TRANSNATIONAL REACH OF ECONOMIC REGULATIONS - THE EXTRATERRITORIAL REACH OF U.S. REGULATION ON TELE-COMMUNICATIONS

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Introduction

The purpose of this paper is to examine how the regulation of the telecommunications sector has been challenged as the industry moves globally from a historic monopoly-controlled or state-owned model to a competitive environment. This shift has generated differences between countries that have already reached a more competitive market and the others that remain non-competitive, producing distortions that affect the whole system of rendering telecommunication services, given the structure of the global telecom industry.

If the sector had much earlier experienced the need of harmonizing different systems and standardizing equipment in order to interconnect their national networks[1], the current challenge is much more difficult to achieve. Now, the task is to deal with interests of several competing players in a world where laws and regulations do not follow the same growth of technological advances.[2]

In this context, one of the most debated issues that has concerned telecommunications companies in several countries, regulators, and international organizations is the applicability of the international accounting rate regime in the new competitive environment. Accounting rate is, roughly speaking, the method of dividing the revenues for international telephone services between the originating and destination countries. The current method, developed in 1865, and based on some premises and market conditions that no longer exist, is under strong pressure, especially by countries that have already reached a good level of competition. The paper examines how the U.S. has dealt with this issue, both on the international level, within the International Telecommunications Union (ITU) and in the World Trade Organization (WTO), and also internally, through the Federal Communications Commis-

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[1] *See* ITU's History http://www.itu.int/aboutitu/history.html

[2] *See* Yoshio Utsumi, Secretary-General, International Telecommunications Union (ITU), *Moving Beyond International Accounting Rates,*The International Journal on Knowledge Infrastructure Development, Management and Regulation, Volume 24, Nº 1 (February 2000) <http://tpeditor.com/utsumi.htm>

sion (FCC), analyzing how the U.S. actions have reached the other countries and how they have reacted.

Part I outlines how the system of accounting rate works and why it has been considered collapsed in the new competitive environment. Part II provides the international scenario where this issue has been discussed. Members of the ITU and the WTO, under the Basic Telecom Service Agreement, have attempted to regulate a transition to competition, considering among other issues, the impacts of the shifting model on developing countries, since they lack financial resources and network infrastructure to compete globally. Part III analyzes an Order issued by the FCC[3] and challenged in Court by over 90 foreign governments, regulators, and telecommunications companies[4]. The Order prohibits domestic telecommunications carriers from paying more than certain cost-based benchmark rates for "termination" services performed by foreign carriers. Part IV analyzes the extra-territorial effects of this Order and the subsequent Court decision that upheld the Order. Part V discusses the role of national regulators, the extraterritorial effects of its economic policies and whether is still possible to achieve multilateral agreements through International Organizations.

I. The accounting rate system

A . Definition of accounting rate

The definition of the accounting-rate regime is essential to understand international telecommunications. The regime was forged in the very beginning of telecommunications developments, when countries decided to conclude agreements to interconnect their national telegraph networks.

One reason why 20 European countries came together in 1865 to form the predecessor to the International Telecommunication Union (ITU) was the need to agree upon a common method of dividing the revenues for international telegraph service between the originating and destination countries. The methodology they developed was later carried over to telephone services, albeit with some modifications. It is based on a dual price system for each call, with independent prices for each route.[5] For each international call, the originating carrier charges users one price, known as the collection charge

[3] *See* 12 F.C.C.R. 19,806 (1997)

[4] *See* Cable & Wireless, et al v. F.C.C., 166 F.3d 1224 (1999).

[5] *See* Chapter 3, Box 3.1 of *"Directon of Traffic, 1996,* ITU/TELEGEOGRAPHY INC. (1996), available at <http://www.itu.int/intset/whatare/howwork.html

or tariff, but the cost to the originating carrier of terminating the call is governed by a second price, known as the accounting rate. This rate is negotiated between the originating and terminating carrier and are commonly denominated in either US dollars or Special Drawing Rights (SDR), which is a market basket of five currencies (the dollar, the pond, the mark, the yen, and the French franc).

The originating and terminating carrier usually divide the accounting rate on a 50/50 basis for each minute of service, which is referred to as the settlement rate. On any given route, one carrier pays settlement rate to another carrier only to the extent that there is a traffic imbalance – there is, one carrier has terminated a greater volume of telephone minutes than the other carrier.[6]

The dual price system for international telephony makes carrier's net revenue for international service a function of their accounting rates as well as their collection charges. If traffic is balanced on a 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. However, where traffic is imbalanced, the accounting rate may have a significant effect on the commercial options of the two carriers.[7]

B. The collapse of the accounting rate system

This system worked well, as long as the criteria on which it was founded were met. These criteria were, basically, the following: (i) international services were jointly provided by monopoly partners; (ii) the prices charged for a call were approximately equal in different directions (the principle of symmetry); (iii) in-coming and out-going traffic was approximately in balance for each bilateral relationship between countries; (iv) collection charges, even for off-peak discounts and volume discounts, were never lower than accounting rates; and (vi) inflation rates and exchange rates were relatively constant between countries.[8]

Nonetheless, the shift in the economic model of rendering telecommunications services, from a monopoly and/or state-owned standard to a competitive model, beginning in the 1980's, has swept the world, streaking

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[6] *See* Id.

[7] *See* Id.

[8] *See* Tarjanne, P. "How will the accounting rate system need to be modified in a liberalized market?", *in* Liberalization and Privatization of the European Telecommunications Sector, Preparing for 1998 & Beyond. 1996. Rome.

down the system of accounting-rate and its premises. The emerging trends of deregulation, privatization, liberalization, and removal of restrictions on competitive entry[9] have completely changed the international environment of the telecommunications sector, transforming it in a market characterized by harsh competition.

The introduction of competition in some national markets, allied with technological improvements, have brought new players to these markets and have led to lower costs and prices in the past two decades. This has generated an imbalance in the traffic flow between countries with lower prices and those with relatively higher prices, which in turn leads to settlement imbalances.

In addition, the competition, even for those countries that decided to adopt this model, takes time to be implemented and most part of the developing countries lack network infrastructure that would allow them to compete globally. These disparities between liberalized and monopolistic markets, between countries that have already reached a satisfactory level of competition and those that are still trying to introduce competition in their market, between countries with increasingly imbalanced traffic, have led to the collapse of the accounting rate system, based on the premises of bilateral, private negotiations between monopoly carriers and on a generally balanced traffic between countries.

In this new environment, with several players in the market, when competitive carriers negotiate with a country controlled by a monopoly carrier, the non-competitive service providers have the ability to exploit the competitive carriers by playing them off one another (which is called "whipsawing"), and forcing a higher settlement rate because the monopoly provider controls access to the end-user's circuits. For example, the United States has a significantly greater volume of outbound traffic than its foreign counterparts and pay high settlement rates to the foreign carriers. As a part of a competitive market, U.S. carriers pay disproportionate settlement rates and ultimately pass these artificially high rates on to their customers.[10] The United States paid roughly $5 billion in settlement to the rest of the world in 1995, up from $2,8 billion in 1990. [11]

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[9] *See* Aileen A. Pisciota, *Global Trends in Privatisation and Liberalisation.*

[10] *See* Robert M. Frieden, *Accounting Rates: The Business of International Telecommunications and the Incentive to Cheat,* 43 FED. COMM. L.J. 111, 112-13 (1991).

[11] *See* International Settlement Rates, *Notice of Proposed Rulemaking*, 12 F.C.C.R. 6184, 9 Comm. Reg. (P&F) 2005 (1996)

The Federal Communications Commission estimated that, besides the high increase in the U.S. outbound traffic, at least three-quarters of the $5 billion in outpayments were from above-cost settlement rate, concluding that U.S. consumers, carriers and their shareholders were subsidizing monopoly foreign carriers.

Although the U.S. is not the only country to experience settlement deficit,[12] this country began to use all available fora, -- the ITU, the OECD, the WTO and others – to push for a reform of the system.

II. How the U.S. and International Organizations have worked to reform the Accounting Rate System

A. The ITU role and pressures for reform

The International Telecommunications Union (ITU) is a specialized agency of the United Nations and is the world's oldest international organization. In general, the ITU seeks to promote, at the international level, the adoption of a broader approach to telecommunications issues in the global information economy and society. ITU decisions are made on a one nation, one vote basis; therefore, each member-nation has equal authority in the ITU decision-making process. In part due to this voting policy, developing countries view the ITU as an important organization to provide assistance and aid infrastructure development in these nations. [13]

The reform of the accounting rate system has been in the ITU's agenda since early 90's, with an increasing pressure from members with large net outpayments, specially the U.S., to revise the system of bilateral agreements. In 1992, the ITU, recognizing the cost differential among countries and considering also the potential impact of accounting rate reform on developing countries, recommended that rate should be "cost-oriented" and non-discriminatory. [14] The ITU acknowledged, at that time, that the current ac-

[12] Several other countries, including Sweden, Australia and Japan, have growing deficits on settlement payments, according to the ITU. *See* Tarjanne, P., at note 8.

[13] *See* Katherine Collins, *International Accounting Rate Reform: The role of International Organizations and Implications for Developing Countries,* 31 LAW & POL'Y INT'L BUS. 1077 (2000), citing George A. Codding, Jr., *The International Telecommunications Union: 130 Years of Telecommunications Regulation,* 23 DENV. J. INT'L L. & POL'Y 501 (1995)

[14] *See* Telecommunication Standardization Sector, International Telecomm. Union, ITU-T Recommendation nº D.140 Charging and Accounting in International Telecommunications Services (July 1998) <http://www.itu.int/intset/itu-t/d140.html.

counting rates were artificially high and should better reflect current cost trends. But the ITU argued that, however imperfect the accounting rate system is in practice, it does finance network growth in areas of the world that might otherwise be falling further behind in the development of telecommunication infrastructures[15]. For the ITU, the challenge was to combine these benefits with the flexibility of alternative systems that are more amenable to the introduction of competition in developing countries.

In its efforts to respond the pressures for reform and reconcile the interests of its members, the ITU formed a study group (ITU-T Study Group 3) to work and develop the best way to establish legitimate costs of providing international telecommunications services, considering the necessity of a "progressive reduction" in accounting rates towards cost. However, the ITU main focus of reform has been expressly recognized on the relationship between developed and developing markets, and between liberalized and monopolistic markets, rather than among those developed markets which are already open to competition.[16] For the ITU, among liberalized markets, which account for some three-quarters of international telephone traffic, the trend towards interconnection at cost oriented rates is already well established. But the gap between these cost-oriented rates, and the prices charged for call termination in monopoly markets is growing.

In 1996 the ITU published its World Telecommunications Development Report, saying that the US Federal Communications Commission (FCC) was pushing hard to reduce accounting rates and was threatening to authorize its national carriers to reduce them unilaterally without waiting for agreement from their international calling partners. [17]

On the Report, the ITU commented: "The *Notice of Proposed Rule-making (NPRM)* in the matter of international settlement rates issued on 19 December 1996 proposes to update the "benchmarks" or price caps. At the time of writing, the NPRM was in the comments period and it is not clear whether the moves proposed will conflict with the United States' obligations as a signatory to the GATS and the International Telecommunications Regulations. Nor is it even evident that a reduction in accounting rate would have any impact on the US net settlements deficit".

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[15] *See Pressures to reform the bilateral agreement regime*, Chapter 6. World Telecommunications Development Report: Trade in Telecommunications. World Telecommunications Indicators 1996/7, ITU.

<http://www.itu.int/intset/whatare/wtdr/wtdr.htm.

[16] *See* Yoshio Utsumi, *supra* note 2.

[17] *See* World Telecommunications Development Report, *supra* note 15.

The WTO Agreement on Basic Telecom and its implication on accounting rates

The issue of international accounting rates and pressures to reform has been also in the agenda of the WTO negotiations. On February 5, 1998, the WTO Basic Telecom Agreement, signed by sixty-nine WTO Members, entered into force, as a Protocol to the General Agreement on Trade in Services (GATS).[18] These sixty-nine Members, representing over 90% of the world's basic telecommunications revenues, under the auspices of the WTO, made commitments to open their markets for some or all basic telecommunications services to foreign competition. Fifty-two countries guaranteed access to their markets for international services and facilities and fifty-six countries agreed to open markets for all or selected services provided by satellites.[19]

Although the agreement had been warmly welcomed, specially by the press, politicians and the U.S. industry, declaring themselves to be "wildly enthusiastic"[20], some more skeptical scholars noticed that the United States, Japan, and the European Union alone account for 74% of total volume. Moreover, that those signing the agreement account for less than 55% of the WTO membership and the world's population, making the Agreement a "monumental effort" instead of a "monumental change"[21]. It is also important to point out that, in the most part of countries that made commitments to guarantee access to their markets for international services, these services have always been provided by a monopoly and they will face competition for the first time.[22]

The Agreement on Telecom was a tough point on the negotiations under the WTO. Basic Telecommunications was one of the four services sec-

[18] FOURTH PROTOCOL TO THE GENERAL AGREEMENT ON TRADE IN SERVICES (WTO 1997), 36 I.L.M. 354, 366 (1997). There is actually no free-standing WTO Basic Telecom Agreement, but a series of commitments that compose part of the GATS, one of the trade agreements included within the WTO Agreement.

[19] The Schedules containing commitments on basic telecommunications services are available on the WTO Web page at http://www.wto.org. The Schedules of Specific Commitments form an integral part of the GATS pursuant to Article XX of the GATS.

[20] *See* Laura B. Sherman, *"Wildly Enthusiastic" About the First Multilateral Agreement on Trade in Telecommunications Services*, 51 FED COMM. L.J. 61,69 (1998).

[21] *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).

[22] *See* Laura B. Sherman. *supra* note 20.

tors left unresolved by the Uruguay Round[23], together with financial services, maritime and movement of persons.

Due to the fact of, traditionally, domestic telecommunications have been owned or strictly regulated by national governments, making the ownership of their networks a matter of national security, countries were reluctant to open their markets to foreign carriers. The GATS requires that WTO Members provide "Most Favoured-Nation" treatment (MFN) to like services and service suppliers from other WTO members, regardless of the commitments undertaken by any individual Member. This obligation precludes a WTO Member from discriminating among services or service suppliers of other Members. It means that a Member that commits to open its market for a certain service cannot close its market on a selective basis to like services or service suppliers from any WTO Member.[24]

At the conclusion of the Uruguay Round, trade ministers agreed to extend the period of negotiations regarding commitments in basic telecommunications. The Decision on Negotiations on Basic Telecommunications established a "Negotiating Group on Basic Telecommunications" (NGBT) to carry out comprehensive negotiations on basic telecommunications, with a final report to the Council for Trade in Services due on April 30, 1996. [25]

Among others contentious issues, questions relating to accounting rates occupied negotiators' attention in the first year of the NGBT. Negotiators addressed the question of whether accounting rates set by international service providers were "measures" of a WTO Member for purposes of the GATS and, therefore, subject to the discipline of the GATS. This would include, among other things, the obligation to provide MFN treatment. The GATS defines "measures by Members" as measures taken by governmental authorities or non-governmental bodies in the exercise of powers delegated by a governmental authority.[26] Since accounting rates differ dramatically from route, imposition of an MFN obligation would have a dramatic effect on the operation of almost all international service providers. The argument that accounting rates are "measures of a Member" is based on the fact that accounting rates are negotiated between operators, and, according to the International Telecommunications Regulations, operators make these agreements as "administrators or recognized operating agencies (RPOAs). Administrators and

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[23] The "Uruguay Round refers to the trade negotiations begun at Punta Del Este, in 1986, and concluded formally in Marrakesh, Marroco in April 1994.

[24] *See* Laura B. Sherman. *supra* note 20.

[25] After, the deadline was extended to February 15, 1997, resulting in the February Accord signed at this date.

[26] *See* Laura B. Sherman. *supra* note 20.

RPOAs are defined by the Constitution of the International Telecommunications Union (ITU) as a governmental department and an entity designated by a governmental department, respectively.[27] Since most international carriers are either part of or owned by the government or have been designated by a government as an operating agency, the acts of these carriers would constitute "measures of a Member".

The contrary argument is that the designation of a RPOA does not confer any governmental authority on the operators, so operators cannot be deemed to "exercise powers delegated by" any governmental body, as required by the GATS definition. Although the ITU Constitution refers to a RPOA "authorized by" a government, the "authorization" can refer to any process a particular country uses to designate private entities to participate directly in the work of the ITU. Negotiators never reached consensus on how to treat accounting rates, and as a result, a number of WTO Members took MFN exceptions for application of accounting rates. Their action left open the question of whether the vast majority of WTO Members that did not take MFN exceptions are vulnerable to charges that their international service providers cannot maintain differential accounting rates. Negotiators, however, reached a "gentlemen's agreement not to bring the issue of discriminatory accounting rates dispute settlement until the beginning of the year 2000. [28]

Due to a lack of consensus on accounting rates when the WTO Telecom Agreement was signed, the WTO solicited recommendations from the ITU for restructuring accounting rates in a manner that would promote cost-oriented pricing. The WTO Telecom Agreement explicitly acknowledges the role of the ITU and requires that "Members recognize the importance of international standards for global compatibility and inter-operability … and undertake to promote such standards through the work of relevant international bodies, including the International Telecommunications Union." Despite this acknowledgement, the agreement raises the concern with some nations that the WTO will supplant the ITU's current role as administrator of international policy. [29] The potential overlap in jurisdiction between the ITU and the WTO has been a special concern of developing countries, since they enjoy majority

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[27] *See* International Telecommunications Regulations, Dec. 9, 1988, TREATY DOC. Nº 102-13, art. I, para., 1.5 (1991). The term "recognized operating authority" was changed to "recognized private operating agency" in the 1992 version of the ITU Constitution and Convention in Geneva. In fact, the concept of RPOA arose from the attempt of the ITU to allow U.S. private carriers to participate directly in the work of the ITU.

[28] *See* Laura B. Sherman. *supra* note 20.

[29] *See* Katherine Collins, *supra* note 13.

status in the ITU, which gives them the power to pass regulations and amendments within the organization which specifically target the needs of developing countries.

On February 15, 1998, the ITU held the Second World Telecommunications Policy Forum on Trade in Telecommunications, in order to discuss the general implications of the WTO agreement for developing countries, and the role of the ITU after the Agreement. In this Forum, the ITU emphasized the impact of movements towards cost-based accounting rates on developing countries and the need of a co-operative relationship among national regulatory bodies, telecommunication operators and multilateral institutions, including the World Bank and WTO, with the aim of giving countries the multilateral support to make the necessary adjustments. [30]

B. The U.S. initiatives and the FCC policies to lower accounting rates

Besides the actions on the international level, the U.S., through its Federal Communications Commission, has worked over the years to formulate a variety of regulatory strategies to accomplish its goal of reducing accounting rates.

In 1980, the Commission developed an International Settlements Policy (ISP) for international services, requiring that all domestic carriers on a given international route establish the same accounting rate with the foreign correspondent, that all settlement rates equal 50% of accounting rates, and that each domestic carrier carry incoming traffic on the route in proportion to its share of outgoing traffic.[31]

The FCC's ISP also requires US carriers to file copies of all contracts, agreements and arrangements that relate to the routing of traffic and the settlement of accounts.

Other policies have attempted to actively promote methods of providing or accessing services that vary from the traditional correspondent rela-

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[30] *See* The Secretary's General Report, Second World Telecommunications Policy Forum, Geneva, 16-18 March 1998, available at <http://www.itu.int/plweb-cgi.

[31] *See* Uniform Settlement Rates on Parallel International Communications Routes, 84 F.C.C. 2d 121 (1980). Although this policy initially applied only to international telegraph and telex services, the Commission extended it to international telephone service in 1986, Implementation and Scope of the Int'l Settlement Pol'y for Parallel Int'l Comm. Routes, *Report and Order*, 51 Fed. Reg. 4736 (1986).

tionship[32], called "alternative calling procedures". For example, the Commission has allowed resale of international private lines to provide switched service[33], call-back[34], switched hubbing[35], and country-direct services[36]. What these alternatives have in common are that they avoid the traditional arrangements for accounting and settling traffic accounts and that they generally respect the rules and regulations of all countries involved. The latter is not always true for the practice of refile and hubbing. Technology and more aggressive marketing have facilitated alternative calling procedures. Their effect is to turn the normal direction of the traffic flow, causing a growing of outflow from countries such as the US in which network operators and service providers which offer these services are located.[37]

The ITU World Telecommunications Develop Report of 1996/1997[38], when commenting the FCC threatening to act unilaterally, put in question whether a reduction in accounting rates would have any impact on the US net settlement deficit, because of the use of these "alternative proce-

[32] *See* Lawrence J. Spiwak, *From International Competitive Carrier to the WTO: A Survey of the FCC's International Telecommunications Policy Initiatives 1985-1998,* 51 FED. COMM. L.J. 111 (1998).

[33] *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).

[34] Call-back is a procedure by which telecommunications service providers can provide international telephone service in a foreign country at rates which are significantly lower than the rates of international calls in that country. Most call-back operators are located in the US. These call-back operators effectively provide a US dial tone to foreign customers who can then make a call to anywhere in the world at very competitive rates.

[35] 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 them 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. So, for instance, if the combined accounting between UK and the US and the UK and France is lower than that between France and the US, there is an incentive to route calls between France and the US via UK as this would be the least cost route.

[36] Country direct enables international calling card holders travelling 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.

[37] *See* Peter A. Stern and Tim Kelly, *Liberalization and Reform of International Telecommunications Settlement Arrangements*, Latin America and Caribbean Telecommunications Finance and Trade Colloquium, Brasilia, 14-16 July 1997.

[38] *See* World Telecommunications Development Report, *supra* note 15.

dures"[39]. The report mentioned that "between 1990 and 1995, when the average US accounting rate fell by 43 per cent, the US net settlement deficit rose by $ 3.3 billion, or 289 per cent", and that the FCC proposed rule "does little to address the distortion in the direction of traffic flows, largely caused by the adoption by US carriers of alternative calling procedures, which gives rise to the settlement payments deficit".

On January 1996, in one more attempt to lower accounting rates, the FCC issued the "Flexibility Order"[40], permitting, subject to certain competitive safeguards, alternative payment arrangements that deviate from the Commissions' International Settlement Policies between any US carrier and any foreign correspondent in a country that satisfies the ECO test.[41]

In 1997, at the last rounds of the WTO negotiations, the FCC, finding that its policies had not led to lower settlements rates and arguing that the work of multilateral organizations to drive accounting rates towards cost was too slow, announced its decision of taking a unilateral proposal to establish benchmark rates for US carriers, regardless of the contractual settlement rate agreements already in force between US carriers and their foreign correspondents. In the Introduction of its Notice of Proposed Rulemaking, the FCC reasoned[42]:

"This Notice represents the next step in an ongoing effort by the Commission, many governments, and multilateral organizations such as the International Telecommunications Union (ITU) and the Organization for Economic Cooperation and Development (OECD) to reform the international accounting rate system."

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[39] *See* Lawrence J. Spiwak, *supra* note 32. "While country-direct services inflate the settlement deficit by converting foreign-originated traffic into U.S. billed calls (which is *good* for consumers), US carriers nevertheless embrace this service not only because it enhances their service offerings, but also because it may increase their market share of outgoing traffic and entitle them to a larger flow of lucrative incoming traffic under the FCC's proportionate return sales."

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

[41] "ECO Test" is an analysis of "effective competitive opportunities" carried out by the FCC, according to its policy for market entry in the US (Market Entry and Regulation of Foreign-affiliated Entities, *Report and Order*, 11 F.C.C.R. 3873, 1 Comm. Reg. (P & P) 459 (1995).

[42] International Settlement Rates, *Notice of Proposed Rulemaking*, 12 F.C.C.R. 6184, 9 Comm. Reg. (P & F) 2005 (1996).

More than 90 foreign carriers and governments presented comments to the proposed rule. These comments, challenging the legality of the unilateral action taken by the FCC in face of international principles, demonstrate clearly how the Notice was received abroad. A critical commentator of the FCC's International Policies said that "As the FCC released its *Benchmarks* NPRM in the throws of the final stages of the WTO negotiations, it would therefore appear that the United States decided to approach the final negotiations with no carrot -- only a very big stick".[43]

III. The FCC *Benchmark* Order and its extraterritorial effects

On August 1997, the FCC issued the *Benchmark* Order[44], establishing that, the settlements rates negotiated by US carriers may not exceed \$0.15 per minute for foreign carriers in upper income nations, \$0.19 per minute for foreign carriers in middle income nations, and \$0.23 per minute for foreign carriers in lower income nations. The FCC based this classification of countries as defined by the World Bank statistics on GNP per capita. The Order allows US carriers to achieve compliance with the benchmark rates over a transition period of one to four years, depending on the per capita income of the foreign country in which the negotiations foreign carrier operates.

The Order contains also special provisions applicable only to foreign-affiliated US carriers.[45] In order to prevent such carriers from engaging in "price squeezing" behavior[46], the Order requires them to comply immediately with the benchmarks as a condition of obtaining approval to provide international long-distance service to the affiliated country.

At the introduction, the FCC stated its broad goal:

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[43] *See* Lawrence Spiwak, *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definitions in a Sea of Analytical Rhetoric,* ANTITRUST REP. Dec. 1997.

[44] *See* 11.F.C.C.R. 20,063, 5 Comm. Reg. (P & F) 452 (1996).

[45] A US carrier is considered to be affiliated with a foreign carrier when a foreign carrier owns a greater than twenty-five percent interest in, or controls, the US carrier. (47 C.F.R. § 63.18(h)(l)(I) (1997).

[46] "Price Squeezing" occurs when a foreign carrier and its US affiliate act together as an integrated firm. By extracting above-cost settlement rates from US carriers, the foreign carrier enables its US affiliate to undercut its competitors, since the above-cost portion of the settlement rate is essentially an internal transfer for the foreign-affiliate US carrier, while for other competitors it represent a real cost.

"*The action we take in this Order, along with our recent Accounting Rate Flexibility Order and our proceedings implementing the World Trade Organization (WTO) Basic Telecom Agreement, substantially completes our plan to restructure the economics of the market for US international telecommunications services. This restructuring will promote the low cost, technologically innovative interconnectivity serving* ***all the world's consumers*** *that should be the hallmark of a Global Information Infrastructure.* (emphasis added).

(…)

"*We emphasize that we would prefer to achieve our goals through a multilateral agreement on accounting rate reform.* ***If, in the future, there is a multilateral consensus on a substantially equivalent international measure to achieve our goals of a more cost-based and non-discriminatory system of settlements in a timely manner, we will waive enforcement of the benchmark settlement rates.*** *(...) Our action in this Order comes after years of efforts by the US Government to achieve cost-based termination fees internationally by means of discussion and negotiation bilaterally and multilaterally at the International Telecommunication Union (ITU), the Organization for Economic Cooperation and Development (OECD), and other international organizations.* (emphasis added).

(...)

We believe that accounting rate reform is necessary ***and will benefit consumers and carriers in all countries****, including businesses and others who rely on global telecommunications services.* ***Thus, contrary to the views of some commenters, it is not the case that accounting rate reform will benefit consumers in the United States at the expense of carriers in overseas markets****. Accounting rate reform will allow consumers in all countries to receive higher quality service, more service options, and lower rates as accounting rates are reduced to a more cost-based level. (*emphasis added)

(…)

"We also find that our settlement rate benchmarks ***are consistent with the ITU regulations and general international law principles of comity and national sovereignty****. The rules adopted here do not constitute the exercise of jurisdiction over foreign carriers. (...)*

Obviously, by placing a cap on the level of the rate US carriers may negotiate with their foreign correspondents, ***our actions will have an indirect effect on foreign carriers****. International services, by their very nature, require one end of the communications to be handled outside of the United States, and thus rules regarding the US end of communication may have an impact on the foreign end as well****. An indirect effect on foreign carriers, however, does not***

militate against the validity of rules that only operate directly on carriers within the United States." (emphasis added)

The comments presented by foreign governments and carriers raised the following main issues:

A. Violation of free-market/Excessive government intervention

Telefonica de Espana, Singapore Telecom, Telecom Italia and Australia contended that FCC needed not take action to reform the accounting rate system because settlement rates have been declining recently without government intervention and competitive market forces will ensure that this downward trend continues. They also argued that FCC's decision in the Access Charge Reform Order to rely upon market forces to generate cost-based access rates in the US conflicts with the proposal to establish settlement rate benchmarks. The answer was that the Commission could not rely entirely on the market to reduce settlement rates on a timely basis.

B. Impact of the Benchmarks SR on Developing Countries

Many developing countries and their carriers, such as Panama, Telekom Malaysia, St. Vincent and the Grenadines, Telmex, CANTO, Telefonica del Peru, COMTELCA , Bolivia, Phillipines, GT&T and others, expressed concern that settlement rate benchmarks will eliminate an important source of revenue for developing countries' telecommunication markets. Some of them asserted that countries are entitled to support universal services through settlement revenues. Brazil pointed out the importance of identifying the level of subsidy and then work to reduce it to a "fair" level. In addition, the European Union expressed concerns about the potential impact of the benchmark Settlement Rates on developing countries, noting that some countries "have traditionally seen settlement in-payments as a form of foreign aid." However, the EU noted that as a form of aid, settlement payments are nor transparent and do not permit accountability and suggested the World Bank's adjustment program as a form of assistance as settlements revenues decrease.

The FCC answered that settlements rates are no longer a stable source of funding for network infrastructure development as a result of changes in the global telecommunications market.

Panama and Mexico, countries that have embarked on steps to introduce competition in their markets, argued that the benchmarks could impede the further development of competition in their markets by restricting an important source of revenue for new entrants. The FCC counter-argued that, for these reasons, the Commission adopted a transition period for US carriers to negotiate settlement rates at or below the benchmarks.

Cable & Wireless and GTE argued that the transition periods are unrealistic and do not take into account the experience of countries introducing competition, including the United States, which took 15 years, the United Kingdom, which had a similar timeframe, and the European Union, with timeframes of 12-17 years. To this argument, the FCC responded that the transition periods are not intended to be schedules for implement competition, but to provide time for adjustments to cost-based system.

C. Lack of legal basis for establishing Benchmarks Settlement Rates/Attempt to exercise Jurisdiction over foreign carriers

Many foreign carriers and government argued that, despite the language of the Notice, the FCC was attempting to exercise jurisdiction over the foreign end of international telecommunications services. Telefonica de Espana and GTE noted that a showing of an affirmative Congressional intent to apply the Communications Act's enforcement provisions extraterritorially is necessary to overcome the presumption against such extraterritorial effects of legislation. Telefonica del Peru commented that there is no way to invalidate the terms of a bilateral settlement rate agreement without exercising jurisdiction over both the US carrier and the foreign correspondent. The FCC's answer was: First, in Sections 1 and 2 (a) of the Communications Act, Congress indicated its affirmative intent to give FCC jurisdiction over "all interstate and foreign communication by wire or radio"[47], and international telecommunications services that are settled under a settlement rate agreed to by a US carrier and its foreign correspondent clearly fall within the definition of "foreign communication". Second, such an affirmative Congressional intent overcomes the general presumption against the extraterritorial effect of a statute (citing Foley Bros., Inc. v. Filardo, Hartford Fire Insurance Co. v. California et al, and United States v. Aluminum Co. of America[48]). The FCC still noted that the rules adopted in the benchmarks Order do not constitute the exercise of jurisdiction over foreign carriers, since, if US carriers and its foreign correspondent fail to agree a settlement rate at the relevant benchmark, the FCC will use its power under the Act to take enforcement actions against US carriers, not against foreign carriers. The FCC recognized, however, that, obviously, in the

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[47] *See* 47 U.S.C. § 152 (a), 201

[48] *See* Foley Bros., Inc. v. Filardo, 336 U.S. 281 (1949); Hartford Fire Insurance Co. v. California et al., 509 U.S. 764 (1993); and United States v. Aluminum Co. of America, 148 F.2d 419 (1945).

context of international telecommunications services, its actions would have an indirect effect on foreign carriers, since such services, by their very nature, require one end of the communication to be handled outside of the United States, and thus, these rules would have an impact on the foreign end as well.

D. Violation of International Regulations

Cable & Wireless, Jamaica, Argentina Telintar and other countries argued violation of the International Telecommunication Union Regulations that require accounting rates to be negotiated pursuant to “mutual agreement”, as well as violation of general international law principles of comity and national sovereignty. The FCC answered that the preamble to the ITR recognizes that “it is the sovereign right of each country to regulate its telecommunications”, and that, although the ITR rules require “a mutual agreement”, it does not suggest that governments cede sovereignty over telecommunication carriers that operate in their markets.

The same countries urged the US to seek a negotiated, multilateral solution to accounting rate reform issues within the framework of the ITU. France Telecom expressed concern that the proposed enforcement measures could have a “chilling effect” on multilateral discussions of accounting rate reform, and would undermine the ability of US carriers to continue negotiations and to develop creative, potentially beneficial solutions to any international accounting disputes. The FCC found, however, that the movement on the international level has been very slow, and the Commission would reconsider the enforcement of the Order if, in the future, meaningful progress were made in a multilateral forum.

E. Violation of GATS Obligations

Japan, European Union and Telefonica de Espana contended that the conditions imposed to foreign carriers to obtain authorization under Section 214 of the Act were a practical barrier to market entry, imposing constraints more burdensome than necessary on carriers seeking access to the US market, and this would be a violation of the MFN principles of the GATS. Japan added that cross-subsidization can be avoided by less restrictive measures and “excessive government intervention” should be avoided. The FCC rebutted the violation of GATS Obligations, by saying that, all WTO Members retain the right under the GATS to maintain laws or regulations to protect competition in their markets, as long as the laws or regulations are applied in a manner consistent with the provisions of the GATS.

Telefonica de Espana, Telstra, Singapore Telecom, Telmex and Telekon Malaysia argued that the FCC should focus on collection rates rather than settlement rates, noting that US international carriers have not passed on settlement rate reductions to consumers in the past and there is no assurance that any reduction in settlement payments that results from adoption and enforcement of benchmarks will be passed on to US consumers. The FCC countered this argument by stating that "the Commission should preserve the ability of US carriers to make pricing decisions in response to these competitive market forces", and "it is not in the public interest at this time to mandate a particular approach US carriers should take to pass through to consumers reductions in net settlements that may occur as a result of the Order".

The tone of the comments mentioned can show clearly that, no matter the FCC had or had not met the legal requirements to establish the Order, and regardless the necessity of enforcing it, the "chilling effect" on the international level was already created.

The reactions against the *Benchmark* Order

A. The ITU reaction

In a response to the FCC's challenge to the ITU that, if a multilateral agreement could be reached, the implementation of the Benchmark Order could be rolled back, the ITU held the Second World Telecommunication Policy Forum on March 1998. The WTPF established a Focus Group to operate within ITU-T Study Group 3, with the task of drafting the text for such a multilateral agreement in a few months. [49]

The Focus Group Report was completed on November 1998 and it was adopted by Study Group 3 on June 1999. The core of recommendations of the Focus Group concern a series of "indicative target rates" for countries of different teledensity to be achieved by the end 2001.[50]

In a comparative approach, the ITU's Secretary General commented that the FCC benchmarks cover a much narrower range (15-23 cents) than the Focus Group's indicative target rates (6-44 cents per minute). The FCC's target rates are, in general, much lower than those of the Focus Group for countries with a teledensity of below 20-30, but higher for other countries, particularly for those with a teledensity above 50. The majority of the world's users of telephone services live in the high-income countries/high teledensity coun-

[49] *See* Yoshio Utsumi, *supra* note 2.

[50] *See* Id.

tries. They generate traffic mainly to other users in high-income countries. Consequently, the net effect of the Focus Group's recommendations for the majority of consumers would be a steeper reduction in prices than that proposed by the FCC.[51]

On the other hand, the majority of the world's potential telephone users live in low income /low teledensity countries. For these potential consumers, the availability and accessibility of telephone service is more important, in the short term, than the price of international calls. The Focus Group's recommendations would result in a more gradual reduction in net settlement, thereby reducing the threat to network investment.[52]

Before sending the Study to approval by ITU Members, under the "accelerated approval" procedure, the ITU's Secretary General issued a challenge to the U.S.: "The process will be a test of whether or not there is still a will to use the ITU as a forum for collective, co-operative decision-making or whether special interests will engage in opportunistic strategic behavior. Within the telecommunications sector, we have been fortunate to have a heritage of consensus and collaboration. If this spirit of co-operation no longer prevails, then perhaps it is time to move towards an alternative, confrontational regime, such as that which has evolved within the WTO".[53]

The text of the Study was integrated as part of a new Annex E to ITU-T Recommendation 140[54]. However, the ITU findings and recommendations do not have legal enforcement.

In the last Plenipotentiary Conference held in Montreal, October 2000, the ITU issued the Resolution 41 on Accounting Rate Principles, instructing the Study Group 3 to publish updated indicative target rates calculated on the basis of the latest data as a supplement to Recommendation D.140.[55]

B. Cable & Wireless, et al v. FCC

[51] *See* Id.

[52] *See* Id.

[53] *See* Id.

[54] *See* Recommendation D.140, Accounting Rate Principles for International Telephone Services (*Geneva, 1992; revised in 1998)*, available at <http://www.itu.int/intset/iyu-t/d140/d140_e_rev.htm.

[55] *See* World Telecommunications Standardization Assembly, Montreal, 27 September – 6 October 2000, Republished WTSA – 2000 Resolutions, available at <http://www.itu.int/itudoc/itu-t/wtsa-res/index.html.

In another reaction to the *Benchmark* Order, again more than 90 foreign carriers and governments, lead by Cable & Wireless, challenged the Order in a US Court[56]. The United States Court of Appeals, District of Columbia Circuit, on January 1999, upheld the Order, reasoning its decision based on the main arguments presented by the FCC, as follow:

B.1. Attempt to exercise extraterritorial Jurisdiction over foreign carrers:

"(...) Since neither the statute nor legislative history makes clear whether the Commission regulates domestic or foreign carriers when it prescribes settlement rates, we must sustain the Commission's view as long as the Order reasonably represents an exercise of its statutory authority to regulate domestic carriers engaged in foreign telecommunications". See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc. 467 U.S. 837 (1984).

(…) *We recognize that regulating what domestic carriers may pay and regulating what foreign carriers may charge appear to be opposite sides of the same coin. However, given the structure of the global telecom industry, we find reasonable the FCC's view that the Order regulates domestic carriers, not foreign carriers. "*

(...) ***The practical effect of the Order will be to reduce settlement rates charged by foreign carriers. But the Commission does not exceed its authority simply because a regulatory action has extraterritorial consequences. Indeed, no canon of administrative law requires us to view the regulatory scope of agency actions in terms of their practical or even foreseeable effects.*** *(...) We thus, hold that the Commission's Order does not regulate foreign carriers or foreign telecommunications services and therefore does not violate the Communications Act."* (emphasis added).

B.2. Violation of International laws

"(...) Nor does the Order violate the International Telecommunications Union Treaty regime, International Telecommunications Regulations. (...) We agree with the Commission that the right to authorize a carrier to provide service in a given country necessarily includes the right to attach reasonable conditions to such authorization to safeguard the public interest. In-

[56] *See* Cable & Wireless v. F.C.C., 166 F.3d 1224 (1999).

deed, the treaty's preamble makes clear that "it is the sovereign right of each country to regulate its telecommunications."

B.3. Lack of legal basis for establishing the Order

"(…) Given the expansive powers delegated to the Commission under sections 201(b), 205(a), and 211(a), we have no doubt that the Commission has authority to prescribe maximum settlement rates."

Despite the upholding of the *Benchmark* Order by a federal court decision, the FCC has not yet determined how it will enforce these new rules, considering all complains that the FCC has overstepped its authority, by attempting to unilaterally impose these new rates[57].

IV. "Global Information Infrastructure serving all the world's consumers" or "Global Telecom Trade War"?

No one doubts that the accounting rate system, established in the last century, when international carriers were part of national sovereignties, has collapsed in the new competitive environment.

The pushing of technology and its wide variety of alternatives in rendering telecommunications services have led many countries to realize that, continued lack of investment, particularly in new technologies, leaves the country vulnerable to loss of revenue through by-pass, at either the local or international level.[58] For this reason, in the 1990's, a rash of privatization has swept around the globe, spreading to emerging markets in Latin America, Asia, then Central Europe, and now Africa.[59]

As far as the trend in privatization and liberalization begins to establish the path toward competition, more alternatives to settlement rates will grow in the market. Experts say that the accounting rate system will continue to exist, but the possibilities opened by the liberalization of telecommunication markets and the alternative means to settle telecommunications accounts will inevitably put more pressure on above-cost accounting rates. Revenues from the international service will most certainly drop and network operators

[57] *See* Telecommunications and Mass Media Regulation, Federal Communications Bar Association, Ad Hoc Committee on Communications, Policy Options for Developing Countries, 1999.

[58] *See* Aileen A. Pisciota, *supra* note 9.

[59] *See* Id.

that have depended on such revenues to develop their networks will be forced to make adjustments.[60]

However, in this transition period, the challenge of achieving an agreement on a multilateral basis, seems to be far. In the absence of a reasonable understanding between countries, national regulators begin to move beyond its national borders. In this context, the inevitable questions are:

(i)Considering the international forum where the debate has been carried out, what is the legitimacy (and even efficacy) of such unilateral action as the Order issued by the FCC? Did the *Benchmark* Order help or hinder U.S. carriers in its efforts to lower settlement rates? What's the role of national regulators in this "*Global Information Infrastructure"?*

(ii)Is still possible to countries, in this harsh competitive environment, to achieve multilateral agreements under International Organizations such as the ITU, which has been only a forum for international co-ordination and standardization, having no power for legal enforcement of its recommendations?

(iii)Is still possible to talk about "indirect effects" in the way telecommunication services are rendered?

Even those who welcomed the FCC actions against above-cost settlement rates ended up recognizing that market pressures – not regulators – will have the final say as regard accounting rates.[61] Other commentator, showing much more criticism about the FCC's international policies, including the *Benchmark* Order, stated that, "by adopting economically flawed policies, the US has achieved neither trade policy's basic goals of promoting investment abroad nor the maximization of consumer welfare. Tragically, the only achievement has been the delay of effective WTO implementation of the Agreement and the rise of international ill-will against the US and the US firms." [62]

While the industry and the press keep talking on a "telecom revolution", or, as it stated by the FCC in its Order, on "a Global Information Infrastructure serving *all the world's consumers*", some scholars warned that this may not be true: "Unfortunately, the actions of many regulators and industry

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[60] *See* Peter A. Stern and Tim Kelly, *supra* note 37.

[61] *See* Telecommunications CEO Conference Merril Lynch and Company, Inc., *Global Telephony After the WTO Agreement* (1997), available at <http://www.TeleGeography.com/Whatsnew/ml_speech97.html.

[62] *See* Lawrence Spiwak, *supra* note 32.

participants more accurately reveal not a telecoms "revolution" but instead a growing telecoms trade war that is dangerously close to spiraling out of hand. Despite the political rhetoric based on "protecting consumer welfare", regulators on both sides of the Atlantic have eschewed innovative and indeed productive solutions to create a market structure conducive to long-term competitive rivalry"[63].

The ITU, despite all the efforts to achieve harmonized solutions to the problems facing its members, seems to be not yet prepared to deal with the gamut of "trade interests" embedded in these conflicts. The recent comment made by the ITU's Secretary General denotes such a disbelief in harmonized solutions: "As a lawyer, perhaps I should not be sad to see the new business opportunities for my colleagues in the legal profession that international telecommunication disputes will bring. But as Secretary-General of the ITU, I recognize that it would mark a sad end to a unique experiment in international collaboration."[64]

Given the very structure of international networks, and the need to be interconnected in a way as much as possible *good* for *all consumers in the world*, can we talk about "indirect effects" of national regulations in other countries, as the FCC *Benchmark* Order and the Court decision do? Are the interests of the new competitors the same as interests' consumers? These questions led us to the well-known problems of the transnational reach of economic regulations: "Are these problems – often problems of conflicting efforts by several concerned nations to regulate – more amenable to solution by treaty than national legislation? Absent legislative or treaty specification, what considerations should shape the judgements of courts or administrative agencies whether to apply a regulatory statute to disputes of a transnational character?[65]

When justifying the extraterritorial reach of the *Benchmark* Order, the FCC cited the landmark cases of extraterritorial reach of American Antitrust laws, *Alcoa* and *Hartfort Fire*. These decisions are the best samples of the US assertions of its right to exercise prescriptive jurisdiction over foreign defendants whose anti-competitive activities have the *intended effect* of causing a substantially adverse impact on US commerce.[66] Based on the "effects

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[63] *See* Comments on the book "The Telecom Trade War", by Mark Naftel and Lawrence J. Spiwak, available at <http://www.phoenix-center.org/telindex.html.

[64] *See* Yoshio Utsumi, *supra* note 8.

[65] *See* Steiner Vagtts, *Transnational Legal Problems*, 4th Edition, Foundation Press, at page 885.

[66] *See* Roger P. Alford, *The Extraterritorial Application of Antitrust Laws: A postscript on Hartford Fire Insurance Co. v. California*, 34 VA. J. INT'L LAW 213 (1993).

doctrine", these decisions have received a lot of critics for its failure to respect principles of international comity, for failing in balancing the interests of the United States in regulating anti-competitive activity against the legitimate sovereignty interests of other nations.[67]

But neither the premises of the "effects doctrine" nor the often absent balance of other's interests nations were necessary for the federal court to uphold the Order. The Court wisely based its decision on the basic principle of "subjective territorial jurisdiction", which permits a state to assert jurisdiction over acts that originated within its territory, even though they may have been completed abroad"[68]. This is exactly the case of an international telephone call originated in the US an ended anywhere. The authorization given by the Communications Act to the FCC, to regulate "foreign telecommunications" was wide enough to guarantee no extraterritorial assertion of jurisdiction. In the Court opinion, "the Commission did not exceed its authority simply because a regulatory action has extraterritorial consequences", no matter if these consequences are being discussed by over 90 foreign countries in the international forum.

Had the Commission (or the Court) to weight the conflict interests between countries, the following questions would arise: Is a legitimate interest to subsidize network developments with revenues from above-cost settlement rates? Is this subsidy transparent enough to be accepted by other countries? Is a legitimate purpose to lower settlement rates in benefit of US consumers? Will the reducing of settlement rates be passed on to US consumers in a transparent way? To what extent and to what cost lower settlement rates will benefit consumers in developing countries?

It is very unlikely that these questions would be arisen in a court reasoning, or even in an international trade dispute between countries trying to protect competitor interests. However, some few commentators still claim to be the role of national *independent* regulators to look for consumer interests, leaving the trade questions for the Executive Branch[69] and the international trade questions for the international arena.

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[67] *See* Id.

[68] *See* Steiner Vagtts, *supra* note 64.

[69] *See* Lawrence Spiwak, *supra* note 32. The Author's conclusion in his extensive and in depth exam about FCC's international policies, including accounting rates, is that the agency is acting as another arm of the Executive Branch to promote trade agendas which, by their very definition, seek to promote competitors instead of consumers. "(...) 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

V. Conclusion

The Telecommunications sector is just another area where economic regulation will more and more crosses national boundaries. If the technology develops fast, allowing suppliers to promise cheap and ubiquitous telecommunications goods and services, the market forces can not solely guarantee consumer welfare and there is still a need of national regulators and national economic policies.

Competition in the telecommunication sector is a new trend and a challenge for the most part of countries, and even for those, where competition already exist, the idea of "natural monopoly" was well accepted during a long period not so far from today.

For these reasons, the dramatic shift in economic models should be worked between countries in order not to result only "winners" and "losers". In this context, the role of the International Organizations, such as the ITU and the WTO must be, as much as possible, harmonized, considering the different goals and interests of each organization.

Finally, the great challenge for countries and its national regulators will be to achieve the independence from governments and from industry interests, as heralded by the U.S. throughout the world, and the acknowledgement, by such regulators, of the importance of a multilateral decision-making process.

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regulatory agencies responsible for protecting and promoting static and dynamic economic efficiencies and the maximization of consumer 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."