

Mexico – Measures Affecting Telecommunications Services

(WT/DS204)

Answers of the United States to the Panel's Questions to the Parties at the Second Meeting

March 27, 2003

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2. (a) What is a “facilities based public telecommunications network”? Please elaborate by referring to relevant regulations. Are there public telecommunications networks that are not “facilities based”?

1. As discussed in paragraphs 50-58 of the United States’ First Written Submission, Mexico chose to inscribe its basic telecommunications commitments based on whether the service supplier owns telecommunications facilities (“facilities-based,” under the chapeau to Sector 2.C.), or instead leases such facilities from another operator (“commercial agencies,” under “(o) other”).

2. The WTO’s glossary of terms defines a facilities-based operator as “[a] telecommunications service provider owning, as opposed to leasing, networks used to provide telecommunications services.”¹ U.S. companies that interconnect with Telmex use their own facilities-based networks in the United States to offer voice telephony services (subparagraph “a”), circuit-switched data transmission services (subparagraph “c”) and facsimile services (subparagraph “f”). These U.S. companies therefore qualify as providing “services supplied by a facilities based public telecommunications network.”

3. Mexico’s Schedule covers “non-facilities-based” suppliers under the entry in subparagraph “o” for “commercial agencies,” a term defined in footnote 4 to mean “[a]gencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire.”

(b) When are telecommunications services supplied “by” a facilities based public network? Do you consider that the term “por” in the Spanish version of the sector inscription in Mexico’s schedule is closer in meaning to the English “through” than to “by”?

4. As discussed above, “services supplied by a facilities-based public telecommunications network” are services supplied by service suppliers that own their own telecommunications facilities. U.S. companies such as AT&T, WorldCom and Sprint, for example, use their own networks in the United States to offer services covered under subparagraphs a, c and d of Mexico’s Schedule between the United States and Mexico.

5. The term “*por*” can be translated as either “through” or “by.” The United States notes that term “*por*” is sometimes also translated as “in” (under the mode 4 inscriptions in Mexico’s Schedule). The United States also notes that in sector 2.C. in the sector column of Mexico’s Schedule, and in the routing restriction in the market access column, the word “through” is used

¹ See http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel12_e.htm.

as a translation for “*a través de*.” In any event, under the United States’ interpretation, the distinction between “through” and “by” is not important. Regardless of whether “*por*” should be translated “through” or “by”, “services supplied” *por* “a facilities-based public telecommunications network” would in either case refer to U.S. companies that use their own networks in the United States to offer covered services between the United States and Mexico.

- (c) **What does the phrase “by a facilities based public telecommunications network” add to the sector inscription in Mexico’s schedule? Without these words in the sector column, what other forms of supplying services would be allowed?**

6. As discussed above, Mexico’s inclusion of this phrase enabled it to divide its commitments based on whether the service supplier owns telecommunications facilities (“facilities-based”), or instead leases such facilities from another operator (“commercial agencies”). Without this phrase in the sector column, Mexico’s commitments would have applied without regard to whether, for example, a U.S. service supplier uses its own network in the United States to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico’s Schedule between the United States and Mexico, or instead leases capacity from another operator in the United States to provide those services.

- (d) **Is there a difference in meaning between the term “infraestructura” in the first column of Mexico’s schedule and “instalaciones” in the second column (both translated as “facilities”)? Does Mexican law or regulations define these terms?**

7. The United States is aware of no difference in meaning relevant to the issues in this dispute. The United States is also not aware of any provision of Mexican law or regulations that defines these terms.

3. (a) **Does the reference to a “facilities based” network imply that the supplier must own or operate the “facilities based” network? Please elaborate by referring to relevant regulations.**

8. As discussed above, Mexico chose to inscribe its basic telecommunications commitments based on whether the service supplier owns telecommunications facilities (“facilities-based”), or instead leases such facilities from another operator (“commercial agencies”). The “facilities based” requirement does appear to imply that the supplier must own or operate the “facilities based” network. For this reason, the term extends to a U.S. service supplier that uses its own network in the United States to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico’s Schedule between the United States and Mexico.

9. Mexican law and regulations are not relevant to the interpretation of this phrase. Mexico's Schedule must instead be interpreted according to the rules of interpretation reflected in the *Vienna Convention*. As reinforced by a Secretariat Explanatory Note, if a Member wanted domestic law or regulations to serve as limitations, it was to have specified as much in its Schedule.² Mexico made no such reference in its Schedule.

(b) Must the supplier use this network for the transaction in question? Please elaborate by referring to relevant regulations.

10. In inscribing its basic telecommunications commitments based on whether the service supplier owns telecommunications facilities ("facilities-based"), or instead leases such facilities from another operator ("commercial agencies"), Mexico's Schedule does not specify whether the supplier must actually use the facilities-based or non-facilities-based network to supply a particular transaction. As a practical matter, a U.S. facilities-based service supplier that owns its own network in the United States will normally use that network to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico's Schedule between the United States and Mexico. A U.S. non-facilities-based service supplier that leases facilities from another operator in the United States will use that leased capacity to offer services between the United States and Mexico.

11. As noted above, Mexican law and regulations are not relevant to the interpretation of Mexico's Schedule, which must instead be interpreted according to the rules of interpretation reflected in the *Vienna Convention*.

(c) If so, does the supplier have to supply through its network(s) the entire service, or is it sufficient that it supplies through its network for a portion of the transmission service? Please elaborate by referring to relevant regulations, and consider the following scenarios: the cross-border service is supplied over a facilities-based network

- (i) on all segments of the transmission service, and on both sides of the border,**
- (ii) on any segment of the transmission service, and on either side of the border,**
- (iii) on the *originating* side of the border only,**
- (iv) on the *terminating* side of the border only.**

12. As stated in response to question 3(b), a U.S. facilities-based service supplier that owns its own network in the United States will as a practical matter normally use that network on the U.S. side of the border to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico's Schedule between the United States and Mexico. As previously explained, Mexico inscribed a routing requirement under mode 1 (cross-border) for both facilities-based operators

² MTN.GNS/W/164/Add.1, para. 8; MTN.GNS/W/164, para. 25.

and commercial agencies. (It is important to recall that there is no permit requirement inscribed under mode 1 for commercial agencies in contrast to mode 3 commercial agencies). Thus, for the cross-border supply of a service, Mexico simply requires that international traffic on the Mexican side of the border be routed “through the facilities of” a concessionaire. Thus, both a facilities-based supplier and a commercial agency can either use the entirety of a Mexican operator’s network by interconnecting at the border or may lease a private line from a Mexican concessionaire to provide its service into Mexico. Both are consistent with the requirement to route “through the facilities of” a Mexican concessionaire.

13. Thus, with respect to the Panel’s specific reference to a facilities-based supplier offering a service on a cross-border basis, Mexico’s Schedule:

- allows Mexico to prohibit scenarios (i) and (ii) on the Mexican side of the border;
- envisions scenarios (i) and (ii) on the U.S. side of the border;
- envisions scenario (iii);
- allows Mexico to prohibit scenario (iv).

14. Once again, the United States emphasizes that Mexican law and regulations are not relevant to the interpretation of Mexico’s Schedule because they are not referenced in the Schedule under the modes of supply and service sectors at issue in this dispute (*i.e.*, mode 1 for facilities-based suppliers and commercial agencies, and mode 3 for commercial agencies). Mexico’s Schedule must instead be interpreted according to the rules of interpretation reflected in the *Vienna Convention*.

- (d) Does a supplier who owns facilities but leases private circuits for part of the transmission still supply services through a “facilities based public telecommunications network”? Please elaborate by referring to relevant regulations.**

15. As a practical matter, a U.S. facilities-based service supplier that owns its own network in the United States will use that network on the U.S. side of the border to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico’s Schedule between the United States and Mexico. As noted above, however, Mexico’s Schedule does not require that a U.S. facilities-based supplier actually use its facilities-based network to supply those services for any given transaction – the supplier may on occasion use private circuits on the U.S. side of the border to supply those services.

16. Since Mexico prohibits a U.S. service supplier that owns its own network in the United States from also owning its own network in Mexico (by virtue of the mode 3 market access

limitations included in Mexico's Schedule), the service supplier will be obliged to use a Mexican operator's network to offer the services inscribed in subparagraphs (a), (c) and (f) of Mexico's Schedule on the Mexican side of the border. As the United States has demonstrated in previous submissions, the mode 1 routing restriction included in the market access column of Mexico's Schedule requires that the U.S. supplier route international traffic "through the facilities of an enterprise that has a concession . . ." The term "facilities" embraces a variety of means that might be used to terminate cross-border traffic, including private leased circuits.

6. What, in your view, would be the legal significance of the routing restriction, in the absence of any mode 3 limitations in Mexico's schedule? Under this hypothesis, which subparagraph of Article XVI:2 of the GATS would the routing restriction fit under?

17. With or without the mode 3 limitations contained in Mexico's Schedule, the routing requirement has no legal significance under Article XVI:2. As the United States has discussed elsewhere, a routing requirement is not a market access limitation, since it is not one of the limitations listed in Article XVI:2 of the GATS. As the Secretariat's Explanatory Note states, "a Member grants full market access in a given sector and mode of supply when it does not maintain in that sector and mode any of the types of measures listed in Article XVI."³ This is not to say that the routing requirement is not valid as a domestic regulation, although Mexico could have maintained the requirement without scheduling it.

18. Thus, with or without the mode 3 limitations contained in Mexico's Schedule, the routing requirement inscribed as a mode 1 limitation would, under its ordinary meaning, simply require foreign suppliers to route international traffic "through the facilities of" a Mexican concessionaire. This is precisely how U.S. suppliers complete (and completed, before Mexico's WTO obligations entered into force) calls into Mexico – by "rout[ing] through the facilities of an enterprise that has a concession . . ."

8. Mexico's commitments relating to commercial agencies – under "(o) other" – appear to be subordinated to the chapeau of its entry on telecommunications services. Please explain this relationship.

19. As discussed in response to questions 2 and 3, Mexico chose to inscribe its basic telecommunications commitments based on whether the service supplier owns telecommunications facilities ("facilities-based," under the chapeau to Sector 2.C.) or leases such facilities from another operator ("commercial agencies," under "(o) other"). U.S. service suppliers use their own facilities-based networks in the United States to offer the services described in subparagraphs (a), (c) and (f). With the exception of "commercial agencies," U.S. service suppliers also use their own facilities-based networks in the United States to offer the services described in subparagraph (o) – "paging services" and "cellular telephone services."

³ MTN.GNS/W/164, para. 4.

Footnote 4 to Mexico's Schedule provides a more specific definition for "commercial agencies" that modifies the chapeau. Footnote 4 and Mexico's "commercial agencies" commitment applies to U.S. service suppliers that offer the services described in subparagraphs (a), (c), (f) and (o) over capacity leased from a facilities-based operator in Mexico.

10. Please explain exactly what forms of access to a supplier of telecommunication transport networks and services (TNNS) constitute "interconnection" and what forms of access do not.

20. Section 2.1 of the Reference Paper defines interconnection broadly to include "linking . . . to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier." In the United States' view, this definition does not *per se* exclude any particular "form of access." We note that Section 2 of the Reference Paper applies only to interconnection with a "major supplier" and on the basis of specific commitments undertaken (which is not limited to mode 3).

11. The phrases "technically feasible point in the network" and "network termination points" are used in section 2.2 of the Reference Paper. Are these terms, or terms that you consider to be substantively equivalent, defined or otherwise reflected in your domestic regulations? If so, please provide the relevant texts.

21. FCC regulations require incumbent local exchange carriers to provide interconnection at "any technically feasible point" within their networks, "including, at a minimum (i) The line-side of a local switch; (ii) The trunk-side of a local switch; (iii) The trunk interconnection points for a tandem switch; (iv) Central office cross-connect points; (v) Out-of-office signaling transfer points necessary to exchange traffic at these points and access call-related databases; and (vi) The points of access to unbundled network elements as described in Section 51.319."⁴

22. The regulations also provide that "[p]revious successful interconnection at a particular point in a network, using particular facilities, constitutes substantial evidence that interconnection is technically feasible at that point, or at substantially similar points, in networks employing substantially similar facilities. Adherence to the same interface or protocol standards shall constitute evidence of the substantial similarity of network facilities."⁵ Additionally, local exchange carriers are required to provide "meet-point" interconnection arrangements, under which "each telecommunications carrier builds and maintains its network to a meet point."⁶

⁴ 47 C.F.R. § 51.305(a). These requirements apply "[f]or the transmission and routing of telephone exchange traffic, exchange access traffic or both." *Id.*, Section 51.305 (a)(1). They do not apply to "interconnection solely for the purpose of originating or terminating . . . interexchange traffic on an incumbent [local exchange carrier's] network." *Id.*, Section 51.305(b).

⁵ *Id.*, Section 51.305(c).

⁶ *Id.*, Section 51.5. *See also* U.S. February 5 Responses to Questions from the Panel, para. 49.

FCC regulations also require incumbent local exchange carriers to provide interconnection arrangements at central offices and other points to all interested parties for the origination and termination of interexchange traffic, which includes interexchange traffic supplied on a cross-border basis.⁷ Such interconnection is required in “central offices that are classified as end offices or serving wire centers,” as well as at certain tandem offices and remote nodes/switches.⁸ Incumbent local exchange carriers are also required to offer collocation arrangements in central offices, with designated “interconnection points” for the circuits of interconnecting carriers.⁹

23. A wide variety of interconnection arrangements providing U.S. nationwide termination also are available with U.S. long-distance and international carriers at various points in their networks. Because none of these U.S. carriers possess market power, these interconnection arrangements are not specified by FCC regulation and are available on market-based terms and conditions. Under these arrangements, cross-border suppliers may interconnect with U.S. international carriers at any mutually agreed network point.

24. The cross-border suppliers that may use these market-based arrangements are carriers that do not possess market power at the foreign end of the international route,¹⁰ and carriers with market power at the foreign end of the international route on 87 routes authorized for ISR or on which the FCC International Settlements Policy has been removed.¹¹

12. Is there a margin for an adequate rate of return that can be interpreted into the terms “cost-oriented rates that are . . . reasonable.” If so, what would be an adequate margin of return. Please provide examples.

25. As explained in paragraph 75 of the United States' February 5 responses to questions from the Panel, Mexico has stated that its interconnection rates “are meant to allow the supplier to recover long term total incremental costs as well as the imputable common costs.”¹² Thus, the

⁷ 47 C.F.R. § 64.1401.

⁸ *Id.*, Section 64.101(b).

⁹ *Id.*, Section 64.101(f).

¹⁰ FCC 99-73, FCC Report and Order on Reconsideration (released May 6, 1999), para. 36, available at http://www.fcc.gov/Bureaus/International/News_Releases/1999/nrin9016.html (In a Section Captioned “Removal of the ISP and filing requirements,” the FCC stated that it “will remove the ISP for arrangements with foreign carriers that lack market power in all foreign markets.”). *See also* 47 C.F.R. Section 63.22(e)(1)-(2); 63.23 (d)(1)-(2) (requiring *no* authorization for ISR arrangements with “a foreign carrier that lacks market power in the country at the foreign end of the private line.”).

¹¹ *See* <http://www.fcc.gov/ib/pd/pf/isr.html> (listing 83 countries authorized for ISR arrangements with foreign dominant carriers); http://www.fcc.gov/ib/pd/pf/isp_exempt.html (listing four additional routes on which the International Settlements Policy has been removed). *See also* FCC, Consolidated Accounting Rates of the United States (January 6, 2003), Note 11, <http://www.fcc.gov/ib/pd/pf/account.html> (“ISR allows U.S. carriers to enter agreements with foreign carriers that can differ from traditional settlement arrangements prescribed by the Commission’s International settlements Policy (ISP).”).

¹² *Access Pricing (with a focus on telecommunications)*, Submission of Mexico to OECD Working Party No. 2 on Competition and Regulation, DAFFE/CLP/WP2/WD(2001)33 (October 5, 2001), pg. 3 (Exhibit US-65).

analysis set out by the United States at paragraphs 121-140 of its First Written Submission showing that Mexico's interconnection rates are not "*basadas en costos*" takes account of *all* relevant costs, including a reasonable rate of return. Because the term "long run" in a long run incremental cost methodology refers to a period long enough so that all costs become variable, Mexico's long run average incremental cost methodology necessarily includes the cost of capital to finance interconnection facilities, which includes a reasonable rate of return.

26. The United States has demonstrated that under Mexican law, interconnection rates for commercially-present suppliers must recover at least the total cost of all network elements.¹³ Once again, the term used for "total cost" in Mexican law is "long term average incremental cost," which includes a reasonable rate of return. Therefore, under the cost standard that Mexico has built into its own law, carriers are to charge rates that recover "at least" all their costs, including a reasonable rate of return. The United States has demonstrated, however, that interconnection rates charged by Telmex substantially exceed the prices charged for the same elements of interconnection sold domestically. Under Mexican law, those prices already recover cost, including a reasonable rate of return. Mexico has made no attempt to show that Telmex's current prices do not include a reasonable rate of return, or that there are additional costs associated with international interconnection.

13. (US) Does cost-oriented pricing allow for flexibility in implementing national goals, as Mexico appears to argue in paragraphs 188-192 of Mexico's Responses to Questions?

27. No. Cost-oriented pricing, as that term is used in Section 2 of the Reference Paper, does not permit Mexico so-called "flexibility" to implement the national goals that Mexico identified in its submission. The provisions on interconnection serve to achieve the requirement to which all Members that subscribed to the Reference Paper committed, namely, to ensure that the scope of all interconnection charges is limited to the specific network components and facilities required for the interconnection service provided, and not other unrelated costs.

28. The terms "*basadas en costos*" and "cost-oriented" require a relationship between interconnection rates and the cost incurred in providing *interconnection*, rather than costs incurred in connection with infrastructure development or other social policy goals. The WTO website defines "cost-based pricing" as "the general principle of charging for services in relation to the cost of providing *these services*."¹⁴ Furthermore, Section 2.2(b) of Mexico's Reference Paper requires that a supplier purchasing interconnection "need not pay for network components or facilities that it does not require for the [interconnection] service to be provided." This language provides relevant context for the interpretation of "*basadas en costos*," and makes clear that the scope of all interconnection charges is limited to the specific network components and facilities required for the interconnection service provided, and not other unrelated costs. By claiming that "accounting rate revenues remain an important source of potential revenue for

¹³ 1995 Federal Telecommunications Law, Article 62 (Exhibit US-16).

¹⁴ See http://www.wto.org/english/tratop_e/serv_e/telecom_e/te112_e.htm (emphasis added).

infrastructure development,”¹⁵ Mexico effectively concedes that its international interconnection rates recover more than the cost of the “network components or facilities . . . require[d] for service to be provided” to U.S. suppliers.

29. Mexico may meet its other national goals, unrelated to interconnection, in a variety of ways. For example, Mexico could put in place a universal service obligation, under Section 3 of the Reference Paper. We are aware of no such obligation implemented by the Mexican authorities (and Mexico acknowledges in paragraph 84 of its oral statement to the second meeting of the Panel that it has not implemented such an obligation with respect to foreign carriers). However, the recovery of universal service subsidies through inflated interconnection charges paid to the major supplier would be contrary to the Section 3 requirement that universal service obligations be “administered in a transparent, non-discriminatory and competitively-neutral manner . . .” Such recovery would not be transparent, because universal service obligations would be hidden in interconnection rates paid to the major supplier. Nor would it adhere to the requirements for non-discrimination and competitive neutrality, because it would burden only those suppliers purchasing interconnection with the funding of universal service obligations.

14. How do Mexico’s considerations on elements to be included in the establishment of cost-oriented rates relate to its obligations under Section 3 of its Reference Paper?

30. Please see the United States’ response to questions 13 and 23(b).

17. In considering the commercial, contractual, technical, and regulatory differences between an accounting rate regime and an interconnection regime, which you described in your responses to our questions following the First Panel Meeting, could you please identify those elements in each regime that *can never be* elements of the other regime?

31. As explained in detail in the United States’ February 5 response to question 8 from the Panel, under the definition included in Section 2.1 of Mexico’s Reference Paper, the “linking” accomplished *via* the accounting rate regime is just one form of “interconnection.” As a result, there is no element of an “accounting rate regime” that cannot also be an element of an “interconnection regime.” Any commercial, contractual, technical or regulatory differences between various types of interconnection arrangements, including accounting rate arrangements, fall under the broad definition included in Section 2.1.

18. (US) Mexico introduced as evidence the text of an early draft of the Reference Paper that contained a separate provision on accounting rates. This provision would have required that a Member be willing to “justify why an international accounting rate differs significantly from domestic interconnection rates”. Mexico claims that this provision was eliminated because negotiators were unwilling to take on any disciplines with respect to

¹⁵ Mexico Second Written Submission, para. 95.

accounting rates in the context of the Reference Paper. Why was this provision of the Reference Paper eliminated?

32. We note that there is no negotiating history that answers the Panel's question. The Panel must look to the text of the Reference Paper to determine its scope. Notwithstanding, the United States considers that the above-mentioned provision was not eliminated "because negotiators were unwilling to take on any disciplines with respect to accounting rates in the context of the Reference Paper." Rather, the provision may have been deleted because negotiators may have felt that it was unnecessary in light of the broad definition of interconnection set forth by the Reference Paper and the requirement of Section 2.2 of the Reference Paper for cost-oriented interconnection rates and reasonable terms. Similarly, those Members that deleted the requirement for cost-oriented rates and reasonable terms from the versions of the Reference Paper inscribed in their Schedules may have been equally unwilling to undertake this commitment.

33. Additionally, this deleted provision would have required "*any supplier of public telecommunications transport networks*"¹⁶ to provide for "public review" of its accounting rates with foreign correspondents, rather than just the major suppliers subject to the final version of the Reference Paper. Members may have felt that it was unnecessary to regulate other suppliers in this way.

19. (US) Mexico states in paragraph 146 of its Responses to Questions that it "is not aware that the United States or any other country among the 55 has explicitly attempted to subject accounting rate arrangements to the obligations of Section 2.2(b)."

- (a) Does the United States share Mexico's belief that most or all of the Members that have accepted Section 2.2(b) Reference Paper commitments also tolerate, or require, non-cost-based "accounting rate arrangements" with carriers in other countries?**

34. No. The United States is aware of no Member, other than Mexico, that has accepted commitments under Section 2.2(b) of the Reference Paper and that has simultaneously imposed an explicit prohibition on competition between suppliers providing interconnection to cross-border suppliers, the effect of which is to prevent competition from reducing rates. Even if other WTO Members do not have explicit requirements for settlement rates to be cost-based, they also do not have restrictions, such as those maintained by Mexico, on competition between suppliers. Those other Members therefore can reasonably rely on competitive market dynamics to yield cost-based settlement rates.¹⁷ As shown by the United States in our earlier submissions, for numerous countries where competitive conditions are allowed to govern international

¹⁶ Emphasis added.

¹⁷ See U.S. Oral Statement at the Second Meeting of the Panel, para. 57.

interconnection rate negotiations, U.S. carriers have negotiated rates for traffic termination in the range of 1.5 to 4 cents per minute.¹⁸

35. Additionally, the United States has submitted evidence at paragraph 146 of its First Written Submission showing one major operator's wholesale rates to terminate calls to various countries, including six EC Member States and eighteen other WTO Members that included the interconnection commitments under Section 2.2(b) of the Reference Paper. All of those rates are lower than the current average rate Telmex charges U.S. suppliers, and many are below 2 cents per minute.¹⁹ Mexico has challenged none of this evidence. To the extent that any WTO Member does not fulfill its obligations under Section 2.2(b) of the Reference Paper, other WTO Members have the right to challenge that failure in dispute settlement.

(b) What, for example, is the situation in the United States in this respect? In particular, what is the relevance of the Benchmarks Order referred to in para 196 of Mexico's Responses to Questions?

36. The FCC benchmark rates have no relevance to this dispute. Mexico mischaracterizes the FCC Benchmarks Order as establishing whether Telmex rates are "sufficiently cost-based" to satisfy Mexico's Reference Paper obligations. In establishing its benchmarks in 1997, the FCC emphasized that the benchmark rates "continue to exceed, usually substantially, any reasonable estimate of the level of foreign carriers' relevant costs of providing international termination services."²⁰ The benchmark rates were lower than the settlement rates charged at that time by many foreign carriers, and were adopted to "place some discipline on a system of inflated settlements rates."²¹ However, the FCC made clear that the benchmark rates "still exceed foreign carriers' costs to terminate international traffic because they are based primarily on foreign carriers' tariffed rates" in effect in 1996, and "include costs associated with providing retail communications services to consumers which would not be included in cost-based settlement rates."²²

37. Therefore, the United States does not consider that a major supplier that agrees to accept the maximum settlement rate from a U.S. carrier allowed by the FCC benchmarks is charging a cost-oriented rate in compliance with its obligations under the Reference Paper. As noted above, the FCC Benchmarks Order itself precludes any such finding.

(c) Do you consider that a "major" supplier, who negotiates and applies the maximum permissible settlement rate for a particular relation, is charging a

¹⁸ U.S. First Written Submission, para. 121.

¹⁹ *See id.* (U.S. suppliers have negotiated interconnection rates below 4 cents per minute in numerous countries where competitive conditions are allowed to govern rate negotiations).

²⁰ FCC *Benchmarks Order*, para. 19.

²¹ *Id.*, para. 69.

²² *Id.*, paras. 44, 70.

“cost-oriented” rate for international interconnection consistent with Reference Paper obligations?

38. Please see the United States' response to question 19(b).

(d) Does Section 2.2 of the Reference Paper require a Member to ensure that a “major” supplier charges cost-oriented international interconnection rates to all suppliers of international basic telecom services that wish to terminate traffic? Does the obligation in Section 2.2 in fact constrain any US supplier?

39. The United States agrees that Section 2.2 of the Reference Paper requires a Member to ensure that a major supplier charges cost-oriented international interconnection rates to all suppliers of international basic telecommunications services that wish to terminate traffic.

40. To the extent that a Member can establish that any U.S. supplier is a major supplier, Section 2.2 would apply. However, neither WorldCom nor AT&T are regulated as dominant or qualify as major suppliers under the Reference Paper. All U.S. carriers negotiate rates independently, and no U.S. carrier has the right to negotiate for the industry. Mexico's characterization of WorldCom as “dominant” in paragraph 296 and footnote 90 of its February 5th responses to questions from the Panel is no more accurate than its prior similar allegations regarding AT&T. WorldCom has never controlled bottleneck facilities, and the FCC specifically found in determining that AT&T was non-dominant in 1995 that AT&T had not controlled bottleneck facilities in more than ten years.²³

20. Is there currently any company other than Telmex that negotiates the settlement rate under ILD Rule 13?

41. No. Pursuant to ILD Rule 13, because Telmex has the largest share of out-going international calls, Telmex negotiates the settlement rate for every international route. Whether Telmex or another operator negotiates the settlement rate is not particularly important, however – the result is that Rule 13 gives the operator the ability to negotiate the settlement rate alone, unrestrained by competitive forces which gives that operator an incentive to negotiate the highest rate possible, and ignore the requirement in Section 2.2(b) to reach a rate that is “*basadas en costos*.”

21. Mexico states that its international settlement rates are consistent with the target rate recommended by ITU Study Group 3 for Mexico, in its Responses to Questions, paragraph 195. Please comment.

²³ *Motion of AT&T Corp. To Be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271, para. 70 (1995) (Exhibit US-61). In contrast, Telmex controls 97 percent of market access lines in Mexico.

42. Mexico's obligation under Section 2 of its Reference Paper is to ensure that Telmex's interconnection rates are cost-oriented, not to observe that Telmex's interconnection rates are consistent with a transitional target rate that makes no claim to be *basadas en costos*.

43. ITU Recommendation D.140 states that its target rates are "to be used . . . during the *transition* to cost-orientation," and should not be "taken as cost-oriented levels."²⁴ After ITU Members have attained these target rates they "should continue to take positive steps to reduce their accounting rates to cost-oriented levels."²⁵ Therefore, these ITU target rates are not the cost-oriented rates required by Section 2.2 of the Reference Paper.

44. Mexico incorrectly claims that it is subject to these ITU target rates. ITU Recommendation D.140 states that the target rates "are not applicable between competitive markets."²⁶ Therefore, the ITU targets do not apply to the termination of U.S. traffic in Mexico, which has made binding commitments to open its basic telecommunications markets to competition.

45. Lastly, it is surprising that Mexico attempts to justify the use of this ITU target rate by citing the European Commission's use of "current best practices" domestic interconnection rates.²⁷ For 2000, the EC established best practices rates of 1.5 to 1.8 Euro-cents (about 1.4 to 1.65 U.S. cents) for double transit (or nationwide termination) at peak (time of day) rates. Adding the Cofetel approved rate of 1.5 cents (used in the pricing methodology outlined in the United States' First Written Submission as an estimated charge for the additional network components (international transmission and gateway switching) required to terminate an international call) to the EC best practices rates for nationwide termination yields a international "best practices" target of only about 3 cents per minute. The current 5.5, 8.5 and 11.75 cents per minute international rates charged by Telmex exceed this target by 83 percent, 183 percent and 292 percent.²⁸

22. Are there any cases in which a traditional joint-service accounting rate regime would *not* violate the MFN obligation in Article II of the GATS? Please specify the precise range of these cases.

46. At the outset, it is important to note that the question of whether Telmex's international interconnection rates are inconsistent with GATS Article II is not before this Panel as it is not a claim within the Panel's terms of reference. That being said, as explained in the United States' February 5 response to question 16(b) from the Panel, "accounting rates," even if "differential," are not *per se* discriminatory in the sense of Article II of the GATS. Providing interconnection to

²⁴ ITU Recommendation D.140, paras. E.1 (emphasis added), E.3.2 (Exhibit MEX-11).

²⁵ *Id.*, para. E.3.1.

²⁶ *Id.*, para. E.3, note 7.

²⁷ Mexico February 5 Responses to Questions from the Panel, para. 194.

²⁸ U.S. First Written Submission, para. 119.

a supplier in a neighboring country involves lower transmission costs than interconnection to a supplier located overseas, which requires satellite transmission or transmission *via* submarine cable. Any differences in “accounting rates” resulting from these different costs would not mean that the overseas supplier is receiving “less favorable” treatment that would be actionable under Article II, since the two suppliers would simply be paying for the different costs of the inputs they receive. Moreover, in countries in which the regulator does not set or approve “accounting rates,” the rate would not necessarily be a government measure susceptible to challenge under Article II.²⁹

23. Section 1.1 of Mexico’s Reference Paper commitments requires Mexico to maintain “appropriate measures . . . for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices.”

- (a) (US) Explain why the Mexican legal requirement that all Mexican suppliers must apply the settlement rate negotiated by the major supplier, amounts to requiring an “anti-competitive practice” in violation of Section 1.1 even if Mexican suppliers do not collude and do not distort competition *voluntarily*.**

47. As noted in response to question 20 above, ILD Rule 13 gives Telmex, as the carrier with the greatest share of outgoing international calls, the exclusive authority to negotiate the settlement rate alone, unrestrained by competitive forces that would in normal market conditions bring settlement rates down. The result, naturally, is that Telmex, acting as a monopolist, is given a free hand to negotiate artificially-high rates. ILD Rule 23 then requires all other Mexican carriers to apply the same rate. It is the setting of the rate by a monopolist (since Telmex is given the exclusive authority, it is acting as a monopolist in this context) and the use of this rate by all other suppliers (horizontal price-fixing) that comprise the anti-competitive practices that form the basis for the United States’ claim under Section 1 of the Reference Paper. The fact that the government requires the anti-competitive practice does not change the nature of the practice as anti-competitive. Just because Mexican regulation *requires* the suppliers to collude does not mean they are not indeed colluding or, in other words, engaging in horizontal price fixing. Under Mexico’s theory, appropriate measures do not have to be maintained for the purpose of preventing “anti-competitive practices” if the government decides to require those anti-competitive practices. This theory renders the obligation under Section 1 meaningless as it would be essentially self-defining. A Member could easily avoid the obligation to maintain appropriate measures to prevent “anti-competitive practices” by formally requiring such practices.

48. In Mexico, Telmex is free to propose and negotiate interconnection rates far in excess of costs that curtail demand for new and competing telecommunications services, thus preserving its market position and super-competitive profits and stifling the growth of new competitors. None of the conduct called for by the ILD rules -- including determination of rates by a single

²⁹ The United States notes that COFETEL approves Telmex-negotiated rates. See ILD Rule 23.

dominant provider for all firms -- resembles how rates would be set in a competitive market with normally functioning antitrust rules. Nor does it resemble a situation in which the government assumes direct responsibility for regulating rates.

- (b) Please also elaborate on the relationship between Section 1.1 and Section 3 of the Reference Paper, i.e. under what conditions can a legislative requirement that all domestic suppliers must apply the same settlement rate negotiated by the major domestic supplier be considered as a “non-discriminatory and competitively neutral” universal service obligation that is not “regarded as anti-competitive per se” in the sense of Section 3 of the Reference Paper.**

49. Initially, we note that Mexico's ILD rules are not “legislative requirement[s],” but regulatory requirements imposed by Cofetel.

50. As noted in response to question 23(a), Mexico's ILD Rule 13 gives Telmex the exclusive authority to negotiate the settlement rate, unrestrained by competitive forces that would in normal market conditions bring settlement rates down. The result is that Telmex negotiates artificially-high rates. The anti-competitive practice at issue in this dispute also includes the conduct required under ILD Rule 23, which requires a horizontal price-fixing cartel for international interconnection among Mexican suppliers. The *per se* anti-competitive nature of these anti-competitive practices under Section 1.1 of the Reference Paper is not mitigated by any application of Section 3.

51. Section 3 allows a Member to “define the kind of universal service obligation it wishes to maintain”. Section 3 further provides: “*Such obligations* will not be regarded as anti-competitive *per se*, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.”³⁰ As noted in response to question 13, we are aware of no universal service obligation implemented or defined by the Mexican authorities, and no such obligation is defined by the ILD rules. Therefore, Mexico has not even identified or defined a universal service obligation that would, were it identified or defined, “not be regarded as anti-competitive *per se*,” pursuant to Section 3. In Mexico's case, Section 3 of the Reference Paper does not apply. Since Mexico has not identified or defined a universal service obligation, it is not entitled to the presumption against *per-se* anti-competitiveness included in Section 3.

52. Even if Mexico had defined a universal service obligation and Section 3 were to apply, Mexico would not be entitled to this presumption, since its ILD rules also breach the additional requirements that the defined obligation be “administered in a transparent, non-discriminatory and competitively neutral manner and ... not [be] more burdensome than necessary for the kind of universal service defined by the Member.”

³⁰ Emphasis added.

53. At present, any alleged universal service obligations levied against foreign suppliers are apparently hidden in interconnection rates paid to Telmex. As noted in response to question 13, there is no transparency when universal service obligations are hidden in interconnection rates paid to the major supplier. A transparent process must, at a minimum, identify the level of charges associated with the universal service obligation. Additionally, charges associated with a universal service obligation should be “administered” and carefully monitored to ensure that the money is spent in a manner reflected in the Member’s definition of universal service. Mexico does neither. The level of charges associated with any universal service obligation has not been disclosed, even to the Panel in this dispute. Mexico also has provided no evidence of any “administration” of any charges associated with any such obligation. Indeed, Telmex is free to use its above-cost profits from international interconnection rates for any purpose whatsoever, including dividends to shareholders, high executive compensation, foreign acquisitions or any other business activity.³¹

54. The ILD rules also fail to provide the “non-discriminatory and competitively neutral” administration of the defined universal service obligation that is required by Section 3. Because the ILD rules only address interconnection rates paid by cross-border suppliers, they ensure that the entire burden of any universal service obligation implemented in this way falls upon cross-border suppliers. Mexico has put forward no evidence that Telmex and other commercially present suppliers within Mexico are subject to any similar universal service obligation. Indeed, at present, even cross-border suppliers providing services that are directly competitive with services provided by Mexican suppliers are forced to pay higher rates than those charged to Mexican suppliers for the exact same network components, which is also contrary to the requirements for competitive neutrality and non-discrimination.

55. Section 3 also requires that a Member’s universal service obligations be “not more burdensome than necessary for the kind of universal service defined by the Member.” Even had Mexico defined its universal service obligation, its ILD rules fail to identify the monetary level of the obligation or to ensure that the charges are commensurate with that obligation. Because Mexico has not defined a universal service obligation, it cannot determine what level of charges would be “necessary” to meet that obligation. Similarly, without defining a universal service obligation, levying charges allegedly associated with that obligation is by definition “more burdensome than necessary for the kind of universal service defined by the Member.”

56. Accordingly, Mexico is not entitled to the presumption against anti-competitiveness included in Section 3 for two reasons. First, Mexico has not identified or defined a universal service obligation, and second, even had it done so, its ILD rules do not meet the additional requirements that the obligation be “administered in a transparent, non-discriminatory and competitively neutral manner” that is “not more burdensome than necessary for the kind of universal service defined by the Member.”

³¹ U.S. Second Written Submission, para. 91.

24. Are there examples of WTO Members other than Mexico who maintain measures similar to ILD Rule 13 – granting one supplier the right to negotiate with foreign suppliers a settlement rate that is applicable to all other domestic suppliers?

57. No WTO Member other than Mexico maintains measures similar to ILD Rule 13. Mexico is the only WTO Member with competitive suppliers of international facilities-based services that at the same time prohibits competitive negotiations by other carriers for the termination of international calls.³²

58. Mexico contends that it “adopted this system in 1996, based on the fact that it was used in the majority of countries that had introduced competition in their domestic markets for international long distance service.”³³ However, Mexico has consistently failed to produce any examples of such rules in force in other WTO Members, especially those, like Mexico, that have undertaken the obligations of the Reference Paper. The SCT document³⁴ cited by Mexico merely contends that proportionate return was “the prevailing mechanism” in “most” countries that had opened their international long-distance markets to competition in 1996, and also states that “[t]he utilization of the proportionate return system is complemented with a uniform settlement rate.” Notably, the SCT document cited by Mexico does not assert that any other country, even in 1996, granted any single supplier in an otherwise competitive market the exclusive right, free from competitive pressures, to negotiate rates with a supplier from another country and Mexico has put forward no evidence that any other country has since that time done so.

59. As it has in previous submissions, Mexico will undoubtedly argue that the United States requires “uniform settlement rates” like Mexico,³⁵ and that other U.S. carriers “lack discretion to deviate from the negotiating position” of WorldCom.³⁶ As stated in previous submissions, unlike Mexico, the United States does not require uniform rates. Instead, the United States simply requires *nondiscriminatory* treatment of U.S. carriers. The U.S. International Settlements Policy states that “all U.S. carrier must be *offered* the same effective accounting rate . . .” All U.S. carriers negotiate rates independently, however, and any U.S. carrier may always seek to negotiate a more favorable rate. Indeed, AT&T complained to the FCC in 2001 that it had attempted to negotiate lower rates with Telmex than WorldCom had negotiated, but that Telmex had refused to negotiate with AT&T.³⁷

60. Additionally, while the United States does not apply its International Settlements Policy to arrangements with foreign carriers that lack market power, Mexico applies its ILD rules

³² U.S. First Written Submission, para. 5; U.S. Second Written Submission, para. 85.

³³ Mexico February 5 Responses to Questions from the Panel, para. 264.

³⁴ Exhibit MEX-25.

³⁵ Mexico February 5 Responses to Questions from the Panel, para. 174.

³⁶ *Id.*, para. 296.

³⁷ See *AT&T and Concert Objection to International settlements Policy Modification request for a Change in the Accounting Rate for International Message Telephone Service with Mexico*, FCC File Number ARC-MOD-20010530-00123.

broadly, to all suppliers, to prevent price competition and to maintain the payment of above-cost subsidies resulting from the artificially high rates required by Telmex.³⁸

25. Please explain whether the effect of Rule 13 of the ILD Rules is pro-competitive or anti-competitive, and support your argument with the appropriate illustrative figures and examples.

61. Mexico's ILD Rule 13 is anti-competitive in principle and practice because it prevents smaller, newer market participants from competing for increased business through the vital and essential tool of lower prices. The results are super-competitive prices, suppressed demand and continued dominance by the major supplier, Telmex, in setting the rates. . As demonstrated in previous submissions and in response to questions 23(a) and 24, ILD Rule 13 gives the carrier with the greatest share of outgoing international calls the exclusive authority to negotiate the settlement rate, unrestrained by competitive forces that would in normal market conditions bring settlement rates down. As a result, this carrier – which has always been Telmex – uses its monopoly power to negotiate artificially high rates, which the United States has shown are not *basadas en costos*..³⁹

62. Mexico has offered two conflicting reasons why Rule 13 should be considered “pro-competitive,” despite the absolute prohibition on price competition. First, Mexico argues that the Rule is necessary to protect *new entrant carriers* from the ability of Telmex to offer discounted rates to “commandeer a greater share than proportionate share of incoming traffic.”⁴⁰ Mexico has offered no evidence that these new entrant carriers need to be protected from a competitive market or from Telmex. Their best prospects of building market share and challenging Telmex's dominance in fact lie in the freedom to compete with Telmex. Mexico's general competition law and its competition authority, the CFC, can address any attempts by Telmex, alone or in collusion with others, to engage in exclusionary or predatory conduct, once the constraints of the ILD rules are lifted.

63. Alternatively, Mexico argues that its prohibition on price competition is necessary to protect *Telmex* from new entrant carriers being pressured to accept predatory, uneconomic prices.⁴¹ Mexico fails to explain why a Mexican carrier, even if minority owned (but not controlled) by a U.S. carrier, would ignore its responsibility to its majority shareholders and agree to predatory, uneconomic prices for international interconnection.

64. The impact of ILD Rule 13 is to prevent new entrant international carriers in Mexico, some of which are affiliated with U.S. or other foreign providers, from undercutting the above-cost prices charged by Telmex, thereby attracting more traffic for themselves. Mexico has

³⁸ U.S. Oral Statement at the Second Meeting of the Panel, para. 87.

³⁹ United States First Written Submission, paras. 101-156

⁴⁰ Mexico February 5 Responses to Questions from the Panel, para. 259.

⁴¹ *Id.*, para. 256. See also Mexico First Written Submission, paras. 206-210.

acknowledged its concern about new entrant carriers engaging in a “price war” with Telmex.⁴² Mexico’s maintenance of ILD Rule 13, in other words, is not directed at preventing harm to competition but rather is directed at preventing the natural results of competition. Mexico prohibits price competition in the market for interconnection provided to U.S. suppliers operating on a cross-border basis, and justifies this prohibition as necessary to prevent such competition from reducing rates. This can only be regarded as anti-competitive.

27. Would the application of uniform settlement rates for the connection of committed international telephone services run foul of the obligations of Section 5(a) of the Annex for those cases where the uniform settlement rate does not provide cost based access to and use of a PTTNS?

65. No. Uniform settlement rates that are merely not cost-based do not violate Section 5(a) of the Annex, as long as those rates are “reasonable.” Through ILD Rule 13, Mexico conditions foreign suppliers’ access to and use of public telecommunications transport networks and services on negotiating exclusively with Telmex, the dominant supplier.⁴³ ILD Rules 3, 6, 10, 13, 22 and 23 also prohibit Mexican suppliers from negotiating an alternative rate.⁴⁴ These rules impose restrictions that impair the ability of U.S. and other foreign suppliers to negotiate fair and competitive access to and use of Mexican networks and services, and therefore fail to ensure access to and use of such networks and services on reasonable terms and conditions, in violation of Section 5(a).

⁴² Mexico First Written Submission, para. 79.

⁴³ U.S. First Written Submission, paras. 237-238.

⁴⁴ *Id.*, paras. 238-241.