Results of the 2005 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. This year USTR received comments from fourteen companies and trade associations and reply comments from eight companies and trade associations. Comments are posted on the USTR website at http://www.ustr.gov/Trade_Sectors/Services/Telecom/Section_1377/Section_Index.html.

Summary of Findings

The 2005 Section 1377 Review focuses on five key areas: excessively high mobile termination rates (the cost of interconnecting calls to wireless networks); restrictions on access to leased lines and submarine cable capacity, including pricing and provisioning times; excessive regulatory requirements, including licensing fees; burdensome testing and certification requirements; and the governmental mandate of particular technical standards. Beyond these general categories, specific points related to Mexico and Japan are also highlighted.

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 issues continue to raise general concerns regarding trade partners' compliance with their trade obligations. Therefore, as in past years, the 2005 Review will establish a list of countries that USTR will actively monitor. Where there are upcoming regulatory decisions (e.g., in Peru, Germany, Singapore and Japan), USTR will also examine developments and take additional action, if necessary, in ongoing efforts throughout the year.

Excessively High Mobile Termination Rates

While the general trend over the past two years has been a reduction in mobile termination rates, excessively high rates in several countries remain a concern. The 2004 Review encouraged a reassessment of the regulator's role in markets where rates are persistently high and regulatory engagement is lacking. This year USTR will continue to actively monitor market trends and the results of on-going regulatory reviews, focusing on particular countries where it appears that the regulator has failed to take appropriate action to address the lack of effective competition for the termination of calls onto mobile networks. In addition, USTR will keep close watch on markets where regulatory action or inaction could result in an increase in rates. Countries of particular concern include Germany, Japan, Mexico, Peru and Switzerland.

Restrictions on Access to Leased Lines and to Submarine Cable Capacity

Commenters this year have alleged unreasonable or discriminatory access to and use of leased lines or public telecommunications networks, including submarine cable capacity, and claimed that such practices hinder the ability of basic and value-added service providers to supply competitive services using these wholesale inputs. In addition, commenters alleged that in several countries a lack of access to partial private circuits and other less expensive lines makes it difficult for providers to compete. Regulatory intervention has proven in the past to successfully address this problem. However, without clear rules backed-up by an empowered regulator, this progress may be blocked by the continued intransigence of incumbent operators. USTR will continue to encourage progress in this area. Countries of particular concern include Germany, India and Singapore.

Excessive Regulatory Requirements, Including Licensing Fees

Excessive regulatory requirements in certain markets can severely hinder U.S. telecommunications providers' ability to compete effectively in overseas markets. Examples of such requirements include high licensing fees and capitalization requirements. USTR will closely monitor developments in this area to determine if additional action is necessary. Countries of particular concern include China, Colombia and India.

Burdensome Testing and Certification Requirements

Commenters this year complained that regulations regarding mandatory testing and certification of terminal equipment are unnecessarily burdensome. Specifically, they raised allegations related to Mexico's draft regulations regarding mandatory testing and certification of terminal equipment, and Korea's testing procedures and policies. USTR will continue to pay close attention to developments in Mexico, and will continue to actively pursue a Mutual Recognition Arrangement (MRA) with Korea on this issue

Limitations on Technology Choices

USTR will again strongly urge governments to focus on the benefits of adopting voluntary, international standards, rather than mandatory indigenous standards, and will closely monitor developments in key countries, such as China and Korea, to ensure that their governments allow telecommunications service suppliers the maximum choice of technologies.

Discussion of Key Issues

1. Excessively High Mobile Termination Rates

As in past years, some companies and trade associations have included in their comments allegations that the cost of completing calls on mobile networks in foreign countries is excessive and has a negative impact on U.S. consumers and businesses both in the United States and abroad. The rapid increase in mobile subscribership and traffic volumes has exacerbated this concern. According to *TeleGeography 2005*, the number of global mobile subscribers now exceeds that of wireline networks. Consequently, the percentage of international calls terminating on mobile phones has increased significantly.

Countries around the world have approached the issue of mobile termination rates in different ways. Some have taken the view that the marketplace itself will correct any distortions that arise. Others have taken a more proactive response, by either directly regulating rates or actively monitoring the situation and committing to intervene if appropriate.

In the United States, the Executive Branch, through the National Telecommunications and Information Administration (NTIA), while not advocating regulation specifically for mobile services, has advocated that a principle of cost-orientation be applied to international mobile termination rates.[1] In addition, the U.S. Federal Communications Commission (FCC) is currently conducting a Notice of Inquiry on mobile termination rates, and is in the process of reviewing related submissions.

Each of the countries cited in this year's Review has undertaken obligations in the WTO to ensure "access to and use of" public telecommunications transport networks and services on terms that are "reasonable." In addition, where a WTO Member with Reference Paper commitments has made basic telecommunications commitments covering mobile services, and a mobile supplier meets the criteria to be designated a "major supplier," that Member must ensure that interconnection rates are provided on a "cost-oriented" basis.

Submissions for this year's Review cited the following countries as having particularly high mobile termination rates: Australia, Colombia, EU member States (including France and Germany), Japan, New Zealand, Peru and Switzerland. Commenters expressed a wide range of views on whether and to what extent regulatory action is necessary to address high mobile termination rates. Similarly, foreign regulators have taken a variety of approaches with respect to this issue. As last year's Review reported, some regulators have engaged in extensive cost analyses and concluded that mobile termination – in a calling party pays (CPP) rate system – is not subject to effective competition, and thus, that regulation (based on a cost methodology) is appropriate. France, in particular, was cited for taking significant steps to reduce the rates paid by U.S. companies and consumers. It was also commented that Australia had made progress by determining in 2004 that mobile termination rates should be regulated as a "declared service" and subject to progressive reductions ending at a rate of 12 Australian cents (about 9.4 cents U.S.) per minute in 2007. Regulators in other countries have begun to review rates in their markets, but for various reasons many have delayed taking action.

Germany

In Germany, the regulator, RegTP, is expected under an EC Directive and national implementing legislation to analyze specific markets, including mobile termination, in order to determine whether regulatory action is warranted due to the presence of an operator with Significant Market Power (SMP). Albeit late, RegTP has begun this process and expects to complete its market analysis of mobile termination by mid-2005. It is unclear, though, whether RegTP will ultimately decide to take any action with respect to termination charges. Germany's mobile carriers did agree in 2004 to voluntary rate reductions of between 23 and 30 percent (i.e., to between 11 and 13 Eurocents, or about U.S. 14 and 16 cents) over two years. However, Germany's rates will remain significantly higher than target rates deemed reasonable by regulators in similar markets (e.g., France has set a target rate of 9.5 Eurocents, or approximately 12.2 U.S. cents per minute, as the benchmark for 2006; the U.K. has set target rates between 5.6 and 6.3 pence, or approximately 10.5 - 11.8 U.S. cents per minute for 2005). USTR expects the current RegTP inquiry to either account for why mobile termination costs in Germany are

[1] See www.ntia.doc.gov/ntiahome/fccfilings/2003/ispfiling_08052003.htm

significantly higher than in many other countries with a CPP rate system, or to recommend a way to ensure that termination rates do not remain excessively high.

Switzerland

While several countries are actively reviewing the mobile termination issue, others remain reluctant to engage. Among major economies with particularly high rates and without regulatory measures in place, Switzerland stands out. While the regulator has attempted to intervene, it has been constrained by legal challenges by the incumbent mobile operator, Swisscom. Recently, however, Switzerland's competition authority has indicated a willingness to address mobile termination issues, and USTR will be following any future developments closely.

Mexico

USTR remains concerned about situations where action by the regulator has the potential to result in a rate increase in the mobile termination market. In Mexico, COFETEL has introduced a proposal to switch from a receiving party pays (RPP) to a CPP rate system for long-distance calls. While regulators have the discretion to choose between RPP and CPP rate systems, the United States has an interest in ensuring that this choice does not result in excessive interconnection rates. COFETEL has asserted that in the event that its proposed switch is adopted, and negotiations between fixed and mobile carriers fail, it would be prepared to intervene and set a cost-oriented interconnection rate. COFETEL reports that it is developing a cost-model for this purpose.

Due to the long lead time required for inter-carrier negotiations and any COFETEL intervention, the charges that may result from COFETEL's proposal to switch to a CPP rate system, if accepted, would likely remain unknown until the late summer or fall of 2005. If a CPP rate system is instituted in Mexico, new termination charges could result in tens of millions of dollars being added to the price that U.S. phone operators and consumers will pay to call mobile phones in Mexico. Accordingly, USTR will monitor these developments closely and continue its engagement with Mexican authorities to ensure that any adverse impact of such a change would be minimized.

Peru

Peru's regulator, Osiptel, is currently reviewing allegations that mobile termination charges in the country, among the highest in the world, are excessive. It is working on a proposal to establish new rates based on a cost-model; Osiptel will incorporate the cost data provided by mobile operators into its proposal. USTR is encouraged that such a review is under way and that Osiptel has stated that a new cost-oriented rate will be established by June of this year. However, given past delays and the effective exercise of pressure by the dominant carrier, Telefónica Móviles S.A.C., USTR remains concerned about the outcome of this decision and its impact on the wireless market in Peru.

Telefonica's mobile affiliates operate in a number of countries in Latin America where mobile termination rates are much lower than the rate its mobile affiliate charges in Peru. Unless there are dramatic differences in the cost structure of the Peruvian market compared to other Latin American markets, the rates for terminating calls on a mobile network should not have such wide disparities. USTR expects Osiptel's decision to either remedy or account for such wide disparities, and also expects Osiptel to address pricing schemes that appear to favor Telefonica at the expense of smaller competitors.

Based on Osiptel's decision, USTR will decide in June 2005 whether additional action may be warranted on this issue.

Japan

NTT DoCoMo has long been subject to criticism for the excessive level of its mobile interconnection rates, currently about 11 to 13 cents per minute, depending on the point of interconnection. These rates represent a 3 percent annual decrease and follow last year's 4 percent cut, which shows a slowing rate of change that may soon put Japan's rates well above most OECD levels. These rates are already three times the level of its neighbor, Korea. The Ministry of Internal Affairs and Communications (MIC), Japan's regulator, previously determined that NTT DoCoMo is a dominant carrier and is currently reviewing the status of competition in the mobile market, setting the groundwork for possible remedies for this sector.

USTR continues to urge MIC to take a more active role in analyzing what a reasonable interconnection rate would be so as to provide NTT DoCoMo with a clearer long-term glidepath towards competitive levels.

2. Restrictions on Access to Leased Lines and to Submarine Cable Capacity

Another issue that has been highlighted in the past, and which, despite increased regulatory action, continues to hamper effective market access is access to and use of leased lines and submarine cable capacity. 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 these lines are offered is potentially discriminatory.

Germany

While Germany's regulator, RegTP, has taken a number of actions in recent years to improve access to leased lines, complaints have persisted, including that Deutsche Telekom (DTAG) refuses to guarantee provisioning times in private contracts. While provisioning times overall have shown improvement in recent years, what remains a concern is whether RegTP, under the new telecommunications law, will have at its disposal the tools and enforcement powers necessary to control potentially abusive practices by DTAG.

Commenters cited DTAG's unwillingness to offer competitors access to specific leased line products it uses itself – in particular, partial private circuits and ISDN lines. Lack of such options was cited as a key means that DTAG has employed to raise competitors' costs. To its credit, RegTP ultimately did require DTAG to offer ISDN lines, but the fact that DTAG would even consider refusing to offer a competitor a tariffed public service is troubling. Lack of access to partial private circuits is an issue USTR will continue to review, especially in light of Germany's obligation to ensure non-discriminatory access to and use of public telecommunication networks and services.

In January 2005, the EC recommended that national regulatory authorities mandate delivery deadlines. We view this as a positive development that may prompt the German government to address persistent allegations that the incumbent is engaging in unreasonable and discriminatory practices in the provision of leased lines.

India

Last year, USTR noted marginal progress by India in resolving a complaint related to access to and use of submarine cable capacity. Unfortunately, problems persist based on the continued control by India's dominant international operator, VSNL, over access to all but one submarine cable landing station in India. Commenters argue that VSNL's persistent refusal to permit interconnection at its cable landing stations, and its failure to activate additional capacity on these cables, result in artificial shortages of bandwidth into and out of India and inflate prices, hampering the provision of robust global telecommunications services.

USTR expects more vigorous oversight by the Indian regulatory body, TRAI, and the Government of India to ensure access to and use of submarine cable capacity through facilities now dominated by VSNL. In conjunction with encouraging immediate measures to improve access to the Indian telecommunications market, USTR will continue to urge the Government of India to make more meaningful commitments in the new round of WTO negotiations to reflect the openness that VSNL benefits from in markets around the world.

Singapore

Commenters allege that Singtel is severely limiting the options competitors can employ to reach end-users by requiring them either to purchase a bundled service that is more than they need or to assemble network elements in an inefficient manner. Singapore's regulator, IDA, is currently reviewing whether Singtel should be required to offer more efficient arrangements for accessing leased capacity. USTR will continue to closely monitor this issue.

3. Excessive Regulatory Requirements, Including Licensing Fees

One group of market access barriers that has emerged in recent years, and is highlighted in this year's Review, are excessive regulatory requirements, in particular high licensing fees, high capitalization requirements, restrictions on resale and restrictions on the entities with whom a foreign licensee can partner.

Article VI of the GATS (Domestic Regulation) requires that, in sectors where specific service commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. Furthermore, Members must ensure that measures relating to qualification requirements and procedures, technical standards, and licensing requirements are not more burdensome than necessary to ensure the quality of service, and in the case of licensing procedures, are not in themselves a restriction on the supply of a service.

India

Recent announcements that India plans to increase the permitted level of foreign direct investment in its telecom sector to 74 percent are a welcome development. Undermining this liberalizing step, however, is India's decision to charge a licensing fee of US $5.7 million for international licenses, to impose build-out requirements, and to assess annual fees based on revenues earned. None of these requirements seem justified in light of the strength of India's own international operators and the market access these operators enjoy in other markets. Such requirements, by design or effect, only serve to restrict competitive entry. We look to India to reform its licensing regime in a manner more conducive to promoting new entry, investment and competition.

Colombia

Colombia imposes a licensing fee for long distance service suppliers of $150 million. The result of this policy has been limited market entry and rampant grey market bypass of authorized operators. We expect to see Colombia commit to a more rational licensing regime in the U.S.-Andean Free Trade Agreement (FTA).

China

USTR has serious concerns regarding licensing requirements maintained by China that severely restrict the ability of U.S. telecommunications companies to compete in the Chinese marketplace. USTR urges China to take steps as soon as possible to: (a) eliminate burdensome capitalization requirements; (b) specifically authorize the offering of basic services on a purely resale basis; and (c) eliminate restrictions on the entities with whom a foreign licensee can partner. USTR looks forward to seeing China use the development and implementation of its new telecommunications law to address these issues.

<u>Capitalization Requirements</u>: In order to obtain a nationwide license to provide basic telecommunications services, China requires applicants to have a domestic capitalization of approximately $240 million. Chinese officials have been unable to articulate an acceptable justification for this hefty capitalization requirement. While the desire to ensure that providers are financially sound is a reasonable goal, there is no evidence that a capitalization requirement of $240 million is necessary to accomplish this objective. USTR is unaware of any other country that imposes such an excessive requirement. Given that foreign joint venture partners are likely to be well-capitalized multinational companies, setting a China-specific capitalization requirement appears to be designed to limit market entry rather than to protect consumers' interests. China's acknowledgement that it wants to prevent the entry of an "excessive" number of operators suggests that this requirement may be functioning as an economic needs test.

<u>Resale-based Services</u>: Although China's regulations do not appear to prevent resale explicitly, MII policy, which includes the failure to provide specific resale licenses, appears to exclude it.

On a more practical level, the capitalization requirement for basic telecommunications providers is incompatible with a resale-based business model, which is premised on low-cost market entry. Given China's WTO commitment to permit resale, USTR has and will continue to urge China to fully open this market segment.

Choice of Partner: MII, as a "matter of policy," limits potential basic service licenses to foreign entities willing to partner with one of China's six incumbent operators. Foreign firms chafe at this restriction, since it strictly limits the scope of potential partners and inevitably means partnering with an entity whose parent is also a competitor. China included no such limitation in its WTO commitments, and should revise this policy to permit foreign investors free choice of partners.

4. Burdensome Testing and Certification Requirements

Commenters complained about burdensome testing requirements for telecommunications equipment in Korea and Mexico in this year's Review. USTR urges Mexico to minimize the burdens associated with any new testing requirements for terminal equipment and not introduce any such requirements until it has adopted procedures that permit testing to be conducted in the United States or Canada. Korea has stated that it would implement the first phase of APEC's telecommunications MRA, which will permit testing to be performed in countries with whom Korea establishes bilateral arrangements. USTR intends to continue to pursue bilateral negotiations with Korea to secure its participation in the first phase of the APEC MRA with the United States.

5. Limitations on Technology Choices

A growing concern for U.S. telecommunications companies is governmental mandates of certain technical standards in relation to telecommunications services and equipment that limit companies' choice of technologies and that could serve as market access barriers for U.S. companies.

China

By the end of this year, MII is expected to announce terms and conditions for new mobile wireless licenses in the 2 GHz band. Despite MII's repeated assurances that it will award licenses on a technology-neutral basis, there is widespread concern that MII will reserve up to two of the likely four licenses for China's home-grown 3G standard, TD-SCDMA. USTR continues to urge China to leave technology choice decisions to operators and not use these decisions as an opportunity to exercise protectionist industrial policy.

Korea

Korea's regulator, the Ministry of Information and Communications (MIC), recently awarded three licenses for a broadband wireless service ("WiBro") and established a requirement that all licensees use a single standard selected by the Korean Government. This has had the effect of limiting the scope of technology that can be marketed in Korea, thus limiting licensee and consumer choice, as well as the ability of U.S. and other firms with proven technologies to compete in this dynamic market. The Korean Government decided to mandate an international standard currently under development (IEEE's 802.16 standard), rather than require use of an indigenous standard for this service. While broadening the scope of eligible technologies is a step forward, the larger issue of allowing all companies, foreign and domestic, access to the Korean telecommunications market remains unaddressed. Further, since the IEEE standard is incomplete, it is unclear if and how Korea will implement the IEEE standard and how it will handle conformity assessment issues before the standard is finalized.

Moving forward, the U.S. Government will continue to urge Korea to fully implement its stated policy of supporting the development and use of international, voluntary standards that are applied in a flexible and technology-neutral manner, and do not serve as barriers to U.S. telecommunications technologies entering the Korean market.

6. Additional Issues

Mexico

One additional concern related to Mexico was raised in this year's Review: persistently high "off-net" interconnection charges by Telmex (charges for calls to regions not yet open to competition are up to six times the level of other interconnection rates in Mexico). USTR urges Mexico's regulator, COFETEL, to re-examine whether such charges are consistent with a cost-oriented standard.

Japan

Commenters raised two additional issues of concern related to the Japanese telecommunications market: unjustified wireline interconnection rate increases proposed by NTT East and West, and a lack of transparency in the allocation of new frequencies to mobile wireless providers. USTR urges Japan to: (1) accelerate steps to bring wireline interconnection rates down to competitive levels, and (2) implement plans to assign new spectrum with a priority on substantially increasing competition in this concentrated market segment and improving the transparency and impartiality of the spectrum assignment process.

<u>Wireline Interconnection</u>: NTT East and West recently filed tariffs with Japan's regulatory authority, MIC, resulting in a substantial increase in interconnection rates – on the order of 3 to 15 percent, depending on the network point of interconnection. This is the third year in a row that rates have increased – unheard of in any other OECD country. Significantly, while NTT has been increasing the rates it charges interconnecting networks, it has not increased any of its retail rates, increasing the danger of an exclusionary price squeeze.

USTR has long argued that it is inefficient to recover non-traffic sensitive costs from per-minute interconnection charges and that such costs should be absorbed directly by the subscribers' network, not interconnecting networks. MIC has agreed to eliminate non-traffic sensitive costs from per-minute interconnection charges, but has allowed NTT five years to do so, starting in

2005. USTR urges Japan to accelerate this transition, and at the same time, take steps to ensure that NTT is not engaging in price squeeze behavior.

Non-Transparent, Discriminatory Allocation of Spectrum: Aspiring new entrants in the mobile wireless sector in Japan have been pressuring MIC for years to make more spectrum available. MIC identified new spectrum last fall (1.7 GHz). Certain carriers are also interested in accessing spectrum in the 800MHz band that will be freed up as a result of MIC's reorganization of that band.

The process of authorizing the 1.7 MHz band has not been completed but is expected to be done by the end of the year. Nevertheless, it is still unclear what basis MIC will use to determine how many and which carriers will be eligible to apply for this spectrum.

USTR remains concerned about how spectrum authorization in the 800 MHZ band has been addressed and its implications for future spectrum authorization. A request to use underutilized spectrum in the 800 MHZ band was rejected last year for unclear reasons and only after the carrier filed a lawsuit was a more transparent process instituted. In February of this year, MIC again rejected a proposal to make a portion of this band available based on the incumbents' assertion that they will need the spectrum during the entire scheduled reorganization of the band (i.e., until 2012). If a significant amount of spectrum in this band is freed up sooner, even if the entire reorganization is not complete, Japan should certainly consider ways to ensure that competitors have the opportunity to put it to productive use.

Given the high concentration of Japan's mobile wireless market (market shares of the three operators are 56 percent, 26 percent and 18 percent, respectively), USTR urges MIC to put a priority on encouraging new entrants, rather than supplementing spectrum resources of incumbents who have yet to exhaust their assigmnents. USTR urges MIC to promote additional competition and ensure that any new assignments are conducted in a transparent and impartial manner, consistent with Japan's WTO obligations.