in circumstances where the Commission has found that the country at the foreign end of the private line provides equivalent resale opportunities and that settlement

rates for at least 50 percent of the settled U.S.-billed traffic between the United States and that country are at or below the benchmark settlement rate adopted for that country in IB Docket No. 96-261. The Commission will provide public notice of its equivalency and settlement rate determinations. The applicant, however, shall not initiate such service on a particular route absent a grant of specific authority under paragraph (e)(6) of this section in circumstances where the applicant is affiliated with a facilities-based carrier in the country at the foreign end of the private line and the Commission has not determined that the foreign carrier does not possess market power in that country.

(C) The authority granted under this paragraph shall be subject to all Commission rules and regulations, including the limitation in § 63.21 on the use of private lines for the provision of switched services, and any conditions stated in the Commission's public notice or order that serves as the applicant's Section 214 certificate. *See* §§ 63.12, 63.21.

(3) If applying for authority to provide international switched basic services over resold private lines between the United States and a country for which the Commission has not made the settlement rate and equivalency determinations specified in paragraph (e)(2)(B) of this section, applicant shall demonstrate that settlement rates for at least 50 percent of the settled U.S.-billed traffic between the United States and the country at the foreign end of the private line are at or below the benchmark settlement rate adopted for that country in IB Docket No. 96-261 and that the country affords resale opportunities equivalent to those available under U.S. law. In this regard, applicants shall: ***

(ii) The procedures set forth in paragraph (e)(3) of this section are subject to Commission policies on resale of international private lines in CC Docket No. 90-337 as amended in IB Docket Nos. 95-22 and 96-261.

(4) Any carrier authorized under this section to acquire and operate international private line facilities other than through resale may use those private lines to provide switched basic services only in circumstances where the Commission has found that the country at the foreign end of the private line provides equivalent resale opportunities and that settlement rates for at least 50 percent of the settled U.S.-billed traffic between the United States and that country are at or below the benchmark settlement rate adopted for that country in IB Docket No. 96-261. The Commission will provide public notice of its equivalency and settlement rate determinations. This provision is subject to the following exceptions and conditions:

(i) The applicant shall not initiate such service on a particular route absent a grant of specific authority under paragraph (e)(6) of this section in circumstances where the applicant is affiliated with a facilities-based carrier in the country at the foreign end of the private line and the Commission has not determined that the foreign carrier does not possess market power in that country.

(ii) The applicant is subject to all applicable Commission rules and regulations, including the limitation in § 63.21 on the use of private lines for the provision of switched services, and any conditions stated in the Commission's public notice or order that serves as the applicant's Section 214 certificate. *See* §§ 63.12, 63.21.

(A) Except as provided in paragraph (e)(4)(ii)(B) of this section, any carrier that seeks to provide international switched basic services over its authorized private line facilities between the United States and a country for which the Commission has not made the settlement rate and equivalency determinations specified in paragraph (e)(2)(B) of this section shall demonstrate that settlement rates for at least 50 percent of the settled U.S.-billed traffic between the United States and the country at the foreign end of the private line are at or below the benchmark settlement rate adopted for that country in IB Docket No. 96-261 and that the country affords resale opportunities equivalent to those available under U.S. law. In this regard, applicant shall include the information required by paragraph (e)(3) of this section.

3. Section 63.21(a) is revised to read as follows:

§ 63.21 Conditions applicable to international Section 214 authorizations.

(a) Carriers may not use their authorized facilities-based or resold international private lines for the provision of switched basic services unless and until the Commission has determined that the country at the foreign end of the private line provides equivalent resale opportunities and that settlement rates for 50 percent of the settled U.S.-billed traffic between the United States and that country are at or below the benchmark settlement rate adopted for that country in IB Docket No. 96-261. *See* § 63.18(e)(3)-(4). If at any time the Commission finds, after an initial determination of compliance for a particular country, that the country no longer provides equivalent resale opportunities or that market distortion has occurred in the routing of traffic between the United States and that country, carriers shall comply with enforcement actions taken by the Commission. This condition shall not apply to a carrier's use of its authorized facilities-based private lines to provide service as described in § 63.18(e)(4)(ii)(B).

Appendix C: Classification of Economies

<i>Teledensity Less Than One*</i>	<i>Low Income** (less than \$726)</i>	<i>Lower Middle Income** (\$726-\$2,895)</i>	<i>Upper Middle Income** (\$2,896-8,955)</i>	<i>High Income** (\$8,956 or more)</i>
Afghanistan	Afghanistan	Algeria	Antigua & Barbuda	Andorra
Angola	Albania	Angola	Argentina	Aruba
Bangladesh	Armenia	Belarus	Bahrain	Australia
Benin	Azerbaijan	Belize	Barbados	Austria
Bhutan	Bangladesh	Bolivia	Brazil	Bahamas, The
Burkina Faso	Benin	Botswana	Chile	Belgium
Burundi	Bhutan	Bulgaria	Czech Republic	Bermuda
Cambodia	Bosnia	Cape Verde	French Guiana	Brunei
Cameroon	Burkina Faso	Colombia	Gabon	Canada
Central Afr. Rep.	Burundi	Costa Rica	Greece	Cayman Islands
Chad	Cambodia	Croatia	Guadeloupe	Channel Islands
Comoros	Cameroon	Cuba	Hungary	Cyprus
Congo, Dem. Rep	Central African Rep.	Djibouti	Isle of Man	Denmark
Congo, Rep. of	Chad	Dominica	Korea, Republic	Faeroe Islands
Cote D'Ivoire	China	Dominican Republic	Libya	Finland
Equatorial Guinea	Comoros	Ecuador	Malaysia	France
Eritrea	Congo, Dem. Rep.	El Salvador	Malta	French Polynesia
Ethiopia	Congo, Rep. of	Estonia	Martinique	Germany
Ghana	Cote d' Ivoire	Fiji	Mauritius	Greenland
Guinea	Egypt	Grenada	Mayotte	Hong Kong
Guinea-Bissau	Equatorial Guinea	Guatemala	Mexico	Iceland
Haiti	Eritrea	Indonesia	New Caledonia	Ireland
Kenya	Ethiopia	Iran	Oman	Israel
Laos	Gambia, The	Iraq	Reunion	Italy
Lesotho	Georgia	Jamaica	Saudi Arabia	Japan
Liberia	Ghana	Jordan	Seychelles	Jersey
Madagascar	Guinea	Kazakhstan	Slovenia	Kuwait
Malawi	Guinea-Bissau	Kiribati	South Africa	Liechtenstein
Mali	Guyana	Korea, DPR	St. Kitts & Nevis	Luxembourg
Mauritania	Haiti	Latvia	St. Lucia	Macao
Mozambique	Honduras	Lebanon	Trinidad & Tobago	Monaco
Myanmar	India	Lithuania	Uruguay	Neth. Antilles
Nepal	Kenya	Macedonia, FYR		Netherlands
Niger	Kyrgyz Republic	Maldives		New Zealand
Nigeria	Laos, PDR	Micronesia		Norway
Rwanda	Lesotho	Moldova		Portugal
Senegal	Liberia	Morocco		Qatar
Sierra Leone	Madagascar	Namibia		Singapore
Somalia	Malawi	Panama		Spain
Sudan	Mali	Papua New Guinea		Sweden
Tanzania	Mauritania	Paraguay		Switzerland
Togo	Mongolia	Peru		Taiwan

Appendix C: Classification of Economies

<i>Teledensity Less Than One*</i>	<i>Low Income** (less than \$726)</i>	<i>Lower Middle Income** (\$726-\$2,895)</i>	<i>Upper Middle Income** (\$2,896-8,955)</i>	<i>High Income** (\$8,956 or more)</i>
Uganda	Mozambique	Philippines		U.A.E.
Zambia	Myanmar	Poland		United Kingdom
	Nepal	Romania		
	Nicaragua	Russian Federation		
	Niger	Slovak Republic		
	Nigeria	St. Vincent		
	Pakistan	Suriname		
	Rwanda	Swaziland		
	Sao Tome & Princip	Syria		
	Senegal	Thailand		
	Sierra Leone	Tonga		
	Somalia	Tunisia		
	Sri Lanka	Turkey		
	Sudan	Turkmenistan		
	Tajikistan	Ukraine		
	Tanzania	Uzbekistan		
	Togo	Vanuatu		
	Uganda	Venezuela		
	Vietnam	West Bank & Gaza		
	Yemen	Western Samoa		
	Zambia	Yugoslavia		
	Zimbabwe			

* Source: "World Telecommunication Development Report", ITU (1996/1997).

** Source: "Social Indicators of Development, 1996," World Bank, 1996.

APPENDIX D: Tariffed Component Prices

Country	International Transmission	International Switching	National Extension	Tariffed Component Price
Argentina	6.7¢	3.4¢	22.0¢	32.1¢
Australia	4.8¢	1.9¢	12.0¢	18.7¢
Austria	8.1¢	1.9¢	21.4¢	31.4¢
Bahamas	5.2¢	1.9¢	12.8¢	19.9¢
Barbados	8.6¢	3.4¢	Zero	12.0¢
Belgium	3.0¢	1.9¢	9.2¢	14.1¢
Bermuda	4.5¢	1.9¢	3.5¢	9.9¢
Brazil	6.6¢	3.4¢	17.8¢	27.8¢
Chile	2.9¢	3.4¢	12.3¢	18.6¢
China	8.7¢	4.8¢	4.2¢	17.7¢
Colombia	5.1¢	4.8¢	8.6¢	18.5¢
Costa Rica	3.3¢	4.8¢	2.2¢	10.3¢
Czech Republic	8.1¢	3.4¢	7.5¢	19.0¢
Denmark	5.9¢	1.9¢	6.6¢	14.4¢
Dominican Republic	3.6¢	4.8¢	6.1¢	14.5¢
Ecuador	2.9¢	4.8¢	2.6¢	10.3¢
Egypt	10.4¢	4.8¢	2.0¢	17.2¢
El Salvador	5.9¢	4.8¢	1.1¢	11.8¢
France	2.9¢	1.9¢	12.7¢	17.5¢
Germany	4.3¢	1.9¢	13.6¢	19.8¢
Greece	5.2¢	3.4¢	14.4¢	23.0¢
Guatemala	3.1¢	4.8¢	2.4¢	10.3¢
Guyana	6.6¢	4.8¢	0.6¢	12.0¢
Haiti	8.6¢	4.8¢	17.0¢	30.4¢
Honduras	3.1¢	4.8¢	8.7¢	16.6¢
Hong Kong	5.1¢	1.9¢	Zero	7.0¢
Hungary	6.1¢	3.4¢	4.9¢	14.4¢
India	8.1¢	4.8¢	18.3¢	31.2¢
Indonesia	6.8¢	4.8¢	23.9¢	35.5¢
Ireland	2.7¢	1.9¢	13.4¢	18.0¢
Israel	4.2¢	1.9¢	2.4¢	8.5¢
Italy	4.8¢	1.9¢	11.5¢	18.2¢
Jamaica	2.9¢	4.8¢	1.0¢	8.7¢
Japan	6.5¢	1.9¢	11.3¢	19.7¢
Jordan	15.9¢	4.8¢	2.3¢	23.0¢
Kenya	25.5¢	4.8¢	12.3¢	42.6¢
Korea	5.1¢	3.4¢	4.3¢	12.8¢
Kuwait	7.1¢	1.9¢	Zero	9.0¢
Malaysia	6.6¢	3.4¢	12.4¢	22.4¢
Mexico	0.9¢	3.4¢	12.5¢	16.8¢
Netherlands	2.6¢	1.9¢	5.3¢	9.8¢
New Zealand	5.7¢	1.9¢	16.2¢	23.8¢
Nicaragua	3.8¢	4.8¢	3.7¢	12.3¢
Norway	3.2¢	1.9¢	6.5¢	11.6¢
Pakistan	14.7¢	4.8¢	7.2¢	26.7¢
Panama	4.7¢	4.8¢	9.9¢	19.4¢
Peru	5.8¢	4.8¢	5.5¢	16.1¢
Philippines	6.5¢	4.8¢	12.6¢	23.9¢
Poland	4.7¢	4.8¢	15.1¢	24.6¢
Portugal	4.6¢	1.9¢	17.4¢	23.9¢
Russia	5.4¢	4.8¢	25.2¢	35.4¢
Singapore	5.0¢	1.9¢	0.7¢	7.6¢
South Africa	5.2¢	3.4¢	8.3¢	16.9¢
Spain	4.8¢	1.9¢	11.4¢	18.1¢
Sweden	3.6¢	1.9¢	4.5¢	10.0¢

APPENDIX D: Tariffed Component Prices

Country	International Transmission	International Switching	National Extension	Tariffed Component Price
Switzerland	4.4¢	1.9¢	14.3¢	20.6¢
Taiwan	5.7¢	1.9¢	6.3¢	13.9¢
Thailand	4.0¢	4.8¢	8.3¢	17.1¢
Trinidad	3.6¢	3.4¢	7.6¢	14.6¢
Turkey	5.4¢	4.8¢	7.7¢	17.9¢
United Arab Emirates	3.3¢	1.9¢	2.5¢	7.7¢
United Kingdom	2.4¢	1.9¢	8.7¢	13.0¢
Uruguay	12.7¢	3.4¢	6.2¢	22.3¢
Venezuela	3.7¢	4.8¢	15.3¢	23.8¢
Vietnam	9.3¢	4.8¢	10.6¢	24.7¢

APPENDIX E

Tariffed Components Price Methodology

I. Introduction

In this Appendix, we describe the "tariffed components price" (TCP) methodology which we adopt in this *Order* as the basis for calculating international settlement rate benchmarks. Pursuant to this methodology, we develop prices for each of the three network elements that are used to provide international telephone service. We describe in this Appendix the structural framework we developed to calculate these prices, as well as the data collection procedures and tariff rate information we used as inputs in the model. We explain the estimation procedures we used to compute the network element prices, including the underlying assumptions for each element, and present several examples to demonstrate the estimation procedures. Finally, we provide a summary of each country's prices and append the underlying basic tariff rate information for each of the countries in the study.

Pursuant to the TCP methodology, we calculate prices for the three network elements that are used to provide international message telephone service (IMTS) identified by the International Telecommunication Union's Telecommunication Standardization Sector (ITU-T) in Recommendation D.140.¹ These three elements are: (1) international transmission facilities; (2) international switching facilities; and (3) national extension (domestic transport and termination). We use foreign carriers' unbundled tariff rates to calculate a price for two of these elements and information published by the ITU to calculate a price for the remaining element. The prices we calculate are based on cost components identified by the ITU for each element. We refer to these prices as the "tariffed component price" of each element, and the sum of these prices for each foreign carrier as the "tariffed components price" (TCP).

Table 1 summarizes the TCPs for each country. More detailed results, which include each of the component elements described in this report, are presented in Tables 2 through 5.

¹ See ITU-T Recommendation D.140, *Charging and Accounting Rate Principles for International Telephone Service, Annex A, "Guidelines for the cost elements to be taken into account when determining accounting rates and accounting rate shares for the international telephone service,"* Geneva (1992). ITU-T Recommendation D.140 calls for transparent, cost-oriented, nondiscriminatory accounting rates.

Table 1. Tariffed Components Prices
(per minute)

<u>Country</u>	<u>TCP</u>	<u>Country</u>	<u>TCP</u>
Argentina	32.1¢	Jordan	23.0¢
Australia	18.7¢	Kenya	42.6¢
Austria	31.4¢	Korea	12.8¢
Bahamas	19.9¢	Kuwait	9.0¢
Barbados	12.0¢	Malaysia	22.4¢
Belgium	14.1¢	Mexico	16.8¢
Bermuda	9.9¢	Netherlands	9.8¢
Brazil	27.8¢	New Zealand	23.8¢
Chile	18.6¢	Nicaragua	12.3¢
Colombia	18.5¢	Norway	11.6¢
Costa Rica	10.3¢	P.R. of China	17.7¢
Czech Republic	19.0¢	Pakistan	26.7¢
Denmark	14.4¢	Panama	19.4¢
Dominican Rep.	14.5¢	Peru	16.1¢
Ecuador	10.3¢	Philippines	23.9¢
Egypt	17.2¢	Poland	24.6¢
El Salvador	11.8¢	Portugal	23.9¢
France	17.5¢	Russia	35.4¢
Germany	19.8¢	Singapore	7.6¢
Greece	23.0¢	South Africa	16.9¢
Guatemala	10.3¢	Spain	18.1¢
Guyana	12.0¢	Sweden	10.0¢
Haiti	30.4¢	Switzerland	20.6¢
Honduras	16.6¢	Taiwan	13.9¢
Hong Kong	7.0¢	Thailand	17.1¢
Hungary	14.4¢	Trinidad	14.6¢
India	31.2¢	Turkey	17.9¢
Indonesia	35.5¢	U.A.E.	7.7¢
Ireland	18.0¢	United Kingdom	13.0¢
Israel	8.5¢	Uruguay	22.3¢
Italy	18.2¢	Venezuela	23.8¢
Jamaica	8.7¢	Vietnam	24.7¢
Japan	19.7¢		

II. Structural Framework

The TCP methodology is based on the framework for calculating cost-oriented accounting rates set forth in ITU-T Recommendation D-140. Recommendation D.140 describes the guidelines for cost elements used by carriers to terminate international calls and identifies the three network elements that are used to provide international telephone service: (1) international transmission facilities, (2) international switching facilities, and (3) national extension. International transmission facilities consist of international terrestrial transmission or submarine cables, international satellite transmission, or a combination of these facilities. The facilities that comprise this network element include the links between the earth stations or cable landing stations and the international switching facilities. International switching facilities consist of international switching centers, including their associated transmission and signalling equipment. Finally, the national extension element includes that part of the national exchanges, national transmission facilities, and the local loop (if specified in the operating agreement between carriers) that is used to terminate international telephone service.

In the absence of information about foreign carriers' costs of terminating international traffic, we use foreign carriers' tariff rates that correspond to the network elements of the

structural framework adopted by the ITU-T in Recommendation D.140 and information published by the ITU to calculate benchmarks that more closely approximate costs than current settlement rates.

III. Data Collection

The data we use to calculate settlement rate benchmarks was obtained through a study of foreign carriers' tariffed rates undertaken by the International Bureau. The Bureau included seventy-one countries in its original study sample. The Bureau selected sixty of the countries in the study because they represent the largest volumes of international service with the United States and the remaining eleven countries to ensure proper representation of all geographic regions. These countries accounted for 95 percent of the U.S. international telephone traffic in 1994.²

The Bureau sent a questionnaire to these seventy one-countries seeking tariff information for international dedicated (private line) services from each country to the United States and for local and long distance service within the countries. The Bureau received data for the study from published tariffs or directly from the carriers. The data collection period was the fourth quarter of 1995 through June 1996. During this time, the Bureau supplemented the original information with revisions and corrections. Responses from sixty-five countries contained information that the Bureau deemed usable for the study. The Bureau excluded the other six countries from the study due to data deficiencies.

Data for the International Transmission Component: International telephone service between the United States and most countries included in the sample is transmitted over international telephone networks equipped with high speed digital circuits, either T1 (1.544 Mbps) or E1 (2.048 Mbps) circuits. Most carriers offer international dedicated service to their customers using the same type of high capacity circuit. Thus, we use foreign carriers' private line rates for dedicated circuits to calculate the TCP for the international transmission component. The Bureau sought in its questionnaire detailed information for all available rates for international dedicated services between the sample countries and the United States, such as the tariff rates for service offerings of all pertinent bandwidths, the transport media used to provide the service offerings, the availability of multi-year pricing plans, and any volume discount options offered to users. Such tariff information is not available for all the countries in the Bureau's study. The carriers in Guyana and Haiti, for example, do not publish tariffs for international dedicated circuits, but they offer dedicated service to the United States under negotiated rates. For these two carriers, we use the highest tariff rate for dedicated service to the United States using a T1 or E1 circuit from another country in the same region as a proxy for the tariff rate for service from Guyana and Haiti. For Guyana, we use the price of an E1 circuit available for international service in Brazil. For Haiti, we use the price for a T1 circuit in Barbados. For other carriers that do not offer international dedicated service with either T1 or E1 circuits, we use the published

² The countries and their associated minutes of service for 1994 are listed in Attachment A.

tariff rate for the highest bandwidth circuit.³ We list the tariffs for international dedicated service used in the study in Attachment C.

Data for the National Extension Component: For the national extension component, the Bureau solicited detailed information in its questionnaire on the prices charged to the carriers' customers in each country for domestic direct dialed telephone service. For each country in the sample, the Bureau collected information on the tariff rates for all available rate periods and rate bands, primarily from public telephone directories. This information includes the hours of the day and days of the week when the rates are in effect, and the distances for the rate bands. The Bureau also collected information on volume pricing plans for domestic telephone service, network configuration for international telephone traffic, domestic numbering plan, and other related information. The tariffs for domestic telephone service used in the study are characterized by substantial structural variations. The number of rate periods, for example, varies from one to five, and the number of mileage rate bands ranges from one to fourteen. Several carriers have tariffs with different rate periods for local service and long distance service. In three of the countries in the study, Barbados, Hong Kong, and Kuwait, consumers are not charged on a per minute basis for domestic calls. Some carriers offer volume discounts, *e.g.*, Germany, Japan and Norway. These discounts are factored into the study. We provide a detailed summary of the tariff rates for domestic public switched telephone service used in the study in Attachment D.

Data for the International Switching Component: We use data published by the ITU-T to calculate a TCP for the international switching facilities rate component.⁴

IV. Estimation Procedures

We use the information collected from the Bureau's study, along with ITU-T data, to estimate a price per minute to terminate switched message telephone service from the United States. As noted above, we refer to the composite of the prices for each network element as the tariffed components price (TCP) of a country. Again, the three network elements are: (1) international transmission facilities; (2) international switching facilities; and (3) costs associated with the local distribution (or "national extension") of calls within the country. The methods we use to compute the price for each element are discussed below.

A. International Transmission Facility Tariffed Component Prices

³ The countries that fall into this category are Argentina, Kenya, Nicaragua, and Uruguay. For Argentina, we use the tariff rate for a 512 Kbps circuit. For the others, we use tariff rates for a 128 Kbps circuit.

⁴ See ITU-T Recommendation D.300R, *Recommendations for Regional Application, "Determination of accounting rate shares in telephone relations between countries in Europe and the Mediterranean Basin,"* Geneva (1995).

Many carriers offer international private line service to their customers using high capacity circuits. Typically, these are 1.5 or 2.0 Mbps circuits. These circuits are functionally equivalent to the dedicated circuits used by carriers to provide IMTS. For international telephony, carriers use high capacity circuits (*e.g.*, 1.5 or 2.0 Mbps facilities) to interconnect with U.S. facilities-based carriers. We therefore use the rates charged by carriers for dedicated private line service to calculate a TCP for the international transmission component.⁵ If a carrier offers private line service to its customers using high-speed digital facilities, we use the rate charged for that service. If a carrier offers private line service using slower speed facilities, we use the tariff rate charge for that service to calculate the TCP for the international transmission component. Some carriers offer multi-year service options at reduced rates to their customers. Others offer reductions from their tariff rates to customers with large billings. We reflect these options where applicable in our calculations. The tariff rates we use to calculate the international transmission component, including the service bandwidth and time period, are shown in Attachment C.

To calculate a TCP for the international transmission component of a carrier's settlement rate, we must convert the monthly private line rates to a charge per minute. We do this by first calculating the number of voice grade circuits that are derived from a private line half-channel. A 2.048 Mbps half-channel is comprised of thirty 64 Kbps circuits.⁶ Each 64 Kbps circuit can be multiplexed to produce voice grade circuits capable of completing switched international calls. Digitalization capabilities enable carriers to derive a range of voice grade circuits from a 64 Kbps half-channel. Typically, U.S. facilities-based carriers derive about four voice grade circuits from a 64 Kbps half-channel for IMTS, although substantially more circuits are possible.⁷ Because the general practice among U.S. carriers is to derive four voice grade circuits from a 64 Kbps half-channel, we use a multiplication factor of 4:1 to calculate the number of voice grade circuits derived from a private line half-channel. Using a multiplication factor of 4:1, we find that 120 equivalent voice grade circuits can be derived from a 2.048 Mbps half-channel.

⁵ As noted, the carriers in Guyana and Haiti do not publish their tariffs for international dedicated service. They do, however, offer the service at rates that are negotiated but not disclosed. In order to include these countries in the study, we used the highest available tariff for comparable service in the respective region as a proxy for these countries' unpublished data. For service with Guyana, we used the tariff for 2.048 Mbps service in Brazil. For service with Haiti, we used the tariff for 1.544 Mbps service in Barbados.

⁶ A 1.544 Mbps half-channel is comprised of twenty-four 64 Kbps circuits, a 512 Kbps half-channel is comprised of eight 64 Kbps circuits, and a 128 Kbps half-channel is comprised of two 64 Kbps circuits.

⁷ Many multiplication factors are used to provide IMTS with the advent of digitalization of international circuits in the late 1980's. In the reseller market, for example, 5:1 or 6:1 multiplication factors are common, and figures of 8:1 or 10:1 have been reported. U.S. facilities-based carriers generally derive about four voice grade circuits from a half channel for IMTS with foreign carriers. Other things being equal, the cost per minute for the international transmission component is inversely related to the multiplexing ratio that is used. In other words, as the number of circuit per half channel increases, the cost per minute decreases.

We next estimate the rate per minute for the voice grade circuits using monthly minutes transmitted over a circuit. Monthly minutes transmitted over international circuits vary from country to country, from carrier to carrier, and from month to month. Recent operating experience of U.S. facilities-based carriers suggests that about 8,000 minutes of voice traffic per circuit per month represents a reliable and reasonable usage level for the countries included in the study. This figure represents a usage level of less than twenty percent and, therefore, may be a bit conservative. It suggests that significantly higher levels of usage can be transmitted over international circuits. Nonetheless, to be conservative in our estimates, we use a usage level of 8,000 minutes per month to convert the private line rates to a per minute charge.

We present here two examples to demonstrate how we use carriers' private line tariffs to calculate the TCP for the international transmission component.

Example 1. France. International private line service offered by France Telecom provides an example involving an E1 circuit (2.048 Mbps). France Telecom's monthly tariff rate for an E1 circuit with a lease period of five years for service to the United States is 167,300 French Francs (FF). France Telecom offers a 15 percent discount to customers with a monthly billing of more than 300,000 FF. Because U.S. facilities-based carriers generate monthly bills that exceed 300,000 FF, they are entitled to the discount. Allowing for the 15 percent discount in France Telecom's tariff rate reduces the monthly charge to 142,205 FF per circuit, at an exchange rate of US\$ 1.00=5.16 FF. With thirty 64 Kbps circuits to an E1 half-channel, a multiplication factor of 4:1, and a usage level of 8,000 minutes per circuit per month, 960,000 minutes are transmitted over an E1 half-channel in an average month. Thus, France Telecom's monthly tariff rate, after the discount, is equal to an average charge of \$0.029 per minute for the international transmission facility component for service from the United States to France.

Example 2. Uruguay. Uruguay provides an example of the procedure used in the study to estimate the international transmission facility component for flat rate private line service transmitted over a circuit with lower bandwidth than an E1 half-channel (*i.e.*, there is no reduction from the tariff rate for a multi-year lease and no discount for large volume customers). Service is offered with a 128 Kbps half-channel. ANTEL's tariff rate for this service, at an exchange rate of US\$ 1.00=New Pesos 7.53, is \$8,131 per month. There are no adjustments in this rate. With two 64 Kbps circuits to a half-channel, a multiplication factor of 4:1, and a usage level of 8,000 minutes per circuit per month, 64,000 minutes are transmitted over a half-channel in an average month. Thus, ANTEL's monthly tariff rate is equivalent to an average charge of \$0.127 per minute for the international transmission facility component for service between the United States and Uruguay.

A summary of the international transmission TCP is presented in Table 2 and included in Attachment B.

Table 2. International Transmission Tariffed Component Prices
(per minute)

<u>Country</u>	<u>TCP</u>	<u>Country</u>	<u>TCP</u>
Argentina	6.7¢	Jordan	15.9¢
Australia	4.8¢	Kenya	25.5¢
Austria	8.1¢	Korea	5.1¢
Bahamas	5.2¢	Kuwait	7.1¢
Barbados	8.6¢	Malaysia	6.6¢
Belgium	3.0¢	Mexico	0.9¢
Bermuda	4.5¢	Netherlands	2.6¢
Brazil	6.6¢	New Zealand	5.7¢
Chile	2.9¢	Nicaragua	3.8¢
Colombia	5.1¢	Norway	3.2¢
Costa Rica	3.3¢	P.R. of China	8.7¢
Czech Republic	8.1¢	Pakistan	14.7¢
Denmark	5.9¢	Panama	4.7¢
Dominican Rep.	3.6¢	Peru	5.8¢
Ecuador	2.9¢	Philippines	6.5¢
Egypt	10.4¢	Poland	4.7¢
El Salvador	5.9¢	Portugal	4.6¢
France	2.9¢	Russia	5.4¢
Germany	4.3¢	Singapore	5.0¢
Greece	5.2¢	South Africa	5.2¢
Guatemala	3.1¢	Spain	4.8¢
Guyana	6.6¢	Sweden	3.6¢
Haiti	8.6¢	Switzerland	4.4¢
Honduras	3.1¢	Taiwan	5.7¢
Hong Kong	5.1¢	Thailand	4.0¢
Hungary	6.1¢	Trinidad	3.6¢
India	8.1¢	Turkey	5.4¢
Indonesia	6.8¢	U.A.E.	3.3¢
Ireland	2.7¢	United Kingdom	2.4¢
Israel	4.2¢	Uruguay	12.7¢
Italy	4.8¢	Venezuela	3.7¢
Jamaica	2.9¢	Vietnam	9.3¢
Japan	6.5¢		

B. International Switching Facility Tariffed Component Prices

There is little information in the public domain concerning the international switching facility component. Carriers in Sweden and the United Kingdom have termination tariffs which could serve as a reference point for international switching costs incurred by a correspondent but these arrangements may not be representative of other countries in the study.⁸ In other cases, developing a reasonable estimate is a complex procedure because a correspondent's switch is often used for domestic service, both local and long distance calls, and for international service, both originating and terminating calls. Thus, even if relevant information is available, potentially complex cost allocation and relative usage problems would need to be addressed in order to develop separate estimates for the international switching facility component.

⁸ Telia, the domestic carrier in Sweden, has an interconnect tariff which allows competing international carriers to interconnect with its domestic network. The tariff has two components: a monthly connection point charge of approximately \$6,000, and fixed monthly charge of approximately \$73 per facility, e.g., 2.048 Mbps circuit. These fixed charges are equivalent to a monthly rate of \$0.003 per minute for usage of 8,000 minutes per circuit.

Fortunately, the ITU-T has published information used by TEUREM member countries⁹ for telephone settlements among them.¹⁰ These countries base settlements on accounting rate shares for each of the three network elements identified in ITU-T Recommendation D.140: international transmission, international exchange, and national extension. The accounting rate shares for each network element, which are denominated in SDRs, vary with the proportion of plant capacity composed of digital equipment relative to total plant capacity. The accounting rate share declines as the digitalization capability rises to reflect the greater efficiency of digital equipment. The digitalization categories are: (1) 0-30%, (2) 31-60%, and (3) 61-100%. To determine settlements for the international exchange component, TEUREM countries use an accounting rate share of 0.0324 SDR (about \$0.048) for the first category, 0.0228 SDR (about \$0.034) for the second category, and 0.129 SDR (about \$0.019) for the third category. Using these digitalization categories, TEUREM countries calculate accounting rate share figures from data filed by the member countries.

We use the accounting rate share information published in ITU-T Recommendation D.300R to calculate the TCP for the international transmission component. However, we must devise a basis for assigning digitalization categories to countries, as the results presented in ITU-T Recommendation D.300R do not list the countries that fall into each digitalization category. Generally, telecommunications networks in developing countries are less technologically advanced and, therefore, have lower levels of digital equipment than those in industrialized countries. We therefore use TEUREM's highest accounting rate share figure for the international exchange component, 0.0324 SDR, to estimate the TCP for the international switching component for the least developed countries in the study. We use the lowest figure, 0.0129 SDR, for the most developed countries, and the middle figure, 0.0228, for other countries.

For purposes of assigning digitalization categories to countries, we classify countries according to their level of economic development. We use the World Bank's classification scheme,¹¹ which is also used by the ITU.¹² This classification scheme has four categories:

⁹ ITU-T Recommendation D.300R. *See supra*, n.4. An exchange rate 1.0 SDR = \$1.48 is used to convert the TEUREM figures to U.S. dollar figures.

¹⁰ The TEUREM results are based on analyses of operating results conducted by a range of member carriers that provide service in industrialized and developing countries. The TEUREM group are: Albania, Algeria, Andorra, Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Gibraltar, Germany, Greece, Greenland, Hungary, Ireland, Israel, Italy, Lebanon, Libya, Liechtenstein, Luxembourg, Malta, Monaco, Morocco, Netherlands, Norway, Poland, Romania, San Marino, Spain, Sweden, Switzerland, Syria, Tunisia, Turkey, United Kingdom, Russia, Vatican City State, and Yugoslavia.

¹¹ *See Social Indicators of Development*, World Bank, Washington, D.C. (1996).

¹² *See World Telecommunication Indicators 1994/1995*, International Telecommunication Union, Geneva (1995).

- low income, GNP per capita of \$726 or less;
- lower middle income, GNP per capita between \$726 and \$2,895;
- upper middle income, GNP per capita between \$2,896 and 8,955; and
- high income, GNP per capita greater than \$8,955.

Table 3 lists the countries in the study by their level of economic development.

Table 3. Economic Development Classification

<u>Low</u>	<u>Lower Middle</u>	<u>Upper Middle</u>	<u>High</u>
Egypt	Colombia	Argentina	Australia
Guyana	Costa Rica	Barbados	Austria
Haiti	Dominican Rep.	Brazil	Bahamas
Honduras	Ecuador	Chile	Belgium
India	El Salvador	Czech Republic	Bermuda
Kenya	Guatemala	Greece	Denmark
Nicaragua	Indonesia	Hungary	France
P.R. China	Jamaica	Korea, Rep.	Germany
Pakistan	Jordan	Malaysia	Hong Kong
Vietnam	Panama	Mexico	Ireland
	Peru	South Africa	Israel
	Philippines	Trinidad & Tobago	Italy
	Poland	Uruguay	Japan
	Russian Fed.		Kuwait
	Thailand		Netherlands
	Turkey		New Zealand
	Venezuela		Norway
			Portugal
			Singapore
			Spain
			Sweden
			Switzerland
			Taiwan
			U.A.E.
			United Kingdom

A summary of the international switched facilities TCP is presented in Table 4 and included in Attachment B.

Table 4. International Switched Facilities Tariffed Component Prices
(per minute)

<u>Country</u>	<u>TCP</u>	<u>Country</u>	<u>TCP</u>
Argentina	3.4¢	Jordan	4.8¢
Australia	1.9¢	Kenya	4.8¢
Austria	1.9¢	Korea	3.4¢
Bahamas	1.9¢	Kuwait	1.9¢
Barbados	3.4¢	Malaysia	3.4¢
Belgium	1.9¢	Mexico	3.4¢
Bermuda	1.9¢	Netherlands	1.9¢
Brazil	3.4¢	New Zealand	1.9¢
Chile	3.4¢	Nicaragua	4.8¢
Colombia	4.8¢	Norway	1.9¢
Costa Rica	4.8¢	P.R. of China	4.8¢
Czech Republic	3.4¢	Pakistan	4.8¢
Denmark	1.9¢	Panama	4.8¢
Dominican Rep.	4.8¢	Peru	4.8¢
Ecuador	4.8¢	Philippines	4.8¢
Egypt	4.8¢	Poland	4.8¢
El Salvador	4.8¢	Portugal	1.9¢
France	1.9¢	Russian Fed.	4.8¢
Germany	1.9¢	Singapore	1.9¢
Greece	3.4¢	South Africa	3.4¢
Guatemala	4.8¢	Spain	1.9¢
Guyana	4.8¢	Sweden	1.9¢
Haiti	4.8¢	Switzerland	1.9¢
Honduras	4.8¢	Taiwan	1.9¢
Hong Kong	1.9¢	Thailand	4.8¢
Hungary	3.4¢	Trinidad	3.4¢
India	4.8¢	Turkey	4.8¢
Indonesia	4.8¢	U.A.E.	1.9¢
Ireland	1.9¢	United Kingdom	1.9¢
Israel	1.9¢	Uruguay	3.4¢
Italy	1.9¢	Venezuela	4.8¢
Jamaica	4.8¢	Vietnam	4.8¢
Japan	1.9¢		

C. National Extension Tariffed Component Prices

The calculation of the TCP for the national extension component requires several steps. The first step is to determine the distribution of international calls from the United States within each country included in the study. The distribution categories vary with the tariff rate classifications for local and toll service within each country. The categories could include time of day, day of the week, mileage, etc., depending upon the carrier's tariff schedule. We distribute international calls from the United States among service classifications, time periods, and the destination of the calls using information collected on customers' calls during a three month period that began on January 6, 1996.¹³ In many countries, most calls from the United States terminate in major metropolitan areas. In many cases, more than 70 percent of the calls fall into this category. Tariff rates for service in metropolitan areas are generally significantly lower than those

¹³ Call distribution information was collected for AT&T's network. The data collected during the sampling period was made available on the record by AT&T on a confidential basis. *See Order Granting Motion for Confidential Treatment*, IB Docket No. 96-261, DA-97-1563 (rel. July 23, 1997).

for calls to remote areas. In Argentina, for example, calls within Buenos Aires have a rate during the normal period of \$0.021 per minute as compared to \$1.418 per minute for a call transmitted beyond 600 kilometers.

The second step in developing an estimate for the national extension TCP is to determine the distance from the foreign international exchange switch through which the calls pass en route to their final destination. This determination is necessary because domestic rates in many countries included in the sample vary with distance.

The third step of the estimation process is to select the appropriate tariff rate to use for the minutes in each distribution category. We use the lowest rate offered by a carrier for each of its different tariff elements. In those cases where a carrier offers a discount available for large volumes of domestic service, the discount is used to calculate the estimates. In Japan, for example, NTT offers volume discounts ranging from 5 to 25 percent, which are reflected in the estimates of the national extension component for Japan. We present a complete list of the national tariffs we use to calculate the national extension component in Attachment D.

The final step is to develop a country's national extension TCP. We derive the TCP from the information about the distribution of international calls from the United States among tariff rate categories, the destination points within a country, and the distance from a country's international gateway switch or switches. The result is a figure that is weighted by each country's distribution of minutes from the United States among service and tariff rate categories, the particular domestic telephone service tariff schedule, and the distribution of calls throughout the country.

We present here two examples to demonstrate how we use carriers' national tariffs to calculate the TCP for the international transmission component.

Example 1. Argentina. Argentina presents an uncomplicated example of the process used to estimate a national extension component. Call distribution information for service from the United States to this country shows that 80 percent of U.S. service terminates in the Buenos Aires area. The local domestic charge for minutes in this area is \$0.021 per minute. There are ten mileage rate bands in Argentina but only a small amount of international traffic from the United States terminates in each rate band. In order to simplify the estimation process without a significant loss in accuracy, the minutes terminating outside the area of Buenos Aires are combined into two categories and the highest rate for each category is used. Thus, all minutes that terminated in mileage rate bands 2 through 6 are combined and the tariff rates for rate band 6 (as shown in Attachment D) are used for these minutes. Similarly, all minutes terminating in mileage rate bands 7 through 10 are combined and the tariff rates for rate band 10 (as shown in Attachment D) are used in the calculation. The result is an estimated national extension TCP of \$0.22 per minute for Argentina.

Example 2. India. India has a complicated tariff rate schedule for service within the country and international service from the United States is more widely distributed throughout the country than is the case with Argentina. These two features of service with India add to the difficulty in estimating the national extension TCP. In addition, there are four international gateway switches that serve the entire country. This last factor means that, in order to estimate India's national extension TCP, it is necessary to locate each city calling code in relation to the nearest gateway switch. We plot the seven mileage rate bands for domestic service in India around each international gateway switch and assign the appropriate city calling code to the proper rate band based on the distance from the nearest gateway switch. We determine the percentage of traffic in each rate band by combining the appropriate city code and international gateway switch. We group international traffic from the United States by the seven mileage rate bands with time-of-day weighted prices. The resulting rates range from \$0.02 per minute to \$0.789 per minute. Finally, we weight the weighted rates for each mileage rate band by the percentage of U.S. traffic terminating in the rate band. The resulting estimated national extension TCP for India is \$0.183.

A summary of the national extension TCPs for all countries is presented in Table 5 and included in Attachment B.

Table 5. National Extension Tariffed Component Prices
(per minute)

<u>Country</u>	<u>TCP</u>	<u>Country</u>	<u>TCP</u>
Argentina	22.0¢	Jordan	2.3¢
Australia	12.0¢	Kenya	12.3¢
Austria	21.4¢	Korea	4.3¢
Bahamas	12.8¢	Kuwait	Zero
Barbados	Zero	Malaysia	12.4¢
Belgium	9.2¢	Mexico	12.5¢
Bermuda	3.5¢	Netherlands	5.3¢
Brazil	17.8¢	New Zealand	16.2¢
Chile	12.3¢	Nicaragua	3.7¢
Colombia	8.6¢	Norway	6.5¢
Costa Rica	2.2¢	P.R. of China	4.2¢
Czech Republic	7.5¢	Pakistan	7.2¢
Denmark	6.6¢	Panama	9.9¢
Dominican Rep.	6.1¢	Peru	5.5¢
Ecuador	2.6¢	Philippines	12.6¢
Egypt	2.0¢	Poland	15.1¢
El Salvador	1.1¢	Portugal	17.4¢
France	12.7¢	Russia	25.2¢
Germany	13.6¢	Singapore	\$0.7¢
Greece	14.4¢	South Africa	8.3¢
Guatemala	2.4¢	Spain	11.4¢
Guyana	0.6¢	Sweden	4.5¢
Haiti	17.0¢	Switzerland	14.3¢
Honduras	8.7¢	Taiwan	6.3¢
Hong Kong	Zero	Thailand	8.3¢
Hungary	4.9¢	Trinidad	7.6¢
India	18.3¢	Turkey	7.7¢
Indonesia	23.9¢	U.A.E.	2.5¢
Ireland	13.4¢	United Kingdom	8.7¢
Israel	2.4¢	Uruguay	6.2¢
Italy	11.5¢	Venezuela	15.3¢
Jamaica	1.0¢	Vietnam	10.6¢
Japan	11.3¢		

V. Summary

In the absence of information about foreign carriers' costs of terminating international traffic, we must look to alternative sources of information to calculate settlement rate benchmarks. In this *Order*, we adopt the tariffed components price, or TCP methodology, to calculate settlement rate benchmarks. As described in detail in this Appendix, the TCP methodology uses foreign carriers' tariff rates that correspond to the network elements of the structural framework adopted by the ITU-T in Recommendation D.140 and information published by the ITU to calculate benchmarks.