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Report No. IN 97-24 | INTERNATIONAL ACTION | August 7, 1997

COMMISSION ADOPTS INTERNATIONAL SETTLEMENT RATE BENCHMARKS
(IB Docket No. 96-261)

Today the Commission adopted a *Report and Order* that will significantly reduce the cost of international long distance telephone service by setting new, lower benchmarks on international settlement rates. It will also further the development of an open, competitive market for international services. Settlement rates are the per-minute fees paid by U.S.-licensed carriers to foreign carriers for terminating U.S.-originated calls. Current settlement rates greatly exceed foreign carriers' actual costs for terminating calls originating from the United States. This *Order*, which takes effect on January 1, 1998, will over time reduce settlement rates to levels closer to cost, thereby sharply cutting U.S. settlement payments to foreign carriers and lowering the cost of international long distance service.

This proceeding has generated significant interest internationally. Over 90 foreign governments and foreign carriers have filed comments relative to this proceeding, and the Commission has taken these comments into account in crafting this *Order*. The Commission notes the international consensus on the need to reform the monopoly-based accounting rate system and commends the efforts of the International Telecommunications Union ("ITU") and other multilateral fora to bring down settlement rates. The Commission believes that this *Order* and ongoing multilateral efforts will work effectively together to reform the settlement rate system. The Commission will continue to seek an effective multilateral solution to the problem. The first deadline for compliance with the new benchmark settlement rates, which applies only to rates with upper income countries, does not occur until January 1, 1999. Therefore, the Commission encourages foreign governments and carriers to work with the United States toward an effective international agreement that achieves more cost-based settlement rates. The Commission emphasizes that it may refrain from enforcing this *Order* if a satisfactory multilateral solution can be reached that will produce substantially equivalent results in a timely manner.

Above-cost settlement rates lead to artificially high international calling prices for U.S.

and foreign consumers. U.S. consumers pay on average 88 cents per minute for an international call -- more than six times the cost of the average domestic long distance call (13 cents per minute). The aggregate U.S. settlements deficit, which was approximately $5.4 billion in 1996, has nearly doubled since 1990. The Commission estimates that at least 70% of the annual settlement payments made by U.S. carriers constitutes an above-cost subsidy paid by U.S. consumers to foreign carriers. The Commission fully expects that the actions prescribed in this *Order* will significantly reduce this subsidy, resulting in much lower consumer prices for international service and significantly higher telephone traffic volumes.

The Basic Telecommunications Services Agreement concluded in the World Trade Organization on February 15, 1997 also takes effect on January 1, 1998. This Agreement, among 69 countries which account for 95 percent of the global market in basic telecommunications services, will open these markets to foreign competition and fundamentally alter the competitive landscape in the international services market. The Commission recently proposed new rules to implement U.S. commitments under the WTO Basic Telecom Agreement which will make it much easier for foreign carriers to enter into and invest in all U.S. markets for basic telecommunications services. In the context of open markets, the settlement rate subsidies to foreign carriers have even greater potential to create market distortions in the U.S. market for international telecommunications services. The Commission's benchmarks seek to address this problem by moving settlement rates closer to cost -- where they would be if the market for terminating international calls were fully competitive -- and thereby promote competition in the international services market.

The *Order* establishes the following benchmark rates: 15 cents per minute for upper income countries; 19 cents per minute for upper middle income countries; 19 cents per minute for lower middle income countries; and 23 cents per minute for lower income countries. The Commission based these benchmark rates on foreign carriers' publicly-available tariff rates and information published by the ITU and on each country's economic development category, as defined by a World Bank and an ITU classification scheme. For each category, the Commission used an average of the tariff rates and other data for countries in each category to set the benchmark. Although the benchmark rates still exceed costs, the Commission believes they will significantly reduce the subsidies embedded in existing settlement rates.

To ensure a gradual and smooth transition to the benchmark settlement rates, the Commission has adopted five transition periods in which settlement rates are to be reduced to the applicable benchmark rate. The transition periods correspond to the four income classifications used to calculate the benchmarks, with an additional category for settlement rates for countries that have teledensity -- lines per one hundred inhabitants -- of less than one. The adopted transition schedule gives U.S.-licensed carriers in upper income countries one year from the effective date of this *Order* (until January 1, 1999) to reach the applicable benchmark rate of 15 cents with carriers in upper income countries. U.S.-licensed carriers have two years, or until January 1, 2000, to reach the applicable rate of 19 cents with upper middle income countries, and until January 1, 2001 to reach the same rate with lower middle income countries. They have until January 1, 2002 to reach the applicable 23 cent rate with low income countries, and an additional year, until January 1, 2003, to do so with countries with teledensity of less than one. The Commission expects

U.S.-licensed carriers to negotiate proportionate annual reductions with foreign carriers during the relevant transition period.

The substantial subsidies embedded in current settlement rates can be used to finance pricing and traffic routing strategies that can create competitive distortions in the U.S. market for international service. The Commission has therefore adopted certain post-entry conditions in carriers' service authorizations to address these potential distortions. One such distortion is "one-way bypass," which would occur if a foreign carrier could send international calls to the U.S. over less expensive private lines and avoid paying settlement rates, while U.S. carriers were required to continue to pay high settlement rates for calls originating from the U.S. To

prevent such one-way bypass, the Commission will permit a carrier to provide switched services over international private lines only if at least half of the traffic on the route in question is being settled at rates that are at or below the relevant benchmark. If the Commission subsequently finds that one-way bypass of the settlements process has occurred, it will take enforcement action. This enforcement action may include a requirement that U.S.-licensed carriers be prohibited from using their authorizations to provide switched services over private lines on a given route until settlement rates for at least half of the traffic on that route are at or below a "best practices" rate, currently calculated at 8 cents.

In addition, in order to prevent a U.S.-licensed carrier which has a foreign affiliate from using above-benchmark settlement rate revenues of its foreign affiliate to gain an unfair price advantage over other U.S.-licensed carriers, the Commission requires that the U.S.-licensed carrier's foreign affiliate charge a settlement rate that is at or below the applicable benchmark rate. If the Commission detects competitive distortions in the U.S. telecommunications market, it will take enforcement action. This enforcement action may include a requirement that the settlement rates of the U.S. carrier's foreign affiliate be reduced to the best practices rate as a condition of continued service on that route from the U.S. market.

Action by the Commission August 7, 1997, by Report & Order (FCC 97-XXX). Chairman Hundt, Commissioners.

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