Results of the 2006 Section 1377 Review of Telecommunications Trade Agreements

USTR annually reviews the operation and effectiveness of U.S. telecommunications trade agreements, pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988. The Section 1377 Review is based on public comments filed by interested parties and information developed in ongoing contacts with industry and private sector representatives in various countries. This year USTR received comments from seven entities (companies and trade associations) and reply comments from five entities, which are available at: http://www.ustr.gov/Trade_Sectors/Telecom-E-commerce/Section_1377/Section_Index.html.

Summary of Findings

The 2006 Section 1377 Review focuses on three main areas: high mobile termination rates (the cost of interconnecting calls to wireless networks); access to leased lines and submarine cable capacity; and universal service-related programs. Beyond these general categories, the Review also highlights specific points related to Australia, China, Egypt, Germany, and India.

While many of these issues have been discussed in past reviews, in each of the cases emphasized this year, we found sufficient evidence to warrant highlighting them again. These matters continue to raise general concerns regarding trade partners' compliance with their trade obligations; therefore, as in past years, the 2006 Review identifies issues that USTR will actively monitor. Where there are upcoming regulatory actions (e.g., in Egypt, Germany, India, Japan, and Singapore), USTR will also examine developments and take additional action, if necessary, in ongoing efforts throughout the year.

Discussion of Key Issues

1. High Mobile Termination Rates

Lack of effective competitive pressure on mobile termination rates in certain markets continues to be of concern, since U.S. operators and consumers are forced to absorb such costs when calling foreign mobile networks. These rates are often very high; they can be up to 20 times the rates fixed network providers charge to access their networks. As global mobile subscribership increases, the overall revenue impact of these high charges to U.S. consumers and operators will increase accordingly. This problem is most pronounced in countries whose operators offer free incoming calls to their mobile subscribers, but charge network usage fees to the interconnecting network – the so-called "calling party pays" system. As a 2004 Organization for Economic Cooperation and Development (OECD) report noted with respect to calling party pays markets, "for fixed-to-mobile calls it seems that competitive pressure on mobile termination charges is

weak."[1] While regulators have the discretion to choose the mobile termination rate system that best fits their country's needs, the United States has an interest in ensuring that this choice does not result in excessive interconnection rates.

In almost all markets with a calling party pays structure, where the regulator has investigated potential abuse by a mobile operator with "bottleneck" control over reaching its subscribers, the regulator has concluded that rates the operator charged the interconnecting network have been unreasonably high. Further, in most of these cases, the regulator concluded that it needed to regulate rates.[2] Key exceptions are Japan and Germany, where despite the existence of high rates and the regulators' findings that operators have market power, the regulator has declined to regulate rates.

Germany

Although Germany has completed an analysis of the mobile termination market as required by the EC "Framework Directive"[3] and concluded that operators in this market exert significant market power, Germany has yet to propose any specific remedies. This is cause for significant concern, particularly since the German regulator – BNetzA – does not appear to have developed a satisfactory analytic basis for determining whether rates are reasonable and reflect competitive outcomes. Instead, BNetzA has benchmarked rates charged by its operators against those charged by operators in other EU countries. However, because regulators in many of those other markets have determined that the rates charged by their operators are excessively high, benchmarking against such rates is not an appropriate basis to determine whether rates charged by German operators are reasonable. USTR will continue to monitor BNetzA's progress in this area and will pay close attention to any remedies that BNetzA may propose. In addition, USTR will encourage BNetzA to make the basis for any such remedies transparent and subject to public comment.

Japan

Japan is undertaking competitive analyses of telecommunications markets similar to those being performed in Europe. Under Japanese law, the regulator may intervene when rates surpass a cost-oriented level. However, despite USTR's urging, Japan has declined to examine the mobile market for termination services and, consequently, is unable to determine whether rates are excessive or whether any remedies may be appropriate to address such rates. Japan's dominant mobile operator, DoCoMo, did reduce its termination rate by 2.6 percent this year, but this is the smallest rate reduction in ten years and suggests that rate reductions have plateaued in this market. This issue will be of growing importance in the next year, as new entrants begin offering mobile services in the Japanese market, and the termination rates charged by incumbent mobile carriers will have a large impact on these new entrants' ability to compete.

[1] "Access Pricing in Telecommunications", OECD Policy Brief, (June 2004), http://www.oecd.org/dataoecd/41/60/33646683.pdf

[2] e.g., France, United Kingdom, Spain, Italy, Australia, New Zealand, Korea, Peru, Chile, and Columbia.

[3] Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services.

USTR will urge Japan to institute a transparent process for addressing high mobile termination rates.

Mexico

USTR is concerned that Mexico's failure to resolve a dispute involving mobile termination rates could seriously affect U.S. operators and their Mexican affiliates that operate in both local and long-distance markets in Mexico.

In January 2005, Mexican cellular companies and the dominant local fixed-line service provider, Telmex, concluded agreements on the rate (now set at around 14 cents a minute or about 1.54 pesos) Telmex would pay cellular companies to terminate calls on their mobile networks. Other competitive local fixed-line providers, however, including U.S. affiliated companies, did not agree to the rates to which Telmex agreed, asserting that they were unreasonably high. (The rates the Mexican cellular companies demanded were about 15 times the rates charged for interconnecting with another fixed-line network). Accordingly, in March 2005 several competitive local fixed-line carriers requested arbitration by Mexico's regulatory authority, COFETEL.

Mexico's telecommunications rules require COFETEL to initiate and conclude arbitration between parties having interconnection disputes within a defined time period and using cost-based principles to guarantee a reasonable outcome. Although COFETEL has developed a cost-model to set parameters for determining reasonable rate levels for terminating calls on mobile networks, it has not made this model public, and it is not clear why COFETEL is not using this model as a basis for resolving the dispute between the Mexican cellular companies and other local fixed-line carriers. Since this dispute has now dragged on for over a year, USTR will urge COFETEL to resolve the dispute expeditiously.

The ongoing local mobile termination dispute may have implications for COFETEL's proposed long distance fixed-to-mobile termination rules. In late 2004, COFETEL proposed new rules that permit cellular companies in Mexico to charge long-distance operators for terminating calls on their mobile networks.[4] However, these rules have yet to be finalized, mainly due to objections from long-distance carriers, who anticipate disputes over termination rates imposed under the new rules and remain highly concerned with how COFETEL would arbitrate such disputes. The ongoing dispute between local fixed and cellular companies could be considered the test case for such arbitration, in as much as it involves the same service – terminating calls on mobile networks.

The impact of the new long distance fixed-to-mobile termination rates on U.S. companies supplying cross-border calls to Mexico is likely to be enormous. For example, if the current local rate of 14 cents per minute were imposed on long-distance operators, the additional costs to

[4] Currently, cellular companies in Mexico do not charge long-distance operators for terminating long-distance calls, but recover such costs directly from their own customers (as is the practice in the United States). Such arrangements avoid termination charges from being used as a barrier to network access.

U.S. operators (costs that would likely be passed on to U.S. consumers) could be over $400 million annually.[5]

USTR intends to closely monitor developments related to mobile termination rates for both local and long-distance operators in Mexico over the coming months. USTR will also watch closely COFETEL's actions to ensure that any rate it may impose is reasonable and carries out Mexico's stated intention of ensuring cost-oriented rates if commercial negotiations between operators fail.

Peru

The 2005 Section 1377 report noted that Peru's regulator – Osiptel – was in the process of reviewing the mobile termination rates charged by operators in Peru. USTR expressed concerns throughout 2005 regarding the possible outcome of this regulatory proceeding given Osiptel's past delays in addressing the issue and because of the apparent ability of Telefonica Moviles SAC – the dominant carrier in the market – to influence the regulator. In November 2005, Osiptel issued a decision designed to lower mobile termination rates towards a cost-oriented level over the course of three years. Despite Telefonica's repeated requests to reverse this decision and increase these rates, Osiptel has maintained its decision to move mobile termination rates closer to cost. USTR, encouraged by Osiptel's decision to thoroughly examine this issue and establish a glidepath to a more cost-based level, will urge Osiptel to remain vigilant against pressure to raise these rates and to assess whether any technological developments may further lower mobile termination costs and, in turn, warrant a decision to accelerate the planned rate reductions over the next three years.

Switzerland

Despite recent reductions, Switzerland's mobile termination rates are still among the highest of any developed economy. Switzerland's telecommunication's regulator – the Federal Office of Communications (OFCOM) – appears unable to address this issue as a consequence of ongoing litigation brought by the dominant provider Swisscom that challenges their its authority to raise mobile termination rates. If this dispute is allowed to continue, it may call into question whether the regulator has sufficient authority or independence. The fact that Swisscom remains government-owned may be creating a conflict of interest between effectively regulating the sector and protecting the government's financial interest in this company. Consequently, Switzerland should consider divestment, combined with explicit legislation to empower the regulator, in order to ensure that OFCOM is able to regulate Switzerland's telecommunications sector effectively. USTR will continue to monitor mobile termination rates in Switzerland, along with movement towards Swisscom's full privatization.

[5] This assumes that traffic from the United States to Mexico is sustained at the 2004 levels of 9.7 billion minutes, and of that, at least one third terminates on cellular networks. (Sources: FCC, COFETEL.)

2. Access to Leased Lines and to Submarine Cable Capacity

Commenters expressed concern about problems associated with access to and use of leased lines and submarine cable systems, and how these issues are hampering U.S. operators' ability to enter and compete in several key markets. As in past years, commenters complained that provisioning times for leased lines are too long, pricing levels for these lines are excessive, and the manner in which they are offered is potentially discriminatory.

India

U.S. operators have perennially identified access to submarine cable systems controlled by VSNL – India's dominant international carrier – as a serious problem in the Indian market. Commenters continue to argue that VSNL's persistent refusal to permit interconnection at its cable landing stations, its potentially anti-competitive provisioning practices, and its failure to activate additional capacity on these cables, is resulting in artificial shortages of bandwidth into and out of India and inflating prices, which in turn, prevents U.S. operators from serving their global customers within India.

Access to affordable bandwidth, sufficient to support commercial needs, is crucial for the development of the information and communications technology sector. Barriers to access to submarine cable systems, and the absence of appropriate policies to address such barriers, constrain competition because operators rely on access to and use of these systems to serve their customers at competitive rates.

This year, the Telecom Regulatory Authority of India (TRAI) took action to overcome issues associated with access to and use of submarine cable systems in the Indian market. Specifically, TRAI submitted recommendations to the Indian Department of Communications (DoT) on "Measures to Promote Competition in International Private Leased Circuits (IPLC) in India", which advised the DoT to take steps to facilitate competitive access to submarine cable systems. Specifically, TRAI recommended that DoT grant it authority to require operators owning cable landing stations to provide licensed operators with equal access to bottleneck facilities on a non-discriminatory basis and to publish the terms and conditions for access to such stations. In addition, TRAI recommends that it have the ability to determine and specify cost-based access charges through regulation.

While USTR commends India for implementing price ceilings rates for IPLCs, it will continue to urge the DoT to adopt the full range of TRAI's IPLC recommendations and to direct TRAI to implement regulations accordingly. This would provide TRAI with the necessary authority to ensure access to and use of submarine cable capacity through facilities now dominated by VSNL. Taking such action would be an important sign of India's continued commitment to promoting competition in its telecommunications market.

Singapore

Onerous conditions for accessing leased lines in Singapore have plagued competitors in that market for the past several years, and when competitors have sought to install their own lines,

SingTel – the majority government-owned, dominant carrier – has refused access to ducts it controls, creating further inefficiencies and slowing competitive entry.

Although Singapore's regulator – the Infocomm Development Authority (IDA) – took the positive step last year of requiring SingTel to offer competitors combinations of high and low-capacity lines (so-called partial private circuits) at end-office switching centers at reasonable rates, this decision has since become mired in legal challenges. Furthermore, SingTel's practice of appealing regulatory decisions, including this one, directly to the Minister of Communications (MOC) has reduced transparency and predictability in the regulatory process. Such appeals appear to be conducted behind closed doors with no clear procedural safeguards or requirement that decisions be justified, and often result in an automatic stay of the regulatory decision pending its appeal.

In addition to urging IDA to implement its decision to require SingTel to offer competitors combinations of partial private circuits at each end-office switching center, USTR will urge IDA to make such combinations available at different points of aggregation. This would allow competitors to decide whether it would be more efficient to build their own links or lease them from SingTel. In addition, USTR will urge Singapore to increase transparency in the process for resolving disagreements between operators, particularly those involving SingTel. USTR will also encourage Singapore to consider developing an objective standard for deciding when to stay a regulatory decision pending a legal challenge.

Germany

Similar to the situation in Singapore, competitive carriers in the German market have long sought access to combinations of high-capacity trunk lines and lower capacity end-user links. As part of its EC-mandated review of the leased line market, the German regulator is currently considering whether the dominant carrier – Deutsche Telekom (DT) – should be required to offer such services. USTR will urge Germany to institute this remedy, given the importance of partial private circuits in the corporate data market.

3. Universal Service-Related Programs

As countries implement universal service programs, USTR will remain vigilant in working to ensure that such programs do not constitute unreasonable barriers to access and use of networks. Such programs should conform, where applicable, to WTO commitments that they be administered in a transparent, non-discriminatory, and competitively-neutral manner and not be more burdensome than necessary.

Jamaica

In April 2005, Jamaica issued an order that required its domestic telecommunications carriers to impose a surcharge on all incoming international calls: three cents per minute for terminating on a fixed network and two cents per minute for terminating on a mobile network. Jamaica claims

the purpose of this surcharge is to fund its e-Learning Project – a universal service program for building broadband access for schools and libraries in Jamaica.

USTR is concerned that Jamaica is choosing to fund this program predominantly, if not exclusively, through fees imposed on foreign operators. Since the program appears to be designed mainly for Jamaican users, levying charges primarily on Jamaican operators and users may be a more equitable approach, and one that would ensure that burdens of the program are not disproportionately imposed on unrelated users. In any event, the program appears to lack sufficient transparency to determine whether the extraordinarily large surcharge is necessary to accomplish Jamaica's goals.

USTR is also troubled about the lack of information on how the funds are to be used, as Jamaican authorities do not appear to have identified the actual costs of expanding broadband access for schools and libraries (and other institutions), nor have they provided details of how they plan to administer disbursal of funds. Given that these funds originate largely from U.S. sources, USTR has a particular interest in seeing an accounting of the funds that have been collected, whether they are appropriate to the needs identified, and how they have been used. USTR will continue to monitor this program and urge Jamaica to collect such funds from a broader base of users (i.e., not exclusively foreign operators) to ensure that it does not adversely affect access to the Jamaican market, nor constitute a program that is more burdensome than necessary to achieve Jamaica's universal service goals. USTR is also particularly concerned that operators are using failure to pay this surcharge as a basis for declining to interconnect with foreign operators, and will continue to discourage this practice.

Further, as USTR has communicated to Jamaica, imposing such a surcharge on calls to mobile networks is particularly problematic, since mobile termination rates currently appear excessively high. Last year, Jamaica's regulator – the Office of Utilities Regulation (OUR) – pledged to investigate these rates and consider appropriate penalties, but so far the OUR does not appear to have taken any action.

USTR will urge Jamaica to follow through on its pledge to investigate mobile termination rates and to consider more equitable alternatives to its new surcharge, including one that requires its own operators to pay the costs associated with Jamaica's e-Learning Project.

Japan

USTR remains concerned about Japan's universal service program. Under Japan's October 2005 program, designed to address high-cost regions, the only entities that appear eligible for this fund are the regional fixed-line operators NTT East and West. USTR has recommended to Japan that it reform this program to enable a broader range of operators, including mobile carriers, to apply for funding from this program to serve these regions.

In addition, USTR is concerned that Japan has approved, under the NTT Law, a cross-subsidy of interconnection revenue from NTT East to NTT West, which Japan asserts is necessary to maintain uniform retail rates. Allowing NTT East and West to cross-subsidize in this way raises

expenses for competitors in NTT East's region and, thus, adversely affects competitors' ability to compete against NTT East.

USTR will continue to work with Japan to promote reform of these programs to ensure more competitively-neutral policies.

India

U.S. companies again raised the issue of India's access deficit charge (ADC), which cross-subsidizes local service with revenue generated by long distance calls. On February 23, 2006, TRAI announced that it would impose a more than 50 percent reduction in its current ADC for international calls and move towards a revenue-share-based ADC for long distance calls in place of the existing system where charges are levied on a per minute basis. In addition, TRAI, in this same announcement, reaffirmed its commitment to reduce the ADC to zero by the end of 2009.[6] These are all positive developments, and USTR congratulates TRAI for taking such actions. However, U.S. carriers remain concerned that the new ADC model will not apply to international calls (i.e., charges will still be levied on a per minute basis) and that they may not benefit fully from the rate reduction unless Indian firms pass their savings on to the U.S. carriers with which they partner. USTR will continue to monitor this issue.

4. Additional Issues

Egypt

Evidence has emerged that Telecom Egypt (TE), the majority government-owned, dominant operator in Egypt, appears to have been discriminating among foreign carriers seeking to interconnect with its network. While some operators are able to obtain interconnection agreements with TE, a large U.S. telecommunications carrier has been seeking such an interconnection agreement with TE for over six years. This situation raises possible issues related to Egypt's WTO commitments to ensure interconnection with a major supplier on non-discriminatory terms and conditions.

USTR has received reports that in recent days that TE has taken steps to complete an interconnection agreement with the U.S. carrier referenced above, which is a significant and welcome development. However, USTR will continue to closely monitor whether this situation is resolved in a timely manner. In addition, USTR will advise the NTRA to take action to ensure that all foreign carriers seeking interconnection agreements with TE are able to obtain one or to provide a legitimate and detailed explanation for why any such agreement is denied.

USTR is also concerned that TE has made neither its current interconnection agreements nor any reference interconnection offer (RIO) publicly available. In fact, as reported by the Ministry of ICT, TE currently only has a RIO in draft form. USTR will call on the NTRA to ensure that TE

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[6] "TRAI Issues Amendment to Interconnect Usage Charges Regulation, 2006", *TRAI Press Release No. 16/2006* (February 23, 2006).

has made publicly available either its current interconnection agreements or a final reference interconnection offer, consistent with Egypt's WTO commitments.

If steps to address both of the issues outlined above have not been taken by June 2006, USTR will decide whether additional action may be warranted on this issue.

Australia

The Australian Parliament has authorized the sale of its remaining stake in the dominant carrier Telstra[7], a development the United States strongly supports. This effort, however, has stimulated a widespread domestic debate about Telstra's willingness and ability to continue its role as a universal service provider without this governmental stake.

Telstra has been aggressive in attempting to undermine the authority of Australia's regulator – the Australian Competition and Consumer Commission (ACCC) – mainly through direct appeals to the Department of Communications, Information Technology, and the Arts (DCITA) for regulatory relief. To date, the DCITA has deferred to the ACCC on pricing decisions. Telstra has worked actively to minimize the scope of safeguards designed to ensure that Telstra offers competitors access to key parts of its networks on terms equivalent to those Telstra offers itself (operational separation) and to curb reforms concerning the structure and level of pricing for unbundled local loops – wholesale inputs that competitors have begun to use to compete against Telstra in local voice and data markets. Telstra has asserted that it can only maintain its policy of uniform retail pricing in Australia if wholesale rates are also set uniformly.

Regarding operational separation, the DCITA recently rejected Telstra's initial plan to implement operational safeguards as insufficient. Whether Telstra will improve upon this plan in a meaningful way remains to be seen.

Regarding unbundled loops, Telstra has refused to lower rates it previously offered on a de-averaged basis, as ACCC proposed. Telstra has also unilaterally set a high, nationally averaged rate, arguing that it needs to cross-subsidize rural services with above-cost urban rates. The likely effect of this new tariff, if Telstra's appeal to the DCITA succeeds, will be to preclude competition based on unbundled loops in the geographic areas that competitors want to serve. Given the effects on competition of Telstra's proposed average rate, Australia should consider other mechanisms to address rural service issues, such as expanded use of a competitively-neutral universal service fund.

USTR will monitor the DCITA's efforts to ensure that Telstra implements an effective operational separation plan. USTR will also encourage Australia to adopt reforms concerning the structure and level of pricing for unbundled local loops that do not foreclose competitive entry into the Australian market.

[7] The Finance Ministry has yet to set a date for the sale.

China

Capitalization Requirements

Although China has begun to discuss making changes to its capitalization requirement for telecommunications operators ($240 million per operator offering inter-regional services), it has taken no concrete steps to address this significant market access barrier. The United States will continue to work with China to eliminate this condition for entry, which raises questions regarding China's compliance with its WTO obligations. If progress appears unlikely, USTR will consider what further actions it may undertake to encourage China to eliminate this barrier.

Preferences for Domestic Wireless Standard

China is now in the process of planning to issue new licenses for third generation wireless services (3G services). China's process suffers from a lack of transparency and raises concerns that China may issue such licenses in a manner that is not in keeping with the licensing and spectrum management commitments it undertook through adoption of the basic telecommunications Reference Paper when it joined the WTO. In addition, press reports indicate that China has taken action to accord broad preferences to the development and testing of TD-SCDMA – a standard developed largely in China. Such preferences, in the form of subsidies and licensing advantages, raise serious questions about China's commitment to impartial regulatory decisions and technological neutrality with respect to licensing. USTR will monitor the process by which China issues 3G licenses to ensure that all standards are given an equal chance to compete in the marketplace.

Germany

A key concern in Germany's telecommunications regulatory policy is its apparent endorsement of temporary monopoly power as a condition for innovation and as justification for broad deregulation of DT. For example, a draft amendment to Germany's telecommunications act proposed by the Ministry of Economics and Technology endorses the concept of a temporary "regulatory holiday" for certain services offered by DT. While the United States strongly supports deregulation as an important element of promoting facilities-based competition, the promotion of deregulation before competitive conditions warrant such steps may undermine the development of an efficient and competitive market. The EC appears to share this concern and are investigating whether it is in compliance with European law. USTR will continue to monitor Germany's activity related to deregulation of the broadband market.

India

Over the past year, India has taken a number of important actions to address complaints about barriers to, and regulation of, its telecommunications market. As noted above, the TRAI set a ceiling rate for IPLCs – an important step towards ensuring the availability of reasonably priced bandwidth in the market. In addition, India lowered the entry fee for new international long distance operators (ILDOs) from about $5.5 million to about $500,000 and the annual revenue share payment requirements from 15 to 6 percent. India also increased the foreign direct

investment (FDI) permissible in that market for most telecommunications services[8] from 49 percent to 74 percent. These are welcome developments that have the potential to promote investment and competition in the Indian market.

However, U.S. telecommunications companies have expressed serious concerns about Conditions 5.6 (v), (viii), and (ix) of both the *Guidelines for Issue of Licence for International Long Distance Service* and the *Guidelines for Issue of Licence for National Long Distance Service*, which include restrictions on remote management of telecom networks, and on the routing of traffic, and the transfer of accounting, user, and network infrastructure information, outside of India. These restrictions are among the most severe in the world. For this reason, and depending on how they are implemented, these rules could erase the practical benefits of the new foreign ownership limits, as it may be impossible for U.S. carriers that provide global corporate data networks to comply with these restrictions within the context of their current business models. On March 3, 2006, India postponed the implementation date of these conditions, pending additional consultation with stakeholders. USTR appreciates India's efforts to thoroughly assess such new requirements, as we agree that more time is needed to consider the potential ramifications of these rules. USTR will continue to work with India to explore ways to address its concerns, while at the same time ensuring an environment that will allow U.S. operators to benefit from the recent increase in FDI limitations.

[8] The FDI limits were lowered for the following telecommunications services: basic, cellular, unified access services, national/international long distance, V-SAT, public mobile radio trunked services (PMRTS), global mobile personal communications services (GMPCS) and other value added services. Government of India, Ministry of Commerce & Industry, "Enhancement of the Foreign Direct Investment ceiling from 49 percent to 74 percent in the Telecom secto", *Press Note No. 5 (2005 Series).*