International Settlements Policy and U.S.-International Accounting Rates

The Commission has established various rules and policies regarding international settlement rates. The following is a general overview of some of those rules and policies.

Background

U.S. carriers negotiate operating agreements with foreign carriers to establish the terms for exchange of telephone traffic between countries. This agreement normally includes a rate for terminating each other's traffic. In traditional arrangements, U.S. carriers negotiate "accounting rates" with the foreign carrier. A division of the accounting rate represents each carrier's obligation to the other for terminating traffic, termed a "settlement rate." Essentially, U.S. and foreign carriers charge each other to terminate the other's traffic, but carriers only pay on the imbalance (i.e., the carrier's credit each other for traffic exchanged and pay on the difference).

Due to increased competition over the past several years, many U.S. consumers have seen lower settlement rates and calling prices on U.S. international routes. Commission policy seeks to further promote competition and lower calling rates by encouraging market-based, commercial arrangements between U.S. and foreign carriers for the exchange of traffic. Commission policy also has provided for competitive safeguards to protect U.S. consumers against anticompetitive behavior, should it occur on a U.S. international route.

International Settlements Policy

The Commission's International Settlements Policy (ISP), originally known as the Uniform Settlements Policy, dates back to the 1930s. The Commission formally adopted the policy into its rules in the 1980s. The ISP was initially developed to prevent anticompetitive behavior on U.S.-international routes at a time when, in most countries, telephone service was provided by a sole company – a monopoly provider. The Commission established the policy to create a unified bargaining position for U.S. carriers because foreign carriers with monopoly power could take advantage of the presence of multiple U.S. carriers by "whipsawing" or engaging in anticompetitive behavior. "Whipsawing" is generally defined as the abuse of market power by a foreign carrier or a combination a carriers within a foreign market that is intended to play U.S. carriers against one another in order to gain unduly favorable terms and benefits in arrangements for exchange of traffic.

The ISP contained three elements designed to ensure a competitive playing field among providers:

1. U.S. carriers must all be offered the same effective rate and same effective date (nondiscrimination).
2. U.S. carriers are entitled to a proportionate share of return U.S.-inbound traffic based upon their proportion of U.S.-outbound traffic.
3. Settlement rates for U.S. inbound and outbound traffic are symmetrical (i.e., the accounting rate is divided 50-50 between the U.S. carrier and the foreign carrier).

1997 Benchmarks Policy

International settlement rates are the most important components of the marginal cost of international telephone service. While the ISP protected U.S. customers from the abuses of market power, such as "whipsawing," international calling rates remained high, despite technological advances and competition. These international calling rates remained high because in many countries, competition was non-existent or insufficient to drive settlement rates down to cost-based levels.

In an effort to drive settlement rates closer to cost, the Commission exercised its jurisdiction over U.S. carriers and prohibited carriers from paying inappropriately high rates to foreign companies to the detriment of U.S. consumers. Specifically, the Commission established its Benchmarks Policy with the goal of reducing above-cost settlement rates paid by U.S. carriers to foreign carriers for the termination of international traffic, where market forces had not led to that result. The Benchmarks Policy requires U.S. carriers to negotiate settlement rates at or below benchmark levels set by the Commission in its 1997 *Benchmarks* *Order (/Bureaus/International/Orders/1999/fcc99124.txt)*. The Benchmarks Order divided countries into four groups based upon economic development levels as determined by information from the ITU and World Bank. As such, the following benchmark rates apply:

1. Upper Income - 15¢
2. Upper Middle Income - 19¢
3. Lower Middle Income - 19¢
4. Lower Income - 23¢

International Settlements Policy Reform

While the ISP was designed to address concerns of anticompetitive behavior, it had shortcomings in competitive markets. Specifically, the requirements of the ISP prevented U.S. carriers from negotiating flexible, individualized rates and terms that are responsive to changing market conditions and beneficial to U.S. customers. Thus, the Commission in its *2004 ISP Reform Order* (http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-53A1.pdf) reformed its rules to remove the ISP from U.S.-international routes for which U.S. carriers have negotiated benchmark-compliant rates. Lifting the ISP on those routes allowed U.S. carriers greater flexibility to negotiate arrangements with foreign carriers. The Commission found that doing so would encourage market-based arrangements between U.S. and foreign carriers that would further its long-standing policy goals of encouraging greater competition in the U.S.-international market and more cost-based rates for U.S. consumers.

Subsequently, in its *2012 ISP Reform Order* (https://apps.fcc.gov/edocs_public/attachmatch/FCC-12-

145A1_Rcd.pdf), the Commission removed the ISP from all U.S.-international routes, with the exception of Cuba to which the nondiscrimination requirement of the ISP continues to apply. The Commission also adopted measures to improve the Commission's ability to protect U.S. consumers from anticompetitive conduct by foreign carriers. The Commission found that, in today's competitive market, maintaining the ISP had the opposite effect for which it was intended because it hindered U.S. carriers' ability to negotiate competitive rates with their foreign counterparts. Foreign carriers no longer had any incentive to agree to pay symmetrical rates to U.S. carriers for their U.S.-bound traffic, as required by the ISP, because they could send that traffic to the United States at significantly lower market rates through traffic re-origination arrangements offered by third country foreign carriers on ISP-exempt routes between the United States and those third countries. Removing the ISP from the remaining U.S.-international routes was designed to provide U.S. carriers greater flexibility to negotiate lower settlement rates on those routes.

Cuba: On October 26, 2015, the State Department rescinded its prior policy guidelines for Cuba and recommended that the Commission, in reviewing proposals for telecommunications services between the United States and Cuba, among other things, discontinue application of the non-discrimination requirement on the U.S.-Cuba route. On February 12, 2016, the Commission issued a Further Notice of Proposed Rulemaking proposing to remove the nondiscrimination requirement on telecommunications services between the United States and Cuba.

Ongoing Competitive Safeguards:

The Commission maintains several safeguards designed to protect U.S. consumers from anticompetitive conduct by foreign carriers and other types of market failures. Included among the safeguards is a process by which the Commission may consider petitions alleging anticompetitive harm on a U.S.-international route. The Commission established three indicia of anticompetitive conduct: (1) increasing settlement rates above benchmarks, (2) establishing rate floors, even if below benchmarks, that are above previously negotiated rates, or (3) threatening or carrying out full or partial circuit disruptions to achieve rate increases or changes to the terms and conditions of termination agreements. The Commission found that each of these types of actions can disrupt normal commercial negotiations to force U.S. carriers to accept above-cost settlement rate increases that would be passed on to U.S. customers, and may require Commission action to protect U.S. customers. The Commission has an established process for bringing allegations of anticompetitive harm before the Commission. Upon a finding of anticompetitive behavior, the Commission can impose a variety of potential remedies including prohibition of increased payments, revoke or limit section 214 authorizations, prohibit termination of traffic, and full stop payment orders.

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