From International Competitive Carrier to the WTO: A Survey of the FCC's International Telecommunications Policy Initiatives 1985-1998

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I. INTRODUCTION 114
II. STRUCTURAL CHARACTERISTICS AND BASIC ECONOMIC CONDITIONS OF THE INTERNATIONAL MESSAGE TELECOMMUNICATIONS SERVICE (IMTS) MARKET 116
A. *Relevant Markets* 116
B. *Supply and Demand Elasticities* 118
C. *Major Exogenous Regulatory Factors* 119
III. RELEVANT COMMISSION PRECEDENT REGARDING IMTS MARKET PERFORMANCE PRE-WTO 121
A. *The FCC's International Competitive Carrier Paradigm and Its Progeny Pre-WTO: Improperly Shifting Policy Priorities from Promoting Competition to Competitors* 121
1. International Competitive Carrier 121
a. *Relevant Product Markets* 122
b. *Relevant Geographic Market* 122
c. *Definition of Market Power* 122

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d. Merits 123
2. FCC's Foreign Affiliate Rules 124
3. The FCC's *Foreign Carrier* or "*ECO*" *Order* 128
a. The Rise of Naked Trade Concerns 128
b. The Improper Redefinition of Market Power 129
c. The New ECO Standard 130
d. Other "Public Interest" Factors 130
e. Accounting Rate Issues 131
f. Joint Marketing Agreements 132
g. Trade and the "Public Interest" 133
4. International 214 Streamlining Proceeding 136
5. Summary and Analysis 137
B. Accounting Rates and the Commission's International Settlements Policy Pre-WTO: The Expansion of Neo-Mercantilism 141
1. General Background 141
2. The FCC's January 1996 *Policy Statement* on Accounting Rate Reform 142
3. "*Flexibility*" *Order* 144
4. Settlement Rate "Benchmarks" *Notice of Proposed Rulemaking* 146
5. Summary and Analysis 148
C. Carrier-Specific Adjudications 149
1. Foreign Firms' Mergers with, and Investments in, U.S. Carriers 149
a. BT/MCI I and BT/MCI II 149
b. The Sprint/Deutsche Telekom-France Telecom Merger 153
2. Questions of Dominance and Effective Competitive Opportunities 156
a. Generic Worldwide Dominance: *The AT&T International Nondominant Petition* 156
b. Does the FCC View Competition/Antitrust Laws as Effective as Regulation? The Telecom New Zealand ECO Case 157
c. ECO and Submarine Cable Landing Rights: The TLD and C&W ECO Cases 160
d. Who Needs Market Power To Apply ECO? The MAP and APC PCS ECO Orders 164
3. Settlement Rate Disputes: The Telintar Trade War 164
D. Summary and Analysis 166
IV. THE WTO AND ITS AFTERMATH 167
A. General Overview 167

1. Brief History ... 167
   a. *The GATS* ... 168
   b. *The Inclusion of Telecommunications Under the GATS* ... 170
   c. *Enforcement of the February Accord* ... 172
2. Apparent International Policy Objectives ... 173

B. *Specific Provisions of the February Accord Regarding Switched Telephone Service* ... 174
1. Entry into "Local" Markets ... 174
2. Entry into IMTS Service ... 175
3. Regulatory Reference Paper ... 176

C. *Exactly How Open Are U.S. Markets Post-WTO?* ... 177
1. The FCC's *Benchmarks Final Order* ... 177
   a. *Pricing Methodology and Application* ... 178
   b. *Timing and Implementation* ... 182
   c. *Enforcement* ... 184
2. The FCC's *Foreign Participation Order* (WTO Implementation Proceeding) ... 187
3. The European Response ... 196

D. *Summary and Analysis* ... 199
1. Problem No. 1: "Mercantilism Rising"—that is, It Is Arguably More Difficult To Enter U.S. Markets Post-WTO than It Was Under *ECO* ... 199
2. Problem No. 2: Despite Rhetoric, FCC *Orders* Reveal that the United States Apparently Has Little Desire To Move to a Full-Circuit World and Eliminate the International Settlement-of-Accounts Regime ... 200
3. Problem No. 3: Bringing Settlement Rates in Line with "Costs" Does Not *a fortiori* Mean that Either: (a) Prices Will Decline; or (b) Telecom Providers' Revenues Will Increase ... 203
4. Problem No. 4: The FCC Apparently Believes that the Mere Potential for Foreign Carriers To Think "Evil Thoughts" Is Sufficient Justification To Impose Stringent Regulation as a Precondition of Entry ... 205
   a. *Price Squeeze-Type Conduct* ... 205
   b. *Posing a "Very High Risk" to Competition* ... 206
5. Problem No. 5: In the FCC's View, What Is Good for the Goose Does Not Necessarily Have To Be Good for the Gander—Even When the Goose Refuses To Lay Any Eggs ... 207
6. Problem No. 6: The Great Universal Service Hypocrisy (a.k.a., A Policy To Ensure that "All the Children of the

World Will Sing Together in the Spirit of Harmony and Peace") 213
V. CASE STUDY: THE BT EXPERIENCE 216
A. *Contextual Background* 216
1. Recap of *BT/MCI I & II* 216
2. Dancing Around BT's Dominance: The Cable & Wireless Nondominant Petition 217
3. Timing, Politics and Maneuvering 220
B. *The BT/MCI III Order* 221
C. *The Fallout* 225
VI. CONCLUSION 227

I. INTRODUCTION

As both the mainstream and trade press reports continue to herald, the world is in the midst of an international telecommunications revolution. With the creation and implementation of the February 1996 World Trade Organization Agreement on Basic Telecommunications Services (the February Accord or WTO Agreement), the international telecommunications community has (at least on paper) promised ostensibly to move away from markets characterized by monopolies and toward a world of competition and deregulation. The big question, however, is whether these efforts will actually lead to better economic performance in the market for international telecommunications products and services. The purpose of this Article is to examine one particular, yet extremely significant, portion of this inquiry—how much have U.S. international telecommunications policies specifically helped or hindered this process.

This Article, after surveying Federal Communications Commission (FCC or Commission) precedent from the FCC's first major international policy decision (*International Competitive Carrier*) through the FCC's implementation of the WTO Agreement (January 1, 1998), concludes that despite a few laudable achievements, several key problematic themes run throughout this time period.[1] In particular, the FCC's efforts have been marred by both the demonstrable rise of neo-mercantilism over the past several years at the expense of consumer welfare, and substantial legal and economic analytical inconsistencies and outright errors resulting from the FCC's embarrassing attempts to implement and defend this neo-mercantilist

1. This Article draws heavily from Lawrence J. Spiwak, *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definitions in a Sea of Analytical Rhetoric*, ANTITRUST REP., Dec. 1997; *Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance*, ANTITRUST REP., May 1997; *What Hath Congress Wrought? Reorienting Economic Analysis of Telecommunications Markets After the 1996 Act*, ANTITRUST, Spring 1997.

policy.[2] By adopting such economically flawed policies, therefore, the United States has achieved neither trade policy's basic goals of promoting U.S. investment abroad nor the maximization of consumer welfare under the FCC's public interest mandate. Tragically, the only tangible achievement apparently has been the delay of effective World Trade Organization (WTO) implementation of the WTO Agreement and the rise of international ill-will against the United States and, *a fortiori*, U.S. firms.[3]

To examine these issues in greater detail, this Article is comprised of three analytical strands: (1) The FCC's formulation, adaptation and modification of its *International Competitive Carrier* (also known as "dominant" carrier) paradigm during this period; (2) the FCC's policies toward international accounting rates and the implementation and adaptation of its Interna-

2. In another article, I describe in detail this policy shift in a multitude of antitrust and regulatory contexts as the doctrine of "neo-competition"—i.e., the end goal of competition (which, through rivalry, attempts to maximize consumer welfare by producing dynamic and static economic efficiencies) has been recast to something more akin to fair, competition-like outcomes accompanied by the benevolent use of "market-friendly" regulation. In other words, competition is now a zero-sum game. Neo-mercantilism is simply one component of this overall "neo-competition" philosophy. *See* Lawrence J. Spiwak, *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definitions in a Sea of Analytical Rhetoric*, ANTITRUST REP., Dec. 1997, at 2 [hereinafter Spiwak, *The Search for Meaningful Definitions*].

3. *See, e.g.*, David Molony, *WTO Basic Agreement Put on Hold as Signatories Clash over Timetable*, COMM. WK. INT'L, Jan. 19, 1998, at 1 (reporting that "signatories to the treaty claim the United States wants to take advantage of the current position by gaining early access to its trade partners' markets on more favorable terms, without having to open its own markets to foreign carriers"); *EU Presses U.S. To Change Telecoms Rules*, REUTERS, Aug. 5, 1997, *available in* LEXIS, News Library, Wires File (reporting that the European Commission warned that the United States "risks violating its world trading obligations" if it continues with mercantile-type policies—i.e., the FCC's continued policy of maintaining "broad and unclear 'public interest' factors" regarding foreign participation in the U.S. domestic telecommunications market and, in particular, the fact that the FCC allows factors such as law enforcement, foreign policy, or trade concerns to be taken into consideration, as well as accepting the concept of "very high risk to competition" as a reason for a license refusal); Albert P. Halprin, *Two Steps Backward on Open Markets*, N.Y. TIMES, July 20, 1997, at F13 ("FCC, citing the supposed requirements of Federal communications law, is . . . backpedal[ing] on major American commitments in the deal. If our nation fails to live up to its end of the bargain, so will other signatories, and this historic opportunity will be lost."). Tragically, the United States' neo-mercantile approach towards international telecoms continues to perpetuate international ill-will and harm consumer welfare even as this Article goes to press. *See* Guy Daniels, *Huffing and Puffing*, COMM. INT'L, Oct. 1998, at 8 ("As a possible trade war looms and Uncle Sam blusters over compatibility issues, . . . the European Community is holding firm in the face of determined U.S. efforts to muscle-in on the third generation mobile standards agenda"); Robert Aamoth, *One Law for the Rich*, COMM. INT'L, Nov. 1998 ("The U.S. Federal Communications Commission's international settlement rate policies have caused such disquiet in the global telecomms community that . . . several of the world's largest carriers—and their governments—are prepared to go to law to get things changed").

tional Settlement Policy (ISP) during this period; and (3) the FCC's attempts to reconcile and distinguish these sometimes contradictory, yet sometimes complementary, policies in the context of carrier-specific adjudications. Each of these strands will be examined in both a pre- and post-WTO context.

II. STRUCTURAL CHARACTERISTICS AND BASIC ECONOMIC CONDITIONS OF THE INTERNATIONAL MESSAGE TELECOMMUNICATIONS SERVICE (IMTS[4]) MARKET

To put the concept of "international telecommunications" into context, it is initially necessary to identify some of the major structural characteristics and basic economic conditions of the market.

A. *Relevant Markets*

First, try not to visualize the market for international telecommunications products and services as some sort of generic, global information superhighway. Rather, this market is made up of a series of individual country-route markets between "originating" countries and "destination" or "terminating" countries.[5] Both supply-side and demand-side factors lead to this view.

From a supply-side perspective, because carriers need to obtain operating agreements and/or regulatory approval from each terminating-country market, a carrier cannot freely provide service to a given country merely if it wishes to do so. In addition, it is very difficult for a carrier to shift its facilities from serving one country to serving another based upon market conditions because the use of relatively few cable and satellite facilities often provides less flexibility than the broader-based domestic facilities. Before reducing or adding facilities, carriers often have to obtain the acquiescence

4. The "MTS" in IMTS was AT&T's old name for standard switched telephone service.

5. Lawrence J. Spiwak, *Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance*, ANTITRUST REP., May 1997, at 22 [hereinafter Spiwak, *Reconcentration*]. For example, while some U.S. residential customers may have a significant number of friends or relatives in several different destination markets (and therefore have a need for an inexpensive, generic worldwide IMTS calling plan), most residential U.S.-outbound calls are generally made to relatives and friends left back in the old country. *Id.* Indeed, there is quite a bit of data that indicates that the majority of U.S.-outbound calls from northern California are often to the Pacific Rim; the majority of U.S.-outbound calls from southern California and the Gulf Coast are commonly to Latin America; the majority of U.S.-outbound calls from Florida are generally to Latin America and the Caribbean; and the majority of U.S.-outbound calls from the Northeast are generally to Europe, the Caribbean, and Asia. *Id.*

of the foreign correspondent in both the country in which facilities were reduced and in which they were increased.

A demand-side perspective also supports a country-pair approach. Because the demand for international telecommunications services tends to be very "country-specific," consumers do not generally view international service as a homogeneous, worldwide service.[6] Rather, demand tends to be targeted to those countries where friends and relatives may be. This demand characteristic is quite different from the demand for domestic long-distance service, where consumers tend to view the market as a single, nationwide market. That is, a U.S. consumer in Chicago (the rough mid-point of the United States) will want to be able to call New York City just as easily as California.

Given the above, the conventional way to view IMTS markets is from a *vertical* perspective, either unilaterally-originated service on country-pair specific routes, or on specific country-pair routes including both domestic and foreign originating traffic. As such, most U.S. regulatory initiatives are ostensibly concerned with preventing, or mitigating, the effects from the economic harms traditionally associated with vertical integration. These harms often include (1) raising rivals' costs (e.g., forcing rivals to enter at two levels or input foreclosure); (2) cross-subsidy/predation; or (3) a "price squeeze."[7] This is not to say, however, that vertical integration cannot produce procompetitive benefits. The most frequently acknowledged benefits of vertical efficiency include: (1) economies of scale and scope; (2) eliminating free-rider problems; (3) spreading the risk of investing/losing sunk costs; (4) coordination in design and production; (5) the elimination of double mark-up of costs; and (6) the minimization of efficiency losses suffered by foreclosed competitors.[8] Accordingly, under conventional economic and legal thought, when reviewing vertical issues, decision makers must balance procompetitive effects against likely anticompetitive harms.[9]

Notwithstanding the above, significant horizontal aspects also affect market performance. For example, there is a well-documented trend of increasing industry reconcentration, both domestically and internationally. Economies of scope can certainly have procompetitive benefits; however, economies of scope can also create the ability to engage in strategic anticompetitive conduct. Therefore, because of the significant costs of entry,

6. *See id.*

7. *Id.* at 23.

8. James W. Olson & Lawrence J. Spiwak, *Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Market Performance?*, 13 CARDOZO ARTS & ENT. L.J. 283 (1995).

9. *See supra* note 5 and accompanying text.

entry rarely occurs in "waves of competition" on a large scale basis. Rather, entry usually occurs in pin-point attacks wherever the incumbent may be the most vulnerable. Yet, if the incumbent enjoys significant economies of scope, it may attempt to allocate the defense costs of these attacks over a much wider customer base where competitive pressures may not be present. The more captive customers an incumbent may have, the more the per-unit share of defense costs will decrease. If there are enough customers to make the per-unit/customer share sufficiently *de minimis*—such that neither captive consumers nor regulators notice (or care about) this *de minimis* increase in price—then the incumbent has used its economies of scope both to deter entry and evade regulation successfully.[10]

B. Supply and Demand Elasticities

As explained more fully below, there is a sufficient amount of public data to support the conclusion that U.S. carriers face a high own-price elasticity of demand, such that customers will readily switch carriers if there is an increase in price or diminution in service. However, this demand is characterized by country-specific preferences, rather than by a preference for a homogeneous worldwide market.[11] Regarding the elasticity of supply of international facilities, there has been a demonstrable upward trend in both the number of suppliers as well as in underlying facilities. This is not to say, however, that there have not been short-term supply shortages from time to time. Given the incredible increase in international traffic minutes, there have been several periods where undersea cable capacity has in fact been constrained. In each case, however, the FCC has determined that these shortages would only be temporary as both additional capacity and new technologies would relieve these constraints.

10. *See Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance, Second edition*, PHOENIX CENTER POLICY PAPER SERIES, Policy Paper No. 2, at 32 (July 1998) (visited Nov. 1, 1998) <http://www.phoenix-center.org/pcpp/pcpp2.doc> [hereinafter PHOENIX CENTER POLICY PAPER]; but compare NYNEX Corp. and Bell Atlantic Corp., *Memorandum Opinion and Order*, 12 F.C.C.R. 19,985, para. 16, 9 Comm. Reg. (P & F) 187 (1997) [hereinafter *NYNEX/Bell Atlantic Memorandum Opinion and Order*], where an increase in market concentration can apparently enhance "regulatory efficiency" as well. (The FCC found it necessary to impose stringent reporting requirements as a condition of merger. "As diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices" because, in the FCC's view, the "Bell Companies, being of similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance.").

11. *See supra* note 5 and accompanying text.

C. Major Exogenous Regulatory Factors

It is impossible to discuss international telecommunications without understanding the international settlement-of-accounts regime. The international settlement-of-accounts regime was developed in 1865 by twenty European countries to provide for a standard, common method to divide the revenues for international service between originating and destination countries.[12] However, neither the "accounting" nor the "settlement" rate is a rate charged to end consumers. The rate charged to end consumers is called the *collection* rate, and comes under the FCC's jurisdiction under Title II of the Communications Act of 1934.

In contrast, the "accounting rate" is the privately negotiated internal price between originating and terminating carriers. The accounting rate is related, sometimes very loosely, to the carriers' end-to-end facilities cost. The carriers then agree to a "settlement" rate—usually one-half of the accounting rate—to hand-off and terminate traffic to each other in the middle of the ocean (hence the phrase "half circuit"). If there is an exact equal amount of traffic exchanged between the originating market and the destination market, then the originating and terminating carriers' "settlement of accounts" will be zero. Unfortunately, for those countries which generally have more outbound traffic than incoming traffic for nearly every international route (i.e., the United States), these settlement rates—which, because of the foreign carrier's monopoly or dominant position, are often set far above the actual costs of terminating a call—can create a substantial subsidy from the originating market's consumers to the destination market. When this occurs, the carrier who has to "settle-up" its account with its foreign correspondent effectively has to pay more to terminate a call—which therefore means it must offer a higher price for service to potential customers. Thus, if a carrier can bypass having to pay a settlement rate to its foreign correspondent, then that carrier will have a significant cost advantage over its rivals.[13]

The significance of this "dual price" system for international telephony (i.e., regulated collection rates and privately negotiated accounting rates) on market conduct and performance cannot be underestimated because carriers' net revenue for international service is a function of *both* their accounting rates as well as their collection charges. Thus, if traffic is balanced on a particular route, the value of the accounting rate is essentially irrelevant since no settlement is necessary and each carrier's revenue will depend directly on its collection charge. On the other hand, however, where traffic is

12. *See* Chapter 3, Box 3.1 of *Direction of Traffic, 1996*, ITU/TELEGEOGRAPHY INC. (1996) (visited Nov. 1, 1998) <http://www.itu.int/intset/whatare/howwork/pdf> [hereinafter *Direction of Traffic*].

13. *See* Spiwak, *Reconcentration*, *supra* note 5, at 22-23.

imbalanced, the accounting rate may have a significant effect on the commercial options of the two carriers.

For example, if a carrier has a significant incoming traffic deficit, then the settlement payments which it must make to its foreign correspondent limit its ability to reduce its collection charges. Conversely, a carrier with a net traffic surplus has little incentive to operate more efficiently or to reduce the accounting rate because of the net settlement benefits it receives under the *status quo*. For this reason, carriers that have relatively lower collection charges, often due to the competition from other carriers, and a net traffic deficit, are dissatisfied with the current accounting rate regime because the *status quo* tends to subsidize high cost monopoly carriers at the expense of lower cost carriers and end-users from competitive regimes.[14]

Basically, there are two ways a carrier can currently bypass the settlement-of-accounts regime. First, carriers can elect to build and own the entire "full" circuit between the originating and the destination/terminating market. Second, an originating carrier could merge with a foreign correspondent, and therefore also obtain a full circuit (the originating half plus the foreign termination half). Under either scenario, however, because one carrier can bypass the international settlement-of-accounts regime while other rivals (for a variety of reasons) cannot, the bottleneck now shifts away from the half circuit to the point(s) of interconnection with the network in the destination market.[15] Thus, without standard, cost-based interconnection rates for *all* carriers (both indigenous and foreign) in the destination/terminating market, a monopoly or "dominant" carrier in a terminating market with an affiliate in a high-volume originating market could potentially engage in some kind of strategic, anticompetitive behavior on that particular route.[16] As mentioned above, such strategic conduct could include, *inter alia*, raising their rivals' costs by forcing them to enter the terminating market at two different levels, a potential "price squeeze" or, depending on the structural characteristics of

14. *See Direction of Traffic*, *supra* note 12.

15. *See* Spiwak, *Reconcentration*, *supra* note 5, at 23.

16. *Id.* That is to say, while the ability to bypass the settlement-of-accounts regime certainly will enable a vertically integrated firm to realize certain economies of scale and scope that competitors may not be able to achieve immediately (and, like any other lawful business, this is not necessarily a bad thing), if a foreign correspondent also has, for example, the ability to control return traffic or charge different interconnection rates to rivals, then any alleged efficiencies resulting from vertical integration are not necessarily the result of improved operational efficiencies, but rather of strategic, anticompetitive conduct. Thus, without standard, cost-based interconnection rates for all carriers at the foreign end, given the structural characteristics discussed *supra*, vertical integration by any carrier that is either a monopolist or a dominant carrier in both the originating and terminating markets could significantly distort the market performance of those IMTS routes, which are in high demand by consumers in its core territory (e.g., U.S./U.K., U.S./Japan, U.S./Germany, U.S./Mexico, U.S./Jamaica). *Id.* (citation omitted).

the originating and terminating markets, some kind of predatory conduct by a local affiliate of a dominant foreign firm.

III. RELEVANT COMMISSION PRECEDENT REGARDING IMTS MARKET PERFORMANCE PRE-WTO

A. *The FCC's International Competitive Carrier Paradigm and Its Progeny Pre-WTO: Improperly Shifting Policy Priorities from Promoting Competition to Competitors*

1. International Competitive Carrier[17]

This Article begins with a discussion of the FCC's decision to apply its domestic "competitive carrier" paradigm to the international market because this decision marks the first clear statement by the FCC that, with proper regulatory incentives and constraints, it was possible to promote competition for international service—in addition to domestic long-distance service.[18] In

17. International Competitive Carrier Policies, *Notice of Proposed Rulemaking*, 100 F.C.C.2d 1270 (1985) [hereinafter *Int'l Competitive Carrier NPRM*], *Report and Order*, 102 F.C.C.2d 812, 59 Rad. Reg. 2d (P & F) 283 (1985) [hereinafter *Int'l Competitive Carrier Report and Order*], *recons. denied*, 60 Rad. Reg. 2d (P & F) 1435 (1986).

18. *See* Policy & Rules Concerning Rates for Competitive Common Carrier Servs. & Facilities Authorizations Therefor, *First Report and Order*, 85 F.C.C.2d 1, 52 Rad. Reg. 2d (P & F) 215 (1980) [hereinafter *Competitive Common Carrier First Report and Order*], *Second Report and Order*, 91 F.C.C.2d 59, 52 Rad. Reg. 2d (P & F) 187 (1982), *Order on Reconsideration*, 93 F.C.C.2d 54, 53 Rad. Reg. 2d (P & F) 735 (1983), *Third Report and Order*, 48 Fed. Reg. 46,791 (1983), *Fourth Report and Order*, 95 F.C.C.2d 554, 56 Rad. Reg. 2d (P & F) 1198 (1983), *vacated*, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), *cert. denied*, MCI Telecomm. Corp. v. AT&T, 509 U.S. 913 (1993), *Fifth Report and Order*, 98 F.C.C.2d 1191, 56 Rad. Reg. 2d (P & F) 1204 (1984), *Sixth Report and Order*, 99 F.C.C.2d 1020, 57 Rad. Reg. 2d (P & F) 1391 (1985), *rev'd*, MCI Telecomm. Corp. v. FCC, 765 F.2d 1186 (D.C. Cir. 1985).

The idea behind the *Competitive Carrier* paradigm was relatively simple: AT&T, as the "dominant" carrier, would be subject to all existing regulations—i.e., rate of return and then later price cap regulation, all new tariffs would continue to be suspended for 45 days before any new rate could go into effect, numerous reporting requirements, and the like. However, in order to accelerate entry into the long-distance market (and therefore improve market performance to a level of sufficient rivalry such that regulation could eventually be removed altogether), the Commission basically removed all regulatory barriers to entry for new entrants. Spiwak, *Reconcentration*, *supra* note 5, at 19 & n.8.

In addition, the Commission—via its 1980 MTS/WATS resale decision, *see, e.g.*, Resale and Shared Use of Common Carrier Domestic Public Switched Network Servs., *Report and Order*, 83 F.C.C.2d 167, 48 Rad. Reg. 2d (P & F) 1067 (1980)—helped new entrants, *inter alia*, to appear to consumers that they had a nationwide, facilities-based presence until their networks could be completed. As a result of this paradigm, the long-distance market was transformed from a market characterized by a single dominant firm with a small competitive fringe, to a market characterized by a highly elastic supply (both in capacity and in the number of competing firms), an extremely high churn rate, and a

other words, in the Commission's opinion, there was finally a sufficient competitive rivalry in the international market to impose "streamlined" Title II regulation on nondominant international carriers of international service.

a. *Relevant Product Markets*

The Commission basically divided the international market into two groups: International Message Telecommunications Service (IMTS) and non-IMTS service.[19] The Commission found the latter market competitive; the former it did not. For purposes of analysis, therefore, this Article will focus exclusively on IMTS services from this point forward.

b. *Relevant Geographic Market*

Because of the significant regulatory approvals and individual operating agreements required to provide IMTS service to more than one country, the Commission concluded that each country-pair IMTS route should be considered to be a separate, distinct geographic market.[20]

c. *Definition of Market Power*

The Commission decided to adopt the same standard to define market power in the IMTS context as it used in the domestic context—that is, the "power to control prices or exclude competition."[21] Moreover, the Commission recognized that while any determination of an international carrier's dominance or nondominance is not "scientifically precise," there are several nonexclusive factors, such as market share, control of bottleneck facilities, rate of return, as well as the existence of actual or potential competition that could indicate the possession of market power.[22]

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demonstrated trend of declining prices and increasing services. *See* Lawrence J. Spiwak, *What Hath Congress Wrought? Reorienting Economic Analysis of Telecommunications Markets After the 1996 Act*, ANTITRUST, Spring 1997, at 35 [hereinafter *Economic Analysis*]; Spiwak, *Reconcentration*, *supra* note 5, at 19 & n.8. Given these market conditions, the Commission eventually decided to remove the asymmetrical regulation previously imposed on AT&T, realizing that the economic harms created by asymmetrical dominant carrier regulation outweighed the public interest benefits the dominant carrier regulation was originally intended to achieve. *See* Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, *Order*, 11 F.C.C.R. 3271, 32 Rad. Reg. 2d (P & F) 605 (1995).

19. The FCC found that IMTS and non-IMTS were discrete product markets because, *inter alia*, from a demand substitutability perspective, the Commission found that customers simply did not view the two types of services as acceptable substitutes for one another. *See Int'l Competitive Carrier NPRM*, *supra* note 17, paras. 13-20.

20. *See id.* para. 29.

21. *Int'l Competitive Carrier Report and Order*, *supra* note 17, para. 40 (quoting United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 391 (1956)).

22. *See id.* para. 42; *Int'l Competitive Carrier NPRM*, *supra* note 17, para. 32.

d. Merits

After review, the Commission concluded that: (a) American Telephone and Telegraph (AT&T) was dominant in the provision of IMTS; and (b) all other IMTS providers (i.e., Sprint, MCI) were not dominant. While the Commission recognized that market share is not determinative of market power, the Commission nonetheless held that it was "a clear indication of dominance for AT&T's provision of IMTS."[23] The Commission found that at the time of the *Report and Order*, AT&T was still the only provider of IMTS between the U.S. mainland and a majority of foreign countries. Moreover, in those countries where there were other IMTS providers, the Commission found that AT&T still had an overwhelming market share. Indeed, the Commission specifically rejected AT&T's argument that it faced actual or potential competition, stating that "[m]erely because more than one carrier provides service to a given geographic area does not automatically mean that all carriers providing service to that area are non-dominant."[24] Additionally, the Commission noted that while it was adopting a country-by-country approach, the question of how many different countries the new entrants served was a factor in determining if AT&T (or any other carrier) faced effective competition. According to the Commission, "[t]here is clearly some competitive marketing advantage to be gained if a carrier has the ability to serve all or most foreign points because a subscriber is more likely to take service from a carrier with the more comprehensive coverage."[25]

In light of the foregoing, the Commission concluded that the IMTS market was not yet sufficiently competitive to ensure that AT&T was unable to manipulate rates in a way to discourage competition. Thus, held the Commission, "until such time as competition in the provision of IMTS more fully develops so as to negate AT&T's ability to control prices or exclude competition, it is necessary to continue the full scale regulation of AT&T for its IMTS offerings to all countries."[26] To determine whether there was such competition, the FCC stated that it would look, on a country-by-country ap-

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23. As an important point, the Commission noted

> that not all operating agreements obtained by AT&T's IMTS competitors provide (or initially provided) for the handling of U.S. inbound traffic. Because the handling of U.S. inbound traffic and the receipt of one half of the agreed upon accounting rate directly influences a route's profitability as well as the U.S. carrier's collection rate for outbound traffic,

the Commission stated that "any analysis of market power which looks at market share must consider both outbound and inbound traffic shares." *Int'l Competitive Carrier Report and Order*, *supra* note 17, para. 44 & n.44.

24. *Id.* para. 44.

25. *Id.* para. 45.

26. *Id*. para. 46.

proach, "at a variety of factors including the number of entrants, market penetration for both inbound and outbound traffic, regional and global market positions, refiling and transiting arrangements, control of facilities and the potential for non-competitive pricing."[27]

2. FCC's Foreign Affiliate Rules[28]

This proceeding was designed to modify the original international dominant/nondominant framework for IMTS services as set forth in *International Competitive Carrier*. Specifically, the Commission stated that it wanted to move away from a policy under which it always presumed that "foreign-owned U.S. common carriers [were] dominant in their provision of all international services to all foreign markets in favor of a policy that regulates U.S. international carriers, whether U.S.-owned or foreign-owned, as dominant only on those routes where their foreign affiliates have the ability to discriminate"[29] in "favor of [their] U.S. affiliate in the provision of services or facilities used to terminate U.S. international traffic."[30] Indeed, the Commission reaffirmed its tentative conclusion in the *NPRM* that its then-current international dominant policy was "*overbroad, unnecessarily burdensome and may be detrimental to competition.*"[31] As such, the Commission believed it appropriate to redirect its "regulation to those instances where a relationship between a U.S. international carrier and a foreign carrier may present some substantial risk of anticompetitive conduct, [in an effort to] promote competition in the U.S. international service market by reducing the costs of entry and operation, while continuing to protect unaffiliated U.S. carriers from discrimination by foreign carriers."[32]

First, the Commission addressed what it would consider as "control" of a U.S. carrier. The Commission stated that it would treat a U.S. carrier "as an affiliate of a foreign carrier when the U.S. carrier controls, is controlled by, or is under common control with a foreign carrier."[33] In adopting this standard, the Commission recognized "the concern that a less-than-controlling interest by a foreign carrier in a U.S. carrier could give the foreign carrier the financial incentive to favor its U.S. affiliate."[34] How-

27. *Id.*
28. Regulation of Int'l Common Carrier Servs., *Notice of Proposed Rulemaking*, 7 F.C.C.R. 577 (1992) [hereinafter *Regulation NPRM*], *Report and Order*, 7 F.C.C.R. 7331, 71 Rad. Reg. 2d (P & F) 717 (1992) [hereinafter *Regulation Report and Order*].
29. *Regulation NPRM*, *supra* note 28, para. 2.
30. *Regulation Report and Order*, *supra* note 28, para. 4.
31. *Id.* para. 6 (emphasis added).
32. *Id.*
33. *Id.* para. 10.
34. *Id.*

ever, the Commission also recognized that "the foreign carrier would not be in a position to direct the actions of the U.S. carrier," and that "the U.S. carrier would be unlikely to risk sanctions by this Commission for participating in discriminatory conduct that violated Commission rules or policy, or any conditions of its Section 214 certificate."[35] Moreover, the Commission noted that "U.S. carriers will be subject to ongoing reporting requirements that are designed to detect discrimination by foreign carriers or administrations in favor of specific U.S. carriers," and that the Commission retained "the option to impose or reimpose dominant carrier regulation on a particular carrier that is found to have engaged in anticompetitive conduct."[36]

Finally, the Commission recognized that the Department of Justice continues to have the authority to take enforcement action under the antitrust laws in appropriate cases.[37] Accordingly, the Commission concluded that, on balance, it did not believe the "possibility of anticompetitive collusion poses enough of a threat to competition to impose dominant carrier regulation absent control by a foreign carrier of a U.S. carrier, particularly in light of the substantial competitive benefits that can result from lifting the burden of current regulation."[38]

In so holding, the Commission specifically declined to craft "an affiliation standard that would capture certain non-ownership arrangements between a U.S. and foreign carrier, such as co-marketing agreements for the provision of telecommunications services or joint ventures for the provision of non-telecommunications services."[39] According to the Commission, although "these arrangements could provide a financial incentive for carriers to act jointly in pursuit of marketing objectives, neither carrier has the ability to direct the actions of the other or to derive a direct financial benefit with respect to the other's telecommunications operations. Moreover, the U.S. carrier would "in all cases be subject to the ongoing regulatory requirements" imposed by the Commission on all U.S. international carriers."[40] Therefore, concluded the Commission, "submission and evaluation of such arrangements would appear to require an unnecessary expenditure of Commission and carrier resources.[41] As such, the Commission held that these arrangements do not present a substantial possibility of anticompetitive effects such that "these relationships need be addressed in the context of de-

35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.* para. 11.
40. *Id*.
41. *Id.*

ciding whether to regulate a carrier as dominant or nondominant."[42] Rather, the Commission stated that it would instead "rely on [its] Section 208 complaint procedures and sanctioning authority to remedy any anticompetitive consequences that might arise once a carrier gains access to the U.S. market."[43]

Having thus defined "affiliate," the Commission next turned to its definition of a dominant carrier. As noted above, the Commission held that it intended "to regulate U.S. international carriers as dominant only on those routes where a foreign affiliate has the ability to discriminate in favor of its U.S. affiliate through control of bottleneck services or facilities in the destination market."[44] To achieve this end, the Commission adopted a three-part threshold to determine the level of regulatory scrutiny it would apply to a given carrier. First, the Commission stated that it would presume that "carriers that have no affiliation with a foreign carrier in the destination market . . . [are] nondominant for that route."[45] Second, the Commission stated that it would presume that all "carriers affiliated with a foreign carrier that is a monopoly in the destination market . . . [are] dominant for that route."[46] And third, the Commission stated that for "carriers affiliated with a foreign carrier that is not a monopoly on that route receive closer scrutiny by the Commission."[47] Finally, the Commission stated that it "will place the burden of proof on any party, applicant or petitioner, that seeks to defeat the presumptions in the first two categories."[48]

However, for those carriers covered by the third category that seek to be regulated as nondominant, the Commission stated that those carriers "bear the burden of submitting information to the Commission sufficient to demonstrate that their foreign affiliates lack the ability to discriminate against unaffiliated U.S. carriers."[49] Indeed, the Commission specifically stated that it fully expects

> carriers to address the factors that relate to the scope or degree of their foreign affiliate's bottleneck control, such as: the duopoly or oligopoly status in the foreign affiliate's country; and whether the affiliate has the potential to discriminate through such means as preferential operating agreements, preferential routing of traffic, exclusive or more fa-

42. *Id.*
43. *Id.*
44. *Id.* para. 19.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.* para. 20.

vorable transiting agreements, or preferential domestic access and interconnection arrangements.[50]

Moreover, the Commission stated that it also expects carriers to address whether public regulation in the destination market can be relied upon effectively to constrain the affiliate's ability to discriminate. According to the Commission, "[t]here would appear to be no substantial risk of discrimination, for example, where a U.S. carrier is affiliated with a foreign carrier that operates solely through the resale of an unaffiliated foreign carrier's services in a destination market that provides equivalent resale opportunities."[51]

Finally, the Commission addressed the issue of potential anticompetitive harm resulting from "third-country leveraging."[52] Given the structure of the international market, the Commission stated that it could not "rule out the possibility that an affiliated U.S. carrier [would] attempt to gain an unfair competitive advantage on affiliated or unaffiliated routes through the negotiation of exclusive arrangements with foreign carriers or administrations."[53] As such, the Commission amended Part 63 of the Rules to require that Section 214 applicants with a foreign carrier affiliate in any market certify in each application filed with the Commission that they "have not agreed to accept special concessions directly or indirectly from any foreign carrier or administration with respect to traffic or revenue flows between the U.S. and any destination market served under the authority of their Section 214 certificates and have not agreed to enter into such agreements in the future."[54] The Commission held that it would "define 'special concession' as any arrangement that affects traffic or revenue flows to or from the U.S. that is offered exclusively by a foreign carrier or administration to a particular U.S. carrier and not also to similarly situated U.S. international carriers authorized to serve a given route."[55]

3. The FCC's *Foreign Carrier* or *"ECO" Order*[56]

On November 30, 1995, the Commission released an *Order* clarifying its "public interest" analysis for international service applications.[57] According to the FCC, this public interest analysis was comprised of two dis-

50. *Id.*
51. *Id.*
52. *Id.* paras. 25-26.
53. *Id.* para. 27.
54. *Id.* (citations omitted).
55. *Id.*
56. Market Entry and Regulation of Foreign-affiliated Entities, *Report and Order*, 11 F.C.C.R. 3873, 1 Comm. Reg. (P & F) 459 (1995) [hereinafter *ECO Order*].
57. *Id.*

tinct parts: (1) an "effective competitive opportunities" or *ECO* analysis; and (2) an analysis of additional public interest factors that could counterbalance (i.e., override) an adverse *ECO* finding.[58] The Commission stated that it undertook this initiative with the hope that this policy would both promote entry by U.S. carriers on the foreign end and also promote foreign entry into the U.S. market.[59] In reality, the *Foreign Carrier Order* marked the debut of naked (of course, relative to the commonly accepted, historically implicit meaning) trade concerns—rather than consumer concerns—as the top priority for FCC international policies.

a. The Rise of Naked Trade Concerns

The Commission reasoned that its desire to promote potential new entry of U.S. firms abroad was legitimate public policy because, in the FCC's opinion, the option of entry into the U.S. telecommunications market was such "a significant advantage, especially for those [foreign carriers] who are trying to establish their U.S. market position largely through their own marketing organization," the FCC assumed *a fortiori* that "a foreign carrier would[, therefore] have a significant incentive to encourage its government to liberalize sufficiently to meet the effective competitive opportunities test for facilities-based or resale entry if that were necessary for the carrier to control an end-to-end network service."[60] Indeed, the Commission found that there was "significant value in being able to establish a substantial investment relationship with a U.S. carrier" because "[p]artnerships with U.S. carriers, cemented by large equity holdings, [would] provide foreign carriers with lower cost options for pursuing the U.S. customer base. The partnerships also [would] provide immediate access to the established customer base of the U.S. affiliate."[61]

Moreover, reasoned the Commission, such partnerships would "greatly strengthen the capacity to offer the benefits of one-stop shopping for all global needs, including a single customized billing and cost control system for all global services, and specialized service and software designed to meet the special needs of the client."[62] In short, argued the Commission, these partnerships offered "important strategic capabilities in a critical global market" and, therefore, "the ability to invest substantially in the U.S. affiliate/partner [would permit] the foreign carrier to strengthen its partner's capabilities in the U.S. market while creating a management structure that

58. *Id.*
59. *Id.*
60. *Id.* para. 32.
61. *Id.* para. 33.
62. *Id.*

better safeguards its competitive interests in the joint venture."[63] Thus, concluded the Commission, "the ability of a foreign carrier to acquire a substantial equity position in a U.S. carrier can be an important advantage in a major world market. This advantage can provide a significant incentive for a foreign government to support liberalization."[64]

b. The Improper Redefinition of Market Power

Given the sales pitch above, the Commission explained that it would apply its new "effective competitive opportunities" standard to foreign carriers or their U.S. affiliates of IMTS service *only whenever a foreign carrier has market power on the foreign end.*[65] This inquiry, stated the Commission, would be applied on a route-by-route basis.[66] If a foreign carrier or its U.S. affiliate failed this test, then the Commission would deny permission to provide service on the particular route.[67] According to the Commission, possession of market power "may include the home market of the foreign carrier, but it also includes all other destination markets where it has the ability to leverage market power."[68]

In contrast to the definition of market power it used in *International Competitive Carrier* and in the domestic context, however, the Commission changed the definition of "market power" for purposes of the *ECO* test.[69] No longer would the Commission use a variation of the traditional test of whether a carrier has the power to control prices or exclude competition. Now, as naked trade concerns became the obvious top priority of FCC IMTS policies, the Commission stated that it would define market power as "*the ability of the carrier to act anticompetitively against unaffiliated U.S. carriers through the control of bottleneck services or facilities on the foreign end.*"[70] The Commission then defined "bottleneck services or facilities" as those facilities "that are necessary for the provision of international services, including inter-city or local access facilities on the foreign end."[71]

63. *Id.*
64. *Id.*
65. *See id.* para. 21.
66. *Id.*
67. *See id*. para. 36.
68. *Id.* para. 116.
69. *Id.*
70. *Id*. (emphasis added).
71. *Id.*

c. The New ECO Standard

Under the new *ECO* standard, the Commission stated that it would examine the following six factors:

> (1) whether U.S. carriers can offer in the foreign country international facilities-based services substantially similar to those that the foreign carrier seeks to offer in the United States; (2) whether competitive safeguards exist in the foreign country to protect against anticompetitive and discriminatory practices, including cost-allocation rules to prevent cross-subsidization; (3) the availability of published, nondiscriminatory charges, terms and conditions for interconnection to foreign domestic carriers' facilities for termination and origination of international services; (4) timely and nondiscriminatory disclosure of technical information needed to use or interconnect with carriers' facilities; (5) the protection of carrier and customer proprietary information; and (6) whether an independent regulatory body with fair and transparent procedures is established to enforce competitive safeguards.[72]

d. Other "Public Interest" Factors

The Commission also held, however, that it would consider several other "public interest" factors, in addition to its *ECO* test, that might "weigh in favor of, or against, authorizing a foreign carrier to serve destination countries where [such carrier] has market power."[73] According to the Commission, there may be occasions when the public interest requires that these additional factors actually override an *ECO* determination to either allow or deny entry.[74] These factors included, *inter alia*, (1) "the general significance of the proposed entry to the promotion of competition in the U.S. communications market"; (2) as discussed more fully *infra*, and perhaps most inflammatory to the international community, any "national security, law enforcement, *foreign policy, and trade concerns raised by the Executive Branch*"; and (3) the "presence"—but not an absolute requirement of—cost-based accounting rates.[75]

e. Accounting Rate Issues

One of the most significant aspects of the FCC's *ECO Order* was that it would *not* require the presence of cost-based accounting rates as a precondition of entry. Quite to the contrary, the Commission was of the opinion that requiring the presence of cost-based accounting rates "*could preclude*

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72. *Id*. para. 40.
73. *Id.* para. 61.
74. *Id.* para. 62.
75. *Id.* (emphasis added).

otherwise qualified candidates from competing in the U.S. international services market. It would become, in effect, a barrier to market entry. Such a result would be contrary to [its] objective of encouraging competitive entry and, thereby, reducing industry concentration on both ends of U.S. international routes."[76] In fact, the FCC argued that

> [a]dditional competition should produce service alternatives and price competition in the U.S. market which should in turn stimulate U.S. outbound demand. This, in turn, will make foreign carriers more amenable to further reducing their accounting rates, in that they will experience less of a loss in settlement revenues. This reduces the per minute settlements burden on U.S. consumers.[77]

Moreover, the Commission specifically rejected the argument that, absent a requirement of cost-based accounting rates, a U.S. affiliate of a foreign carrier would be able to price its services without the full cost of settlements with its foreign parent and, thereby, would have some kind of anticompetitive advantage (in this docket, an alleged price squeeze) over other unaffiliated U.S. carriers.[78] The Commission gave several reasons to support this conclusion. First, the Commission stated outright that it was

> *not convinced that dominant foreign carriers can set the "input" accounting rate level unilaterally. These rates are established by negotiation between a U.S. and foreign carrier.* Competitive pressures from end users and carriers, as well as [its] International Settlements Policy, have strengthened the position of U.S. carriers during accounting rate negotiations, and [it] expect[s] this trend will continue.[79]

Second, the FCC explained that "[e]ven assuming *arguendo* that a dominant foreign carrier can unilaterally set an accounting rate, a squeeze will not succeed if the high price of a particular input can be offset by lower prices for other inputs, or economies of scale and scope, or other efficiencies."[80] Where such offsets are possible, "the integrated firm will have little or no ability to inflict substantial harm on competitors via a squeeze."[81] Moreover, "the affiliated U.S. carrier must maintain low prices and high accounting rates over a sufficiently long time period so as to inflict substantial economic harm to competitors."[82]

Third, because the FCC found that no party had demonstrated conclusively under the record of this proceeding that "above-cost accounting rates

76. *Id.* para. 67 (emphasis added).
77. *Id.* (citation omitted).
78. *Id.* para. 68.
79. *Id.* para. 69 (emphasis added).
80. *Id.* para. 70.
81. *Id.*
82. *Id.*

on particular routes where a carrier has an affiliate on the foreign end realistically jeopardize the ability of unaffiliated carriers to compete on those routes or in the U.S. international services market as a whole," the FCC found that "the possibility of such harm is [actually] outweighed by the benefits of additional price and service competition that will result from further U.S. market entry."[83]

f. Joint Marketing Agreements

The Commission was also concerned about the competitive effects of "global alliances." On one hand, the Commission specifically refused to apply its *ECO* test to both exclusive and nonexclusive nonequity arrangements between a U.S. international carrier and a foreign Post, Telegraph, and Telephone Administration (PTT) because the Commission found that "foreign carrier participation in such alliances did not constitute entry into the U.S. international services market as a common carrier."[84] Moreover, the Commission held that application of the *ECO* test in such circumstances could actually have negative consequences, as "[s]uch an application could deny U.S. consumers the competitive benefits of the services of such alliances and would do little to open foreign markets."[85] Indeed, the Commission specifically recognized that such non-equity arrangements can actually attenuate the potential for collusive conduct because while "[n]on-equity arrangements can provide a financial incentive for carriers to act jointly in the pursuit of marketing objectives . . . neither carrier [will derive] a direct financial benefit with respect to the other's telecommunications operations."[86]

On the other hand, however, the Commission found no evidence "to contradict the conclusion that *exclusive* co-marketing or other agreements affecting the provision of U.S. basic international services pose an unacceptable risk of anticompetitive harm where the agreement is between a U.S. carrier and a dominant foreign carrier."[87] The Commission held that it would "view such exclusive agreements as within the scope of the 'no exclu-

83. *Id.* As explained more fully *infra*, the significance of the Commission's specific refusal to require cost-based accounting rates as a precondition of entry cannot be understated. Much to the dismay of the international community, while the FCC has steadfastly insisted on retaining the "national security, law enforcement, foreign policy and trade concerns raised by the Executive Branch" component of its public interest inquiry, political pressure subsequently fueled these fires by convincing the FCC to reverse completely its decision not to require cost-based accounting rates as a precondition to entry. As discussed more fully *infra*, the FCC announced in its *Foreign Participation* proceeding that the United States will now charge an entry fee—i.e., the FCC's "benchmarks" condition.

84. *Id.* para. 95 (citation omitted).

85. *Id.* (citation omitted).

86. *Id*.

87. *Id.* para. 255.

sive arrangements' condition [it has] placed on numerous Section 214 authorizations and cable landing licenses."[88] This condition requires that "[the] carrier shall not acquire or enjoy any right for the purpose of handling or interchanging traffic . . . that is denied to any other U.S. carrier."[89]

The Commission also held that it would "view such exclusive agreements as prohibited by the special concessions prohibition applied to foreign-affiliated U.S. carriers under Section 63.14 of [its] rules."[90] According to the Commission, it would

> continue to enforce these provisions to prohibit any exclusive co-marketing agreement or joint venture between a U.S. and a dominant foreign carrier that, either on its face or in practice, grants exclusive rights to the U.S. carrier for the provision of basic telecommunications services originating or terminating in the United States.[91]

However, the Commission also stated that it would look

> favorably on requests to waive these provisions where the U.S. carrier can demonstrate that its allied foreign carrier lacks market power, i.e., the ability to discriminate among U.S. international carriers in the provision of bottleneck services or facilities used to terminate U.S. international traffic.[92]

g. Trade and the "Public Interest"

Finally, the Commission made clear that it had jurisdiction to adopt an *ECO* analysis under both Section 214 and Section 310(b)(4) of the Communications Act.[93] Moreover, the Commission reasoned that its *ECO* paradigm is "consistent with [its] responsibilities under the Clayton Act to consider anticompetitive issues under the public interest standard."[94] First, the Commission rejected commenters' arguments that it was adopting nothing more than a naked trade reciprocity requirement under Section 214.[95] In the Commission's words, it was "not adopting a reciprocity requirement" but was, instead, simply "adopting a public interest analysis that is comprised, in part, by an effective competitive opportunities analysis for those Section 214 applications filed by U.S. carriers affiliated with foreign carriers that have the ability and incentive to discriminate against unaffiliated U.S. carriers, thereby harming U.S. consumers and businesses."[96] The Commission

88. *Id.*
89. *Id.* (citation omitted).
90. *Id.* (citation omitted).
91. *Id.*
92. *Id.*
93. *Id.* para. 222.
94. *Id.* (citation omitted).
95. *Id.* para. 227.
96. *Id.*

reasoned that it did not formulate this policy paradigm "to secure open markets as an end in itself, but rather to ensure that U.S. consumers and businesses realize the benefits of effective competition in the provision of their international telecommunications services."[97] In support of this position, the Commission reasoned that "effective competitive opportunities on the foreign end of U.S. international routes are necessary to limit the potential for anticompetitive conduct by foreign carriers and to ensure that their entry promotes rather than hinders competition in the U.S. international services market."[98] Thus, concluded the Commission, "[t]he fact that Congress did not require us to consider specifically the openness of foreign markets under Section 214 in no way implies that this factor is not relevant under the broader concept of the public interest, convenience and necessity."[99]

Second, the Commission also concluded that the *ECO* test is a "permissible component" of the public interest analysis required by Section 310(b)(4) of the Communications Act.[100] According to the Commission, under Section 1 of the Communications Act, it has

> a general mandate to promote the availability to U.S. consumers of a "rapid, efficient, Nation-wide and world-wide wire and radio communication service with adequate facilities at reasonable charges," and a specific mandate under Section 310(b)(4) to allow foreign investment above the benchmark level unless the Commission determines that the investment is inconsistent with the public interest.[101]

Thus, reasoned the Commission, the *ECO* test will "promote increased competition in the U.S. telecommunications market, thus furthering the public interest by reducing rates charged to consumers, increasing the quality of services, and encouraging the development of new and innovative services for U.S. consumers."[102] Moreover, the Commission rejected arguments that in adopting the *ECO* test, the Commission was, in fact, engaging in trade issues which are outside the Commission's mandate. According to the Commission, the *ECO* paradigm "is fully consistent, not only with [its] responsibility to promote the U.S. public interest, *but also with the responsibility of the Executive Branch to formulate and execute U.S. international trade policy.*"[103]

Of course, keeping with the trade-centric theme of this *Order*, the FCC specifically declined to apply its *ECO* test to U.S. carriers' investments

97. *Id.*
98. *Id.*
99. *Id.* (citation omitted).
100. *Id.* para. 238.
101. *Id.* (citation omitted).
102. *Id.*
103. *Id.* para. 239 (emphasis added).

overseas because, in the Commission's words, "such scrutiny would not further the goals underlying this proceeding."[104] In the Commission's view, although "a substantial investment by a U.S. carrier in a dominant foreign carrier may raise competition concerns with respect to traffic between the foreign country and the United States, there are established Commission rules and policies, as well as antitrust laws, that address such concerns."[105] As such, the Commission stated that while it has "confidence" in its own ability to address any such competitive concerns with its own safeguards, including its dominant carrier safeguards, it lacked such confidence in other regulators' ability to regulate to the same standard of excellence over issues outside the FCC's jurisdiction.[106] Moreover, the Commission professed that it did "not want unnecessarily to impede the flow of U.S. telecommunications carriers' investment and entry into foreign markets."[107] In the FCC's opinion, the "presence of U.S. carriers not only benefits those carriers' U.S. customers, but also may foster liberalization efforts."[108] Why? Because, in the FCC's view, "such a restriction on U.S. investment in foreign carriers would be tantamount to an export control and would be directly contrary to long-standing U.S. policy in favor of U.S. investment abroad."[109]

The FCC further argued that it was wholly appropriate for it to apply a different regulatory approach to U.S. carrier investment in foreign carriers because its *ECO* analysis distinguishes between U.S. carriers and foreign carriers for three separate reasons. First, "the same anticompetitive concerns [did not] exist where a U.S. carrier invests in a foreign carrier as where a foreign carrier invests in a U.S. carrier."[110] In circumstances where "a U.S. carrier has a substantial investment in a dominant foreign carrier and uses its influence over the foreign carrier to obtain an anticompetitive advantage on the affiliated route," the FCC has "jurisdiction over the U.S. carrier, through its licenses and authorizations in the United States, to redress its behavior," but in contrast, "where a dominant foreign carrier has a substantial investment in, and influence over, a U.S. carrier, [it did] not have similar jurisdiction over the foreign carrier, through its foreign licenses and authorizations, to redress any anticompetitive use of its bottleneck facilities."[111] Second, the FCC argued that applying its ECO analysis to "a U.S. carrier

104. *Id.* para. 103 (citation omitted).
105. *Id.* para. 105 (citation omitted).
106. *Id.* (citation omitted).
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.* para. 106.
111. *Id.*

seeking to invest abroad would be contrary to U.S. policy."[112] Finally, the FCC maintained that any application of the *ECO* analysis "to a U.S. carrier investor simply would not serve the market opening goals of this proceeding."[113]

4. International 214 Streamlining Proceeding[114]

In this docket, the Commission proposed to eliminate unnecessary regulatory burdens on international nondominant carriers in light of the "dramatic growth in international competition"[115] and international facilities.[116] As such, the Commission concluded that it was no longer appropriate to require nondominant carriers to obtain an additional Section 214 authorization to acquire or lease capacity on noncommon carrier facilities, as well as to add circuits on these facilities.[117] The Commission stated that "the public interest would be served by expanding the types of global Section 214 applications eligible for processing to include those [applications] filed by U.S. carriers with foreign affiliations."[118] However, the FCC cautioned that, in its view, the public interest would only be served "so long as the applications [were] tailored such that they [did] not request authority for service on routes where applicants [had] affiliations with foreign carriers," and the Commission had not made "a determination that the affiliate [lacked] market power in the destination market."[119]

Similarly, the Commission held "that a foreign-affiliated U.S. carrier . . . should be treated no differently than a U.S. carrier without foreign affiliations to the extent the affiliated carrier [sought] authority to serve routes where it [was] not affiliated with a foreign carrier with market

112. *Id.*

113. *Id.*

114. Streamlining the Int'l Section 214 Authorization Process and Tariff Requirements, *Notice of Proposed Rulemaking*, 10 F.C.C.R. 13,477, 2 Comm. Reg. (P & F) 2191 (1995) [hereinafter *Streamlining NPRM*], *Report and Order*, 11 F.C.C.R. 12,884, 2 Comm. Reg. (P & F) 857 (1996) [hereinafter *Streamlining Report and Order*].

115. *Streamlining NPRM*, *supra* note 114, para. 1.

116. In fact, the Commission noted that between 1988 and the time of this proceeding, there was "no shortage of common carrier facilities as competition in satellite and cable capacity [had] increased greatly on most routes" and in all major regions (Atlantic, Pacific, American Caribbean). *See id.* para. 25 & n.30. The Commission further noted that in recent years, there had been "a large increase in submarine cable transmission capacity to all major markets" and that "many new competitors [had] entered these markets." *Id.* para. 29. Additionally, over the last several years, the FCC found that "AT&T routinely [had] filed applications to convey transmission capacity in submarine cables," none of which had been "opposed, commented on by a third party or denied." *Id.*

117. *Id.* para. 26.

118. *Streamlining Report and Order*, *supra* note 114, para. 11.

119. *Id.*

power."[120] Again, the Commission held that those "applications should be specifically tailored . . . to ask for limited global authority to provide service to points where either the carrier does not have affiliations, or [the Commission] has previously determined that its affiliate does not possess market power in the destination market."[121] Finally, the *Report and Order* directed the International Bureau to maintain an exclusion list that identifies any restrictions on providing service to particular countries or using facilities and whether Section 214 authority is needed for these countries and/or facilities.[122]

5. Summary and Analysis

The *Orders* analyzed above in Part III.A.3 demonstrate a clear and wholly improper shift in U.S. government priorities toward protecting *competitors* rather than *competition* (i.e., consumers).[123] Indeed, even though *International Competitive Carrier* focused on the ability of AT&T's rivals to obtain an operating agreement with a foreign correspondent, the FCC did not attempt to force foreign markets open for the benefit of these carriers. By adopting a naked reciprocity approach as a precondition of foreign entry in *ECO*, however, the FCC improperly changed its policy objectives of IMTS regulation from ensuring that U.S. carriers charge U.S. consumers just and reasonable rates, to acting as a wholly-owned subdivision of the U.S. Trade Representative and the Executive Branch to promote international trade for the benefit of these very same carriers.[124]

As explained below, the FCC often makes use of its broad "public interest" standard as support for its various IMTS policy initiatives. With the rise of naked trade concerns as a primary emphasis of these policy initiatives, the question of whether or not trade may be a legitimate public interest factor must therefore be resolved. While the Commission has stated that trade may be a permissible component of the public interest standard, established legal precedent and economic theory indicate a contrary conclusion.

120. *Id.* para. 12.

121. *Id.*

122. *Id.* para. 17.

123. *See* discussion *supra* Part III.A.3.

124. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 36 n.95 (citing Reed Hundt & Charlene Barshefsky, *FCC Isn't Backpedaling on Telecommunications Deal*, N.Y. TIMES, Aug. 17, 1997, at F36 ("FCC will continue to show deference to the executive branch on matters concerning foreign policy and trade . . ." and the "executive branch fully supports this view.")). As I have observed in the past, such a statement is really quite interesting, given the fact that the FCC is supposed to be an *independent* regulatory agency. *See id.* at 18. As an additional anecdotal postscript, proponents of this hypocrisy continue to spout this view to this day.

It is very important to remember that, as a general proposition, economic regulation and trade policy seek to promote *very* different goals. Antitrust and regulatory policy appropriately focuses on *consumers*—not competitors.[125] Trade policy, on the other hand, by its very definition seeks to promote *competitors* (i.e., competitors of the "domestic" sort). Thus, while antitrust is certainly one of a number of policies affecting international trade, the various national trade policies (which very often are not even in harmony with each other) may at times be in tension with antitrust policies.[126] Accordingly, because economic regulators have the responsibility to maximize consumer welfare, and therefore these regulators—just like under antitrust jurisprudence—are similarly not at liberty to subordinate the public interest to the interest of equalizing competition among competitors, trade considerations correspondingly should not be a legitimate public interest factor in regulatory decision-making.[127]

By tragically becoming "captured" by the Executive Branch—rather than fighting to maintain its independence—the FCC took its first giant step in dislodging the dominant carrier paradigm from its analytical anchors established in the domestic *Competitive Carrier* and *International Competitive Carrier* proceedings; the FCC made final divorce from any analytical foundation in the adjudications and rulemakings discussed *infra.* Indeed, by removing the analytical underpinnings of the dominant carrier paradigm, the FCC has now apparently turned the concept of dominance into a regulatory term of convenience—in other words, the terms "market power," "anticompetitive," and "dominant" now essentially boil down to nothing more than the intellectual equivalent of "I don't like you."[128]

While such an approach may make great press release headlines, the reality is that any argument that reciprocity can actually improve consumer welfare is specious at best. Over 200 years ago, Adam Smith, in his classic treatise THE WEALTH OF NATIONS, powerfully demonstrated that whenever government attempts to coordinate the efforts of entrepreneurs, such policies almost invariably discourage economic growth and reduce economic

125. *See, e.g.*, Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (quoting Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962)); Hawaiian Tel. Co. v. FCC, 498 F.2d 771, 775-76 (D.C. Cir. 1974); SBC Comm., Inc. v. FCC, 56 F.3d 1484, 1491 (D.C. Cir. 1995) (citing W.U. Tel. Co. v. FCC, 665 F.2d 1112, 1122 (D.C. Cir. 1981) ("equalization of competition is not itself a sufficient basis for Commission action")).

126. *See* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 991 (4th ed. 1997).

127. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 16.

128. *Id.* at 25 n.15.

well-being. Smith called this system "mercantilism."[129] Indeed, given certain economic realities, it is quite unclear how, in the long run, American consumer welfare will be enhanced by reciprocity. For example, by essentially adopting a "reciprocity" analysis in favor of an accurate economic analysis, a "reciprocity" approach actually *creates*—rather than eliminates—significant barriers to entry for both new firms into U.S. domestic telecommunications markets and U.S. firms into foreign markets. Specifically, by adopting an aggressive "America First" approach, both foreign governments and carriers will probably have a (if not exacerbating an existing) substantial *disincentive* to engage in good faith negotiations with U.S. carriers to enter their home markets (which, paradoxically, is supposed to be the whole goal of such an approach in the first place).[130] As noted above, cultivating foreign recalcitrance is precisely the one thing that the FCC's IMTS policies have managed to accomplish successfully.[131]

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129. Adam Smith concluded that mercantilism

> retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour [because of] . . . two basic reasons . . . : a tendency of special interests to turn government programs to their own narrow advantages, and a tendency of joint business efforts to result in collusion to reduce output and raise prices, especially when government willingly permits such collusion. [As such, although] "the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary."

James C. Miller, et. al., *Industrial Policy: Reindustrialization Through Competition or Coordinated Action?*, 2 YALE J. ON REG. 1, 5 (1984) (citations omitted).

130. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 19; *see also* Halprin, *supra* note 3, at F13 (FCC simply "wants to keep its ability to treat foreign carriers worse than its own domestic carriers—though this is exactly what the United States and 68 countries promised in Geneva *not* to do." *Id.* This policy will "delay other nations' entry into our market by months, if not years, while allowing identical investments by United States carriers to proceed immediately. *Free trade delayed is free trade denied.*" *Id.* (emphasis added)).

131. See Scott Blake Harris, *Why the EC Has Got Its Priorities All Wrong*, COMM. WK. INT'L, Jan. 19, 1998, at 9, where the former (and inaugural) Chief of the FCC's International Bureau lambasted the European Commission for suggesting the need for a European-wide approach to licensing and other basic regulatory issues. In Mr. Harris' purported expert opinion, the "EC has a very long way to go before it could possibly be qualified to act as a regulator. Indeed, it would need radically to reorient its thinking so that it focuses more on fairness and openness, and less on industrial policy." *Id.* In fact, Mr. Harris appears shocked at the notion that a regulator, in particular the European Commission and Directorate General XIII—would apparently "consider the promotion of European industry to be the motivating rationale for competition and open markets." *Id.* This view, admonished Mr. Harris, "*squarely conflicts with the role of a regulator, which is to bring consistency, fairness, and openness to the decision-making process.*" *Id.* (emphasis added). To help guide our European friends, therefore, Mr. Harris suggested that the European Commission look to the FCC as the very model of a *pareto optimal* regulatory body. For example, Mr. Harris noted that as "a regulatory agency, the FCC is not al-

Moreover, international commerce, by its very definition, raises far more investment risks than domestic commerce does (e.g., different or ineffective legal systems, political graft, retroactive or *post-hoc* "windfall" taxes, etc.).[132] As such, the prices for international goods that require the investment of substantial sunk costs are usually higher in order to reflect this risk.[133] An aggressive trade approach, therefore, merely exacerbates the possibility that a foreign country may, in an act of trade retaliation, "nationalize" a U.S. firm's sunk assets—often without any adequate compensation. This "uncertainty" can raise prices for U.S. consumers in two ways. First, the greater the risk, the higher a U.S. firm's cost of capital becomes; as a firm's cost of capital becomes higher, end-prices for consumers increase. Second, as risk increases, a U.S. firm will have a greater incentive to *raise* its prices to ensure that it can recover its costs in the shortest time possible.[134] It would seem, therefore, that "FCC" should not stand for "Facilitating Cartels and Collusion."[135]

B. Accounting Rates and the Commission's International Settlements Policy Pre-WTO: The Expansion of Neo-Mercantilism

1. General Background

As highlighted *passim*, some of the more prominent economic distortions of the IMTS market are above-cost accounting rates and "whipsawing" among U.S. carriers by foreign monopolists. To mitigate the latter distortion, the Commission, *inter alia*, developed an International Settlements Policy (ISP) for IMTS service. The ISP is designed to prevent foreign monopolies from using their market power to obtain discriminatory accounting

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lowed to play favorites. It must treat [foreign firms] no better, and no worse, than it treats other [domestic] applicants." *Id.* Most importantly, argued Mr. Harris, is that "the FCC cannot strike deals with other governmental agencies favoring" either domestic or foreign firms. *Id.* Thus, concluded Mr. Harris,

> [t]o put it mildly, such trade-offs have no place at any regulatory agency. Let's hope this is just a misunderstanding. But do not be shocked if it is not. The EC still thinks its role is to protect European industry, and its respect for independent regulatory processes seems to be mere talk. . . . If it ever hopes to be a regulator—or have respect from regulators—the EC must understand that the fair and open application of rules to facts is what regulators do. Looking out for "client" industrial interests is not.

I believe the correct legal and economic term to describe accurately this argument can be summarized in one word—"chutzpa."

132. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 19.

133. *Id.*

134. *Id.*

135. *Id.* at 34 n.73.

rate concessions from competing U.S. carriers (hence the phrase "whipsawing"). To accomplish this goal, the ISP basically ensures: (1) the equal division of accounting rates; (2) nondiscriminatory treatment of U.S. carriers; and (3) proportionate return of inbound traffic.[136]

As far as lowering above-cost accounting rates (and eliminating the huge outpayment flows they create), the Commission has over the years attempted to formulate a wide variety of regulatory strategies to accomplish this goal. Primarily, these policies have attempted to actively promote methods of providing or accessing services that vary from the traditional correspondent relationship. For example, the Commission has allowed resale of international private lines to provide switched service,[137] call-back,[138] switched hubbing,[139] and country-direct services.[140] While the Commission has recognized that these "alternative routing practices have put downward pressure on accounting rates and on foreign calling prices," these practices ultimately do not resolve how to decrease substantially the out-flow of above-cost accounting rates created by traffic imbalances under the existing system.[141] For example, while country-direct services inflate the settlements deficit by converting foreign-originated traffic into U.S.-billed calls (which is *good* for consumers), "U.S. carriers nevertheless embrace this service not only because it enhances their service offerings, but also because it may in-

136. *See* Implementation and Scope of the Int'l Settlements Pol'y for Parallel Int'l Comm. Routes, *Report and Order*, 51 Fed. Reg. 4736 (1986), *modified in part on recons.*, 2 F.C.C.R. 1118, 62 Rad. Reg. 2d (P & F) 408 (1987) [hereinafter *ISP Report and Order*], *further recons.*, 3 F.C.C.R. 1614, 64 Rad. Reg. 2d (P & F) 956 (1988). *See also* Regulation of Int'l Accounting Rates, Phase I, *Report and Order*, 6 F.C.C.R. 3552, 69 Rad. Reg. 2d (P & F) 241 (1991), *on recons.*, 7 F.C.C.R. 8049, 71 Rad. Reg. 2d (P & F) (1992). The FCC's ISP also requires U.S. carriers to file copies of all contracts, agreements and arrangements that relate to the routing of traffic and the settlement of accounts.

137. *See* Regulation of Int'l Accounting Rates, Phase II, *First Report and Order*, 7 F.C.C.R. 559, para. 8, 70 Rad. Reg. 2d (P & F) 156 (1991). *See also* Market Entry and Reg. of Foreign-affiliated Entities, *Report and Order*, 11 F.C.C.R. 3873, paras. 157-61, 1 Comm. Reg. (P & F) 459 (1995) [hereinafter *Market Entry Report and Order*].

138. "Call-back enables a customer in one country to access a dialtone in another country and carriers to bill customers at the latter country's collection rate." Policy Statement on Int'l Accounting Rate Reform, *Policy Statement*, 11 F.C.C.R. 3146, para. 12 n.8, 2 Comm. Reg. (P & F) 182 (1996) (citations omitted) [hereinafter *Int'l Accounting Policy Statement*].

139. "Switched hubbing refers to the routing of U.S. switched traffic over U.S. international private lines, whether resold or facilities-based, that terminate in equivalent countries and then forwarding that traffic to a third, non-equivalent country by taking at published rates and reselling the international service of a carrier in the equivalent country." *Id.* para. 12 n.9 (citation omitted).

140. "Country direct enables international calling card holders traveling in a foreign country to call an international toll free number and gain direct access to an operator and the calling prices of their home country." *Id.* para. 12 n.10.

141. *Id.* para. 12.

crease their market share of outgoing traffic and entitle them to a larger flow of lucrative incoming traffic under [the FCC's] proportionate return rules."[142]

Faced with this Faustian dilemma of having to choose between promoting consumer welfare or substantial industry pressure to reduce the out-payment flow, the Commission chose the latter and decided that it was time to take a more aggressive approach to the above-cost settlement rate problem. Starting in 1996, and leading right up to the WTO Agreement (and, as discussed *infra*, even *after* the conclusion of the WTO Agreement), the FCC decided it would fight foreign *monopoly* power with the substantial *monopsony* or, more accurately, "bargaining" power of the United States—that is, it would set (and essentially give foreign carriers no opportunity to refute) the maximum rate at which U.S. carriers could pay foreign correspondents under the settlement-of-accounts regime.

2. The FCC's January 1996 *Policy Statement* on Accounting Rate Reform[143]

In this *Policy Statement*, the Commission argued that under current market conditions, there was a clear need to establish new benchmark settlement rates for IMTS service.[144] The Commission determined that, in its view, "the traditional system of bilateral correspondent services and above-cost accounting rates has slowed progress toward competitive markets [because] this system unnecessarily restrains the development of competition in the supply of services and their pricing."[145] The Commission further found that this performance is "especially true in a digital world where technological advances are rapidly reducing the costs of providing service, yet above-cost accounting rates prevent consumers from getting the full benefit of these reductions."[146]

Playing the monopsony card, the Commission announced that "U.S. consumers are the largest users of international telecommunications services."[147] For virtually all countries, the Commission noted that "a greater number of calls originate in the United States than are terminated here" and, because originating carriers make settlement payments to terminating carriers, "U.S. carriers pay substantial sums to foreign carriers. To the extent that accounting rates exceed the actual cost of terminating an international

142. *Id.*
143. *Id.*
144. *Id.* para. 43.
145. *Id.* para. 8 (citation omitted).
146. *Id.*
147. *Id.* para. 9.

call," the Commission reasoned that this payment is nothing more than "a substantial subsidy" to the foreign carrier.[148]

In support of this conclusion, the Commission cited to a variety of data. For example, the Commission noted that "[b]etween 1985 and 1994, U.S. carriers paid $26 billion in settlement payments to foreign carriers[, and] as much as one half of these payments may have exceeded the actual costs of terminating calls."[149] The Commission found that "[t]his subsidy adds significantly to the cost of providing service and results in higher U.S. calling prices" and is exacerbated as additional foreign carriers become global carriers.[150] According to the Commission, because accounting rates remain "significantly above the cost of originating and terminating international telephone calls," such that "the ever-increasing number of U.S.-originated calls and the growing disparity between U.S.- and foreign-billed minutes have resulted in a dramatic increase in U.S. net settlement outpayments" (specifically, since 1985, "the net settlement outpayment has quadrupled, reaching over 4.3 billion dollars in 1994").[151]

As such, the Commission held that while "a competitive global market might still yield a net U.S. deficit, . . . a substantial part of the current settlements outpayments is the result of economically inefficient accounting rates and monopoly pricing practices for consumers in foreign markets."[152]

3. "*Flexibility*" *Order*[153]

In this *Order*, the Commission stated that it wanted to attempt to establish "a more flexible framework for regulating international accounting rates, . . . [thereby] creat[ing] or replicat[ing] market-based incentives and prices for both suppliers and consumers of international telecommunications service."[154] To achieve this goal, the Commission stated that it would "permit, subject to certain competitive safeguards, alternative payment arrangements that deviate from [the Commission's] ISP between any U.S. carrier

148. *Id.* (citation omitted).

149. *Id.* (citing Regulation of Int'l Accounting Rates, Phase II, *Second Report and Order and Second Further Notice of Proposed Rulemaking*, 7 F.C.C.R. 8040, para. 18 & n.40, 71 Rad. Reg. 2d (P & F) 868 (1992)).

150. *Int'l Accounting Policy Statement*, *supra* note 138, para. 9.

151. *Id.* para. 16.

152. *Id.* (citations omitted). Not to appear too maudlin, however, the Commission provided a back-handed compliment to the rest of the international community, noting that some significant, procompetitive changes had in fact occurred in the global communications market in recent years as a result of technological innovations, privatization, regulatory reform, and evolving national market conditions. *Id.* paras. 29-30.

153. Regulation of Int'l Accounting Rates, *Fourth Report and Order*, 11 F.C.C.R. 20,063, 5 Comm. Reg. (P & F) 452 (1996) [hereinafter *Flexibility Order*].

154. *Id.* para. 13 (citation omitted).

and any foreign correspondent in a country that satisfies the [*ECO*] test."[155] Moreover, the Commission stated that it

> [would] also consider alternative settlement arrangements between a U.S. carrier and a foreign correspondent in a country that does not satisfy the ECO test, where the U.S. carrier can demonstrate that deviation from the ISP [would] promote market-oriented pricing and competition, while precluding abuse of market power by the foreign correspondent.[156]

Specifically, the Commission stated that while it believed that "the ECO test provides an effective measure of whether sufficient competitive conditions exist in a foreign market to warrant flexibility in the ISP," it recognized that "departures from the ISP may be justified in some circumstances where the ECO test [was] not satisfied."[157] For example, suggested the FCC, "a departure from the ISP [might have been] warranted where a non-dominant U.S. carrier sought to negotiate an alternative arrangement with a foreign entity that [did] not have economic market power in a foreign market, or where a foreign regulator guarantees cost-based interconnection for international traffic."[158] In such cases, reasoned the Commission, "the potential for abuse of market power by a foreign carrier to the detriment of U.S. carriers would [have been] constrained, and alternative settlement arrangements [might have] foster[ed] competition and benefit[ed] U.S. consumers."[159] The Commission therefore stated that it would consider "alternative settlement arrangements between a U.S. carrier and a foreign correspondent in a country that did not satisfy the ECO test where the U.S. carrier [demonstrated] that deviation from the ISP [would] promote market-oriented pricing and competition, while precluding abuse of market power by the foreign correspondent."[160]

Notwithstanding the above, the Commission was concerned nevertheless that "allowing carriers with a significant share of the market to negotiate alternative arrangements [might] have unanticipated anticompetitive effects in the U.S. market for IMTS services."[161] For example, the Commission reasoned that "dramatic and sudden shifts in return traffic away from a U.S. carrier might impede that carrier's ability to compete effectively in the IMTS market, at least in the short term."[162] Moreover, the

155. *Id.* para. 2 (citation omitted).
156. *Id.*
157. *Id.* para. 40.
158. *Id.*
159. *Id.*
160. *Id.*
161. *Id.* para. 44.
162. *Id.*

Commission believed that there might be circumstances under which either: (a) "a foreign carrier with a significant share of its market [might] have the ability and incentive to misuse its market power to discriminate against U.S. carriers, notwithstanding the existence of effective competitive opportunities in the foreign market"; and/or (b) "a U.S. carrier with a significant share of the market [might] be in a position to extract anticompetitive special concessions from foreign carriers to the detriment of other U.S. carriers."[163] As such, if carriers seek flexibility from the ISP, the Commission stated that it would require: (1) U.S. carriers to file with the Commission "a copy of all alternative settlement arrangements affecting more than either twenty-five percent of the outbound traffic on a particular route or twenty-five percent of the inbound traffic on a particular route" that would be made public; and (2) that "any alternative arrangement that affects more than twenty-five percent of the outbound traffic or twenty-five percent of the inbound traffic on a particular route not contain unreasonably discriminatory terms and conditions."[164]

4. Settlement Rate "Benchmarks" *Notice of Proposed Rulemaking*[165]

Soon after the penultimate round of WTO negotiations disintegrated and two months before the final February Accord was concluded, the United States apparently decided to push its negotiating hand by announcing that it was strongly considering a unilateral proposal to establish benchmark settlement rates for U.S. carriers—regardless of the contractual settlement rate agreements already in force between U.S. carriers and their foreign correspondents. The Commission reasoned that such unilateral action was necessary because under the traditional accounting rate system, most "settlement rates greatly exceed the underlying costs of providing the service in question, i.e., terminating an international call."[166] Indeed, the Commission found that "[i]t is not unusual for settlement rates to be between five and ten times a reasonable estimate of the underlying cost of terminating an international call."[167] As such, reasoned the Commission, "[s]uch significantly inflated settlement rates represent a major subsidy from U.S. consumers, carriers and their shareholders to foreign carriers and raise prices for international services to U.S. consumers many times above the costs of providing those

163. *Id.*
164. *Id.* para. 45.
165. International Settlement Rates, *Notice of Proposed Rulemaking*, 12 F.C.C.R. 6184, 9 Comm. Reg. (P & F) 2005 (1996) [hereinafter *Int'l Settlement Rates NPRM*].
166. *Id.* para. 7.
167. *Id.* (citation omitted).

services."[168] Moreover, the Commission found that such rates "also distort IMTS market performance and restrict market growth."[169]

Once again, the FCC argued that the most egregious competitive distortions were those distortions

> flowing from above-cost settlement rates when a foreign carrier collecting those rates is able to send its switched service over resold international 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 expensive settlement rate.[170]

The Commission believed that because

> foreign carriers could use the subsidy embedded in above-cost settlement rates to cross-subsidize an affiliate providing international services in the U.S. market . . . a foreign carrier's U.S. affiliate could afford to price its services in the U.S. market below the costs of providing those services because its foreign parent would be earning substantial subsidies from terminating traffic at above-cost settlement rates.[171]

In the Commission's opinion, however, "if a foreign carrier [was] collecting cost-based settlement rates, or if its ability to collect above-cost settlement rates [was] constrained by the existence of effective competition in its home market, concerns about anticompetitive behavior [would] be significantly diminished."[172]

To mitigate these market distortions, therefore, the Commission proposed, *inter alia*, to condition various types of authorizations to provide U.S. international services to address the potential market distortions created by above-cost settlement rates.[173] "First, when a carrier seeks authorization to provide international facilities-based service from the United States to an affiliated foreign market, whether to provide switched service or private line service," the Commission proposed to condition "any authorization to serve that affiliated market on the foreign affiliate offering U.S. licensed interna-

168. *Id.*

169. *Id*.

170. *Id.* para. 75.

171. *Id.*

172. *Id.* Notwithstanding the above, however, the Commission recognized that there were, in fact,

> opportunity costs to the foreign parent of offering service through an affiliate in competition with U.S. carriers that formerly purchased termination service from the parent. In serving its home market directly through its affiliate, the foreign parent would no longer receive the settlement payment it formerly received from U.S. carriers to terminate traffic in that market.

Id. para. 80.

173. *Id.* para. 76.

tional carriers a settlement rate within the benchmark range" set forth in this *NPRM*.[174]

Moreover, the Commission proposed that, consistent with its existing ISP, "all U.S. carriers should receive the same settlement rate for traffic on that route."[175] However, if, "after the carrier has commenced service to the affiliated market," the Commission learns that "the carrier's service offering has distorted market performance on the route in question," the Commission proposed to order that "settlement rates to that country be reduced to the bottom of the range ([its] estimate of cost-based termination) or to revoke the authorization of the carrier to serve the affiliated market."[176]

Notwithstanding this proposal, however, the Commission recognized that requiring cost-based accounting rates as a precondition of entry may actually be inconsistent with its *ECO* test. As such, the Commission sought comment on whether this proposal would affect the *ECO* test—that is, "should this proposal be used in conjunction with the ECO test, replace the ECO test, or should [the Commission] modify the ECO test to ensure that it is compatible with this proposal?"[177] The Commission emphasized, however, that the proposal contained in the *NPRM* is "to prevent U.S.-licensed carriers from distorting the IMTS market through service to affiliated markets with excessive settlement rates."[178] According to the Commission, "[t]he proposal does not serve as a barrier to market entry for foreign carriers."[179] Moreover, the Commission argued that under the pending proposal, "[it] would not limit the ability of foreign carriers to enter the U.S. market. Rather, it would ensure that all U.S.-licensed carriers (U.S. or foreign-owned) would face similar conditions on service to affiliated foreign markets."[180]

5. Summary and Analysis

The preceding section raises an unusual question: If the FCC's International Settlements Policy is expressly designed to keep the U.S. IMTS "cartel" fat and happy, then why were all of the U.S. carriers nonetheless jointly lobbying for a *reduction* in cost of a common input? Was this just an industry attempt to cultivate some regulatory good will? Alternatively, perhaps such lobbying might have been intended to portray U.S. carriers (which

174. *Id.* (citations omitted).
175. *Id.* (citation omitted).
176. *Id.* (citation omitted).
177. *Id.* para. 78 (citation omitted).
178. *Id.* para. 79.
179. *Id.*
180. *Id.*

are certainly not struggling or nascent firms) as victims of the foreign monopolist correspondents. Yet, such a "victim" mentality seems a bit disingenuous, however, given the fact that U.S.-based carriers are not the only ones faced with large settlement imbalances. Indeed, Japan-based carriers have large deficits with Taiwan, the Philippines, South Korea, Singapore, and other major Asian countries. Similarly, France Telecom has large outflows to Africa, the Middle East, and even Latin America. Moreover, the same holds true for British Telecom, Deutsche Telekom, Telecom Italia, and other large overseas telephone companies.[181]

Perhaps the more likely reason was—just like the motivations behind *ECO* and its progeny—U.S. carriers' and government officials' xenophobia of foreign competition. In their view: (a) under the existing international settlement-of-accounts regime, the U.S. traffic imbalance effectively forces U.S. firms to subsidize—via above-cost settlement rates—foreign firms' activities; which subsidy (b) allegedly permits foreign firms to build a "full circuit" and therefore bypass the international settlement-of-accounts regime (i.e., provide IMTS service at *lower cost*); and because (c) the ability for any firm to achieve lower costs must be *a fortiori* "anticompetitive," the U.S. government should make it as difficult as possible for foreign firms to enter the U.S. market.[182]

As such, the *Orders* discussed above appear to demonstrate a desire by the United States to not put all of its "promoting U.S. investment abroad" eggs into the reciprocity basket. To wit, the FCC in *ECO* at least made the pretense of stating that entry into the United States would be conditioned on reciprocal effective competitive opportunities for U.S. carriers abroad. With the release of the *Benchmarks NPRM*, the FCC sent the first salvo that it would set a fee for entry as well.[183] As the FCC released its *Benchmarks NPRM* in the throws of the final stages of the WTO negotiations, however, it would therefore appear that the United States decided to approach the final negotiations with no carrot—only a very big stick.

181. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 18; Maev Sullivan, *Why Is the United States Whining About Its Own Creation?*, COMM. WK. INT'L, Jan. 20, 1997.

182. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 20.

183. *See id.* at 19.

C. Carrier-Specific Adjudications

1. Foreign Firms' Mergers with, and Investments in, U.S. Carriers

a. BT/MCI I[184] *and BT/MCI II*[185]

BT/MCI I and *II* marked the first time that the FCC was forced to deal with a substantial investment by a dominant foreign firm into one of the largest telecommunications firms in the United States. In an apparent effort to avoid a lengthy regulatory approval process, MCI and BT filed a petition for declaratory ruling that: (1) the terms and conditions of BT's investment in MCI did not result in a transfer of control of MCI to BT, and, accordingly, prior Commission approval was not required pursuant to Section 310(d) of the Act; and (2) BT's proposed 20 percent ownership interest, even when aggregated with existing non-BT foreign investment for a total of up to 28 percent foreign investment, was consistent with and permissible under Section 310(b)(4) of the Communications Act.[186]

Resolution of both questions was expeditious. In the former case, the Commission found that because, under the deal as then-structured, BT would not be able to exercise control over MCI, the transaction did "not constitute a transfer of control and, therefore, did not require Commission approval under § 310(d) prior to consummation of the transaction."[187] Similarly, the Commission found no public interest reason under Section 310(b)(4) to deny the petition because the proposed investment did "not raise the traditional concerns present in a Section 310(b)(4) analysis as [there was] only the potential 3 percent fluctuation in alien ownership beyond the 25 percent statutory benchmark due to the widely-held nature of [MCI's] stock."[188]

184. MCI Comm. Corp. & British Telecomm. PLC, *Declaratory Ruling and Order*, 9 F.C.C.R. 3960, 75 Rad. Reg. 2d (P & F) 1024 (1994) [hereinafter *BT/MCI I Order*].

185. MCI Comm. Corp. & British Telecomm. PLC, *Declaratory Ruling*, 10 F.C.C.R. 8697 (1995) [hereinafter *BT/MCI II*].

186. In *BT/MCI II*, MCI petitioned the Commission to declare that an increase in the foreign ownership of MCI's capital stock from 28 to 35 percent would be consistent with the public interest under Section 310(b)(4) and would not constitute a transfer of control under Section 310(d). The Commission granted the petition, finding that the increase in foreign ownership of MCI would come from passive investors—each of which would own less than 1% of MCI stock. These new owners would have neither the incentive nor the ability to control MCI. Moreover, the Commission found that BT's ownership in MCI was not expected to change as a result of the proposed increase in MCI's foreign ownership, and, in any event, MCI continued to be bound by the requirements of the previous *BT/MCI I Order* outlined above. *Id.* para. 9.

187. *BT/MCI I Order*, *supra* note 184, para. 18; *see also id.* paras. 10-17.

188. *Id.* paras. 19-23. The Commission was also comforted by the fact that the transac-

Yet, despite the fact that the Commission "granted" the BT/MCI petition, the Commission announced that because of other "public interest concerns . . . regarding the effect that the BT and MCI alliance may have on competition in the telecommunications market as a result of the potential for either discrimination or other anticompetitive conduct," it would, nonetheless, conduct a *post hoc* in-depth review of the likely competitive effects of the investment.[189] For example, the Commission believed that, post-merger, "BT could leverage its dominant position in both the U.K. international and local exchange markets to favor MCI . . . to the disadvantage of competing U.S. International carriers."[190] According to the Commission, this "favorable treatment could manifest itself in a variety of ways, such as preferential pricing or the provision of technical network information in advance of such disclosure to other U.S. carriers."[191] To wit, at the time of the proposed merger, BT controlled 97 percent of the local termination points and had the most fully developed long-distance network to which interconnection is essential for the distribution of international traffic in the United Kingdom.[192]

On the U.S. end, the Commission found that "MCI [was] the second largest interexchange carrier and international service provider in the market and, as such, maintained a significant U.S. customer base."[193] As such, the Commission reasoned that "BT's 20 percent interest in such a major U.S. carrier, coupled with its participation on MCI's Board of Directors, [might] provide BT with the incentive both to discriminate in favor of MCI and to influence the corporate decision-making process of MCI."[194] "Thus, in spite of the fact that MCI and BT [were] not 'affiliated' within the meaning of [the Commission's] rules, [the Commission] believe[d] that these factors create[d] additional incentives for BT to favor MCI, directly or indirectly."[195]

The curious thing about this conclusion, however, is that despite the potential incentives for strategic behavior mentioned above, the Commission nonetheless concluded that dominant carrier regulation was not necessary for

tion involved "a dominant U.S. presence among MCI's officers, directors and shareholders." *Id.* para. 22. As such, the Commission stated that it would view "the possible 3 percent fluctuation in non-BT alien ownership beyond the statutory benchmark . . . in light of the presence of 80 percent U.S. directors and 100 percent U.S. officers in MCI, in addition to the 100 percent U.S. officers and directors in MCI's Title III licensee subsidiaries." *Id.*

189. *Id.* para. 29.
190. *Id.* para. 30.
191. *Id.*
192. *Id.* para. 36.
193. *Id.*
194. *Id.*
195. *Id.*

MCI.[196] The FCC reached this conclusion for two reasons: (1) "the safe-guards imposed in the order [were] sufficient to ensure that the parties do not engage in anticompetitive activities" (basically *de minimis* reporting requirements); and (2) MCI's agreement to a "no special concessions" provision.[197] For example, the Commission found that

> the amendment of MCI's international Section 214 certificates to include a "no special concessions" obligation would preclude MCI from accepting from BT, or from any other foreign carrier or administration, preferential or exclusive operating agreements or marketing arrangements for the provision of basic telecommunications services, including the introduction and provision of new basic services.[198]

Similarly, the Commission found that MCI's amended certificates would "preclude it from accepting from BT any distribution or interconnection arrangements, including pricing, technical specifications, functional capabilities, or other quality and operational characteristics, such as provisioning and maintenance times, at rates or on terms and conditions that are not available on a nondiscriminatory basis to all competing U.S. carriers."[199]

The FCC also rejected arguments that BT and MCI could use their relationship to manipulate traffic streams or accounting rates, again repeating its belief that "*existing Commission policy with respect to these matters effectively limits the parties' ability to engage in such anticompetitive conduct.*"[200]

Finally, the FCC made two other significant findings in this case that it would be forced to ignore deliberately two years later in *BT/MCI III—that is, that BT's failure to enter independently would not make a significant competitive impact in either the U.S. domestic market or the market for U.S.-originated traffic on the U.S.-U.K. route*.[201] Indeed, based on specific findings that even though BT had previously demonstrated an active interest in (and made two unsuccessful attempts to enter) the U.S. market, and, absent this transaction, BT might have elected to enter the U.S. telecommunications market on its own, the Commission found that even if BT were

196. *Id.* para. 37.

197. *Id.* (citation omitted). Indeed, the Commission specifically found that "nothing in the record indicate[d] that there [was] any need for several key provisions of dominant carrier regulation, such as filing of tariffs on 45-days notice, requirement of cost support justification, and prior Section 214 authorization for circuit additions. [According to the Commission,] these restrictions would be needlessly burdensome in this context." *Id.* n.69.

198. *Id.* para. 37.

199. *Id.* (citation omitted).

200. *Id.* para. 38 (emphasis added).

201. *Id.* para. 50. Subsequent to this *Order*, the Commission granted BT's U.S. affiliate a Section 214 application, subject to certain reporting requirements, to provide U.S.-originated IMTS service. *See* BT North America, Inc., *Order and Certification*, 9 F.C.C.R. 6851, 76 Rad. Reg. 2d (P & F) 920 (1994).

viewed as a potential entrant, there did not appear to be any anticompetitive effect if BT did not enter.[202] Indeed, the Commission noted that, at the time of this *Order*, there were "several hundred carriers, both facilities- and resale-based, competing in the U.S. interexchange market" and, as such, "the loss of the incremental competition that might [have been] provided by BT's independent entry into the U.S. telecommunications market . . . appear[ed] to be of little competitive significance."[203] Similarly, because at the time of this *Order* there were "approximately 10 international facilities-based carriers and hundreds of international resellers providing U.S.-U.K. telecommunications services," the Commission again "conclude[d] that the number of existing and potential competitors indicate[d]" that BT's failure to enter independently would "not significantly lessen potential competition in the provision of U.S.-U.K. telecommunications services."[204]

b. The Sprint/Deutsche Telekom-France Telecom Merger[205]

In this *Order*, the Commission granted, subject to certain conditions, Sprint's requests for rulings that a proposed alien ownership in Sprint of up to 28 percent was "not on balance inconsistent" with Section 310(b)(4) of the Communications Act, and that the proposed transaction was "not on balance inconsistent" with the public interest.[206] The Commission also found that "10 percent equity investments each by France Telecom (FT) and Deutsche Telekom (DT) in Sprint [did] not result in a transfer of control of Sprint to FT and DT and thus [did] not require prior Commission approval under Section 310(d) of the Act."[207] As explained more fully below, while the Commission was concerned that France and Germany did not offer effective competitive opportunities for U.S. carriers, the Commission nonetheless granted the petition because the Commission found that: (a) the proposed transaction would create procompetitive benefits; and (b) "the French and German governments [were] committed to full competition, . . . in which U.S. companies [would] be allowed to participate."[208]

What is particularly significant (and humorous) about this *Order*, however, is the FCC's apparent inability to decide whether it should apply its *ECO* test in this situation. At first, the Commission decided to apply the

202. *BT/MCI I Order*, *supra* note 184, para. 49.
203. *Id.*
204. *Id.* para. 50 (citation omitted).
205. Sprint Corp., Petition for Declaratory Ruling Concerning Section 310(b)(4) and (d) of the Communications Act, *Declaratory Ruling and Order*, 11 F.C.C.R. 1850, 2 Comm. Reg. (P & F) 409 (1996) [hereinafter *Sprint Declaratory Ruling and Order*].
206. *Id.* para. 1.
207. *Id.*
208. *Id.* para. 3.

ECO test to the proposed transaction simply because of the size of the carriers involved.[209] Yet, several paragraphs later, the Commission changed its mind and decided that an *ECO* analysis was unwarranted in this case because it had already reached "the ultimate conclusion . . . that, on balance, the public interest weighs in favor of granting Sprint's petition . . . ."[210] Notwithstanding this statement, however, commenters had convinced the FCC that the proposed transaction created "*ECO*-type" competitive concerns, and the FCC stated that it would address these concerns in this proceeding nonetheless—*independent* of the *ECO* analysis.[211]

In particular, the Commission shared the commenters' fundamental concerns "about the potential for anticompetitive behavior by FT and DT on the U.S.-France and U.S.-Germany routes."[212] The Commission again pointed out that "FT and DT [were] monopoly providers of French and German international facilities-based services, [they controlled] the local termination points in those countries, and [they controlled] the national long distance networks to which interconnection is essential for the distribution of international traffic."[213] As such, the Commission reasoned that although prior to the "proposed transaction, FT and DT had no incentive to discriminate in favor of Sprint, the Joint Venture or any of their competitors over others," after the transaction FT and DT would "each [have] a substantial financial stake in the success of Sprint and the Joint Venture and [would], therefore, give each an incentive to engage in anticompetitive strategies to maximize the return on their investment."[214] As such, the Commission con-

209. *Id*. para. 39.
210. *Id.* para. 49.
211. *Id.* para. 51.
212. *Id.* para. 55.
213. *Id.* One other interesting aspect in this case is that the FCC specifically rejected Sprint's claims that FT and DT had no more leveraging power than BT did in the *BT/MCI* proceeding. For example, the Commission pointed out that Sprint overlooked the fact that, in the United Kingdom, there was *de jure* competition in nearly every market segment (in that BT faced competition to some extent at all levels), and, unlike in France and Germany, U.S. carriers had a choice of carriers to haul their traffic. The FCC also found that as of the time of this *Order*, there was an effective regulatory authority that is independent of BT, which employed fair and transparent procedures while there were no such independent regulatory authorities with fair and transparent procedures in France or Germany. *Id.* para. 58. Finally, the Commission rejected Sprint's arguments that EU regulatory prohibitions on discriminatory conduct by FT and DT were sufficient to protect competition, particularly in the U.S. market for "global, seamless services." *Id.* para. 60.
214. *Id.* para. 56. According to the FCC, potential discrimination

> could take a number of forms, such as: (1) routing calls to Sprint and the Joint Venture in proportions greater than those justified under [its] proportionate return policy; (2) otherwise manipulating the calculations and settlements payments to wrongfully favor Sprint and the Joint Venture; (3) routing high-profit calls to Sprint and the Joint Venture, and leaving the rest to their competitors;

cluded that "[a]bsent effective conditions, such strategic behavior could yield Sprint more customers, calls and revenues, and ultimately higher returns, than would otherwise be the case."[215]

Notwithstanding the above, however, the Commission found several strong countervailing reasons to grant the petition. First, the Commission believed that the recent liberalization efforts by the French and German governments were an important first step toward effective facilities and services competition.[216] Moreover, the Commission noted that the European Union established January 1, 1998, "as the date by which most Member States, including France and Germany, must fully open their telecommunications markets by liberalizing existing monopolies for public voice telephony services and transmission facilities."[217]

Second, the Commission found that the proposed transaction would result in significant procompetitive benefits—primarily by permitting Sprint to use the substantial sum of new investment capital to upgrade its existing infrastructure—in a variety of relevant product markets, including domestic interexchange services, terrestrial commercial mobile radio services (CMRS), U.S. international services, and the nascent market for global seamless services.[218] While the Commission reasoned that "capital invest-

> (4) undercharging Sprint and the Joint Venture and/or overcharging their competitors for use of the same essential facilities in France or Germany; (5) leaking to Sprint and the Joint Venture the confidential information that FT or DT receives from Sprint's and the Joint Venture's competitors; (6) giving Sprint and the Joint Venture advance notice of network changes and other information that Sprint, the Joint Venture and their competitors will need to know; or (7) either as an agent or through an affiliated third party, selling the services of Sprint or the Joint Venture in ways that use FT's and DT's home market power.

Id. (citation omitted).

215. *Id.* para. 57. In the end, the FCC imposed the following five conditions: first, the Commission classified Sprint as a dominant carrier (without price cap regulation, however) for the provision of U.S. international services on the U.S.-France and U.S.-Germany routes. Second, the Commission prohibited Sprint from operating additional circuits "on the U.S.-France and U.S.-Germany routes until France and Germany . . . liberalized two important markets: alternative infrastructure for already liberalized services (which include most non-public voice services) and basic switched voice resale." *Id.* para. 4. Third, the Commission required Sprint to comply with nondiscrimination and reporting requirements. Fourth, the Commission held that the proposed transaction would serve the public interest only if Sprint obtained a written commitment from FT to lower the accounting rate between the United States and France to the same range as the U.S.-U.K. and U.S.-Germany accounting rates. *Id.*

216. *Id.* paras. 63-73.

217. *Id.* para. 74.

218. *Id.* para. 88. The Commission recognized that at the time of the *BT/MCI* decision, there were no established global seamless service providers. At the time of Sprint's petition, there were several such providers in this market, such as AT&T's partnerships (through Worldpartners and Uniworld), and the BT/MCI alliance (Concert). As such, the Commission held that the "Joint Venture between Sprint, FT and DT would add another

ment is not, by itself, necessarily procompetitive or efficient, the competitive forces in [these markets should] drive Sprint to devote the investment to making itself a stronger competitor in the ways it describ[ed]."[219] As such, the Commission believed that

> Sprint's strengthening of itself as a competitor against its larger rivals, AT&T and MCI, should yield procompetitive benefits for consumers. . . . [B]y permitting Sprint to expand and upgrade its existing network, undertake additional research and develop new applications and services, the capital should ultimately benefit consumers through lower prices and more service choices.[220]

2. Questions of Dominance and Effective Competitive Opportunities

a. Generic Worldwide Dominance: The AT&T International Nondominant Petition[221]

In this *Order*, the Commission finally granted AT&T's petition to be declared a nondominant carrier for all U.S.-based IMTS routes.[222] At the time of this *Order*, "dominance" for AT&T meant that AT&T, for every single international route, was subject to stringent FCC reporting requirements, price cap regulation, and any new tariff AT&T filed was subject to a forty-five-day notice and comment period before it could go into effect.[223]

First, the Commission found that AT&T's market share for IMTS service declined consistently over the past several years (indeed, AT&T actually lost market share faster for IMTS service than for domestic service). This pattern of sustained reductions of AT&T's market share suggested in-

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significant competitor to this market" and would yield significant competitive benefits for U.S. customers. *Id.* para. 86. Specifically, the Commission reasoned that "[t]he establishment of a new, viable competitor in this area should result in more competitive options for U.S. customers, particularly in terms of pricing and variety of services available for large scale, high-end customers such as multinational corporations." *Id.* para. 87. In addition, the Commission believed that the Joint Venture would "offer a number of efficiencies for Sprint, such as greater economies of scale, easier entry into new markets and the sharing of risks. Given that several strong competitors already exist[ed] in this market," the Commission therefore concluded that "the procompetitive effects of the Sprint/FT/DT transaction outweigh[ed] any possible anticompetitive results in this market." *Id.*

219. *Id.* para. 80 (citations omitted).

220. *Id.* (citation omitted).

221. Motion of AT&T Corp. to be Declared Non-Dominant for International Service, *Order*, 12 F.C.C.R. 17,963, 3 Comm. Reg. (P & F) 111 (1996) [hereinafter *AT&T Order*].

222. *Id.* para. 98. However, because there were four markets with *de minimis* revenues, the Commission decided to forbear from imposing dominant carrier regulation on those routes. *Id.* paras. 94-97.

223. As explained *infra* in Part III.D, the FCC's concept of dominance was widely inconsistent depending on its political mood *du jour*.

tense rivalry for IMTS service.[224] Second, the Commission found that, as of the time of this *Order*, demand was highly elastic for IMTS service; in fact, the Commission held that consumers are even more price sensitive for international services than they are for domestic services.[225] Third, the Commission analyzed the elasticity of supply of the IMTS market, in terms of both the number of operators and the amount of capacity available. In both cases, the Commission found that there were sufficient competitive alternatives available to mitigate against any successful exercise of market power by AT&T.[226] In fact, the FCC found that to the extent that barriers to entry continued to exist, they were not so great as to bar effective competition, nor were they particular to AT&T.[227]

As such, the Commission found that the "increasing availability of both multiple operating agreements and of alternative means for U.S. facilities-based carriers to route their traffic support[ed] a finding to reclassify AT&T as non-dominant on all but the four U.S. international routes" on which it exercised its new authority to forbear from imposing dominant carrier regulation.[228]

224. *AT&T Order*, *supra* note 221, paras. 37-39.

225. *Id.* paras. 42-47.

226. *Id.* paras. 48-51.

227. *Id*. paras. 56-57. While the Commission readily agreed "that U.S. international calling prices are at the very high end of the 'zone of reasonableness'" (indeed, the Commission noted that residential IMTS pricing was (and continued to be) significantly higher and more profitable than U.S. domestic long-distance calling prices, and some IMTS prices had risen over the past several years), the Commission concluded that because: (a) the record in the *ECO Order* suggested that "high international calling prices result[ed] more from problems with the structure, conduct and performance of the international market than from market power unique to AT&T; [and (b) there was] evidence in the record to support [a] conclusion that residential IMTS customers [were] very price sensitive," and could be expected to switch international carriers in response to price promotions, the Commission therefore found that "AT&T alone could not raise and sustain prices above a competitive level for residential services without risking loss of its customers to its competitors." *Id.* para. 83. In particular, the Commission stated that it was "especially concerned about the apparently large profits that U.S. international carriers make as a result of imperfections in the U.S. international market." *Id.* Indeed, the Commission found that "AT&T's competitors, including WorldCom, could choose to sacrifice some of their profitability to increase their market share, but have not done so." *Id.* (citing report that "WorldCom and its predecessor companies, for example, provided a total return to investors of 57.3 percent per year during the past decade." WALL ST. J., Feb. 19, 1996, at D2.) To remedy this situation, the Commission stated that it would continue to take steps to "expedite the entry of additional U.S. competitors to the U.S. international services market as provided for under the *1996 Act*," because, in the Commission's own words, "[a]dditional competition is the best way to reduce high U.S. international calling prices." *Id.* para. 86.

228. *Id.* para. 51. *See also Streamlining Report and Order*, *supra* note 114, para. 49. There, the Commission streamlined its procedures for discontinuing international service because it found that the "increase in the number of international carriers and competition

b. Does the FCC View Competition/Antitrust Laws as Effective as Regulation? The Telecom New Zealand ECO Case[229]

In this *Order*, the FCC granted, subject to certain conditions, Telecom New Zealand Limited's (TNZL) application to obtain Section 214 authority to acquire U.S. half-circuits in transoceanic cables and satellite capacity in order to provide services between the United States and New Zealand on a full-circuit basis.[230] TNZL proposed to "terminate its facilities at a point of interconnection on the West Coast of the United States, outside the geographic areas served by the local exchange telephone companies of Bell Atlantic Corporation and Ameritech Corporation," which held indirect minority ownership interests in TNZL at the time of this *Order*.[231]

The Commission reasoned that because TNZL was a "foreign carrier" within the meaning its rules, it had to examine TNZL's application under the framework established in *ECO*—that is, whether it should apply *ECO* if TNZL had sufficient market power in its home market that could potentially be leveraged to the detriment of unaffiliated U.S. carriers providing service to those countries.[232] After reviewing: "(1) TNZL's market share; (2) the supply elasticity of the market; (3) the demand elasticity of TNZL's customers; and (4) TNZL's cost structure, size and resources,"[233] the Commission concluded that because TNZL "controlled the only ubiquitous local exchange network in New Zealand," TNZL therefore had market power in the local access market and, as such, it was appropriate (and necessary) to conduct an *ECO* analysis.[234]

The first public interest factor the Commission examined was whether New Zealand had any legal barriers to entry for U.S. carriers to provide international telecommunications services. After review, the Commission concluded that there were none.[235] The Commission found that all applicants (indigenous and foreign alike) seeking to provide international service in New Zealand simply had to register with, and pay a registration fee to, the Communications Division of the Ministry of Commerce, "in circumstances where the applicant (other than a 'call-back' operator) proposes to intercon-

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in international services means that customers can switch to another international carrier if service is discontinued by their current carrier."

229. Telecom New Zealand Limited, Application for Authority under Section 214 of the Communications Act of 1934, *Order, Authorization and Certificate*, 12 F.C.C.R. 19,379, 6 Comm. Reg. (P & F) 1 (1996).

230. *Id.*

231. *Id.* para. 3 (citation omitted).

232. *Id.* para. 5.

233. *Id.* para. 8 (citations omitted).

234. *Id.* para. 9.

235. *Id.* para. 11.

nect international facilities to the public switched network."[236] The Commission further found that as of the time of this *Order*, ten companies had registered as international service operators in New Zealand (five of which were facilities-based) and, moreover, that no applicant had been denied registration as an international service operator as of the date of the *Order*.[237]

Next, the Commission examined New Zealand's terms and conditions for interconnection. The Commission stated that while the New Zealand interconnection regime may not have been designed as the Commission preferred, it appeared that—based on existing laws and regulations, the existence of multiple international facilities-based carriers (including one with 23 percent market share), and most importantly on favorable toll interconnection rates—U.S. carriers had the opportunity to obtain interconnection on reasonable and nondiscriminatory terms for the provision of international facilities-based service.[238] Indeed, the Commission stated that while it was "concerned" that "New Zealand [did] not have standard rates for toll interconnection, accompanied by a pricing methodology that enables carriers seeking such interconnection to determine whether prices are cost-based," the Commission nonetheless believed that "[o]ther aspects of New Zealand's regulatory regime and market performance . . . weigh[ed] in favor of finding that New Zealand satisfi[ed] this aspect of [the] ECO test."[239]

Specifically, the Commission found that "New Zealand relies primarily on its Commerce Act 1986—its general competition law—to regulate telecommunications."[240] "In particular, Section 36 of the statute prohibits entities with a dominant position in a market from using their position to restrict or eliminate competition."[241] In addition, the Commission noted that New Zealand had issued some sector-specific legislation, including the Telecommunications Act of 1987, "which, along with subsequent amendments, liberalized the provision of telecommunications services, authorized the government to regulate international services and required [incumbent carriers] to disclose financial and interconnection information."[242] Moreover, the Commission found that the New Zealand government has published several sets of regulations regarding telecommunications, including: (1) the Telecommunications (Disclosure) Regulations of 1990; and (2) the Telecommunications (International Services) Regulations of 1994.[243] In addition, the Commission

236. *Id.* (citation omitted).
237. *Id.* para. 12.
238. *Id.* para. 17.
239. *Id.*
240. *Id.* para. 18.
241. *Id.* (citation omitted).
242. *Id.*
243. *Id.*

noted that while "[i]nterconnection arrangements in New Zealand are negotiated on a private contractual basis, . . . several factors [nonetheless] help protect against discriminatory conduct."[244] In the FCC's view, such factors included:

> (1) the legal requirement that [the incumbent carrier] provide interconnection on terms that are not unreasonably discriminatory; (2) public and private remedies for anticompetitive conduct, and the apparent willingness of the New Zealand government to utilize such public remedies;[245]

(3) the requirement that the incumbent carrier publish its prescribed services and all interconnection agreements on a quarterly basis; and "(4) emerging competition in the New Zealand local exchange market."[246]

Notwithstanding the above, the Commission could not resist taking several cheap pot-shots at a country that decided to take a different regulatory approach than that adopted by the United States. To wit, even though the FCC found that there was, in fact, adequate regulatory oversight in New Zealand (particularly when considered in combination with the expanding list of competitors in the New Zealand international telecommunications market), the FCC stated that it believed that "*competition in the New Zealand telecommunications market would be better served if the government played a more direct role in overseeing interconnection arrangements*"[247] as the U.S. government had "*concerns about the effectiveness of the New Zealand regulatory regime*."[248] Indeed, the FCC felt compelled to comment that, in its humble, expert opinion, "*competition would be better assured if the Ministry took a more active regulatory approach*."[249] The fact that the FCC made these statements while priding itself as the leader in "deregulatory" and "procompetitive" initiatives is comical at best.

c. ECO and Submarine Cable Landing Rights: The TLD and C&W ECO Cases

If a foreign carrier wants to land an undersea cable onto U.S. shores, this carrier must first obtain permission from the U.S. government before it may do so. These situations are governed by the Cable Landing License Act, which gives the President of the United States broad discretion to grant, withhold, condition or revoke cable landing licenses if the President determines

244. *Id.* para. 19.
245. *Id.*
246. *Id.* (citations omitted).
247. *Id.* para. 20 (emphasis added).
248. *Id.* para. 35 (emphasis added).
249. *Id.* para. 34 (emphasis added).

> after due notice and hearing that such action will assist in securing rights for the landing or operation of cables in foreign countries, or in maintaining the rights or interests of the United States or of its citizens in foreign countries, or will promote the security of the United States, or may grant such license upon such terms as shall be necessary to assure just and reasonable rates and service in the operation and use of cables so licensed.[250]

By Executive Order, the Commission has been delegated the responsibility for issuing cable landing licenses. This delegated authority is subject to the proviso, however, that "no such license shall be granted or revoked by the Commission except after obtaining approval of the Secretary of State and such advice from any executive department or establishment of the Government as the Commission may deem necessary."[251]

Thus, even though there is no "public interest" standard contained in the Cable Landing License Act, the Commission decided to apply its *ECO* test to these situations as well. For example, in *Telefonica Larga Distancia de Puerto Rico, Inc.* (TLD),[252] the FCC denied TLD's applications to acquire ownership interests in the COLUMBUS II Cable System (COLUMBUS II)—a common carrier cable—and for Section 214 authority to provide service to Spain on COLUMBUS II. Specifically, TLD, "which [was] affiliated with Telefonica de España, [applied] to have ownership interests as a licensee in a submarine cable landing in both the United States and its home market, Spain. The ownership interests consist of three minimum investment units ('MIUs') from the United States to Spain to be jointly owned with Telefonica de España."[253] Yet, because, in the Commission's opinion, "U.S. carriers [were] denied effective competitive opportunities to have ownership interests in cable facilities landing in Spain and to operate as facilities-based international service providers in Spain,"[254] the Commission nonetheless denied TLD's application.

In defense of its actions, the FCC stated that its actions were fully in accord with the coordinated positions of the U.S. State Department, the Department of Defense, the National Telecommunications & Information Administration, and the Office of U.S. Trade Representative, and that it was also legally required to "consider whether granting a license will assist in securing the rights for U.S. companies to land or operate cables in foreign

250. 47 U.S.C. § 35 (1998).

251. Exec. Order No. 10,530, 19 Fed. Reg. 2709, 2711 (1954).

252. Telefonica Larga Distancia de Puerto Rico, Inc., *Memorandum Opinion and Order*, 12 F.C.C.R. 5173, 8 Comm. Reg. (P & F) 64 (1997) [hereinafter *Telefonica Memorandum Opinion and Order*].

253. *Id.* para. 31. "A MIU is the minimum unit of investment for ownership in COLUMBUS II. Each MIU contained 30 64 Kbit/s voice paths." *Id.* n.41.

254. *Id.* para. 2.

countries."[255] Moreover, even though the Commission conceded that it did not address its market entry rules for applications under the Cable Landing License Act in its *ECO Order*—and, in particular, that its analysis as it applies to applications under the Cable Landing License Act "is similar but not identical to" its analysis under Sections 214 and 310(b)(4) of the Act—this *Order* gave it "the opportunity to explain [its] historical approach to those types of applications, and how it relates to the effective competitive opportunities analysis adopted in the *Foreign Carrier Entry Order*."[256]

Once again, the FCC defined market power as "'the ability of the carrier to act anticompetitively against unaffiliated U.S. carriers through the control of bottleneck services or facilities on the foreign end.'"[257] Thus, because the Commission found that "U.S. carriers [were] forbidden from having ownership interests in the Spanish end of international submarine cable systems . . . Telefonica de España, through its control of TLD, [would] have ownership interests at both ends of the cable with monopoly control at the Spanish end."[258] Because, in the Commission's view, there would be no "equivalent rights . . . for U.S. carriers to have ownership interests in submarine cables in Spain, . . . the Spanish market . . . [did] not pass the first prong of its analysis that looks at the legal, or *de jure*, ability of U.S. carriers to have ownership interests in submarine cables landing in Spain."[259] Moreover, the FCC found that because TLD's ownership in COLUMBUS II "would yield significant economic benefits to Puerto Rican consumers that would outweigh [its] concerns about the lack of effective competitive opportunities for U.S. carriers to have ownership and operation rights in the Spanish market," there were no countervailing reasons for it to grant this application.[260]

255. *Id.* para. 25 (citation omitted).

256. *Id.* para. 26.

257. *Id.* para. 28.

258. *Id.* para. 32 (citation omitted).

259. *Id.*

260. *Id.* para. 33. In a related part of this *Order*, the FCC—for reasons similar to those provided to support a denial of TLD's cable landing petition—also denied TLD's Section 214 application to provide IMTS service between the United States and Spain. Notwithstanding Spain's failure of the FCC's *ECO* test, the Commission added that a denial was also warranted in this case due to the FCC's concerns about Telefonica de España's high accounting rates for traffic between the United States and Spain. In the Commission's view, not only were these rates much higher than other European countries' rates, but Telefonica de España's affiliates' rates to the United States were also "quite high." As such, the Commission reminded the industry that while it declined to make cost-based accounting rates a precondition to entry in the *Foreign Carrier Entry Report and Order*, it would consider the presence of cost-based accounting rates as part of its overall public interest analysis. In the Commission's view, therefore, the above-cost accounting rate of Telefonica de España was simply another negative factor in its overall public interest

Not content to apply its *ECO* test exclusively to landing applications from common carrier undersea cables, the Commission announced that it would also apply its *ECO* test to cable landing license applications from private (i.e., noncommon carrier) submarine cables as well. As a test case for this new policy shift, the Commission decided to use an application by Cable & Wireless (C&W) to land a private undersea cable between the United Kingdom and the United States.[261] C&W responded, however, that its application was not subject to an *ECO* analysis because the Commission previously determined in the *Foreign Carrier Entry Report and Order* that the *ECO* analysis did not apply to "'domestic interexchange services, enhanced services, separate satellite systems and other non-common carrier facilities.'"[262]

Citing its previous decision in the *Telefonica Memorandum Opinion and Order*, the Commission rejected C&W's argument.[263] Yet, while the Commission recognized that C&W, unlike TLD, was requesting authority to land and operate a noncommon carrier cable, the Commission nonetheless concluded that it should conduct an *ECO* analysis in this situation because the same principles "apply regardless of whether a carrier seeks to own and operate a cable system on a common carrier or non-common carrier basis because all submarine cable applications are subject to the provisions of the Cable Landing License Act."[264] As such, the FCC looked to see whether C&W could exercise market power—that is, whether C&W had the ability "'to act anticompetitively against unaffiliated U.S. carriers through the control of bottleneck services or facilities on the foreign end.'"[265]

Upon review, the FCC found that at the time of this *Order*, there was a "wide availability of circuits between the United States and the United Kingdom."[266] Moreover, the FCC found that the government of the United Kingdom had just "issued licenses to forty-five new entrants, including a number of U.S. carriers, to provide U.K. facilities-based service."[267] Because no further authorization was needed to land cables in the United Kingdom under the terms of these licenses, the FCC also expected that "new entrants [would] take advantage of this liberalization to construct and operate

analysis. *Id.* para. 39.

261. *See* Cable & Wireless, PLC., Application for a License to Land and Operate in the U.S. a Private Submarine Fiber Optic Cable Extending Between the U.S. and the U.K., *Cable Landing License*, 12 F.C.C.R. 8516, 8 Comm. Reg. (P & F) 712 (1997).

262. *Id.* para. 19 (citing *ECO Order*, *supra* note 56).

263. *Id.* para. 22.

264. *Id.* para. 25 (citation omitted).

265. *Id.* para. 26 (citation omitted).

266. *Id.* para. 16 (citation omitted).

267. *Id.* para. 34.

new cable facilities in competition with BT and Mercury."[268] Accordingly, the FCC concluded that C&W did not have market power in the United Kingdom, and, as such, it did not have to "reach the issue of whether the United Kingdom affords U.S. carriers effective competitive opportunities to land and operate cable systems in the United Kingdom."[269]

d. *Who Needs Market Power To Apply ECO? The MAP and APC PCS ECO Orders*[270]

On May 16, 1997, the FCC's International Bureau issued two *Orders* which approved a foreign investment into a U.S. personal communications services (PCS) company that would exceed the 25 percent benchmark contained in Section 310(b)(4) of the Communications Act. In the first *Order*, the Commission approved the investment by an Australian company into MAP Mobile Communications, Inc., a U.S. PCS company; in the second, the FCC approved the investment of a German company in APC PCS, another U.S. PCS company. What is significant about these *Orders* is not the fact that the FCC made no mention of the possibility of having either the dominant firm from Australia or Germany leverage its foreign market power into the U.S. PCS market, *but the fact that in the absence of such a concern*, the FCC performed an *ECO* analysis of the German and Australian wireless markets nonetheless.[271] What is also significant to note is that the FCC decided to apply the reciprocal *ECO* test in these two situations despite the fact that both Germany and Australia had signed on to the February Accord and, in particular, the Regulatory Reference Paper.[272]

3. Settlement Rate Disputes: The Telintar Trade War

The seeds of the Telintar "trade war" were first planted when AT&T's settlement rate agreement with Telintar—the monopoly provider of IMTS service in Argentina at the time of this *Order*[273]—expired, and the parties

268. *Id.*
269. *Id.*
270. MAP Mobile Comm., Inc. Petition for Declaratory Ruling Concerning Section 310(b)(4), *Order*, 12 F.C.C.R. 6109 (1997) [hereinafter *MAP Order*]; APC PCS d/b/a Am. Personal Comm. Petition for Declaratory Ruling Concerning Section 310(b)(4) of the Comm. Act of 1934, as amended, *Declaratory Ruling and Order*, 12 F.C.C.R. 6535 (1997) [hereinafter *APC Declaratory Ruling and Order*].
271. *See MAP Order*, *supra* note 270, para. 7; *APC Declaratory Ruling and Order*, *supra* note 270, paras. 8-9.
272. *See MAP Order*, *supra* note 270, para. 19; *APC Declaratory Ruling and Order*, *supra* note 270, paras. 17-18, 21; *cf. ECO Order*, *supra* note 56, para. 187 ("We do not believe it is unfair to hold foreign carriers accountable for the policies of their home governments.").
273. AT&T Corp., Proposed Extension of Accounting Rate Agreement for Switched

could not come to a new agreement (under the previous contract, the parties had agreed to an accounting rate of $1.47 per minute).[274] Although the parties agreed to an interim extension of the contract, the parties nonetheless immediately started to engage in surreptitious conduct against each other.[275]

On Telintar's part, it allegedly: (a) blocked 180 of AT&T's circuits over this period, thus preventing the use of those circuits by AT&T for outbound U.S. international calls to Argentina; (b) "disabled AT&T's USADirect® Service from Argentina"; and (c) "rerouted a portion of AT&T's return traffic to other carriers."[276] Not without its own arsenal, however, AT&T petitioned for, and in the end received, help from the U.S. government in this matter. This help included communications from both the State Department and the FCC to the Argentine regulator, the National Telecommunications Commission (CNT).[277] Unfortunately, the U.S. diplomatic efforts failed, as Telintar continued to refuse to restore service.[278]

With the failure of regulatory diplomacy, the United States—through the FCC—decided to take stronger measures to protect its flagship telephone company. As its opening salvo, the FCC announced to the IMTS community that, "*This Commission will not allow foreign monopolists to undermine U.S. law, injure U.S. carriers or disadvantage U.S. consumers. Telintar, of Argentina, is attempting to do just that. We must use our regulatory authority to prevent this effort from being successful*."[279] To back this fiery rhetoric up, the Commission ordered *all* U.S. carriers to suspend settlement payments to Telintar effective immediately and, moreover, directed all U.S. carriers to continue this suspension until AT&T's circuits were no longer blocked and its USADirect® Service was restored.[280]

Yet, it appeared that the FCC only used rubber, rather than real bullets in this skirmish. Specifically, Telintar would suffer no direct financial dam-

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Voice Service with Arg., *Order*, 11 F.C.C.R. 18,014, para. 1 n.1 (1996). In addition, "Telefonica of Argentina and Telecom Argentina, Argentina's two regional monopoly providers of local telephone service, each own[ed] 50 percent of Telintar" at the time of this Order. *Id.*

274. *Id.* para. 4.

275. *See id.* paras. 4-5.

276. *Id.* para. 5.

277. *Id.* para. 6.

278. *Id.* The casualties of this trade war unfortunately spilled beyond the AT&T/Telintar theater. As this fight was going on, Telintar allegedly refused to grant WorldCom adequate facilities to terminate all of WorldCom's traffic destined for Argentina which forced WorldCom to overflow as much as 25% of its traffic to other carriers for termination in Argentina. However, WorldCom did advise the Commission "that the additional capacity it requires could be accomplished by means of circuit multiplication, and that no additional investment in cable or satellite facilities [wa]s required." *Id.* para. 7.

279. *Id.* para. 1 (emphasis added) (citation omitted).

280. *Id.* para. 15.

age because the FCC instructed U.S. carriers to pay Telintar any settlements that had been withheld.[281] Moreover, the Commission set a maximum interim accounting rate that U.S. carriers could pay of $1.43 per minute. While this rate was still higher than the FCC's prior maximum benchmark rate of $1.20, this rate reflected the lowest level agreed to by Telintar with a U.S. carrier (i.e., MCI and Sprint). In the FCC's view, $1.20 "appear[ed] generous as an interim accounting rate."[282]

When the dust cleared, however, the "power of the purse" won this trade war in the end. Apparently finding that its immediate need for a consistent and substantial stream of above-cost accounting rate revenue outweighed its willingness to stand on principle and suspend service indefinitely as a matter of national pride, Telintar restored the blocked circuits. As soon as it did, the FCC permitted U.S. carriers to resume payments.[283]

D. Summary and Analysis

The cases analyzed in the preceding section run the full gamut between the good, the bad, and the ugly. On a high note, AT&T was finally reclassified as a nondominant carrier, an *Order* that, especially when placed in context with the other recent FCC items discussed herein, was long overdue. As this Article has highlighted above, the Commission's definition and application of its dominant carrier regulation have differed greatly depending on the particular circumstances. To wit, at the time of the *AT&T Order*, even though AT&T controlled neither foreign nor domestic bottleneck facilities, AT&T's "dominance" meant that AT&T, for every single international route, was subject to stringent FCC reporting requirements, price cap regulation, and any new tariff AT&T filed was subject to a forty-five-day notice and comment period before it could go into effect. Yet, in the *Sprint Declaratory Ruling*, where the investment of two foreign, state-owned monopolists was involved, the Commission imposed no price cap regulation and only required fourteen days notice and comment period for any new rate filings.[284] Similarly, in *BT/MCI I*, where BT readily admitted it was the dominant carrier in the United Kingdom at the time of the initial transaction (indeed, *BT/MCI I* occurred well before the United Kingdom started its recent comprehensive deregulation and pro-competition initiative), the FCC said

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281. *Id.* para. 11.

282. *Id.* para. 12.

283. *See* FCC News Release, *International Action AT&T Circuits to Argentina Reactivated; Settlement Payments to Resume*, Rep. No. IN 96-9, 1996 FCC LEXIS 1498 (Mar. 27, 1996).

284. These are essentially the same "dominant carrier" requirements the FCC imposed in its *ECO Order. See supra* note 56.

that it would not impose dominant carrier regulation because of increasing effectiveness of competitive pressures plus the effectiveness of the FCC's own ISP.

Unfortunately, everything seemed to go downhill from there. At bottom, it appears that the Commission simply could not make up its mind as to whether it wanted foreign firms to invest in U.S. carriers or even to enter the U.S. market outright. For example, despite its reciprocity bravado, the Commission's application of its *ECO* test in the *Sprint Declaratory Ruling* turned out to be nothing more than a political sieve as the FCC permitted the transaction to proceed essentially because France and Germany stated "officially" that they were "committed to full competition." In the case of New Zealand, the FCC had the hubris to tell the New Zealand government that its exclusive reliance on market performance and competition laws were insufficient and that the FCC would prefer more government intervention (i.e., *regulation)* in the market. Finally, in the *Map Order* and *APC Declaratory Ruling and Order*, the FCC announced that reciprocity concerns would trump the potential benefits consumers could receive when somebody was actually willing to spend (and sink) the substantial amount of money necessary to construct additional submarine cable capacity in a market where demand increases exponentially on nearly a daily basis.

In the end, therefore, the cases above demonstrate that the Commission's bravado, coupled with its ambivalence toward the effective enforcement of its *ECO* standard, apparently contributed positively to neither consumer welfare nor promotion of U.S. investment abroad. Rather, such policies unfortunately only succeeded in making everyone mad.

IV. THE WTO AND ITS AFTERMATH

A. *General Overview*

On February 15, 1997, under the auspices of the WTO, more than sixty countries agreed to an international accord designed to promote global competition for telecommunications services. The following Section tries to explain exactly what the February Accord is—and, perhaps more importantly, what it is *not*.

1. Brief History

The WTO Basic Telecommunications Agreement was concluded under the framework established by the General Agreement on Trade in Services (GATS), which is one of the agreements negotiated in conjunction with the

creation of the WTO.[285] For the first time, the GATS brought trade in services within the international trading regime established for trade in goods by the General Agreement on Tariffs and Trade (GATT) after the Second World War. The GATS consists of general obligations and specific sectoral commitments contained in individual Member Schedules.

a. The GATS

The GATS is composed of three major components. The first component consists of general obligations and disciplines which apply to all WTO Members. The second component is comprised of specific commitments relating to market access, national treatment, and other commitments, which are embodied in individual WTO Member Schedules of Specific Commitments.[286] The final component sets out exemptions from the general obligations embodied in Lists of Article II (Most-Favoured-Nation (MFN)) Exemptions.[287]

The most important of the general obligations and disciplines that apply to all WTO Members is the requirement in Article II of the GATS to accord MFN treatment to like services and service suppliers of all other WTO Members, no matter what specific commitments a WTO 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

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285. The WTO came into being on January 1, 1995, pursuant to the Marrakesh Agreement Establishing the World Trade Organization. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS 2 (GATT Secretariat 1994), 33 I.L.M. 1125 (1994) [hereinafter Final Act]. The Marrakesh Agreement consists of multilateral agreements on trade in goods, services, intellectual property and dispute settlement. *See* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1B, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS 325 (GATT Secretariat 1994), 33 I.L.M. 1167 (1994) [hereinafter GATS]. There are currently about 130 Members of the WTO.

286. The Schedules of Specific Commitments form an integral part of the GATS pursuant to Article XX of the GATS. The Schedules containing commitments on basic telecommunications services are available on the WTO Web page at <http://www.wto.org>. GATS, *supra* note 285, art. XX.

287. The Annex on Article II Exemptions specifies the conditions under which a WTO Member is exempted from its MFN obligations under paragraph 1 of Article II. The United States excluded from its market access commitments and national treatment obligations and took an MFN exemption for the provision of direct-broadcast satellite services, direct-to-home satellite services and digital audio radio satellite services. GATS, Annex on Article II Exemptions, WTO Agreement, Annex 1B, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS 352 (GATT Secretariat 1994), 33 I.L.M. 1196 (1994).

similarly.[288] In addition to the MFN obligation, all WTO Members undertake transparency obligations in accordance with Article III (Transparency) of the GATS, which requires prompt publication of all laws and regulations applicable to the provision of services.[289]

Many WTO Members, including the United States, undertook specific commitments with respect to market access and national treatment as a result of the February Accord. GATS Article XVI (Market Access) requires each WTO Member to "accord services and service suppliers of any other [WTO] Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule" and to refrain from imposing certain types of quantitative restrictions, economic needs tests or local incorporation requirements, in those sectors where the WTO Member has undertaken specific market access commitments.[290] This means that a Member may not maintain limits such as the number of service suppliers or the corporate form in which a service can be provided unless the Member has specifically listed such limitations in its Schedule. Article XVII (National Treatment) is a nondiscrimination rule that requires a WTO Member to treat like services and service suppliers from other WTO Members no less favorably than it treats its own services and service suppliers.[291] Under GATS Articles II (MFN) and XVII (National Treatment), treatment of domestic and foreign service suppliers need not be identical to accord MFN or national treatment. The critical aspect of an MFN or national treatment analysis is whether the treatment accorded modifies the conditions of competition in favor of certain foreign or domestic suppliers. Thus, dissimilar treatment can be consistent with MFN or national treatment obligations if it does not put the foreign supplier at a competitive disadvantage to another foreign supplier or a domestic supplier.

288. Article II of the GATS requires WTO Members to accord "to services and service suppliers of any other [WTO] Member treatment no less favourable than that it accords to like services and service suppliers of any other country." GATS, *supra* note 285, art. II.

289. *See id.* art. III.

290. *Id.* art. XVI. A quantitative restriction is a cap on the number of permitted suppliers; an economic needs test is a limitation on the number of service suppliers based on an assessment of whether the market will be able to absorb new service suppliers without harm to existing service suppliers.

291. Article XVII states that "[i]n the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers." *Id.* art. XVII (citation omitted).

b. The Inclusion of Telecommunications Under the GATS

At the conclusion of the negotiations creating the WTO in April 1994, the United States and other WTO Members made commitments to allow market access for a broad range of services—including such diverse industries as construction services, professional services (such as legal and medical services), distribution services, and value-added (or enhanced) telecommunications services.[292] Basic telecommunications, however, was one of a limited number of service sectors for which negotiations were extended beyond April 1994.[293] WTO Members recognized the economic importance of basic telecommunications services and established a separate, sector-specific negotiation for these services which were scheduled to conclude by April 30, 1996. Because the negotiations had made insufficient progress by that date, the WTO agreed to extend the deadline for concluding the negotiations to February 15, 1997. This extension resulted in the February Accord.[294]

292. The United States adopted the Commission's definition of enhanced services for purposes of its GATS obligations, that is, "services, offered over common carrier transmission facilities . . . which employ computer processing applications that act on the format, content code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702 (1997).

293. The other sectors were financial services and maritime services.

294. For a truly excellent summary of the negotiations, political back-stabbing and other events leading up to the February Accord, see CYNTHIA A. BELTZ, THE BORDERLESS ECONOMY: GLOBAL TRADE RULES AND THE INTERNET (AEI, forthcoming 1999). For example, if the second round of WTO negotiations fell apart, the United States was fully prepared to blame its "friendly neighbors to the north"—the Canadians—for seeking to impose stringent indigenous content restrictions on broadcast and satellite services. *See* David Molony, *U.S. Guns for Canada at WTO*, COMM. WK. INT'L, Feb. 3, 1997, at 1. Not only is this act alone outrageous (after all, how is one more choice—even if it is Canadian rules football or repeats of SCTV's "Great White North"—actually *bad* for American consumers), but it is especially hypocritical given Canada's long track record of broadcasting "acceptable" children's educational programming—one of the Clinton/Gore/Hundt Administration's primary regulatory agendas. *See, e.g.*, Statement by FCC Commissioner Susan Ness on the Death of Shari Lewis, 1998 WL 439268, Aug. 4, 1998 ("lament[ing]" that Shari Lewis "had to go to Canada to find funding for educational children's programming"); *see also* Reed Hundt, *Statement on Westinghouse's Children's Educational Television Announcement, WDC*, Sept. 20, 1995 (visited Nov. 4, 1998) <http://www.fcc.gov/Speeches/Hundt/spreh527.txt> ("Westinghouse's assurance that it will deliver three hours of children's educational TV on CBS underscores the tremendous importance of teaching our kids, instead of harming them, with broadcast TV." In the words of President Clinton, American children must not "lose 'countless opportunities to learn' from quality educational TV delivered by commercial networks for free to every home in the country.") (Note: The FCC attempted to act deceptively when Disney sought to acquire ABC/Cap Cities. Considering Disney's well-documented record with creating children's programming, however, Mr. Hundt could only argue that "it remain[ed] to be seen" whether Disney could still do something more to help America's children.); Statement of Reed Hundt in Response to AT&T's Pledge of $150 Million to Help Put the Nation's Schools on the Information Su-

Those WTO Members that undertook market access commitments in basic telecommunications services also became subject to the requirements relating to domestic regulation of those services contained in Article VI (Domestic Regulation). Pursuant to Article VI, paragraph 1, in sectors where specific commitments are undertaken, domestic regulation must be "administered in a reasonable, objective and impartial manner."[295] Article VI, paragraph 4 provides that a WTO Member could be in contravention of its commitments if it applies measures that are not based on objective and transparent criteria, are more burdensome than necessary, or restrict the supply of the service.[296] A WTO Member arguing, however, that a measure does contravene Article VI, paragraph 4 also must show that application of the measure could not have been reasonably expected at the time specific commitments were made.[297]

The United States and fifty-four other countries also undertook additional specific commitments as a result of the negotiations in accordance with Article XVIII of the GATS.[298] These additional commitments are the much-heralded "pro-competitive" regulatory principles contained in a document known as the "Reference Paper."[299] The Reference Paper contains principles relating to competition safeguards, interconnection, transparency of licensing criteria, independence of the regulator, allocation of scarce resources, and, of course, universal service.[300] Section 1 of the Reference Paper obligates a WTO Member to maintain appropriate measures "for the purpose of preventing suppliers who, alone or together, are a major supplier

perhighway, 1995 FCC LEXIS 7113, Oct. 31, 1995 ("We at the FCC hope that AT&T's gift," mysteriously made concurrent with the FCC's decision to declare AT&T as a non-dominant carrier for domestic service "of free internet access and voice-mail to all the children of America will catalyze a nationwide public/private partnership to network all classrooms as the President and Vice President have challenged.").

295. GATS, *supra* note 285, art. VI, para. 1.

296. *Id.* para. 4.

297. Article VI, paragraph 5(a) states that a Member "shall not apply licensing and qualification requirements and technical standards that nullify or impair [its] specific commitments in a manner which . . . could not reasonably have been expected of that Member at the time the specific commitments in those sectors were made." *Id.* para. 5(a).

298. Article XVIII states that "Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule." *Id.* art. XVIII.

299. The Reference Paper was distributed by the WTO Secretariat but never formally issued as a WTO document. The text has been published in 36 I.L.M. 367. *See* Reference Paper, FOURTH PROTOCOL TO THE GENERAL AGREEMENT ON TRADE IN SERVICES 436 (WTO 1997), 36 I.L.M. 354, 367 (1997). Another 10 countries either agreed to adopt the Reference Paper principles in the future or inscribed their own regulatory principles in their Schedules.

300. *Id.*

from engaging in or continuing anti-competitive practices."[301] With regard to licensing, the Reference Paper requires that all licensing criteria and the terms and conditions of individual licenses be made publicly available.[302]

The GATS also allows for exceptions to a WTO Member's obligations. Where these exceptions apply, a WTO Member may act inconsistently with its MFN, national treatment, market access commitments, or any other GATS obligation. Article XIV (General Exceptions) establishes a limited set of exceptions including measures necessary to protect public morals and order, protect human and animal health, or secure compliance with nondiscriminatory laws and regulations.[303] Article XIV *bis* (Security Exceptions) permits a WTO Member to deviate from its GATS obligations in order to protect its national security interests or to carry out any obligations under the U.N. Charter to maintain international peace and security.[304]

c. Enforcement of the February Accord

Again, it is extremely important to remember that the February Accord is a *trade* agreement—*not a regulatory* agreement. As such, the commitments of the sixty-nine countries that participated in the WTO Basic Telecommunications Agreement are to be enforced through the WTO dispute settlement process, and *not* before any one particular regulatory commission (including the FCC).[305] For example, if a WTO Member (Country *A*) fails

301. *Id.* para. 1.1. "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." *Id.* Anticompetitive practices include: "(a) engaging in anti-competitive cross-subsidization; (b) using information obtained from competitors with anti-competitive results; and (c) not making available to other service suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services." *Id.*

302. *Id.* para. 4. The Reference Paper also requires that the period of time normally required to reach a decision concerning an application for a license be made publicly available. *Id.* para. 4(a).

303. Article XIV states that "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order; (b) necessary to protect human, animal or plant life or health; (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement . . . ." GATS, *supra* note 285, art. XIV.

304. Article XIV *bis* states that "[n]othing in this Agreement shall be construed . . . (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests . . . or (c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security." *Id.* art. XIV *bis*.

305. GATS Article XXIII provides that any WTO Member may initiate a dispute settlement if it believes that another Member has failed to carry out its obligations and com-

to give a carrier from Country *B* market access consistent with that WTO Member's commitments or fails to implement the Reference Paper regulatory principles, then Country *B* may enforce those commitments through the dispute settlement process at the WTO. The remedies available if Country *B* prevails include, first, an obligation by Country *A* to fulfill its market access commitments or implement the necessary regulatory principles. If Country *A* fails to do so, then it is required to compensate Country *B* in trade terms. Otherwise, Country *B* may take compensatory trade action, first in the services sector, but if sufficient compensatory trade action is not available in the services sectors (e.g., telecommunications), then Country *B* would be authorized to take compensatory action in the goods sector (e.g., widgets). Thus, if Country *A*, a WTO Member that has committed to allow market access to provide international service, denied a license to a carrier from Country *B* on the grounds of its nationality, then Country *B* would have the right to take a dispute against Country *A* to the WTO. Similarly, if a dominant carrier in Country *A* provided interconnection to carriers from Country *B* on less favorable terms than it provides to its own affiliates or to carriers from a third country, then Country *B* could take a dispute to the WTO against Country *A* for failing to maintain measures to ensure nondiscriminatory interconnection.

2. Apparent International Policy Objectives

Notwithstanding the above, the real questions to ask are: what type of IMTS market structure is supposed to emerge post-WTO, and what kind of performance can we expect from this particular market structure? After reviewing the February Accord, the general policy objectives of the WTO seem to be the following: (1) the creation of an IMTS market structure characterized by multiple vertically integrated providers of bundled IMTS telecommunications products and services; (2) full "point-to-point" service between country-pairs; (3) the abolition of the international settlement-of-accounts regime; (4) the abolition of economically expensive "anti-whipsawing" provisions (i.e., the FCC's ISP); (5) elimination of domestic monopolies; and, especially, (6) good market performance.[306] The obvious residual question, therefore, is whether the signatories to the February Accord will implement both the letter and spirit of their respective commitments, such that the end goals of the WTO can be achieved.[307]

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mitments. *Id.* art. XXIII.

306. *See generally* Rules and Policies on Foreign Participation in the U.S. Telecomm. Market, *Report and Order on Reconsideration*, 12 F.C.C.R. 23,891, 10 Comm. Reg. (P & F) 750 (1997) [hereinafter *Foreign Participation Order*].

307. It is no coincidence that the end-policy objectives look remarkably similar to the market structure envisioned by the 1996 Act. *See* Spiwak, *Reconcentration*, *supra* note 5

B. Specific Provisions of the February Accord Regarding Switched Telephone Service

The February Accord contains three different provisions relating to telephone service: (1) provisions for opening "local" domestic markets; (2) provisions for opening IMTS markets; and (3) the Regulatory Reference Paper briefly discussed above.[308] Each provision is discussed in more detail below.[309]

1. Entry into "Local" Markets

As a general proposition, ownership of local distribution facilities is one of the quintessential elements for success in the telecommunications industry. Under the February Accord, while it is indeed true that several countries have in fact agreed to permit some kind of foreign ownership or control of *local* telecommunications services and facilities by 1998, a close examination of the WTO commitments reveals that investment into local markets may not be as easy as it may seem. That is to say, for those countries that committed to permit foreign ownership by 1998, most of those countries prohibit foreign investment in the dominant incumbent provider. Therefore, in these aforementioned countries, it appears that new entrants are certainly welcome to invest in local facilities, but they must do so from

passim; Spiwak, *Economic Analysis*, *supra* note 18 *passim*. Indeed, U.S. officials and FCC *Orders* were extremely quick to claim that the world had adopted the U.S. model in the Regulatory Reference Paper as its "gold standard." *See* Reed Hundt, Statement of FCC Chairman Reed Hundt Concerning WTO Agreement on Telecom Services, 1997 WL 63345 (Feb. 18, 1997). Unfortunately, given the current success record of the 1996 Act, I can see why the world eliminated the gold standard.

308. The February Accord also contains a separate provision for satellite services. However, because the focus of this Article is on IMTS, and not satellite service, a thorough exegesis of the WTO's satellite provisions and the FCC's implementation of those provisions will not be discussed in detail here.

309. What is particularly interesting to note, however, is that contrary to the plethora of press reports and politicians' statements that the February Accord accounts for approximately 90% of world telecommunications revenue, the actual scope and depth of the February Accord may be far less than suggested. *See* William J. Drake & Eli M. Noam, *The WTO Deal on Basic Telecommunications: Big Bang or Little Whimper?*, 21 TELECOMM. POL'Y 799, 811 (1997) (While the February Accord is a "step in the right direction," it is "quite another matter to declare it, as credit-grabbing victory bulletins did, a revolution, a breakthrough, a telecommunications D-Day" because "the people directly involved in the drafting, lobbying, analyzing, and implementing of the agreement have worked hard to seal the deal, and it is therefore natural for them to believe that the result of their attention has been a monumental change rather than a monumental effort."). To wit, the United States, Japan, and the European Union alone account for 74% of total volume. Moreover, those signing the agreement account for less than 55% of the WTO membership and the world's population. In fact, as of the time of this writing, China and Russia are not signatories to the February Accord, *primarily because they are not even Members of the WTO*. *See* BELTZ, *supra* note 294; Drake & Noam, *supra* at 811-12.

the ground up. Moreover, several countries did not promise to permit foreign ownership by January 1, 1998, but instead only agreed to permit foreign ownership beginning in 1999 or well beyond. Similarly, ten countries agreed to permit only limited foreign ownership or control in certain telecommunications services, and ten countries did not agree to permit foreign control under any circumstances.

Under any conditions, however, entry into local markets is very expensive—for example, high sunk costs, incumbent's first-mover advantage, subsidized "local" service, marketing costs, etc.[310] Indeed, as evidenced by the U.S. experience of cable overbuilding or the current struggle to establish facilities-based competition for local telephone service, sometimes the economics just do not justify the investment and the risks. The difficulty of creating a successful business case for local entry is often exacerbated in those poor countries where there really is not much money to be made providing service to, and keeping on the network thereafter, people who probably cannot even afford to buy food—much less basic telephone service.

2. Entry into IMTS Service

Unfortunately, so long as the *huge* revenue stream generated by above-cost accounting rates continues, the real profit source in international telecoms is the market for IMTS service. As such, it should also come as no surprise that while thirty-one countries have in fact agreed to "guarantee" market access to *international* telecommunications services and facilities in 1998, a substantial number of countries on high-volume routes only agreed to permit competition for IMTS service originating from their markets until well into the future. These range from Peru (1999) to the most egregious offer of Jamaica (2013).[311] Moreover, six countries are open only for "selected" international service, and eight countries have limited or no market access commitments for international service.

310. George S. Ford, *Opportunities for Local Exchange Competition Are Greatly Exaggerated*, ELECTRIC LIGHT & POWER, Apr. 1998, at 20-21.

311. *See C&W Sees Threat*, THE JAMAICA GLEANER, Aug. 13, 1998 (visited Nov. 4, 1998) <http://204.177.56.98/gleaner/19980813/f1.html> (reporting that the President and Chief Executive Officer of Cable & Wireless Jamaica (a.k.a. "Telecommunications of Jamaica" or "ToJ") said that the monopoly on telecommunications enjoyed by the company through its exclusive license was the only model which could deliver the infrastructure required by the country: "'We feel that the model has worked for Jamaica and is the only model that will deliver the type of infrastructure that Jamaica will require to enter the 21st century.'"); *Bunny [Wailer] Bewails ToJ Monopoly*, THE JAMAICA GLEANER, Jan. 27, 1998 (visited Nov. 4, 1998) <http://www.204.177.56.98/gleaner/19980127/news/n3.html> ("'Jamaica cannot afford to be observed as being alienated from international competitiveness in the telecommunications market by practices that corrupt goodwill and fair trade.'").

3. Regulatory Reference Paper

Finally, nearly seventy countries agreed to guarantee some or all of the "pro-competitive" regulatory principles stated in the Regulatory Reference Paper. As mentioned above, these principles include the adoption of competitive safeguards, interconnection, publicly available licensing criteria, independent regulators, the "objective, timely, transparent and non-discriminatory" allocation and use of "scarce resources" (e.g., frequencies, numbers and rights-of-way) and, of course, universal service.[312] It is important to note, however, that of the total number of these countries, only fifty-four countries agreed to guarantee all of these regulatory principles. Moreover, three countries only agreed to adopt an ill-defined amount of the "pro-competitive" regulatory principles in the future, eight countries agreed to adopt "some" amount of "pro-competitive" regulatory principles, and three countries stated that they would make no additional regulatory commitments.

It is also very important to note that among those countries which agreed to guarantee these regulatory principles *are many of the very countries that refused to agree to open their markets*. As such, it would seem that any international multilateral agreement in which, on one hand, the signatory countries agree to uphold certain "pro-competitive regulatory principles" yet, at the same time, these signatory countries also condone those signatory countries which refuse to allow any new competitors to enter their market, at first blush, the WTO agreement may not appear to be really such a great bargain after all.

Actually, such a conclusion may not necessarily be entirely correct. At the end of the day, presumably no one would disagree that open markets are the best way to maximize consumer welfare. Yet as noted above there are numerous countries that are, to state it politely, a bit recalcitrant to open their markets. So long as these foreign incumbents' monopoly power re-

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312. Reference Paper, *supra* note 299. Several scholars are skeptical about the true efficacy of the principles set forth in the Regulatory Reference Paper. For example, Drake and Noam argue that:

> Much is made over the acceptance of a regulatory reference model, making it seem like the adoption of some universal charter of telecommunications freedom. The reality is more modest. The "model" principles are mostly procedural, not substantive. They speak of "independence" of the regulator, but this merely refers to the independence from the monopolist, not from politics. As if formal independence prevents capture. The principles speak of openness, public licensing criteria, transparency, and objective allocation procedures. All this sounds good, but is worth little because of its vagueness, if a government drags its feet. For example, an openness of process can mean very little outside the public "sunshine" on the senior staff level before ceremoniously reaching the official decision event.

Drake & Noam, *supra* note 309, at 816-17.

mains unchecked, therefore, foreign incumbents can engage in whipsawing and other numerous price and non-price discrimination strategies against or among U.S. carriers.[313]

Unfortunately, because the goal of promoting good market performance is not always complementary to the goal of promoting trade issues, numerous constituencies are more concerned about promoting mercantile agendas than focusing on the economic issues at hand. The problem of such an arrogant approach is that it will not gain any ground. In these situations, basic international law is pretty clear about enforcement options: barring evidence that one country is using its territory to stage a military attack against another, one country may not interfere in the internal domestic affairs of another. Thus, the best way to mitigate unilateral, strategic anticompetitive conduct for IMTS service is to convince the recalcitrant country to establish, *inter alia*, standard, cost-based accounting rates and transparent regulation to mitigate against non-price discrimination. This is precisely what the hard-fought WTO Agreement (mainly at U.S. insistence) achieves. As such, from an economic point of view, whether or not a U.S.-based carrier has the ability to set up a rival network in a WTO Member destination country should be irrelevant to the question of whether a foreign firm can successfully engage in strategic conduct for U.S.-originated traffic on that country-route.[314] Instead, substantial priority should appropriately be dedicated to effective implementation of the WTO regulatory principles; issues of entry can be addressed at a subsequent time.

C. *Exactly How Open Are U.S. Markets Post-WTO?*

1. The FCC's *Benchmarks Final Order*[315]

In this *Benchmarks Order*, the Commission unilaterally established benchmarks to "govern the international settlement rates U.S. carriers may pay foreign carriers to terminate international traffic originating in the United States."[316] In doing so, the Commission stated that the actions it took in this *Benchmarks Order*, along with its *Flexibility Order*[317] and its proceedings implementing the February Accord, "substantially complete[d its] plan to restructure the economics of the market for U.S. international tele-

313. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 20.

314. *Id.*

315. International Settlement Rates, *Report and Order*, 12 F.C.C.R. 19,806, 9 Comm. Reg. (P & F) 1 (1997) [hereinafter *Benchmarks Order*], *recons. pending, appeal filed*, *Order*, 13 F.C.C.R. 9188 (1998).

316. *Id.* para. 1.

317. *Flexibility Order*, *supra* note 153.

communications services."[318] The Commission reasoned that this restructuring would "promote the low cost, technologically innovative interconnectivity serving all the world's consumers that should be the hallmark of a Global Information Infrastructure."[319] While the Commission emphasized that it would prefer to achieve its goals through a multilateral agreement on accounting rate reform, it argued that it must take unilateral action to reform the current international settlement-of-accounts regime in order to (a) fulfill its "duty to ensure reasonable rates for U.S. consumers";[320] (b) "allow consumers in all countries to receive higher quality service [and] more service options";[321] and (c) "benefit every carrier [regardless of nationality] that provides international services by stimulating growth of those [IMTS] services."[322]

a. Pricing Methodology and Application

The Commission reaffirmed its belief that it should use the "Tariffed Components Price" (TCP) methodology—that is, the tariffed prices carriers charge to their own domestic customers—set forth in its *International Settlement Rates NPRM* to establish settlement rate benchmarks in the absence of carrier-specific cost data.[323] The Commission reasoned that by "[r]elying

318. *Benchmarks Order*, *supra* note 315, para. 1.

319. *Id.*

320. *Id.* para. 5.

321. *Id.* para. 7 (citation omitted).

322. *Id.* It is also interesting to note the FCC's opinion about the efficacy of participating in international organizations, especially the ITU, to achieve accounting rate reform. The Commission stated that while it had "contributed actively to the work of multilateral organizations and agreed that [it] should continue to work vigorously with these organizations to pursue accounting rate reform, . . . [it] did not . . . agree that [its] contribution to multilateral efforts should be [its] exclusive means of addressing accounting rate reform." *Id.* Indeed, the Commission recognized that even though it must take action as the implementation process of the commitments made by the United States in the WTO Basic Telecommunications Agreement moves forward, it nonetheless believed that it "must also take action domestically in the interim to reduce settlement rates to a more cost-based level." *Id.* Yet, according to the Commission, the unilateral action taken in this proceeding was "concurrent with [its] continued efforts to achieve reform of the accounting rate system in the ITU and other multilateral organizations." *Id.* para. 18 (citation omitted).

323. According to the Commission, it used the following three network components to calculate the "tariffed component price" for each country basket: (1) the "international facility component," consisting of "international transmission facilities, both cable and satellite, including the link to international switching facilities" (the Commission included "only the half-circuit on the terminating end," however, because it reasoned that "originating carriers have traditionally been responsible for the half circuit on the originating end of a call"); (2) the "international gateway component," consisting of "international switching centers and associated transmission and signalling equipment"; and (3) a "national extension component," consisting of "national exchanges, national transmission, and the local loop facilities used to distribute international service within a country." *Id.* para.

on publicly available tariff data and information published by the ITU," it would both be able "to make some progress in achieving the goal of cost-oriented settlement rates" and "treat foreign carriers fairly."[324] To wit, the Commission reasoned that the TCP methodology is appropriate not only because it relies on carriers' publicly available "tariffed rates and information published by the ITU," but because the TCP methodology is "based on a framework that [already] received consensus approval from the members of the ITU."[325] Moreover, reasoned the Commission, "[r]eliance on tariffed prices also means that U.S. carriers are treated fairly" because "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."[326]

Rather than establish country-specific benchmarks, however, the Commission decided to establish benchmarks categories based on a particular country's level of economic development, as defined by gross national product (GNP) per capita: (1) "high income" countries (GNP per capita of $8,956 or more); (2) "upper-middle income" countries (GNP per capita of $2,896-$8,955); (3) "lower-middle income" countries (GNP per capita of $726-$2,895); and (4) "lower income" countries (GNP per capita of less than $726).[327] The Commission opted for this "basket" approach because it believed that there were "certain shortcomings of using tariff data that make reliance on each country's TCP to establish individual country benchmarks inappropriate."[328] Using the simple average of the TCPs for all countries for

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324. *Id.* para. 66.

325. *Id.* para. 67 (citations omitted).

326. *Id.*

327. *Id.* para. 120.

328. *Id.* para. 101. According to the Commission, "[t]he 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." *Id.* para. 102. For example, the FCC maintained that "carriers' tariffed prices in many cases do not reflect the underlying cost of providing the tariffed service" because "the tariffs reflect social policies such as universal service goals." *Id.* Similarly, argued the Commission, "many countries have rate structures that use high international and domestic long distance charges to offset below-cost local service fees." *Id.*

Another reason the Commission believed that "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." *Id.* (citation omitted).

Moreover, reasoned the Commission, "using tariff data to calculate settlement rate benchmarks" could be inaccurate because a foreign "country could attempt to influence the

which it had data in each category, the Commission adopted the following benchmark for each respective category:[329]

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

However, notwithstanding the fact that the Commission stated that it would "revise and update [its] benchmarks periodically as necessary," (according to the Commission, "periodic revisions are necessary to avoid the problem in the future of [its] benchmarks not keeping pace with cost reductions, and to encourage further movement toward cost-based settlement rates"),[330] the Commission also stated—over substantial international opposition—that it would not forbear from applying its settlement rate benchmarks "*on any route, including routes where competition has been introduced.*"[331] As support for this position, the Commission noted that because, as a general matter, "it will take time for vigorous competition to create efficient pricing," it therefore could not "rely entirely on the development of competitive markets to reduce settlement rates to more cost-based levels in a timely manner."[332]

As to why it would not forbear its benchmarks policy where there is fully developed competition, the Commission dismissed opposing arguments by presuming that in such circumstances, settlement rates would likely be below its benchmarks. Thus, reasoned the Commission, "whether the settlement rate benchmarks should be implemented on those routes would be a moot question."[333] Moreover, the Commission maintained that "with the increasing market liberalization that will result from implementation of countries' commitments made in the WTO Basic Telecom Agreement, [its] benchmarks policy [would] have minimal impact on most WTO Member countries."[334]

level of its future benchmark rate by changing its carriers' tariff rates." *Id.*

329. *Id.* para. 111.

330. *Id.* para. 112 (citation omitted).

331. *Id.* para. 114 (emphasis added).

332. *Id.*

333. *Id.* para. 115.

334. *Id.* As an interesting side note, the Commission rejected arguments that its benchmarks policy is inconsistent with its flexibility policy. According to the Commission, its flexibility policy is supposed to create a more "flexible regulatory framework that permits carriers to take their international traffic off the traditional settlement system where

Because the Commission lacked "the incremental cost data or a costing methodology necessary to calculate a precise estimate of carriers' incremental cost of terminating international traffic," however, the Commission stated that it would "use the TCP methodology to calculate the top end of its benchmark ranges."[335] As a proxy for the low end of its benchmark ranges, therefore, the Commission announced that it would instead adopt a "best practice" rate that it would enforce "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 a safeguard when it detects a distortion in the U.S. market for IMTS.[336] Yet, "[b]ecause [it] did not have [any] data to establish an accurate cost-based rate," the Commission stated that it would "use a market-based rate as a substitute."[337] In the Commission's words, this would be 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."[338] This "best practice" rate would "be a presumptive rate that [would] apply in cases of market distortion until evidence is presented that other factors should be taken into consideration."[339] After review, the Commission eventually settled on the rate of $0.08 offered by Sweden as a best practice settlement rate.[340]

b. *Timing and Implementation*

To implement these benchmarks, the Commission allotted a certain period of time for U.S. carriers to negotiate settlement rates with their foreign

effective competitive conditions permit and to negotiate alternatives for terminating international calls that do not comply with the Commission's ISP." *Id.* para. 116. By contrast, argued the Commission, "the goal of [its] benchmarks policy is to reduce settlement rates where market forces have not led to more cost-based settlement rates." *Id.* The Commission stated, however, that to the extent it "may in the future need to consider the application of the two policies in individual circumstances, [it would] examine those situations at the time they arise, on a case-by-case basis." *Id.* (citation omitted).

335. *Id.* para. 130.

336. *Id.* para. 132.

337. *Id.* para. 133.

338. *Id.*

339. *Id.*

340. *Id.* para. 134. The Commission chose Sweden for a variety of factors. First, it found that "the lowest settlement rate that U.S. carriers currently pay on average is with Sweden, at 0.06 SDR ($0.08)." *Id.* (citation omitted). Second, the Commission concluded that this rate is "commercially viable," in that "[t]his rate [was] in effect since March 1996 and during that time, Sweden had experienced sustainable, vibrant, procompetitive development of its telecommunications industry." *Id.* Third, the Commission found that Sweden offered "effective competitive opportunities ('ECO') for U.S. carriers to offer facilities-based switched and private line services." *Id.* As such, concluded the Commission, the "vibrant procompetitive development of the Swedish telecommunications sectors indicates that its settlement rate with the United States is economically feasible and sustainable." *Id.*

correspondents for each income category discussed above. Significantly, the Commission added one additional category for those "'least telecommunications developed'" countries, where it would use teledensity (as measured by lines per one hundred inhabitants) rather than GNP data.[341] The Commission reasoned that if a country has "a level of teledensity [that is] less than one, [such data] is generally a strong indication that a country's telecommunications infrastructure is severely underdeveloped."[342] Depending on the specific country category, therefore, the Commission required U.S. carriers to negotiate settlement rates with their foreign correspondents in accordance with the following schedule:[343]

carriers in upper income countries	1 year from implementation of this *Order*[344]
carriers in upper-middle income countries	2 years from implementation of this *Order*
carriers in lower-middle income countries	3 years from implementation of this *Order*
carriers in lower income countries	4 years from implementation of this *Order*
carriers in countries with teledensity less than 1	5 years from implementation of this *Order*

In order to avoid the situation where U.S. carriers are unable to negotiate settlement rate reductions until the end of the applicable transition period, however, the Commission stated that it would "expect"—but not mandate—U.S. carriers to negotiate proportional annual reductions in settlement rates.[345] In particular, the Commission stated that it would expect "U.S. carriers [to] negotiate twenty percent reductions annually of the spread 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," an annual 25 percent reduction in the spread; "for carriers with a three year transition period," an annual reduction of 33 percent in the spread; and "for carriers with a two year transition period," an annual reduction in the

341. *Id.* paras. 163-64.
342. *Id.* para. 164 (citation omitted).
343. *Id.* para. 165.
344. The Commission set the effective date of this *Order* as January 1, 1998, which is the accepted implementation date of the WTO Accord on telecommunications. *Id.* para. 165 n.294.
345. *Id.* para. 172.

spread of 50 percent.[346] Moreover, the Commission stated that it would "consider providing additional transition time for negotiations with foreign carriers in countries for which annual reductions in settlement rates, according to [its] transition schedule, would entail a loss of greater than 20 percent of the country's annual telecommunications revenue."[347]

Moreover, it appeared that the Commission was just as unwavering about the sanctity of its implementation schedule as it was about the sanctity of the benchmark calculations themselves. For example, the Commission rejected arguments that its transition periods were unrealistic given historical experience (including that of the United States). While the Commission once again "recognize[d] that the transition to competition takes time and requires difficult adjustments," the Commission simply responded that the transition periods required by this *Order* were "not intended to be schedules for implementation of competition in other countries. Rather, they [were] 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."[348]

Similarly, the Commission explicitly refused to adopt its original proposal in its *Notice* "to provide additional flexibility in implementation of the benchmarks beyond [its] transition periods for U.S. carriers and their correspondents in developing countries"—even if those countries had "demonstrated an actual commitment to fostering entry and promoting competitive market environments."[349] The Commission gave two reasons for its reversal. First, it believed that its "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 [it] adopt[ed] here for lower-middle income countries and countries with teledensity lower than one."[350] Second, it was "concerned that a policy which would create an exemption based on market conditions in the destination market . . . [might] not be consistent with [its] MFN obligations under the GATS."[351]

346. *Id.*

347. *Id.* para. 174 (citation omitted). However, the Commission did "emphasize . . . that [it might] 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 [its] benchmarks." *Id.* para. 173.

348. *Id.* para. 168.

349. *Id.* para. 175 (citation omitted).

350. *Id.* para. 176.

351. *Id.* (citation omitted). The Commission did state, however, that if, in the future, there is an alternative "multilateral consensus on a substantially equivalent international measure" that would achieve the United States' "goals of a cost-based system of settlements in a timely manner, [then it would] waive enforcement of the benchmark settlement rates." *Id.* para. 190; *see also id.* para. 5.

c. Enforcement

Notwithstanding the above, however, the Commission was a bit more oblique as to actual enforcement mechanisms for its benchmark paradigm. While the Commission stated that it would both: (a) identify recalcitrant carriers and work with the responsible government authorities;[352] and (b) "allow the U.S. international carrier to ask [it] to consider stronger steps,"[353] it declined in this particular *Report and Order* to "adopt any set enforcement mechanism."[354] Instead, the Commission stated that it would "consider the individual circumstances surrounding each carrier-initiated petition to determine the appropriate enforcement action to take."[355] However, the Commission made clear that "whatever enforcement action [it] take[s] with regard to a complaint about a foreign correspondent's unwillingness to negotiate a settlement rate at or below the relevant benchmark[, this action would] apply to all U.S. international carriers' dealings with that foreign correspondent."[356]

Yet, while the Commission was unwilling to impose a specific enforcement mechanism directly in this proceeding, it was willing to impose two enforcement mechanisms ("competitive safeguards") indirectly. First, the Commission stated that it would condition any and all facilities-based switched and private line Section 214 authorizations (existing and prospective) of carriers seeking to serve affiliated foreign markets from the United States on the requirement that the affiliated foreign carrier offer all "U.S. carriers a settlement rate [for] terminat[ing] U.S.-originated traffic on the affiliated route that is at or below the relevant benchmark."[357] The Commission stated that such a generic condition was necessary in order to mitigate

352. In particular, the Commission stated that it would convey its "concern about continued high settlement rates and the lack of meaningful progress," as well as "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." *Id.* para. 185.

353. *Id.* para. 186. According to the Commission, "a U.S. international carrier may file a petition that: (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." *Id.*

354. *Id.* para. 187.

355. *Id.*

356. *Id.* (citation omitted).

357. *Id.* para. 207. In fact, for those U.S. carriers that served affiliated markets with existing Section 214 certificates, the Commission required these affiliated carriers to negotiate with all U.S. carriers *and have "in effect within ninety days of the effective date of this Order"* a settlement rate for the affiliated route that is at or below the appropriate benchmark. *Id.* para. 228 (emphasis added).

potential anticompetitive distortions in the U.S. market—in particular, predatory price squeeze behavior.[358]

To determine whether a market distortion has occurred, the Commission "establish[ed] a rebuttable presumption that a carrier has engaged in price squeeze behavior that creates distortions in the U.S. market for IMTS if . . . any of a carrier's tariffed collection rates on an affiliated route are less than the carrier's average variable costs on that route."[359] "If any tariffed collection rate is less than average variable costs, [the Commission would] presume that the carrier is engaging in anticompetitive price squeeze behavior and [as such would] take enforcement action."[360] The Commission stated that its presumption of market distortion could be rebutted, however, if a carrier demonstrates that it had "an economically justifiable reason for pricing below average variable costs" (e.g., "a carrier could show that its pricing strategy is a time limited promotion in order to gain market share").[361] If this presumption was triggered and not rebutted, however, the

358. *Id.* paras. 208-16. What is particularly interesting to note is that the Commission performed almost a perfect 180-degree reversal of its price squeeze analysis in the *ECO Order*. As discussed *supra*, the Commission concluded in *ECO* that it was unnecessary to impose such a condition to mitigate against a successful price squeeze. According to the Commission, its "balance of considerations has changed significantly" since *ECO* because its action in this proceeding "comes after the time period for implementation of ITU Recommendation D.140 has concluded, yet settlement rates remain far above cost-based levels." *Id.* para. 218. Against this backdrop, the Commission maintained that "the prospect of freer entry into the U.S. market after January 1, 1998 pursuant to [its] rulemaking proposals implementing the WTO Basic Telecom Agreement increases [its] concern that foreign carrier entry could create competitive distortions in the U.S. market." *Id.* Moreover, the Commission argued that such a reversal was appropriate because "[it could] not find on that record persuasive evidence that foreign carriers that entered [the U.S.] market pursuant to [its] *ECO* framework could successfully engage in a price squeeze." *Id.* para. 217. The Commission nonetheless found that the concerns raised in the record in this proceeding were "serious enough for [it] to take the preventive measure of adopting a Section 214 authorization condition at this time." *Id.* para. 218.

359. *Id.* para. 224.

360. *Id.*

361. *Id.* para. 225.

> For purposes of this bright line test, [the Commission] define[d] a carrier's average variable costs on the affiliated route as the carrier's net settlement rate plus any originating access charges [because t]hese 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 . . . [and m]ost other expenses are fixed in the short term, and would be incurred regardless of whether the carrier provided service.

Id. para. 224 (citations omitted). The Commission reasoned that

> recovery of average variable costs [was] 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

FCC stated that it may, *inter alia*, require that "the settlement rate of an affiliated carrier for the route be at a level equal to or below its best practices rate" (again, $0.08), or revoke "the authorization of the carrier to serve the affiliated market."[362]

The second Section 214 authorization condition the FCC imposed was a requirement that any carrier that provides switched basic services over international facilities-based or resold private lines between the United States and foreign destination countries must ensure that the "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."[363] Again, the Commission warned that if it determines that competition "has been distorted," it may, *inter alia*, "prohibit[] 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 . . . best practice rate of $0.08, or revocation of the carrier's authorization."[364] As a triggering mechanism, the Commission established a presumption that a "market distortion exists, [that is,] 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."[365]

The Commission reasoned that such a condition was required in order to mitigate the threat of "one-way bypass" of the international settlement-of-accounts regime.[366] Yet, as the Commission itself noted, "[t]he provision of switched services over private lines has strong procompetitive effects in the marketplace."[367] Indeed, according to the Commission,

> a more liberal policy with respect to resale of international private lines will allow new entities to enter the market and offer services

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> 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.

Id. para. 225.

362. *Id.* para. 231.

363. *Id.* para. 243.

364. *Id.*

365. *Id.* para. 249. As an example, the Commission stated that its "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." *Id.*

366. *Id.* para. 242.

367. *Id.*

> 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.[368]

The Commission resolved its self-described "dilemma" by weighing the "procompetitive effects of private line resale . . . against the market distorting effects of one-way bypass."[369] After review, the Commission held that the latter condition posed a greater public interest burden. According to the Commission, the "threat of one-way bypass of the accounting rate system cannot be ignored [because i]t 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."[370] The Commission also rejected the notion that the threat of one-way bypass was ephemeral just because it had yet to take action against carriers for such conduct. Quite to the contrary, the FCC argued proudly that "[t]he reason [it had] been able to avoid one-way bypass in the past [was its] equivalency policy. [The] policy permits private line resale only to countries that afford resale opportunities equivalent to those available under U.S. law."[371]

2. The FCC's *Foreign Participation Order* (WTO Implementation Proceeding)[372]

In this *Order*, the FCC stated that it was abolishing its *ECO* test and replacing it with an "open entry standard" for applicants from WTO Member countries.[373] In particular, the Commission adopted, as a factor in its public interest analysis, a rebuttable presumption that applications for Section 214 authority from carriers of WTO Members do not pose concerns that would justify denial of an application on competition grounds.[374] The

368. *Id.* (citation omitted).

369. *Id.* (citation omitted).

370. *Id.*

371. *Id.*

372. *Foreign Participation Order*, *supra* note 306.

373. *Id.* para. 9.

374. *Id.* para. 69. Significantly, the Commission also concluded that it would apply its post-WTO entry policy "equally to U.S. carrier investments in foreign carriers as well as foreign carrier investments in U.S. carriers." *Id.* para. 70. The Commission recognized that while it previously found in *ECO* that "it was unnecessary and contrary to the goals of that proceeding to apply the ECO test to U.S carrier investments in foreign carriers" (indeed, the Commission feared that the application of its *ECO* test on U.S. carriers would actually "*frustrate* U.S. policy of encouraging foreign investment by U.S. companies"), its subsequent experience indicated that

> there is a likelihood of competitive harm from an international carrier operating in the U.S. market that possesses sufficient foreign market power in a market for services necessary for the provision of U.S. international services to adversely af-

FCC also adopted a "rebuttable presumption that such competitive concerns are not raised by applications to land and operate submarine cables from WTO Members or by indirect ownership by entities from WTO Members of common carrier and aeronautical radio licensees under Section 310(b)(4) of the Act."[375] Yet, despite substantial international objection, the Commission stated that it would, in appropriate situations, deny entry to a WTO Member country if "other public interest factors" (i.e., the general significance of the proposed entry to the promotion of competition in the U.S. communications market, the presence of cost-based accounting rates, and any national security, law enforcement, foreign policy and trade policy concerns brought to its attention by the Executive Branch) warrant.[376] The Commission was quick to disclaim, however, that "other public interest issues" would be present only in "very rare circumstances."[377]

Notwithstanding the above, the Commission stated that because, in its view, the circumstances that existed when it adopted its *ECO* and *Flexibility Orders* did not change sufficiently with respect to non-WTO Member countries, it continued "to serve the goals of [its] international telecommunications policy to apply [its] ECO and equivalency tests in the context of non-

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> fect competition on the U.S. end of the route, regardless of whether the entity is U.S. or foreign owned.

Id. (emphasis added) (citation omitted). Of course, the fact that the Commission also feared "that continuing to treat foreign carrier investments in U.S. carriers differently from U.S. carrier investments in foreign carriers could be viewed as inconsistent with U.S. GATS obligations." *Id.* (citation omitted).

375. *Id.* para. 50.

376. *Id.* para. 65. For example, the FCC recognized that while foreign indirect investment in U.S. common carrier wireless markets is unlikely to raise anticompetitive dangers (as those markets are, for the most part, wholly domestic and therefore, there is no possibility of leveraging foreign bottlenecks in order to create advantages for some competitors in U.S. markets) and, in fact, could *promote* competition in the U.S. market, foreign ownership of U.S. spectrum may raise national security concerns. As such, the FCC accepted the FBI's concerns that even small investments in publicly traded securities could, if aggregated, nevertheless create a degree of control or influence over a licensee that would be contrary to U.S. national security or law enforcement interests that Executive Branch agencies may need an opportunity to evaluate before a grant of section 310(b)(4) authority. The FCC also found similar concerns for foreign ownership of aeronautical en route and fixed services licenses. *Id.* paras. 111-18.

377. *Id.* para. 50. Moreover, given the substantial criticism received by the FCC that it was inappropriately stepping beyond its mandate, the Commission was also quick to emphasize that it would only "make an independent decision on applications to be considered and [would] evaluate concerns raised by the Executive Branch agencies in light of all the issues raised (and comments in response) in the context of a particular application." *Id.* para. 66. The FCC was equally quick to point out, however, that it expected "that the Executive Branch [would] advise [it] of concerns relating to national security, law enforcement, foreign policy, and trade concerns only in very rare circumstances, [and that those concerns] . . . must be communicated in writing and [would] be part of the public file in the relevant proceeding." *Id.* (citation omitted).

WTO Member countries."[378] Significantly, the Commission specifically rejected the argument that its sole focus in this proceeding should have been on the "potential harm to competition in the U.S. markets."[379] In the FCC's view, "[i]t continues to serve the public interest to maintain policies directed at encouraging non-WTO Member countries to open their telecommunications markets to competition."[380]

Along a similar vein, the Commission also stated that it would henceforth apply the *ECO* test to a route whenever a carrier or its foreign affiliate, "without regard to whether the applicant, or its affiliate, is a U.S. carrier, . . . controls, is controlled by, or is under common control with a carrier that has market power in a destination market, where that destination market is a non-WTO country."[381] In the Commission's opinion, as a "more liberalized environment [emerges] from the WTO Basic Telecommunications Agreement, it will become increasingly difficult to define a 'U.S. carrier' for the purpose of distinguishing between U.S.-carrier and foreign-carrier ownership of carriers," and, "[i]n light of those difficulties, [it could] no longer rely on [its] greater ability to redress anticompetitive conduct by U.S. carriers as compared to foreign carriers."[382]

Again, the Commission specifically rejected the argument that the application of the *ECO* test to third countries exceeds its statutory mandate because when "a foreign carrier that controls bottleneck facilities controls, is controlled by, or is under common control with a carrier that is affiliated with a U.S. carrier, there is a danger that the bottleneck facilities will be used to discriminate against unaffiliated U.S. carriers" and, absent the application of its *ECO* test in these circumstances, the "U.S. affiliate of a foreign carrier that enters various markets through wholly owned subsidiaries would be able to serve all of those subsidiaries' routes."[383] In such a case, reasoned the FCC, the "other subsidiaries would have the ability and incentive to use their market power to discriminate against unaffiliated U.S. carriers by routing traffic in ways that take advantage of their market power."[384] Moreover, reasoned the Commission, "applying the ECO test to non-WTO countries [would] encourage non-WTO countries to open their markets to competition in addition to privatizing their telecommunications carriers."[385] In the FCC's opinion, "[b]ecause privatization without liberalization neither

378. *Id.* para. 124 (citation omitted).
379. *Id.* para. 125.
380. *Id.*
381. *Id.* para. 139.
382. *Id.* para. 140.
383. *Id.* para. 141.
384. *Id.*
385. *Id.* para. 142.

promotes competition nor reduces the risk of anticompetitive conduct, [its] goal is to encourage simultaneous privatization and liberalization. . . . If the ECO test lowers the value of an exclusive arrangement in a privatization, it would thereby encourage simultaneous liberalization and privatization."[386]

In light of this new "open entry" approach, the Commission stated that it was appropriate to revisit, review, and modify its "competitive safeguards governing foreign-affiliated carrier provision of basic telecommunications services in the U.S. market and, more broadly, U.S. carrier dealings with foreign carriers."[387] The Commission stated that it would, in particular, focus its examination of its "rules preventing the exercise of foreign market power in the U.S. market" in order "to monitor and detect anticompetitive behavior in the U.S. market without imposing regulations that are more burdensome than necessary."[388] According to the Commission, "[c]oncerns about potential anticompetitive conduct generally [would be] triggered where one party has sufficient market power to cause harm to competition and consumers in the U.S. market."[389]

Significantly, however, the Commission moved away from its definition of market power it used in previous international *Orders* (i.e., "'the ability to act anticompetitively against unaffiliated U.S. carriers through the control of bottleneck services or facilities on the route in question'")[390] to the more conventional definition of market power as "a carrier's ability to raise price by restricting its output of services."[391] The Commission maintained that such a clarification was necessary because the regulatory framework it adopted in this proceeding focused "on dealings with foreign carriers that possess sufficient market power on the foreign end of a U.S. international route to affect competition adversely in the U.S. international services market."[392] In particular,

> "telecommunications services that originate or terminate in, or transit the United States . . . includ[ing] the U.S. market for global, seamless network services that increasingly are being used by U.S. businesses." [*The Commission's*] *primary concern in this proceeding, however, involves the ability of U.S. carriers to terminate traffic on the foreign end of an international route.*[393]

386. *Id.*
387. *Id.* para. 143 (citation omitted).
388. *Id.*
389. *Id.* para. 144.
390. *Id.* (quoting *ECO Order*, *supra* note 56, para. 116).
391. *Id.* (citation omitted).
392. *Id.*
393. *Id.* (alteration in original) (citations omitted) (emphasis added).

Yet, despite the regulatory commitments agreed to in the February Accord, the FCC rejected the view that it should eliminate competitive safeguards altogether. In the FCC's opinion, absent effective regulation in the U.S. market, "a foreign carrier with market power in an input market on the foreign end of a U.S. international route [could] exercise, or leverage, that market power into the U.S. market to the detriment of competition and consumers."[394] Such anticompetitive conduct could, in the FCC's view, include, *inter alia*, price discrimination, non-price discrimination, and price squeeze behavior.[395]

The first competitive safeguard the Commission imposed was to modify its "No Special Concessions" rule, under which U.S. carriers were prohibited from entering into exclusive arrangements with any foreign carrier affecting traffic or revenue flows to or from the United States.[396] Yet, because the Commission again recognized "that special concessions granted by a foreign carrier [could] serve the public interest in appropriate circumstances" (e.g., "[s]uch arrangements . . . [could] involve innovative services or operational efficiencies that reduce the rates for U.S. international services or increase the quality of such services"), the Commission modified its rule to prohibit only "U.S. carriers from agreeing to accept special concessions granted by foreign carriers that possess market power in a relevant market on the foreign end of a U.S. international route."[397] In the FCC's view, such an approach "strike[s] an appropriate balance" between "encourag[ing] such arrangements," yet deterring arrangements that result in an "unacceptable risk of harm to competition and consumers in the U.S. international services market."[398]

However, because the FCC believed that "determinations of market power on the foreign end of an international route can involve extensive analysis," the Commission decided to establish a "bright-line test."[399] This test would be "a rebuttable presumption that foreign carriers with less than 50 percent market share in each relevant market on the foreign end lack sufficient market power to affect competition adversely in the U.S. market."[400] "If a U.S. carrier seeks to use the under-50 percent market share presumption as the basis to accept a special concession from a foreign carrier, it

394. *Id.* para. 145.
395. *Id.* paras. 145-49.
396. *See* 47 C.F.R. § 63.14 (1997).
397. *Foreign Participation Order*, *supra* note 306, para. 156 (citations omitted).
398. *Id.* (citation omitted).
399. *Id.* para. 159 (citation omitted).
400. *Id.* para. 161 (citation omitted).

must file data with the Commission to substantiate that claim for the relevant input markets on the foreign end of the international route."[401]

In addition, the Commission found that it would be beneficial to delineate the types of exclusive arrangements that the modified No Special Concessions rule would prohibit. After consideration, the FCC decided to limit its No Special Concessions rule to "exclusive dealings involving services, facilities, or functions on the foreign end of a U.S. international route that are necessary for the provision of basic telecommunications service."[402] In the Commission's view, the rule would therefore

> prohibit any U.S. carrier from agreeing to accept from a foreign carrier with market power any special concession not offered to similarly situated U.S.-licensed carriers involving: (1) operating agreements for the provision of basic services; (2) distribution arrangements or interconnection arrangements, including pricing, technical specifications, functional capabilities, or other quality and operational characteristics, such as provisioning and maintenance times; and (3) any information, prior to public disclosure, about a foreign carrier's basic network services that affects either the provision of basic or enhanced services or interconnection to the foreign country's domestic network by U.S. carriers or their U.S. customers.[403]

401. *Id.* para. 163 (citation omitted). *See id.* paras. 156-62. Although the Commission did not specify exactly what "share" it was concerned about (e.g., minutes? revenues? facilities?), it recognized correctly nonetheless that "market share is but one factor in a traditional market power analysis." *Id.* para. 161. Yet, because the Commission believed that "market share data is more readily available" than other information, market share would "serve as a sufficient approximation of foreign market power for purposes of satisfying [its] rebuttable presumption." *Id.*

402. *Id.* para. 165. Unfortunately, this case was one of several "pavlovian" attempts by the Commission to rely on market share as a bright-line test, even though using market share as a bright-line test in these circumstances is a "tricky enterprise" at best. *See, e.g.*, PHOENIX CENTER POLICY PAPER, *supra* note 10, at 32; Spiwak, *Economic Analysis*, *supra* note 18, at 34 & n.14. Tragically, the European Union is not much better in this regard, where the EC's blind reliance on market shares alone also has produced some truly absurd regulatory decisions. *See* Mark Naftel, *How Does One Say "Dominance" in European?*, ANTITRUST REP., Oct. 1997, at 2.

403. *Foreign Participation Order*, *supra* note 306, para. 165. Significantly, the Commission took great pains to clarify that its modified No Special Concessions rule would prohibit "one-stop shopping." *Id.* para. 167. According to the Commission, "the rule does not prevent a U.S. carrier and a foreign carrier from offering end-to-end services. It does, however, prohibit U.S. carriers from entering into exclusive arrangements with certain carriers for certain services." *Id.* To illustrate this point, the FCC stated that, for example, "a U.S. carrier cannot agree to enter an *exclusive* 'one-stop shopping' arrangement in which the U.S. carrier acts as an agent on behalf of its U.S. customers in obtaining private line service from a foreign carrier with market power, where the foreign carrier refuses to recognize other U.S. carriers as agents." *Id.* In the Commission's view, "[t]his type of exclusive arrangement would preclude competing U.S. carriers from serving an important segment of the U.S. international services market." *Id.*

Next, the Commission again believed it necessary to impose competitive safeguards for those U.S. carriers affiliated with a foreign carrier with market power in the destination market. As such, the Commission stated that it would condition any authorization to serve an affiliated market on the requirement that the foreign carrier offer U.S.-licensed international carriers a settlement rate for the affiliated route at or below the relevant benchmark adopted in the *Benchmarks Order*.[404] Significantly, however, the Commission "decline[d] to apply [its] settlement rate benchmark condition to switched resale providers."[405] The Commission rationalized this conclusion by noting that because its "goal in this proceeding [was] to adopt a regulatory framework that is narrowly tailored to address identifiable harms to competition and consumers in the U.S. market," it approached "critically any request for conditions that would impose additional burdens on the manner in which companies could provide service to the U.S. market and thereby provide consumers with additional choices."[406]

Specifically, the Commission stated it would not impose its benchmarks condition on resellers because it did not find the same degree of danger of anticompetitive effects resulting from a switched reseller's provision of service to an affiliated market as it did regarding the "ability of a facilities-based U.S. affiliate of a foreign carrier to 'price squeeze' its competitors because of its relationship with the foreign affiliate."[407] The Commission gave two basic reasons in support of this conclusion. First, the Commission believed that "a switched reseller has substantially less incentive to engage in a predatory price squeeze strategy than a facilities-based carrier."[408] Second, the Commission believed that "it is easier to detect a predatory price squeeze in the switched resale context than in the facilities-based context."[409] Thus, reasoned the Commission, "[e]asier detection should deter switched resellers from attempting a predatory price squeeze and will allow [it] or other authorities to take action in the event a carrier does attempt a predatory price squeeze."[410] Finally, the Commission believed that the "benefits to consumers of additional new entrants and existing switched resale providers in the U.S. market outweigh the minimal risk to competition from a possible predatory price squeeze or other anticompetitive behavior by a switched resale provider providing service to an affiliated market."[411]

404. *See* discussion *supra* pp. 177-87 and note 315.
405. *Foreign Participation Order*, *supra* note 306, para. 194.
406. *Id.*
407. *Id.*
408. *Id.* para. 195.
409. *Id.*
410. *Id.*
411. *Id.*; *see also id.* paras. 193-94, 198-206.

Third, given the February Accord, the Commission found it appropriate to modify the safeguards it applied to U.S. carriers classified as dominant due to an affiliation with a foreign carrier that has market power in a relevant market in the following ways: (1) the FCC replaced the fourteen-day advance notice tariff filing requirement with a one-day advance notice requirement and accorded these tariff filings a presumption of lawfulness;[412] (2) the FCC removed the prior approval requirement for circuit additions or discontinuances on the dominant route;[413] (3) the FCC required a limited form of structural separation between a U.S. carrier and its foreign affiliate;[414] (4) the FCC retained its quarterly traffic and revenue reporting requirement;[415] (5) the FCC replaced its provisioning and maintenance recordkeeping requirement with a quarterly reporting requirement that summarizes the provisioning and maintenance services provided by the foreign affiliate;[416] and (6) the FCC required dominant carriers to file a quarterly circuit status report.[417] The FCC declined, however, to ban exclusive arrangements

412. *See id.* paras. 240-45. As discussed above, the Commission had recently modified the tariff filing requirements it imposed on dominant and nondominant foreign-affiliated IMTS carriers. In the former case, the FCC shortened the advance notice period for dominant carriers to 14 days; in the latter case, the Commission shortened the advance notice period for nondominant carriers of IMTS service to one day. *Id.* para. 242. Yet, while the FCC recognized that "retaining the existing tariff filing requirements possibly could constrain the ability of a dominant foreign-affiliated carrier to engage in anticompetitive conduct," the Commission reasoned that "the fact that these requirements might help to deter anticompetitive behavior [was] not, by itself, sufficient to retain these measures." *Id.* para. 243. In the Commission's view, "[it] should also consider whether and to what extent these regulations would dampen competition and whether other regulatory provisions accomplish the same objectives." *Id.*

After review, the Commission concluded that, on balance, "retaining the fourteen-day notice period [would] significantly inhibit[] a dominant foreign-affiliated carrier's incentive to reduce prices, because competitors can respond to pro-consumer price and service changes before the tariff would become effective." *Id.* para. 244 (citation omitted). The Commission believed that a "one-day notice period, coupled with a presumption of lawfulness, [would] provide carriers with additional flexibility to respond to customer demands. To the extent that a foreign-affiliated carrier has the ability to engage in a predatory price squeeze," however, the Commission maintained that "the existence of a tariff filing requirement, regardless of the length of the advance notice, [would] serve to deter such behavior." *Id.* (citations omitted). Moreover, the Commission argued that "in the unlikely event that a foreign-affiliated dominant carrier files an unlawful tariff, remedial action"—either by complaint or on its own motion—"[could] be taken after the tariff becomes effective." *Id.* para. 245.

413. *See id.* paras. 246-51.

414. *See id.* paras. 252-69.

415. *See id.* paras. 270-73.

416. *See id.* paras. 274-80.

417. *See id.* paras. 281-86.

involving joint marketing, customer steering, and the use of foreign market telephone customer information.[418]

Again, however, the Commission reaffirmed the appropriateness of its unilateral policy perspective. For example, the Commission stated that it would "not consider the effectiveness of foreign regulation as a separate matter when making a determination of a foreign-affiliated carrier's regulatory classification" because "the benefits derived from such evaluations [did not] outweigh the costs incurred."[419] In the Commission's opinion, "such attempts at evaluating the effectiveness of regulation in a foreign market impose significant burdens on the Commission," and its "experience has shown that obtaining sufficiently reliable and timely information about a foreign regulatory regime is a difficult, resource-intensive, and time-consuming process."[420]

Similarly, the Commission stated that it would maintain its dominant carrier safeguards for U.S. affiliates of foreign carriers from WTO Member countries that agreed to adopt the regulatory principles contained in the Reference Paper—*even where the settlement rate may be within the FCC's benchmark range*—because, in the FCC's opinion, "removal of foreign entry barriers alone will be insufficient to prevent foreign carriers with market power from seeking to leverage their market power into the U.S. market, especially in the short term."[421] According to the Commission, because the WTO Reference Paper "expressly provides that governments have the right to adopt rules to prevent anticompetitive behavior by carriers that, alone or together, control 'essential facilities or otherwise have the ability to affect the market adversely,'" it was wholly appropriate for the FCC to adopt an "open entry policy for carriers from WTO Member countries with an understanding that the public interest mandates that [it] ensure against the leveraging of foreign market power into the U.S. market."[422] Moreover, argued the FCC, even where a settlement rate may be within the FCC's benchmark range, the "achievement of settlement rates does not address all forms of anticompetitive conduct, such as non-price discrimination, that [its] dominant carrier safeguards are intended to address."[423]

418. *See id.* paras. 287-92.

419. *Id.* para. 230 (citations omitted).

420. *Id.* (citation omitted). The Commission did state, however, that "[i]n making a foreign market power determination, . . . [it would] consider the presence and degree of barriers to entry or expansion, which may relate to the foreign regulatory regime." *Id.* (citation omitted).

421. *Id.* para. 237.

422. *Id.* (citation omitted).

423. *Id.* para. 236 (citation omitted).

Finally, the Commission believed that it was also appropriate to modify the framework it adopted in its *Flexibility Order*[424] for approving alternative settlement arrangements in light of the February Accord. As such, the Commission stated that it would no longer apply its *ECO* test as the threshold standard "for determining when to permit accounting rate flexibility with carriers from WTO Member countries."[425] Instead, the Commission established "a rebuttable presumption that flexibility is permitted for carriers from WTO Member countries."[426] In order to rebut its presumption in favor of permitting flexibility, the Commission stated that "a party must demonstrate that the foreign carrier is not subject to competition in its home market from multiple (more than one) facilities-based carriers that possess the ability to terminate international traffic and serve existing customers in the foreign market."[427] However, in order to mitigate its residual concerns that a foreign carrier with market power may discriminate among U.S. carriers in settlement rate negotiations—even if the foreign carrier is subject to competition in its home market—the Commission retained the safeguards it imposed in its *Flexibility Order*.[428]

3. The European Response

As demonstrated *passim*, the rest of the international community has been—to state it politely—extremely dismayed and chagrined with the FCC's unilateral neo-mercantile actions. Thus, in response to the FCC's unilateral actions, on November 6, 1998, the international community—via the Focus Group to ITU-T Study Group 3—submitted a "Final Report" regarding "Accounting Rate Principles for International Telephone Service."[429] This International Telecommunication Union (ITU) Report, quite deliberately, took a very different approach to settlement rate reductions than the FCC's improper and arbitrary attempt to do so unilaterally. In the ITU's own terse words:

> The figures attained by applying the Focus Group's methodology contrast markedly with those that would be necessary if the FCC's "Benchmark" methodology were applied. The FCC methodology makes no allowance for dependence on net settlement payments. In almost all cases the average rate of reduction necessary under the FCC's methodology is steeper than even the worst case under the Fo-

424. *See* discussion *supra* Part III.B.3 and note 153.

425. *Id.* para. 132.

426. *Id.*

427. *Id.* para. 307.

428. *Id.* para. 308; *see id.* paras. 302-12. For a detailed analysis of these safeguards, see discussion *supra* pp. 144-45.

429. This Final Report takes the formal form of a new draft Annex E to ITU-T Recommendation D.140 and is available at <http://www.itu.int/intset/focus/index.html>.

> cus Group methodology. In particular, for low-income countries, the FCC's necessary rate of reduction would be between 22 and 28 percent per year. For middle income countries, the necessary rate of reduction is between 31 and 38 percent per year, while high income countries would need to achieve a reduction equivalent to a 50 percent cut in one year during the remaining three months of 1998. Application of the FCC methodology would be particularly disadvantageous to small island states especially for those such as [the] Cayman Islands, New Caledonia or British Virgin Islands that are categorised as being high income and which currently have settlement rates of around 0.3 SDR per minute. In order to comply with the FCC benchmark for the upper middle income group, they would be required to cut their settlement rate to 0.112 SDR within three months. This represents an annualised rate of reduction in excess of 95 percent! Overall, if the Focus Group methodology is applied, the average rates of reduction that would need to be applied by a typical (median) country / territory are around 6 percent per year (between 1999 and 2004) for an LDC or a low teledensity country with a high dependence on net settlements ranges, 7 percent for small island states (between 1999 and 2001) and around 16 percent per year (between 1999 and 2001) for other countries. On the other hand, if the FCC methodology is applied (for different target year-ends between 1998 and 2002) the average necessary rate of reduction would be some 34 percent year. The FCC methodology implies a rate of reduction which is at least twice as fast as that required by the Focus Group methodology and, in some cases, is up to five times faster.[430]

Thus, in marked contrast to the FCC's "exacting" draconian unilateral actions in which rates are prescribed arbitrarily, the ITU believes the better way to obtain a "smoother transition path" is through "bilateral negotiations" using a wide variety of tools including, but not limited to:

(1) Staged reductions negotiated on the basis of volume-based settlement rates;

(2) Staged reductions negotiated in absolute amounts (e.g., going down by 0.1 SDR per year, rather than by the same percentage each year (i.e., the percentage reduction in the early years is less dramatic than in the later years);

(3) Negotiating an agreement under which the accounting revenue could be split in a manner which deviates from 50/50 by a few percentage points—e.g., asymmetric arrangements could be triggered if the net settlement payment were to fall by more than a certain amount in any given year (According to the ITU, this type of asymmetric arrangement could be negotiated in advance,

430. *See* Methodological Note on Transition Paths to Cost-Orientation, Revision 1 of Contribution from the ITU Secretariat, Nov. 9, 1998 (visited Nov. 16, 1998) <http://www.itu.int/intset/focus/transition_path%20rev1.pdf>.

at any time during the transition period, but applied retrospectively);[431] and

(4) Extending the transition period by mutual agreement.[432]

Again, the ITU reiterated that:

> These are only examples of the sort of the arrangement that could be made to smoothen the transition period, for instance by making revenue stabilisation measures to assist the Administration/ROA which is the net recipient. The final report is not intended to be prescriptive. *The exact form that a "smoother transition path" could take is better left to bilateral negotiations.*[433]

D. Summary and Analysis

The cases examined in the preceding section represent perhaps the nadir of FCC IMTS policy decision-making. The passage of the Telecommu-

431. In the ITU's view, applying asymmetric arrangements during the transition to cost orientation may be appropriate because such mechanisms may both: (a) achieve a faster rate of reduction in the total accounting rate; and (b) stimulate increases in the volume of traffic. Moreover, as briefly alluded to above, the ITU would find it perfectly acceptable for an asymmetric arrangement to be based on a prior agreement but applied retrospectively in the event of a sudden fall in the net settlement payment in order to "cushion the impact of the changing international telecommunications environment on those countries/territories which are considered the most vulnerable." *Id.*

Finally, in addition to these proposed areas where asymmetric arrangements could be applied, the ITU also acknowledged that regulators "in high teledensity countries may, *on a voluntary basis*, offer cost-oriented call termination at cost-oriented rates without requiring reciprocal treatment." *Id.* The ITU provided two reasons to support allowing the possibility for this non-reciprocal treatment: First, the ITU recognized that because "many countries have made commitments under the WTO agreements relating to basic telecommunications to apply principles such as non-discrimination, national treatment and most-favoured nation (MFN) status to market access, these same principles could, in theory, also be applied to the termination of international traffic." *Id.* While the ITU conceded that this interpretation is "not explicitly covered by the existing WTO agreements," this interpretation might be made explicit by "new WTO agreements concluded during the lifetime of the transition period (i.e., before 2001 or 2004)." *Id.* As the ITU further recognized, however, implementation "would imply moving away from the bilateral regime of the ITU towards a multilateral accord," and it is "likely that such arrangements would be based on interconnection agreements rather than on settlement rates." *Id.* Second, the ITU argued that "a non-reciprocal commitment to call-termination at cost-oriented rates could be offered in order to enhance Universal Access to telecommunications among the Least Developed Countries and other countries/territories with low teledensity" because, in general terms, "these countries/territories produce very little outgoing international traffic." *Id.* Therefore, "the possible loss to the higher teledensity economy in offering this favourable treatment is likely to be minimal." *Id.* Indeed, argued the ITU, "if the cost savings achieved by the low teledensity country are passed on to its consumers in terms of lower collection charges, then the net result could be a lower net settlement payable by the high teledensity country." *Id.*

432. *Id.*

433. *Id.* (emphasis added).

nications Act of 1996 (1996 Act) and the conclusion of the February Accord presented the Commission with a truly unique and once-in-a-lifetime opportunity to lay, virtually *tabula rasa*, the foundations for an underlying market structure conducive to tangible, competitive facilities-based rivalry and only *de minimis* prophylactic regulation. Yet, because the Commission tragically succumbed to both industry pressure and political narcissism, the FCC squandered this unique opportunity because it attempted improperly to play Metternich-style "power politics" rather than attempting properly to seize this singular opportunity to maximize consumer welfare *a la* Grotius. Critiques of the most glaring examples are outlined below.

1. Problem No. 1: "Mercantilism Rising"—that is, It Is Arguably More Difficult To Enter U.S. Markets Post-WTO than It Was Under *ECO*

As highlighted in Part III.A.3 above, the FCC stated specifically in its *ECO Order* that it would not make the presence of cost-based accounting rates a *per se* precondition of entry. Rather, the FCC would permit foreign entry to occur if it found either: (a) that U.S. carriers could avail themselves of "effective competitive opportunities" in the foreign destination market; and (b) *even in the absence of such effective competitive opportunities*, if it found that certain countervailing "public interest factors" were present.[434] In the Commission's recent *Foreign Participation Order*, however, the FCC decided to apply a *completely opposite standard for foreign entry into U.S. markets*.[435] That is to say, in its *Foreign Participation Order*, the FCC stated specifically that it would not undertake any analysis of the basic economic conditions and structure of foreign markets of WTO Member countries (and, in particular, the effectiveness of regulation or other protections on the foreign end), but that it would simply charge a substantial entry fee—that is, the FCC's infamous "benchmark condition"—to any WTO Member country that wants to participate in U.S. markets.[436]

434. *See, e.g.*, *Sprint Declaratory Ruling and Order*, *supra* note 205.

435. *Foreign Participation Order*, *supra* note 306.

436. *Id.* para. 230. As noted in Part IV.C.2 *supra*, those non-WTO Member countries that want to enter U.S. telecommunications markets (e.g., China and Russia) will be subject to the worst of both regulatory worlds—an *ECO* analysis *and* the mandatory acceptance of the Benchmarks condition. *But cf. id.* paras. 125-26 ("Since 1995, our application of the ECO test has provided incentives for foreign governments to allow U.S. participation in their markets, and it played a part in the WTO negotiations that resulted in the Basic Telecom Agreement. We believe that continuing to apply the ECO test to non-WTO Member countries may encourage some of those countries to take unilateral or bilateral steps toward opening their markets to competition and may provide incentives for them to join the WTO.").

Yet, because the FCC stated specifically that it would not undertake any analysis of the basic economic conditions and the structure of foreign markets of WTO Member countries (and, in particular, the effectiveness of regulation or other projections on the other end), then any time the FCC classifies a firm as a "dominant" carrier (and with such classification, the additional regulatory constraints associated with this status) *a fortiori* simply has no analytical foundation.[437] That is, without performing an economic analysis to determine whether a firm has the ability to raise prices anticompetitively or restrict output, the FCC has essentially reduced the concept of "dominance" to nothing more than "I don't like you."[438] Accordingly, although it may *prima facie* appear that entry into U.S. markets is easier post-WTO, the cases above indicate that due to the myriad of complex (and not too subtly hidden) new regulatory hurdles that foreign firms must nonetheless overcome, there is a strong argument that these additional regulatory compliance costs actually make the process far more difficult than before. Given the above, therefore, perhaps the more appropriate and accurate nomenclature to describe the FCC's attempt to make its rules consistent with the United States' WTO obligations should be the ("We don't want any") *Foreign Participation Order.*

2. Problem No. 2: Despite Rhetoric, FCC *Orders* Reveal that the United States Apparently Has Little Desire To Move to a Full-Circuit World and Eliminate the International Settlement-of-Accounts Regime

The cases discussed in the preceding section are replete with prolific pronouncements from the FCC about how the world is moving away from monopolies to "competitive" markets—in particular, IMTS country-route markets characterized by: (a) numerous suppliers (with each carrier using their own full-circuits), (b) standard cost-based interconnection rates, and (c) a transparent and independent regulator on both the originating and terminating end of the routes and, with this purported competition, the elimination of (if not only a *de minimis* requirement for) both the international settlement-of-accounts regime and the Commission's ISP (replete with proportionate return requirements). While this vision is certainly a worthy social goal, once practitioners read past the introductory sections of these extremely lengthy *Orders* where these rhetorical "sound-bites" are con-

437. *But cf.* Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, *Order*, 11 F.C.C.R. 3271, 1 Comm. Reg. (P & F) 63 (1995).

438. *See supra* note 83; Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 25 n.15.

tained, it unfortunately appears that the substance of the FCC's policies are never intended to reach this purported outcome.

In particular, the cases discussed above appear to indicate that despite its "pro-competition" rhetoric, the FCC nonetheless intends to continue to unilaterally impose settlement rate "benchmarks" and maintain its ISP in a full-circuit world. The problem with this policy approach, however, is that it is wholly inapposite to the very reasons the international community agreed to the February Accord in the first place—that is, once Member countries fully implement all of the regulatory principles contained in the Reference Paper, the international settlement-of-accounts regime is ostensibly supposed to be eliminated. Likewise, any unilateral regulation by the FCC to impose benchmarks to constrain the settlement-of-accounts regime and to perpetuate its ISP should, *a fortiori*, essentially be unwarranted under such a market structure as well.

To get around this metaphysical inconvenience, the *Orders* discussed above reveal that the FCC's policy response is simply to make the requisite conditions precedent for "flexibility" as difficult as possible to satisfy. For example, under the FCC's "No Special Concessions" rule, while joint ownership of end-to-end facilities is prohibited, it is apparently perfectly acceptable under current FCC rules to have a single firm own the entire full circuit using two affiliates—one U.S., the other foreign—each affiliate owning 100 percent of its respective "half" of the circuit. Under this arrangement, however, the two affiliates are nonetheless forced to correspond with each other using the traditional international settlement-of-accounts regime and, *a fortiori*, the FCC's benchmarks. Of course, while the parent carrier is certainly welcome to petition the FCC for "flexibility" on that route, the FCC nonetheless imposes benchmarks on a portion of "flexible" traffic; it therefore appears that the *FCC never intends to let firms out of the very regime it is allegedly trying so hard to eliminate.*

To readers unfamiliar with the inner politics of the IMTS business, it does indeed seem a bit incredulous that the FCC would actually seek to circumvent the very policy outcome it has publicly promised to achieve. There are, however, several explanations for this paradoxical behavior. First, contrary to their public admonitions, the large, "traditional" U.S. carriers actually tend to like the ISP and would therefore like to see it retained. Why? Because under oligopolistic market conditions, carriers' profits rise with a coordinated increase in price/cost margins across all competitors—that is, a publicly known, date-certain reduction in termination prices provides a coordinated increase in price/cost margins across the industry.[439] Moreover,

439. *See* Douglas A. Galbi, Cross-Border Rent Shifting in International Telecommunications (INFORMATION ECONOMICS & POL'Y, forthcoming Nov. 1998) (manuscript at 20-22,

because it is highly unlikely in the short-term that there will be either a radical redistribution of market share among the big firms or a mysterious, radical jump in minutes, the ISP provides a very convenient mechanism for corporate finance officers to forecast somewhat accurately their firm's expected revenue stream.

It must also be noted, however, that it is not appropriate to lay the entire blame for industry pressure to perpetuate the ISP upon the collective feet of the big U.S. IMTS carriers—that is, because proportionate return favors carriers with small market share, new entrants are also likely to seek to perpetuate such a regime.[440] Finally, because it is a well-known (but nonetheless unfortunate) fact that regulators are only truly happy when they have something to regulate, if those firms subject to the regulator's jurisdiction are actually begging to be thrown voluntarily into the proverbial "briar patch," then what self-respecting regulator could really refuse such a generous offer?[441]

3. Problem No. 3: Bringing Settlement Rates in Line with "Costs" Does Not *a fortiori* Mean that Either: (a) Prices Will Decline; or (b) Telecom Providers' Revenues Will Increase

Under the cases outlined *supra*, it appears that the following logic underlies the FCC's actions.

(1) Settlement rates are "above costs";
(2) Regulation can bring settlement rates in line with "costs";
(3) Once settlement rates are in line with costs, collection rates to end-users will fall;
(4) A reduction in end-user rates will spur an increase in demand;
(5) An increase in demand will cause providers' net revenue to rise;

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on file with author).

440. *Id.*

441. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 1-12; Frank H. Easterbrook, *The Supreme Court, 1983 Term: Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 15-16 (1984) ("People demand laws just as they demand automobiles, and some people demand more effectively than others. Laws that benefit the people in common are hard to enact because no one can obtain very much of the benefit of lobbying for or preserving such laws." Easterbrook, *supra*, at 15. As such, because "cohesive groups can get more for themselves by restricting competition and appropriating rents than by seeking rules that enhance the welfare of all, . . . we should expect regulatory programs and other statutes to benefit the regulated group . . . ." *Id.* at 16. Accordingly, these groups *"need not 'capture' the programs, because they owned them all along. The burgeoning evidence showing that regulatory programs increase prices for consumers and profits for producers supports this understanding."* (emphasis added and citations omitted)); *see also* George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). It would seem, therefore, that U.S. carriers are now protected by "market-friendly" regulation.

(6) The FCC's policies are a good idea because both carriers and consumers will be better off in the long run.

Wrong. First, even if the overall logic of this paradigm were true, because the FCC has deliberately failed to articulate exactly what "costs" it is talking about, it is metaphysically impossible to bring anything into line that is ephemeral at best.[442] Instead, the concept of economic costs appears to be tragically reduced to yet another regulatory term of convenience to facilitate predetermined social outcomes.[443]

Moreover, the FCC should be careful for what it wishes. As discussed below, the FCC has taken great pains to hide both the scope and scale of the economic costs relating to its current flawed and controversial universal service program. Much to everyone's surprise, however, the FCC recently won one battle relating to universal service in court, where it convinced the Eighth Circuit that access charges (the domestic version of settlement rates) imposed on long-distance providers that include LECs' universal service costs are not "above-cost" "*since universal service contributions are a real cost of doing business.*"[444] Yet, if the logic of the Eighth Circuit is followed, then current settlement rates are similarly not "above-cost," since international settlement rates are also simply "a real cost of doing business."

More significant, however, is the FCC's misunderstanding about the relationship between per-minute prices for international calls and the international settlement-of-accounts regime. Foreign carriers and regulators (i.e., parties reaping the benefits from the above-cost settlement rates) are unsurprisingly reluctant to reduce settlement rates. Yet, even though economic theory indicates that prices are related to cost, for U.S. carriers the settlement rate does *not* measure the settlement cost of providing a minute of IMTS service. With multiple carriers and proportionate returns, the cost relevant to the setting of prices is not only a function of the settlement rate but of the input-output ratio (the ratio of inbound to outbound IMTS traffic) and the carrier's market share.[445] Only for a monopolist is the settlement

442. *See, e.g.*, City of Holyoke Gas & Electric Dept. v. FERC, 954 F.2d 740, 743 (D.C. Cir. 1992) ("Since it is already doing the relevant calculation, it is a small matter to abide by the injunction of the arithmetic teacher: Show your work! For the Commission to do less deprives the [consumer] of a rational explanation of its decision.").

443. *See, e.g.*, Adri den Broeder, *KPN Must Eliminate Corporate Discounts Says Regulator*, TotalTele.Com (Oct. 2, 1998) (visited Nov. 1, 1998) <http://www.totaltele.com/ news/view.asp?articleID=19554&Pub=TT> ("Dutch telecommunications regulator OPTA said telecommunications company Royal KPN NV must eliminate discounts for corporate telephone-service clients by January 1, and base its charges on costs.").

444. Southwestern Bell Telephone v. FCC, 153 F.3d 523, 554 (8th Cir. 1998) (emphasis added).

445. Specifically, the marginal settlement cost is $S \cdot [1 - IO \cdot (1 - w)]$ where S is the set-

rate equal to the marginal settlement cost of the carrier. Given the absence of monopoly in the United States, therefore, there is no reason to expect that the IMTS prices of U.S. carriers should be directly related to the settlement rate. In other countries, however, where monopoly is prevalent, the marginal settlement cost *is* the settlement rate, and, as such, any reduction in the settlement rate will unambiguously reduce the marginal settlement cost of the carrier, other things constant.[446] Thus, rather than develop constructive solutions for the problem, the debate over the relationship between prices and cost tragically continues to be fueled by the FCC's lack of understanding of what the true settlement costs are.

4. Problem No. 4: The FCC Apparently Believes that the Mere Potential for Foreign Carriers To Think "Evil Thoughts" Is Sufficient Justification To Impose Stringent Regulation as a Precondition of Entry

a. Price Squeeze-Type Conduct

As noted above in the preceding *Orders*, the FCC now concludes (contrary to conclusions made in its earlier international proceedings and other domestic proceedings)[447] that because a foreign carrier has the *per se* ability to engage in "price squeeze" behavior, the mere fact that a foreign carrier might also have the "*incentive*" to engage in price squeeze behavior is sufficient grounds to justify the imposition of its "*Benchmarks* condition" as a prophylactic device. The problem with this analysis, however, is that it runs completely inapposite to established antitrust and regulatory price squeeze precedent.

That is to say, a predatory price squeeze plaintiff generally has two options available. First, a plaintiff may apply for an administrative remedy from the regulatory administrative agency with jurisdiction over the alleged

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tlement rate, *IO* is the input-output ratio, and w is the market share of the carrier. Note that for a monopolist, (where $w = 1$), the marginal settlement cost is equal to the settlement rate. Given proportionate returns, the cost function of the U.S. carrier to a particular country is $S \cdot q - S \cdot F(q/Q)$ where q is the carrier's outbound minutes, F is the industry inbound minutes, and Q is the industry outbound minutes so that q/Q is the market share of the carrier. I am grateful to George Ford, MCI Worldcom and Adjunct Fellow of the Phoenix Center, for this economic analysis.

446. The common argument proffered by foreign carriers and regulators against the reduction of settlement rates that U.S. carrier's IMTS prices bear no relationship to the settlement rate (since prices are not related to the settlement rates) and therefore, reductions in the settlement rates offer no benefit is equally specious. Under basic economic theory, the reduction of a price or rate substantially above marginal cost is unambiguously welfare *improving*.

447. *See* Parts III.A.-III.D *supra*.

anticompetitive rate.[448] Alternatively, the plaintiff may elect to sue under section 2 of the Sherman Act in federal district court. However, because of the different roles of antitrust and regulation, each avenue has different criteria for success and different remedies.[449]

On one hand, as explained *supra*, it is well established that the role of an administrative remedy is to ensure that rates are just and reasonable.[450] As such, if a plaintiff seeks an administrative remedy from the regulator, then the regulator typically is not required to focus its examination on the firm's intent, but rather on the anticompetitive effects of the alleged price squeeze on the wholesale customer/retail competitor and whether they are outweighed by the effect on the supplying firm's financial viability and its ability to serve its customers.[451] If a plaintiff successfully proves a price squeeze claim, however, then the regulator may remedy the price squeeze only by reducing the offending jurisdictional rate within a "zone of reasonableness."[452]

In contrast, a section 2 claim seeks to remedy some kind of intentionally imposed anticompetitive harm.[453] A section 2 plaintiff must show more than a general intent, however; rather, this plaintiff must show that the defendant had some degree of monopolistic intent, as well as some demonstrable harm to competition.[454] If both prongs of the test are met, then treble damages are available to punish the offender (and, moreover, the plaintiff will not have to share this award with any other potential similarly-situated plaintiffs not party to the suit because rate reductions benefit *all* customers receiving service under the regulated firm's tariff).[455]

The FCC's approach to price squeeze conduct, unfortunately, requires neither a showing of specific intent nor—even more importantly—any showing of anticompetitive harm. Rather, the FCC seems to believe that it may set prices over firms clearly not under its jurisdiction simply because they have the potential to think "anticompetitive thoughts" in their hearts. Indeed, the FCC's anticompetitive concerns appear unfortunately to be far more ephemeral than probable. By deliberately choosing not to undertake a

448. Lawrence J. Spiwak, *Is the Price Squeeze Doctrine Still Viable in Fully-Regulated Energy Markets?*, 14 ENERGY L.J. 75, 77 (1993).

449. *See id.*

450. *Id.* Notwithstanding this precedent, as mentioned elsewhere, the FCC now believes erroneously that its "public interest" authority may be far broader and, as such, has created its own trade division to address its regulatory constituents' concerns.

451. *Id.* (citation omitted).

452. *Id.*

453. *Id.* (citations omitted).

454. *Id.*

455. *Id.* (citation omitted).

detailed economic analysis of the structural conditions in a WTO Member country's home market, therefore, it is difficult to discern exactly any clear nexus between the regulation imposed by the FCC and the specific anticompetitive harms this regulation is supposed to mitigate.

b. Posing a "Very High Risk" to Competition

Not content with the foregoing "prophylactic" mechanisms, however, the FCC stated that it could not "rule out the possibility" that its various "regulatory safeguards" would be "ineffective at preventing anti-competitive conduct in a particular context, *and* that, as a result, a carrier would be able to raise the costs of its rivals to the degree that end-user customers would be injured."[456] As such, the Commission also decided to adopt yet one more regulatory mechanism by introducing a brand new term into the legal and economic lexicon—that is, a presumption that "an application does not pose a risk of competitive harm that would justify denial unless it is shown that granting the application would pose . . . a *very high risk to competition.*"[457] The big problem, however, is the FCC's failure to provide a precise definition of the heretofore unknown standard of "very high risk to competition."[458]

According to the Commission, a "very high risk to competition" in the U.S. market occurs whenever there is a situation which "cannot be addressed by [its] safeguards or conditions, and would therefore warrant denial of a license."[459] In order to have the ability to pose such a risk, however, "an applicant must possess the ability to harm competition in the U.S. market in addition to the ability to exercise its foreign market power."[460] While the Commission was quick to point out various situations that it would not consider a "very high risk to competition,"[461] this standard is just too vague (and gives the regulator far too much subjective discretion) to have any analytical anchoring. In removing this analytical anchor, the FCC has once again decided improperly that a "Potter Stewart I Know It When I See It" test of anticompetitive conduct or market power can be an acceptable sub-

456. *Foreign Participation Order*, *supra* note 306, para. 51.

457. *Id.* (emphasis added).

458. Indeed, is this standard the same as "very *very* high risk to competition?" Or, conversely, somehow less dangerous than a plain old "high risk" to competition?

459. *Foreign Participation Order*, *supra* note 306, para. 52.

460. *Id.*

461. For example, the Commission stated that it would find it "highly unlikely" that a "very high risk to competition" was present: (a) when an acquisition of less than a controlling interest in a U.S. carrier by a foreign carrier occurs; (b) when a carrier from a WTO Member country has "open, competitive markets and a procompetitive regulatory regime in place"; or (c) that the FCC would deny entry "'based solely on [the applicant's] market share.'" *Id.* (citations omitted).

stitute for sound legal and economic analysis in public-policy decision-making.[462] As such, the terms "market power," "dominant," or "anti-competitive" once again tragically have been boiled down improperly to nothing more than the intellectual equivalent of "I don't like you."

5. Problem No. 5: In the FCC's View, What Is Good for the Goose Apparently Does Not Necessarily Have To Be Good for the Gander—Even When the Goose Refuses To Lay Any Eggs

To get around the jurisdictional issues associated with its *Benchmark* conditions, the FCC stated that its settlement rate benchmarks applied only to the charges paid by U.S. carriers to their foreign correspondents, and not to the foreign correspondents themselves. At the end of the day, however, the big question of what will the United States do if a foreign carrier simply refuses to cooperate with the FCC's unilateral actions remains unresolved. Indeed, if a foreign carrier refuses to negotiate a settlement rate at or below the FCC's benchmarks within the exact time specified by the FCC, is a U.S. carrier really going to ask the FCC to declare their own rates unlawful? Hardly.

History has taught that if countries are going to engage successfully in *real-politic* diplomatic maneuvers, words must be backed with demonstrable and swift action. In the U.S. case, however, while there certainly is no shortage of fiery neo-mercantile rhetoric to create (if not exacerbate an existing) substantial *disincentive* for both foreign governments and carriers to engage in good faith negotiations with U.S. carriers to enter their home markets (which, paradoxically, is supposed to be the whole goal of such an approach in the first place),[463] the FCC's rhetoric is backed up with nothing more than threats to punish rogue international carriers either by: (1) public identification; (2) working with (i.e., complaining to) the offending carrier's government; or (3) allowing U.S. international carriers to petition the FCC to consider stronger steps. As such, both U.S. consumers and business should really not be surprised when the economic costs of neo-mercantilism outweigh the very economic benefits the FCC promised that they would receive.

As mentioned above in Part IV.A.5, the economic costs of mercantilism can be substantial. These include as a general matter the *creation*—rather than the *elimination*—of significant barriers to entry for both new firms into U.S. domestic telecommunications markets and U.S. firms into foreign markets; and, with such barriers, increased investment "uncertainty"

462. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 4 n.15 (citing Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (while it is impossible to define "obscenity," "*I know it when I see it.*" (emphasis added)); *see also supra* note 3.

463. *Id.* at 19.

markets; and, with such barriers, increased investment "uncertainty" for international telecommunications development projects. When this occurs, U.S. consumers are forced to pay higher prices to reflect both this increased cost of capital and the firm's incentive to *raise* its prices to ensure that it can recover its costs in the shortest time possible.

There are, moreover, many significant legal issues associated with these policies of which practitioners may not be aware. For example, settlement rates are set by privately negotiated agreements among U.S. carriers and their foreign correspondents. After the parties reach an agreement, the FCC accepts that rate and permits the U.S. carrier to pass that cost component (if any) through to end consumers in the collection rate.[464] However, by unilaterally imposing mandatory settlement benchmarks calculated by the FCC on a *sua sponte* basis, the FCC has essentially modified the parties' private agreement. In doing so, the FCC may have violated the parameters of the *Mobile-Sierra* doctrine.[465]

Under the *Mobile-Sierra* doctrine, the Commission has the power to prescribe a change in contract rates when it finds them to be unlawful and "to modify other provisions of private contracts when necessary to serve the public interest."[466] As Judge Bork once explained,

> Although the legal standard for changing contract rates (they must be "unlawful") differs from the standard for changing other contract provisions (they must disserve "the public interest"), in fact the two standards are not very different. Before changing rates, the Commission must make a finding that they are "unlawful" according to the terms of the governing statute, which typically requires a finding that existing rates are unjust, unreasonable, unduly discriminatory, or preferential. . . . But as the Supreme Court recognized in *Sierra*, complaints about existing rates do not concern the Commission unless the problems raised are sufficiently serious to "adversely affect the public interest."[467]

Despite this authority, however, courts have held that *Mobile-Sierra's* "public interest" standard is "practically insurmountable."[468] Indeed, courts require an exceptionally high burden of proof to show why a contractual

464. *See generally* 47 C.F.R. § 43.51 (1997).

465. *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332, 339-43 (1956); FPC v. Sierra Pac. Power Co., 350 U.S. 348, 353-55 (1956).

466. *See* Western Union Tel. Co. v. FCC, 815 F.2d 1495, 1501 (D.C. Cir. 1987).

467. *Id.* at 1501 n.2 (citations omitted).

468. *See, e.g.*, Papago Tribal Authority v. FERC, 723 F.2d 950, 954 (D.C. Cir. 1983); *but cf.* Northeast Utils. Serv. Co. v. FERC, 55 F.3d 686, 691 (1st Cir. 1995) ("We do not think that *Papago*, read in context, means that the 'public interest' standard is practically insurmountable in all circumstances. It all depends on whose ox is gored and how the public interest is affected.").

term is not in the public interest.[469] Moreover, satisfying this burden is simply made more difficult by the fact that the Commission lacks jurisdiction over one of the signatories (i.e., the foreign correspondent) and that most of these agreements deliberately do not contain either a "choice of law" or a "choice of venue" provision.

Perhaps more troubling, however, is that the FCC believes that it may proscribe, *sua sponte*, specific, long-term prices under both the Communications Act and international law on a unilateral basis in the first instance.[470] While the Commission certainly has the authority to proscribe a particular ratemaking *methodology*,[471] the Commission's authority to proscribe rates is much more limited. Under existing precedent, courts have held that it is only permissible for the Commission to proscribe specific *interim* settlement rates because "any harm caused by the interim rates [can] be remedied."[472] Moreover, the Commission may not exercise its proscription authority in a vacuum. Under the plain language of the Communications Act, *the Commission may exercise its authority to proscribe interim rates under section 205 only after it has first rejected rates initially proposed by carriers as unjust and unreasonable.*[473] Thus, because it is still the carrier who has the burden

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469. *See, e.g.*, *Western Union Tel.*, 815 F.2d at 1501-02 (holding the FCC was not justified in abrogating settlement agreement which established compromise rates for leasing special access facilities and set specific procedures for changing those rates in the future).

470. Specifically, the FCC's actions may, in fact, violate the International Telecommunication Union (ITU) regulations, a treaty to which the United States is party and for which the Commission is the U.S. enforcement authority under U.S. domestic law. 47 U.S.C. § 303(r) (1998). *See, e.g.*, International Telecommunication Regulations, Dec. 9, 1988, S. TREATY DOC. NO. 102-13, art. I, para. 1.5 (1991) [hereinafter ITU]. ("Within the framework of the present Regulations, the provision and operation of international telecommunications services in each relation is pursuant to *mutual agreement* between administrations [or RPOAs]."); ITU, *supra*, art. 6.2.1 ("For each applicable service in a given relation, administrations [or RPOAs] shall by *mutual agreement* establish and revise accounting rates to be applied between them, in accordance with the provisions of Appendix 1 and *taking into account relevant CCITT Recommendations and relevant cost trends*.") (emphasis added).

471. *See* Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486 (D.C. Cir. 1984).

472. FTC Comm. v. FCC, 750 F.2d 226, 232 (2d Cir. 1984); Western Union Int'l v. FCC, 652 F.2d 136, 144 (D.C. Cir. 1980); *cf.* discussion *supra* Part IV.C.3 (indicating FCC conceded that it only had authority to proscribe interim rates). Of course, "interim" rates in the telecommunications context can often last for quite a long time.

473. *See* Ralph Nader v. FCC, 520 F.2d 182, 198 (D.C. Cir. 1975); AT&T v. FCC, 449 F.2d 439, 450-53 (2d Cir. 1971); *Western Union Tel.*, 815 F.2d 1495. *See also* Communications Act of 1934, ch. 652, § 205, 47 U.S.C. § 205, which provides in relevant part that:

> Whenever, after full opportunity for hearing, upon a complaint or . . . on its own initiative, the Commission shall be of opinion that any charge, classification, regulation, or practice of any carrier or carriers is or will be in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge or . . . charges to be thereafter observed . . . .

to justify that its specific rates are just and reasonable, basic ratemaking principles instruct that there cannot be a single, generic industry-wide rate under the common "just and reasonable" standard.[474] Accordingly, the FCC's "one-size"—or, more accurately "five-sizes"—"fits all" approach to ratemaking is specious at best. The costs of wiring Uzbekistan are simply not the same as the costs of wiring Uruguay, and, moreover, if either Uzbekistan or Uruguay fail to meet the FCC's benchmarks, *the costs of wiring either country are still not the same as the (U.S.) $0.08 the FCC thinks is the cost of wiring Sweden.*

This process is not as difficult to satisfy as it may seem. In order for a rate to be "just and reasonable," prices only need to fall within a "zone of reasonableness"—that is, that these rates are neither "excessive" (rates that permit the firm to recover monopoly rents) nor "confiscatory" (rates that do not permit the regulated firm to recover its costs).[475] They need not—just like caviar or Rolls Royce limousines—be "*fair*" or "*affordable*" for everyone.[476] Yet, while this standard is not very precise, the phrase "just and reasonable" is clearly more than a "mere vessel into which meaning must be poured."[477] Rather, the delineation of the "zone of reasonableness" in a particular case will involve a "complex inquiry into a myriad of factors."[478] These myriad of factors, however, may include both *cost and non-cost* factors to determine whether particular rates fall within the zone.[479] Thus, had

474. *See* 47 U.S.C. § 203 (1998). *See also* New England Tel. & Tel. Co. v. FCC, 826 F.2d 1101, 1104 (D.C. Cir. 1987).

475. *Farmers Union*, 734 F.2d at 1502. Courts generally give administrative agencies substantial discretion to define this zone. Indeed, as the D.C. Circuit Court once explained, when examining an agency's determination that a particular rate falls within the zone of reasonableness, it is not a court's "function . . . to impose [its] own standards of reasonableness upon the Commission, but rather to ensure that the Commission's order is supported by substantial record evidence and is neither arbitrary, capricious, nor an abuse of discretion." *Nader*, 520 F.2d at 192 (citations omitted). However, the court was also quick to point out that, "[i]n terms of ratemaking, the agency's expertise allows us to accept its judgment after it defines the zone of reasonableness; *but we cannot rely on claims of judgment to explain how the agency arrived at the zone.*" *Id.* at 193 (emphasis added).

476. *See* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 8 (emphasis added); *see also Farmers Union*, 734 F.2d at 1504 (holding the concept of "'just and reasonable'" must clearly be more than a "'mere vessel into which meaning must be poured'") (citation omitted).

477. *See Farmers Union*, 734 F.2d at 1504.

478. *Id.* at 1502.

479. *Id*. When considering the latter, courts have upheld the legitimate role non-cost factors may play in order to achieve a particular public policy objective (e.g., a desire to establish additional supply), so long as the agency specifies the nature of the relevant non-cost factor and offers a reasoned explanation of how the factor justifies the resulting rates. *Id.* at 1502-03 (citations omitted); *see also* National Ass'n of Regulatory Utility Comm'rs v. FCC, 737 F.2d 1095, 1137 (D.C. Cir. 1984); National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 182-83 (D.C. Cir. 1993) (affirming price cap regulation although not tied di-

the FCC recognized the legitimacy of the basic notion that different countries have different economies and, *a fortiori*, cost structures—much as the ITU did in its recent proposal—the FCC's unilateral approach would have stood on much firmer footing.

Moreover, the regulator is also going to have to determine whether the firm under its jurisdiction is a single-output or, more likely in today's era of "convergence," a multi-product firm. As such, whenever government attempts to define the "zone of reasonableness," a primary focus on a multi-product firm's *aggregate* profits is irrelevant. Rather, the appropriate scope of government's inquiry should be whether the specific profits derived from providing *regulated* products and services (and *not* from ancillary businesses or investments) are the result of the regulated company's ability to charge an excessive (i.e., monopoly) rate for the regulated product or service—that is, the product or service over which it can raise price or restrict output absent regulation. If the rate reflects the regulated company's true costs of providing the regulated product or service, but government nonetheless believes that this just and reasonable rate is "too expensive," "unfair," or not sufficiently "affordable," then it is therefore wholly improper for government to require the regulated firm to "subsidize" the price it charges for its regulated service with ancillary profits just to make the rate more politically "affordable" or "fair." When this occurs, "affordable" simply becomes an excuse for government to set unlawfully confiscatory rates instead.

Similarly, because regulation is supposed to be the substitute for, and not the complement of, competitive rivalry,[480] regulators should attempt to set a rate that approximates the equilibrium price (i.e., where supply equals demand) that a rivalrous market would produce.[481] Thus, if government truly wants to make prices for a "public" good or service more "affordable"—regardless of whether the end-price for this product or service is set by regulation or not—then government should focus its priorities on promoting entry and rivalry, such that firms will be forced to innovate and lower costs and, with such innovation and increased efficiency, force supply and demand to move down and to the right. If this shift occurs, then the entire "zone" should therefore also be forced down and to the right over time. So long as the U.S. government erects barriers to entry in the name of promoting competition, however, such policies will provide U.S. firms with no

rectly to cost).

480. Indeed, it is not—contrary to popular belief—"*because we can*." Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 7.

481. *Cf.* Town of Concord v. Boston Edison Co., 915 F.2d 17, 26 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 1337, *reh'g denied*, 111 S. Ct. 2047 (1991).

real incentive to innovate and lower costs and, as such, true deregulation and competition will never occur.[482]

Finally, from a policy and economic point of view, any proposal that advocates that the Commission should set prices *sua sponte* in the first instance—especially a unilateral attempt to set international settlement rates that were negotiated privately between parties, one of which the Commission clearly does not have jurisdiction over—has odious implications. Permitting government to unilaterally set prices over products and services—especially without first determining the actual underlying costs of these products and services—is a proven way to eliminate innovation and harm competition.[483] As mentioned above, this issue is especially acute in the international context because U.S. public policy should not remove any incentive for competitive reform in other countries. Similarly, because U.S. consumer demand for IMTS service continues to grow exponentially, mandating specific prices does not improve market performance either; rather, it simply guarantees U.S. carriers a substantial revenue stream (they make up the lost revenues by increased volume) and thus removes any incentive for them to compete.[484] And, of course, as mentioned repeatedly above, so long as the FCC wants to play the "trade" game as well as the "regulation game," any unilateral attempt to prescribe prices over people not subject to the United States' jurisdiction will only create, and more likely exacerbate an existing, recalcitrance by foreign carriers to do business with U.S. carriers, which was the whole goal of this exercise in the first place.[485]

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482. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2 *passim.*

483. *See, e.g.*, Competitive Telecomm. Ass'n v. FCC, 87 F.3d 522, 529-30 (D.C. Cir. 1996) ("The test of a competitive market is whether consumers are offered the lowest possible prices or more or better services. . . . As [such], the goal of the agency 'is to promote competition in the interchange marketplace, not to protect competitors.'" *Id.* at 530 (citations omitted)); *see also* Central Iowa Power Corp. v. FERC, 606 F.2d 1156, 1163 (D.C. Cir. 1979) (holding simply because a tariff may be unduly discriminatory or preferential does not automatically mean that a tariff may be, in fact, anticompetitive).

484. Considering the fact that the FCC's former Chairman stated publicly that the Commission would not be in the business of setting rates on the domestic side, it does seem a bit hypocritical for the FCC to rationally believe that it could otherwise lawfully set prices in the international context. *See Competition: Walking the Walk and Talking the Talk*, Statement of FCC Chairman Reed Hundt before Alex. Brown & Co.'s "Media & Communications '96 Conference" Waldorf-Astoria Hotel, NY, 1996 WL 529213 (Sept. 17, 1996) (What "our interconnection order does not do is set any specific prices new entrants will pay for leasing elements of the existing network, like unbundled loops and switching capacity. These will be set in state arbitrations or through negotiations between the parties.").

485. *See supra* note 2; *see also Gunship Diplomacy: The FCC's International Settlement Rate Policies*, Dataquest, PUBLIC TELEPHONY SERVICES NORTH AMERICA MARKET ANALYSIS (Feb. 9, 1998) *available at* <http://www.gartner11.gartnerweb.com/dq/static/dq.html> ("[W]hile the traditional ac-

6. Problem No. 6: The Great Universal Service Hypocrisy (a.k.a., A Policy To Ensure that "All the Children of the World Will Sing Together in the Spirit of Harmony and Peace")

Universal service, as a general public policy, is certainly a worthy social goal.[486] The whole purpose of both the 1996 Act and the February Accord, however, was allegedly to promote competition and lead to deregulation.[487] Thus, it seems a bit paradoxical that anyone could rationally believe that it is possible to have *both* "competitive" markets yet, at the same time, require firms (a) to guarantee that everyone will receive reliable service, and moreover (b) to ensure that particular sectors of society will enjoy not only "reliable" service but also some sort of *subsidized* service as well.[488]

What is so surprising, however, is that it was a majority of the European Union Member States (many of which have long and well-documented histories of socialist-type public welfare policies), and not the United States (allegedly the paragon of a successful capitalist, democratic society), that recognized that trying to reconcile these diametric goals would be a fool's errand. As such, the European Commission has specifically refused to permit Member States to use universal service to subsidize Internet access to the schools.[489] Yet, despite the cacophony of pressure and empirical evidence demonstrating that the United States should follow this same path, the FCC nonetheless continues to stick rigidly to enforcing the Clinton Administration's policy of ensuring that the telecommunications industry pays for the yellow-brick toll-road that will lead our children over the bridge to the twenty-first century—even if it takes backroom deals and regulatory coercion to accomplish this goal.[490]

counting rate system must be reformed, . . . the adversarial structure designed by the FCC is bound to fail in the long term. The FCC does not appear to want to work cooperatively in international forums but, instead, mandates onerous rates, terms, and conditions concerning international settlement rates. The FCC's rigid policies and benchmark rates to improve the international accounting rate system have set off an international firestorm, and this could come back to haunt the FCC as it strives to effect a competitive international marketplace.").

486. Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 14.

487. *Id.* at 15.

488. *See id.*

489. *See EU's Bangemann Says Only France, Italy Adopt Universal Service Telecom Funding*, AFX NEWS (Feb. 25, 1998), *available in* WL ALLNEWSPLUS Database (indicating EC does not "intend to allow money raised from universal-service funding to be used to fund internet in schools"; rather, while this Internet access to the schools should be encouraged, it should appropriately "be paid out of education budgets."); *see also* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2 (outlining massive economic costs to consumer welfare by current universal service policies).

490. *See* Scott Cleland, *The "Real Story" Behind the FCC's Subsidy Reform Decision?*, TELECOM BULLETIN, May 9, 1997 (Wash. Research Group) ("[O]nly 'escape route' possi-

What is particularly sad, however, is that the FCC apparently believes that it must also perpetuate this charade on the international telecommunications community as well.[491] Yet, as long as foreign carriers must pay access charges to terminate a call in the United States, these foreign carriers—and *a fortiori* their customers—must pay into the U.S. universal service fund

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ble from the 'political trap' of appearing to be increasing the nation's telephone rate burden to pay for new school subsidies" was for the FCC to enter into a "last minute 'deal' with AT&T," which, in "return for public promises from AT&T to pass on any access charge reductions to basic consumers for the first time in years, the FCC would decrease the local telcos' price caps by an additional $750 million." This "'deal,' combined with a slower phase-in of the new universal service fund, enabled the FCC to defensively claim 'offsetting savings' for both long distance and local customers to pay for the $3 billion in new subsidies."); *Furchtgott-Roth Tells LECs To "Stand Up" to FCC on Universal Service*, COMM. DAILY, Mar. 5, 1998, at 3, 4 (reporting that a packed ballroom audience erupted in applause and jumped to their feet when Commissioner Furchtgott-Roth "sharply criticized fellow commissioners for what he declared was 'secret deal' made with AT&T and MCI to conceal actual costs for USF and access reform charges: 'I will never support negotiations in secret without public notice and comment.' [In addition, Furchtgott-Roth, i]n strongest criticism, questioned increase in administrative expenses for Universal Service Administrative Corp. (USAC) to $4.4 million from $2.7 million—65%—in latest quarter: 'That's $18,000 per day in additional expenses.'").

491. See, for example, *Benchmarks Order*, *supra* note 315, paras. 148, 171, where the FCC recognized that the "Reference Paper on 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.'" *Id.* para. 148. Further, the Commission noted that

> [h]idden 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. 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.

Id. (citation omitted).

Of course, given FCC officials' flagrant denials that these fees even exist at all, this regulatory deception really should not be too surprising. *See, e.g.*, Mike Mills, *AT&T Imposing Fee on Residential Users*, WASH. POST, May 6, 1998, at C11 (reporting that AT&T has begun to impose a fee on residential customers to pay for FCC's universal service program. In a bald-faced lie, however, FCC officials complained that AT&T and other carriers should be absorbing the charges themselves, and were never ordered by the FCC to pass them on to consumers. "'This is not a federal charge. This is a charge that AT&T is creating on its own,' said the FCC's Chief of Staff, John Nakahata." *Id.* Such a claim is really quite incredulous, given the fact that former FCC Chairman Reed Hundt tried actively to "keep the fees from appearing as new line items on consumers' bills. Long-distance companies declined that request, but in a deal with [Hundt,] AT&T said it would refrain [temporarily] from charging the fees to consumers who pay undiscounted rates for long-distance service.").

whether they like it or not.[492] Fortunately, however, the international community is not so naïve as the FCC apparently believes. As the ITU recently pointed out:

> [I]f the international accounting rate system were ever intended to provide a mechanism for transferring funds from high teledensity countries to low teledensity ones, then it is a singularly inefficient mechanism for doing so. Indeed, high cost countries, which usually have a low teledensity, are cross-subsidizing low cost countries in that the accounting rate system, as it currently works, is based on revenue-sharing rather than underlying costs. Thus, because the accounting rate is invariably split 50/50, the high cost country (which has a lower mark-up over its real cost base) gains less from the transaction than the lower cost country (which has a higher mark-up). Thus a settlements system which is actually cost-oriented should be more effective in transferring funds between countries to meet differing needs because the underlying cost differences would be reflected in asymmetric rates for call termination.[493]

So long as the FCC continues to strain its own credibility—as well as the Administration's overall reputation—abroad, the Commission simply continues to deprive both U.S. consumers and businesses of the very benefits that these policies were supposed to achieve originally.[494]

492. *See* David Molony, *EC and U.S. To Clash over Universal Service Funds*, COMM. WK. INT'L, Apr. 6, 1998, at 1, 30 (reporting that Diane Cornell, chief of the telecoms division of the FCC's international bureau, argued that foreign carriers should pay their fair share to use U.S. local networks because an "'international carrier benefits from being able to terminate a call to rural areas or low-income subscribers'" in the United States. The article further reported, however, that the international telecoms community found this official U.S. response to be specious at best. Quoting, among other anonymous sources, a leading Washington, D.C. telecommunications analyst, the article questioned why, given the scale and scope of the U.S. domestic telecommunications network, "'[e]very call from the poorest African nation is paying for an ISDN link to Ted Turner's ranch.'").

493. Methodological Note on Universal Service Obligations, *Note by the ITU Secretariat*, Oct. 9, 1998 (visited Nov. 16, 1998) <http://www.iut.int/intset/focus/usos3.doc>.

494. *See also* Spiwak, *The Search for Meaningful Definitions*, *supra* note 2, at 19-21 (explaining ill-effects of Administration's "neo-mercantile policies"). Unfortunately, the U.S. continues to attempt to perpetuate (unsuccessfully) this charade even at the time of this writing. *See, e.g.*, Remarks of Vice President Al Gore Before the ITU Plenipotentiary Conference in Minneapolis, calling for a "Digital Declaration of Interdependence" because "our children and our world are waiting." (Oct. 12, 1998). If this indeed is the case then, as discussed *supra*, the current universal service program is clearly "taxation without representation."

V. CASE STUDY: THE BT EXPERIENCE

A. *Contextual Background*

Before turning to a specific analysis of *BT/MCI III*, perhaps it might be useful to summarize some of the FCC's own findings about the U.K. domestic market and the U.S.-U.K. IMTS market to date, any additional public information about these markets that was available at the time of this *Order*, and the significant exogenous political and current events that would affect the outcome of this proceeding. In this way, the acts and omissions of the *BT/MCI III Order* will be easier to identify and to analyze.

1. Recap of *BT/MCI I* & *II*

As discussed *supra*, the Commission reached several conclusions in *BT/MCI I* that are worth highlighting here. For example, it is important to remember that the Commission specifically rejected the argument that because BT was a potential competitor for the U.S.-U.K. IMTS market as well as for the U.S. domestic interexchange, local exchange, and wireless markets, the FCC should not approve the initial BT investment.[495] Citing to the fact that there were numerous other competitors in all of these markets (with the exception of local—*BT/MCI I* was decided before the 1996 Act), the incremental addition of BT would have a *de minimis* affect on competition.[496] Moreover, the Commission adopted a similar view when these same arguments were raised in the *Sprint Declaratory Ruling*. Indeed, in both cases, the Commission found that these foreign investments would actually have procompetitive benefits in the form of economies of scale and scope, new capital, etc.[497] This point is especially crucial to remember with the introduction and application of the FCC's new "Sufficiently Precluded Competitor" merger analysis.[498]

Moreover, the FCC specifically declined in *BT/MCI I* to regulate MCI as a dominant carrier on the U.S.-U.K. route because it found that: (1) there was sufficient competition in this market to constrain BT's behavior;[499] and (2) the Commission's existing ISP would protect against any potential anticompetitive harm.[500] However, because of BT's admitted dominance in the

495. *BT/MCI I Order*, *supra* note 184.
496. *Id.* para. 50.
497. *Id.* para. 51.
498. *See infra* note 523 and accompanying text.
499. *BT/MCI I Order*, *supra* note 184, para. 49.
500. *Id.* para. 38.

U.K. market at the time of *BT/MCI I*, the Commission nonetheless imposed some residual reporting requirements to ensure compliance with its ISP.[501]

2. Dancing Around BT's Dominance: The Cable & Wireless Nondominant Petition[502]

In this *Order*, C&W sought Section 214 authority from the Commission in order to provide international facilities-based switched and private line services between the United States and the United Kingdom.[503] In order to determine whether it should conduct an *ECO* analysis, the Commission initially needed to determine whether C&W possessed market power in the U.K. market.[504] Unfortunately, the FCC's task was not as straightforward as it seemed—that is, the FCC was in a rather delicate predicament because *BT/MCI III* was concurrently pending, and the Commission did not want to state or find anything in the C&W proceeding about the state of competition in either the U.K. or the U.S.-U.K. route for IMTS service that might tie its hands in its final disposition of the BT/MCI merger. As such, the FCC attempted to analyze the relevant markets without directly discussing BT's positions in those markets.

The Commission first examined "the local and national (domestic long distance) markets for terminating international private line and switched services at their U.K. destination."[505] After review, not only did the FCC find that the market shares (based on revenues) of C&W's U.K. affiliate, Mercury, in the U.K. domestic market for local services were low, but the FCC also found that "'Mercury [was] not the sole provider of telecommunications services in any part of the United Kingdom.'"[506] The Commission also found at the time of this *Order* that, *inter alia*, "Mercury provide[d] facilities-based local and long distance service in the United Kingdom in direct competition with BT . . . and 22 [other] regional and national facilities-based licensed holders"; there were "125 cable operators licensed to provide local telecommunications services; . . . the United Kingdom [had] opened its markets for the provision of domestic local and long distance services; . . . and 60,000 customers a month [were switching] from BT to local cable companies for their telephone service" supported a finding that there was sufficient

501. *Id.*
502. Cable & Wireless, Inc., Application for Auth. Pursuant to Section 214 and Petition for Non-Dominant Status on Int'l Private Line Routes, *Order, Authorization and Certificate*, 11 F.C.C.R. 16,486, 5 Comm. Reg. (P & F) 815 (1996).
503. *Id.*
504. *Id.* para. 8.
505. *Id.* para. 10.
506. *Id.* para. 11 (citation omitted).

supply elasticity in the U.K. domestic market, and therefore, that Mercury certainly did not control bottleneck facilities and services in that market.[507]

The Commission next examined the "facilities-based markets for international switched and private line services" in the United Kingdom.[508] The Commission found that with the imminent "issuance of new facilities-based international licenses by DTI," Mercury would "lack the ability to raise and sustain prices above a competitive level for the provision of international switched and private line services."[509] Similarly, the Commission found that "[w]ith respect to supply capacity in the facilities-based international services market, . . . there [was] significant capacity on existing and future cables and satellite circuits between the United States and the United Kingdom."[510] Indeed, the Commission specifically found that the "continental United States and the United Kingdom are served or will soon be served by a number of submarine cables, including the TAT-12/TAT-13 cable network, the PTAT system, the Atlantic Express I and II cables, as well as by Intelsat, PanAmSat, Orion, and Columbia/TDRS satellite systems."[511] The Commission also found that "the current number of international service competitors [was] evidence of an elastic demand for Mercury's services."[512] Indeed, the Commission found, and no party disputed, that "a 'multitude' of carriers resell international private line services and IMTS, and 25 operators provide ISR services."[513] Moreover, the Commission reasoned that "the likely increase in the number of facilities-based competitors resulting from the issuance of new licenses by DTI [would] add to the level of competition by vendors for customers."[514]

With respect to barriers to entry into these product markets, the Commission noted that "DTI announced that it [would] eliminate the restrictions limiting the provision of international facilities-based services to BT and Mercury and [had] invited companies to apply for licenses to provide international facilities-based telecommunications services on all routes from the United Kingdom 'on the same terms enjoyed by BT and Mercury.'"[515]

At the time of this *Order*, however, DTI had "not yet authorized any carrier other than Mercury or BT to provide international facilities-based

507. *Id.*
508. *Id.* para. 13.
509. *Id.* para. 14.
510. *Id.* para. 15.
511. *Id.* (citation omitted).
512. *Id.* para. 18.
513. *Id.* (citation omitted).
514. *Id.*
515. *Id.* para. 16 (citation omitted).

services."[516] Nevertheless, the Commission stated that it was "encouraged by the United Kingdom's decision to accept applications for international facilities-based licenses and its announced intention to 'quickly' issue additional licenses for such services 'on the same terms as those enjoyed by BT and Mercury.'" As such, the Commission believed that "DTI's execution of this intention by issuing additional licenses for international facilities-based services [would] introduce a new wave of competitors in the provision of international facilities-based and resold services from the United Kingdom."[517]

Moreover, the Commission found nothing in the record to suggest that the United Kingdom will currently or in the future "impose restrictions on foreign ownership or participation in the provision of international facilities-based switched and private line services."[518] Nor did the Commission find any "reason to believe that DTI would impose restrictions on entrance into the international facilities-based switched services market based on demand."[519]

Finally, the Commission granted C&W's petition to be declared non-dominant on the U.S.-U.K. route because C&W's U.K. affiliate (Mercury) would "not control bottleneck services or facilities in the United Kingdom once DTI issue[d] additional international facilities-based licenses."[520] Consequently, the Commission held:

> that [C&W] should be regulated as a non-dominant carrier for the provision of the international facilities-based switched and private line services between the United States and the United Kingdom *after* DTI issue[d] additional international facilities-based licenses. For the same reason, . . . [C&W] should then be regulated as a non-dominant carrier for the provision of resold interconnected and non-interconnected private line services for which [C&W] previously obtained Section 214 authority on a dominant carrier basis on the U.S.-U.K. route.[521]

3. Timing, Politics and Maneuvering

Notwithstanding the above, because of the extremely political nature of this case (i.e., the British were invading) and the fact that this case would be the first test to see exactly how strongly committed the United States was to the just-concluded February Accord, a tremendous amount of politics and maneuvering was taking place to influence the decision-making process. Un-

516. *Id.*
517. *Id.* para. 17 (citation omitted).
518. *Id.*
519. *Id.* (citation omitted).
520. *Id.* para. 26.
521. *Id.* (emphasis added).

fortunately, it appeared that any inquiry about whether the merger may actually lead to a potential reduction of output or increase in price was not high on the priority list.

For example, because the ink on the February Accord was not yet totally dry, the United States was trying to see how far it could unilaterally stretch the edge of the envelope to assuage nationalistic constituencies before it had to pay attention to international comity concerns. At the same time, however, because the 1996 Act sparked a worldwide trend in telecommunications industry reconcentration (of which the *BT/MCI III Order* was a part), the Commission was under substantial pressure to explain what steps it planned to take in order to ensure that the old Bell System was not reconstituted.[522] Finally, and certainly not least on the FCC's collective mind, because the Eighth Circuit Court of Appeals struck down the FCC's much-hyped interconnection rules, the FCC was under substantial political pressure to make it look like they were doing something to "enhance competition."

Yet, while all this bickering was going on, everyone seemed to forget that the merger agreement was conditioned on FCC action by date certain.[523] In order to complete the negotiations and not have a multi-billion dollar deal fall through because of regulatory delay, the FCC issued a very cryptic press release stating that it had approved the merger, with conditions, over *one month* before it released a final, written order.[524]

B. *The BT/MCI III Order*

On September 24, 1997, well over one month after the FCC purportedly adopted its *Order* and issued its cryptic press release, the FCC finally released its final *Order* in the *BT/MCI III Order*.[525] For purpose of its analysis, the FCC identified "three relevant *end-user markets* that [were] likely to be affected by the merger of BT and MCI: (1) U.S. local exchange and exchange access service; (2) U.S.-U.K. outbound international service; and (3) global seamless services."[526] In addition, the FCC identified "six

522. *See* Spiwak, *Reconcentration*, *supra* note 5; *see also* PHOENIX CENTER POLICY PAPER, *supra* note 10.

523. *See* BT/MCI Merger Agreement Article VI (Conditions Precedent), Section 6.1(d) ("If then legally required, an FCC Order shall have been obtained, which has not been revoked or stayed as of the Closing Date."). The Merger of MCI Comm. Corp. and British Telecomm. PLC, *Memorandum Opinion and Order*, 12 F.C.C.R. 15,351, paras. 298-303, 9 Comm. Reg. (P & F) 657 (1997) [hereinafter *BT/MCI III Order*].

524. *International Action FCC Approves MCI/British Telecom Merger Subject to Certain Conditions*, Rep. No. IN 97-25, 1997 FCC LEXIS 4489 (Aug. 21, 1997).

525. *BT/MCI III Order*, *supra* note 523.

526. *Id.* para. 52; *see also id.* paras. 53-57.

relevant *input markets*: (1) international transport between the United States and United Kingdom; (2) U.K. cable landing station access; (3) U.K. back-haul; (4) U.K. intercity transport; (5) U.K. local terminating access services; and (6) U.K. local originating access services."[527]

The Commission provided two very legitimate reasons for considering input markets in the context of this case:

> First, if as a result of the merger, the merged parties have increased market power over an input, they might be able to raise the price of that input, either unilaterally or through coordinated interaction, which could harm consumers to the extent that, in the absence of regulation in the end-user market, the increased input price would be passed on in the form of higher end-user prices. Second, if as a result of the merger, the merged parties possessed market power over an essential input and, at the same time, competed in the downstream, competitive, end-user market, the merged company conceivably could injure competition by discriminating against unaffiliated producers of the end-user service. Because BT control[led] numerous inputs in the United Kingdom that other carriers need in order to provide U.S.-U.K. outbound international service and global seamless services, [the FCC reasoned that] these input markets [were] accordingly relevant in assessing the competitive effects of the merger of BT and MCI.[528]

Turning to the merits of the case, the FCC found it unlikely that the merger would "have any [horizontal] anti-competitive effects on any of the three relevant end-user markets."[529] In fact, the FCC actually found that the merger would have procompetitive benefits in two of the three relevant markets—"the market for U.S. local exchange and exchange access services and the market for global seamless services."[530] The Commission similarly concluded that it was unlikely that the merger would have any horizontal anti-competitive effects in four out of the five input markets. The only reservation the FCC had was toward the merger's affect on the market for international transport between the United States and the United Kingdom. The Commission found that, at the time of this *Order*, there was a short-term capacity constraint that the merged company could use to its strategic advantage to the detriment of competition as a whole. Until this short-term constraint was ameliorated, therefore, the FCC suggested, and the applicants "voluntarily" proposed, certain commitments to mitigate the FCC's concerns.[531]

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527. *Id.* para. 52; *see also id.* paras. 58-60.
528. *Id.* para. 58.
529. *Id.* para. 132.
530. *Id.*; *see also id.* paras. 126-31.
531. *See id.* paras. 133-52. Specifically, BT/MCI committed to:

> (1) offer U.K. international facilities licensees a total of 147 whole circuits, for sale on an IRU basis to new entrants; (2) allow certain U.K. international facili-

The FCC next looked to see if the applicants, post-merger, would be able to use their position in any of the input markets to create successfully any vertical anticompetitive effects in any of the relevant end-user markets. In the Commission's opinion, because of the voluntary commitments offered by BT, it was unlikely that the merged entity could use its position in the international transport on the U.S.-U.K. market to affect adversely the performance of any of the end-user markets.[532] The Commission also concluded that, given demonstrable entry and effective regulation by OFTEL, it was unlikely that the merged company could use its positions in the U.K. cable landing station access,[533] U.K. backhaul,[534] U.K. intercity transport,[535] and U.K. terminating access services[536] markets. The FCC was, however, very concerned about the merged entity's ability to use its position in the U.K. originating access services market to affect anticompetitively the three end-user markets.[537] Unfortunately, it appears that these concerns are related more to the British government's refusal to adopt a regulatory regime identical to one adopted in the United States, rather than any particular harm specifically created by the merger. As such, even though the FCC conceded that BT faced "increasing competition in this market,"[538] and that "U.K. originating access services [were] subject to many of same regulatory constraints as those described for terminating access services (*e.g.*, price caps and various license conditions regarding non-discriminatory behavior)," the FCC again had little reservation in publicly criticizing another sovereign government.[539] To wit, "[o]ther U.K. regulatory policies, however, undermine these constraints and allow BT to leverage its market power over originating ac-

> ties licensees that are currently taking eastern end half-circuit international private leased circuits (IPLCs) for international simple resale to convert the IPLCs into IRUs; (3) sell to U.S. correspondents or their U.K. affiliates, upon request, eastern end matched half-circuits owned by BT and currently used for the provision of IMTS or international private line services between BT and the U.S. correspondents; and (4) offer to convert such international private lines leases into IRUs in such a manner that international simple resellers that become U.K. international facilities licensees will be in the same financial position as if their international private line leases had been scheduled to terminate on the date on which the conversion takes place.

Id. para. 136 (citations omitted).

532. *See id.* paras. 164-65.
533. *See id.* paras. 166-69.
534. *See id.* paras. 170-71.
535. *See id.* paras. 172-74.
536. *See id.* paras. 178-80.
537. *Id.* para. 181.
538. *Id.*
539. *Id.* para. 182.

cess market [sic] into the markets for end-user services that depend on originating access (e.g., U.K. domestic and international services)."[540]

> [T]hese policies include the decision not to require BT to provide equal access to other long distance carriers, to provide unbundled local network elements to other carriers, and to resell local service at wholesale prices. Alternatives to BT's local network may grow in time and eventually constrain BT's control of originating access services, but they do not significantly do so at this time. *In fact, the absence of equal access, unbundled local exchange network elements, and resale in the United Kingdom appears to create the conditions by which BT's market power over U.K. domestic and international services will be perpetuated.*[541]

Both "BT/MCI and the U.K. Government respond[ed] that there [wa]s no need to require BT to implement equal access in order to ensure effective competition in the provision of U.K. outbound calls to the United States."[542] In their view, "the different regimes in the United States and the United Kingdom [were] due to differences in the development of the telecommunications markets and competition in the respective countries. More specifically, the U.K. Government state[d] that its industrial policy of encouraging facilities-based competition would be undermined by the introduction of equal access."[543]

The FCC ignored and rejected outright these comity arguments. In the FCC's opinion, "[b]y not providing equal access to long distance carriers," BT was engaging—with the help of Her Majesty's Government—"in a form of non-price discrimination which allow[ed] it to leverage power over the local exchange to enhance its control over the U.K. long distance and international markets."[544] To prove this point, the FCC proudly pointed out that equal access was an essential requirement for the development of competitive intercity and international markets.[545] Yet, because the United Kingdom refused to implement an equal access policy (even though this policy was intended to, and succeeded in, "foster the development of alternative facilities-based local infrastructure"), the FCC maintained that this "deliberate omission allowed BT to minimize its loss of intercity and international market share."[546] In this case, however, because the European Union was making its own plans to implement an equal access requirement for Member States by January 1, 2000, the FCC conditioned its "grant of this license

540. *Id.*
541. *Id.* (emphasis added).
542. *Id.* para. 186.
543. *Id.* (citations omitted).
544. *Id.* para. 187.
545. *Id.*
546. *Id.* para. 188.

transfer upon MCI's non-acceptance of BT traffic originated in the United Kingdom to the extent BT is found to be in non-compliance with U.K. regulations implementing the European Union's equal access requirements."[547]

The FCC was equally dismayed with the U.K.'s choice not to require incumbent LECs (i.e., BT) to provide unbundled local exchange network elements and resale as U.S. ILECs are required to do under the Telecommunications Act of 1996.[548] Once again, the U.K. Government disagreed that "'lineside' unbundling was necessary or appropriate in the United Kingdom." In its view,

> the cost advantages of lineside unbundling would be small in the United Kingdom because prices are in line with costs, interconnection charges are to be based on long-run incremental costs, and access deficit charges have been abolished. The U.K. Government also claimed that making BT unbundle its local exchange network elements would be unlikely to promote local competition but would instead jeopardize the development of facilities-based local competition now underway.[549]

And, once again, the FCC ignored and rejected outright these comity arguments.[550] Yet, the FCC found that other factors were present—in particular, the recently concluded WTO Agreement and ongoing EU regulatory initiatives—to mitigate its concerns.[551]

Finally, even though the WTO Agreement was signed over seven months prior to this *Order*, because the FCC had yet to adopt final rules that implemented the WTO Basic Telecom Agreement, it stated that it was obligated to examine BT's entry as a foreign carrier into the U.S. market under its *ECO* test.[552] Because the Commission had previously found that BT did possess market power in its home market, but that the U.K. market nonetheless provided U.S. carriers with effective competitive opportunities, the FCC decided to regulate the merged entity as a dominant carrier.[553] On its own motion, however, "[the FCC] waive[d] the application of [its then]-current dominant carrier requirements to MCI pending the effective date of any new rules [it might] adopt in the *Foreign Participation* proceeding."[554] Instead, because the FCC believed that "it would be unduly burdensome, and therefore not in the public interest, to require MCI at this time to comply with [its then-]current dominant carrier regulations which may be modified

547. *Id.* para. 294; *see also id.* paras. 190-91.
548. *Id.* para. 192.
549. *Id.* para. 194.
550. *Id.* para. 195.
551. *Id.* paras. 197-98.
552. *Id.* para. 214.
553. BT North America, Inc., *Order and Authorization*, 13 F.C.C.R. 5992 (1997).
554. *BT/MCI III Order*, *supra* note 523, para. 286.

in a few months," the Commission simply required MCI to continue to comply with the safeguards it imposed on MCI in *BT/MCI I* until it adopted final dominant carrier regulations.[555]

C. The Fallout

Tragically, in the end, all of this effort—both public and private sector—that was put into resolving this case, was for naught. After MCI announced that it lost over $800 million in its efforts to enter the U.S. local market, (not surprising given the FCC's almost total failure post-1996 Act to promote affirmatively new facilities-based entry for local service),[556] coupled with all of the events chronicled above, BT was looking for an excuse to get out of the deal. As fate would have it, Bernie Ebbers of WorldCom gave BT that excuse by counter-offering $34.5 billion (and, coincidentally, providing BT with a $1.2 billion profit on their original investment made in *BT/MCI I*).[557]

Yet, regardless of whether BT had decided to go ahead with its acquisition of MCI, the adverse precedent created by the FCC's embarrassing conduct in the *BT/MCI III Order*—in particular, the stringency of "voluntary commitments" the FCC imposed and the appalling breach of international comity—makes neither investment in U.S. companies an attractive opportunity for foreign firms nor does it help grease the skids for U.S. firms to make investments abroad.[558] Moreover, the analytical hypocrisy of this

555. *Id.* para. 287. In a small gesture of international comity, however, the Commission recognized "OFTEL's active role in the United Kingdom in protecting against abuse of market power by BT." *Id.* para. 288. This gesture completed, the FCC went on to state that

> [it did] not believe that OFTEL's regulation of BT alone [was] sufficient to justify regulating MCI as non-dominant on the U.S.-U.K. route. [In the FCC's view,] [u]naffiliated U.S. competitors of BT/MCI who must rely on BT in order to terminate traffic in the United Kingdom should be able to rely on [its] enforcement process to address complaints of discrimination.

Id. para. 288.

556. *See* Ford, *supra* note 310; *see also* Comments filed by the Technology Entrepreneurs Coalition in the FCC's Section 706 "Advanced Network Proceeding," Sept. 14, 1998, Inquiry Concerning the Deployment of Advanced Telecomm. Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecomm. Act of 1996, *Notice of Inquiry*, 13 F.C.C.R. 15,280 (1998).

557. *See* Peter Elstrom et al., *The New World Order*, BUS. WK., Oct. 13, 1997, at 26.

558. *See, e.g.*, Guy de Jonquieres, *Rules for the Regulators*, FIN. TIMES, Mar. 2, 1998, at 21 (While the "US, in particular, is a frequent advocate of global rules—where they suit its own interests . . . it has [, however,] been repeatedly tripped up by its own demands" in cases like its dispute with the Japanese in the WTO about film and its dispute with Mexico about how inadequate regulation is blocking U.S. companies' access to Mexico's telecommunications markets.); Mark Clough, *Caught Out on Film*, FIN. TIMES, Jan. 20, 1998, at 13 ("The US cannot credibly criticize [WTO] panel decisions that refrain from findings

case is truly astounding, as it is quite unclear why the FCC found it necessary to impose *more* regulation on the parties in *BT/MCI III* than it imposed in *BT/MCI I* (even though the FCC proceeded to waive these additional regulatory constraints), *when competitive conditions both in the U.K. domestic market and along the U.S.-U.K. route for IMTS service demonstrably and substantially improved since BT/MCI I.*[559] Of course, considering the fact that the Chairman of the FCC during this period stated publicly that if the FCC approves the various mergers pending before it, it is actually possible to have *more* competition with *three* RBOCs—down from the original seven—we really should not be so surprised.[560]

VI. CONCLUSION

In sum, the preceding Article, at bottom, requires us to ask a fundamental yet heretofore unsatisfactorily answered (or, perhaps, deliberately unanswered) question: exactly what is the purpose of the FCC in international telecommunications? Should the FCC act as yet another arm of the Executive branch to promote trade agendas which, by their very definition, seek to promote *competitors* (i.e., competitors of the "domestic" sort), or should the FCC limit appropriately its scope of inquiry to determining exclusively that U.S. *consumers* enjoy just and reasonable rates for IMTS service—regardless of provider? As I have argued in the past, and as I continue to believe today, the latter course must be followed. Indeed, as Adam Smith observed well over two hundred years ago, "Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer."[561] Competition, therefore, is not something to be feared; rather, it is something to be welcomed.

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on restrictive business practices when such practices are not within its jurisdiction.").

559. Indeed, just three months after the FCC issued its *BT/MCI III Order*, the European Commission issued a public report finding that "[e]ffective local loop competition currently only takes place in three Member States"—one of which is the United Kingdom. *See* Commission Communication Concerning the Review Under Competition Rules of the Joint Provision of Telecommunications and Cable TV Networks by a Single Operator and the Abolition of Restrictions on the Provision of Cable TV Capacity over Telecommunications Networks, 1998 O.J. (C 71) 4, 7; *see also* Guatam Naik, *Telecom Deregulation in Britain Delivered a Nice Surprise: Jobs*, WALL ST. J., Mar. 5, 1998, at A1.

560. *See* Jared Sandberg & Steven Lipin, *Bell Atlantic and GTE Boards Approve Plans for a Merger*, WALL ST. J., July 28, 1998, at A3 (According to Mr. Hundt, the spate of recent consolidations (in particular, AT&T/TCI, Ameritech/SBC, and Bell Atlantic/GTE) "would mean a triumvirate of telecom giants is likely to emerge, *resulting in more competition.*") (emphasis added).

561. 2 ADAM SMITH, THE WEALTH OF NATIONS 155 (1910).

Accordingly, because trade goals are generally inapposite to the goals of antitrust and economic regulation, trade policy is best left for those agencies or departments responsible for implementing these objectives—not with antitrust enforcement or independent regulatory agencies responsible for protecting and promoting static and dynamic economic efficiencies and the maximization of consumer (and not individual competitors') welfare. As long as "FCC" continues to improperly stand for "Facilitating Cartels and Collusion," however, it is unlikely that consumers will enjoy any of these competitive benefits anytime soon.