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Clarifying the Meaning of WTO Telecommunications Obligations: Mexico Measures Affecting Telecommunications Services

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About the Author...



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Introduction

In April 2004, a panel established under the dispute settlement procedures of the World Trade Organization ("WTO") issued its decision in the first (and so far only) case involving telecommunications services commitments.² The case, brought by the United States against Mexico, raised a number of fundamental questions on the scope of WTO obligations in the telecommunications sector. In ruling that Mexico violated its WTO commitments, the WTO Panel enunciated a number of important precedents and provided guidelines on the meaning of the Annex on Telecommunications ("Telecom Annex") to the General Agreement on Trade in Services ("GATS") and the Reference Paper, a set of regulatory principles adopted by many WTO members. This article sets out the significant panel findings in a way that will help telecom regulators and government officials interpret and implement their WTO commitments.

Background

As part of the negotiations creating the WTO, member governments ("Members") negotiated the GATS, which sets the rules for trade in all kinds of services, including telecommunications. The GATS consists of:

- A general framework of obligations that apply to all WTO members;
- Each Member's Schedule of Specific Commitments, stating which services sectors that Member has agreed to open to foreign competition (known as "market access"),³ how open those markets are and how a foreign service supplier is treated (known as "national treatment");⁴ and
- Annexes which elaborate on the framework rules for certain services and issues, including the Telecom Annex.

¹ This article is an excerpt from a longer, more detailed analysis of the WTO Panel decision, which appeared in *info*, Vol. 7, No. 6 2005, pp. 16-32, published by Emerald Insight, www.emeraldinsight.com/info.htm.

² "Mexico-Measures Affecting Telecommunications Services," WT/DS204/R (Apr. 2, 2004), available at http://www.wto.org/english/tratop_e/dispu_e/204r_e.pdf ("WTO Panel Report").

³ GATS Art. XVI.

⁴ GATS Art. XVII.

In February 1997, 70 members of the WTO concluded negotiations on market access and national treatment for basic telecommunications services. The results, referred to as the "WTO Basic Telecom Agreement," were incorporated into Members' Schedules of Specific Commitments. The negotiations also produced the "Reference Paper," a set of regulatory principles applicable to the provision of basic telecom services, which was incorporated by many Members into their Schedules.⁵

In scheduling market access and national treatment commitments, a Member can distinguish between types of services and modes of supply. The GATS describes four "modes" of delivery for a service:⁶

- Mode 1 -- cross-border supply
- Mode 2 -- consumption abroad
- Mode 3 -- commercial presence
- Mode 4 -- movement of natural persons

Mexico's Commitments and its Regulatory System

As part of the WTO Basic Telecom Agreement, Mexico agreed to allow market access and national treatment for the provision of voice telephony, circuit-switched data transmissions services, facsimile services, private leased circuit services, paging services and cellular telephone services through facilities-based public telecommunications network (wire-based and radio-electric). It also agreed to provide market access and national treatment for resale of public switched telecommunications services through commercial agencies once licensing regulations are issued.

Mexico did not limit cross-border (Mode 1) market access, except to require that international traffic be routed through the facilities of an enterprise that has a "concession" granted by the Secretariat of Communications and Transport ("SCT"). Only enterprises with a concession from SCT are entitled to establish a commercial presence (Mode 3). Mexico limited foreign ownership of enterprises holding a concession to 49%. Mexico incorporated the Reference Paper as an additional commitment with respect to basic telecommunications services.

The Federal Telecommunications Law ("FTL") provides the legal framework for the regulation of telecommunications activities in Mexico. The Federal Telecommunications Commission ("COFETEL") had issued rules governing the provision of long distance service ("ILD Rules"), which required each operator holding a concession to apply the same "uniform settlement rate" to every call to or from a given country. The settlement rate could only be negotiated by the carrier with the largest market share of outgoing international service, which had always been Telmex. The ILD Rules also required "proportional return."

The FTL also provides for resale of public telecommunications networks and services by "commercial agencies," entities that do not own their own networks. In the five years that passed between the entry into force of Mexico's WTO telecom obligations and the U.S. request for consultations prior to invoking the WTO dispute settlement process, neither SCT nor COFETEL

⁵ The Reference Paper was negotiated during the basic telecom negotiations to deal with the potential for anti-competitive practices of former monopoly services providers. See Negotiating Group on Basic Telecommunications, "Review of Outstanding Issues, Note by Secretariat," TS/NGBT/W/2, Para. XV (July 8, 1994). GATS Art. XVIII provides that Members may include in their Schedules of Specific Commitments additional obligations "with respect to measures affecting trade in services not subject to scheduling" under other provisions of the GATS.

⁶ GATS Art. I:2.

had issued regulations providing for licensing commercial agencies so that resale was not possible.

U.S. Claims

The United States stated four claims against Mexico based on Mexico's Schedule of Specific Commitments (which incorporated the Reference Paper) and the Telecom Annex. The WTO Panel rejected one of the four claims, finding that Mexico not made a market access commitment to permit the provision of international services through resale. The other three U.S. claims were:

- Mexico failed to comply with Section 2 of the Reference Paper which requires a major supplier to provide interconnection on “terms, conditions . . . and cost-oriented rates that are . . . reasonable.”
- Mexico had not maintained appropriate measures to prevent Telmex, a major supplier, from engaging in “anti-competitive practices” in accordance with Section 1 of the Reference Paper.
- Mexico failed to ensure “access to and use of” its public telecommunications network and services, including private leased circuits, on “reasonable and non-discriminatory terms and conditions,” in accordance with Section 5(a) of the Telecom Annex.

Key Findings By the WTO Panel

- “Interconnection” includes linking of a network in one country with the network of another country at the border so the Reference Paper obligations relating to interconnection apply to termination of international traffic at the border and to accounting rate regimes.
- As defined in the GATS, “Mode 1” (cross-border supply of services) does NOT require a supplier to operate the relevant “full circuit.” Hence Mode 1 supply can take place without the supplier being present on both sides of the border.
- The “relevant market” for purposes of determining whether a supplier is a “major supplier” for purposes of the Reference Paper is defined by application of a “demand substitution” test.
- “Cost-oriented” means pricing based on the costs incurred in supplying the service, in this case the interconnection service. “Cost-oriented” does not equate exactly to cost, but should be founded on cost. Costs associated with the general state of the telecom industry or the coverage and quality of the network CANNOT be included in calculating interconnection costs.
- Costs for termination at the border that are 75% higher than the demonstrated costs for domestic termination are not “cost-oriented.” The fact that the international termination rates are consistent with benchmarks set by the International Telecommunication Union (“ITU”) is not relevant to the analysis.
- “Reasonable” means “something of such an amount, size, number, etc., as is judged to be appropriate or suitable to the circumstances or purpose.”

- Prices for access to and use of the public telecommunications network must be reasonable. Prices that are "reasonable" for purposes of the Telecom Annex may be higher than rates that are cost-oriented in terms of the Reference Paper.
- Rates that exceed cost-based rates "by a substantial margin" and whose uniform nature excludes price competition do not provide "access to and use of " the public telecommunications network and services on "reasonable" terms.
- "Anti-competitive" practices include any action that lessens rivalry or competition in the market. The list in paragraph 1.2 of the Reference Paper is not exhaustive and other practices, such as price fixing and formation of cartels are anti-competitive practices for purposes of the Reference Paper.
- Given a WTO Member's obligation to "maintain measures for the purpose of preventing" anti-competitive practices, it is inconsistent with that obligation for the Member to have measures which *oblige* operators to engage in such practices.
- A WTO Member's obligation to ensure access to and use of the public telecommunications network under the Telecom Annex must be extended to all foreign suppliers of any service included in another WTO Member's Schedule of Specific Commitments, including suppliers of scheduled basic telecommunications services.
- Regulations required to make market access commitments effective should be in place at the time the commitments become effective or soon thereafter. At a minimum, the effort to draft and adopt such rules should be commenced by the time the commitment comes into force.

Lessons for Regulators and Policy Makers

The panel findings offer a number of lessons for WTO Members that 1) have agreed to provide market access and national treatment to foreign service suppliers (either cross-border or through commercial presence) for the provision of basic telecommunications services and 2) have adopted the Reference Paper.⁷ Drawing on the *WTO Panel Report*, it is clear that such a WTO Member should:

- Make sure that all regulations necessary to implement its commitments have been adopted by the implementation date of its commitments or are in the process of being drafted.
- Require that interconnection rates for both international and domestic termination and accounting rates charged by the former monopoly (while it retains market power) are based on a costing methodology that only looks at the costs of providing the specific service. Costs associated with providing universal service or achieving other social goals are not related to the cost of providing interconnection and should be funded by other mechanisms.
- Make sure that charges for network components do not differ significantly based on whether they are used for domestic or international service.
- Do not limit the ability of carriers to negotiate on a commercial basis international termination rates or accounting rates with foreign carriers.

⁷ These lessons are applicable to those WTO Members who are considering making commitments in basic telecommunications services in the Doha Round of negotiations that are now being conducted.

- Adopt measures to prevent all forms of anti-competitive conduct on the part of all market participants, including anticompetitive price-fixing, market-sharing arrangements and other cartel practices. This includes the elimination of government measures which allow former monopoly operators to engage in "legacy" practices, such as cross subsidization, that are inconsistent with a competitive environment.
- Include a demand substitution test as part of an analysis of relevant markets.
- Adopt measures to ensure that new competitors have "access to and use of" the former monopoly's network and services, including private leased circuits, at rates that are reasonable and non-discriminatory. "Reasonable" rates may be somewhat, but not substantially, higher than cost-oriented rates.

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