Mexico – Measures Affecting Telecommunications Services

(WT/DS204)

Second Written Submission of the United States of America

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I. INTRODUCTION

1. In our First Written Submission, the United States demonstrated that Mexico has failed to ensure cost-based rates and reasonable terms and conditions for interconnection with its major supplier, Telmex, as required by Section 2 of the Reference Paper, which was adopted by Mexico as an additional commitment under the Fourth Protocol. The United States also demonstrated that Mexico's International Long Distance ("ILD") rules actually compel anti-competitive practices on the part of Telmex, in violation of Section 1 of the Reference Paper. Finally, the United States established that Mexico's ILD rules, the above-cost interconnection rates charged by Telmex, and Mexico's refusal to permit the use of private leased circuits are inconsistent with Sections 5(a) and (b) of the GATS *Annex on Telecommunications*, which require Mexico to ensure access to and use of public telecommunications networks and services on reasonable terms and conditions and to permit the interconnection of private leased circuits with such networks and services.

2. As explained more fully below, Mexico has failed to refute the claims presented by the United States. Indeed, Mexico does not even attempt to rebut key elements of the U.S. case. For example, Mexico does not dispute that Telmex is a major supplier, nor has it contested the factual basis for the various cost proxies set forth in the U.S. First Written Submission. Mexico does not dispute that the physical network elements identified in the U.S. First Written Submission constitute the elements of interconnection. Likewise, Mexico does not dispute the prices charged domestically for those elements, or the fact that those prices constitute a cost-ceiling because they are required by Mexican law to be cost-based. In fact, Mexico has not even argued that Telmex's interconnection rates are *basadas en costos*.

3. Similarly, Mexico has not specifically responded to the United States' argument that the above-cost interconnection rates and the circumstances created by the exclusive authority given to Telmex to negotiate interconnection rates on behalf of all Mexican carriers, along with other ILD rules, constitute unreasonable terms and conditions on interconnection, and in particular on access to and use of public telecommunications networks and services in general.

4. Instead, Mexico offers essentially a four-part rebuttal: (1) that it did not undertake a specific commitment that would trigger the obligations of Section 2 of the Reference Paper or Section 5 of the Annex on Telecommunications; (2) that the scope of the Reference Paper does not extend to interconnection provided to mode 1 suppliers; (3) that its ILD rules are actually pro-competitive rather than anti-competitive; and (4) that the routing restriction noted in its Schedule allows Mexico to prohibit the use of private leased circuits.

5. As explained in detail below, Mexico's arguments do not withstand scrutiny and should be rejected by the Panel. First, Mexico's Schedule is clear and unequivocal: Mexico committed to allow the supply of basic telecommunications services on a cross-border basis for both facilities-based operators and commercial agencies, and on a commercial presence basis for commercial agencies. However labeled, Mexico's routing restriction does not eviscerate Mexico's mode 1 commitment.

6. In addition, the routing restriction does not justify a prohibition on the use of private leased circuits, as alleged by Mexico. This limitation does not say that international traffic must be routed through a "switched port" which would, by definition, preclude the use of private leased lines. Instead, it simply says that international traffic must be routed "through the facilities of" a concessionaire. As explained below, routing international traffic over a line leased from a Mexican concessionaire is entirely consistent with the requirement to route traffic through the facilities of a Mexican concessionaire. Mexico's arguments regarding its scheduled commitments are simply not supported by the ordinary meaning of the terms used by Mexico in its Schedule, and should be rejected by the Panel.

7. Likewise, Mexico's argument regarding the scope of the Reference Paper is not supported by the ordinary meaning of the terms of the Reference Paper. There is simply no basis to conclude that the Reference Paper *only* applies to domestic regulation and therefore excludes "international" interconnection.

8. By virtue of its scheduled commitments, Mexico is obligated to adhere to the requirements of Section 2 of the Reference Paper and Section 5 of the Annex. As explained in our First Written Submission and below, Mexico has failed to observe these obligations.

9. With regard to Section 1 of the Reference Paper, Mexico's argument that the price-fixing mandated by its ILD rules actually promotes competition is contrary to basic economic principles and the facts. As explained below, Mexico's prohibition on competition on all international routes between firms that would otherwise be direct competitors is exactly the opposite of promoting competition. This is readily seen through a comparison with the international service rules in place in the United States. The facts demonstrate that Mexico's ILD rules serve one purpose – to protect the subsidy Telmex receives from above-cost interconnection rates charged to U.S. carriers.

10. Finally, the United States notes that Mexico has made various assertions (including the success of competition in the Mexican domestic market and that U.S. carriers have failed to pass-through reductions in settlement rates between the United States and Mexico) that, while not relevant to the United States' claims in this dispute, are factually inaccurate and require correction. For example, contrary to the impression given by paragraphs 89-90 of Mexico's First Written Submission, Telmex has increased its share of the Mexican domestic long distance market since 2000, and is now reported to control "roughly 90%" of Mexico's lines.[1] Similarly, Mexico's average interconnection rates for domestic long distance calls are higher than all but one of the countries listed in Figure 2 of the Appendix to Mexico's First Written Submission, when account is taken of its "off-net" interconnection rate of 7.5 cents per minute, which applies

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[1] *See* Dow Jones Business News, *Mexico's Antitrust Commission Rules Against Telmex, Again* (January 15, 2003) (Exhibit US-52).

to approximately 20 percent of domestic long distance traffic.[2] Likewise, Mexico's argument that U.S. carriers have failed to pass-through reductions in settlement rates is based upon a mathematical trick. Mexico compares reductions in average retail revenues of U.S. carriers on the U.S.- Mexico route to reductions in settlements rates on the same route in *percentage* terms, instead of looking at the actual amount of reduction in settlement rates. A proper comparison shows that retail rates in the United States have actually declined more than the reduction in settlement rates on the U.S. - Mexico route. In other words, U.S. carriers have not only passed-through the reduction in settlement rates, they have *further* reduced their retail rates.

II. MEXICO UNDERTOOK MODE 1 AND MODE 3 COMMITMENTS FOR THE SUPPLY OF BASIC TELECOMMUNICATIONS SERVICES

11. In its First Written Submission, the United States established that Mexico undertook in its GATS Schedule a specific commitment to allow facilities-based *and* non-facilities-based operators (*i.e.*, commercial agencies) to supply basic telecommunications services on a cross-border basis.[3] The United States also established that Mexico undertook a specific commitment to allow the supply of basic telecommunications services by commercial agencies on a mode 3 or commercial presence basis.[4] (Mexico's mode 3 commitment for commercial agencies is relevant to the U.S. claims under the Annex, but not the Reference Paper.) As explained more fully below, Mexico has failed to refute this showing.

A. Mexico Committed to Allow the Supply of Basic Telecommunications Services on a Cross-Border Basis by Both Facilities-Based Operators and Commercial Agencies

12. Mexico's primary defense is that, despite the inscription of the word "None" in the market access limitations column in its Schedule, its commitment under mode 1 for facilities-based operators and commercial agencies is *unbound* by virtue of the routing requirement noted in the mode 1 limitations column, and its mode 3 limitations requiring a concession, and that the concession be held by a Mexican company or individual.

13. Mexico's argument should be rejected by the Panel as it is not supported by, and is in fact directly contrary to, the ordinary meaning of the terms used in Mexico's Schedule and the context of various Secretariat scheduling notes. Accepting Mexico's interpretation essentially makes its commitment of "None" in the market access limitation column of its Schedule for mode 1 completely meaningless.

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[2] Additionally, Mexico has permitted Telmex to retain a monopoly over significant portions of the country, because the "cit[ies] opened to long distance competition" referred to in paragraph 63 of Mexico's First Written Submission exclude approximately 20 percent of Mexico's lines.

[3] *See* First Written Submission of the United States, paras. 49-58.

[4] *See id.*, paras. 252-257.

14. As explained in our First Written Submission and Oral Statement at the First Panel Meeting, Mexico included the following limitation in the market access column of its Schedule with respect to mode 1 or cross-border supply of basic telecommunications services for *both* facilities-based operators and commercial agencies:

> (1) **None**, except the following:
>
> International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).[5]

15. The commitment is clear and straightforward: there are no limitations on the mode 1 commitment, with the exception of a routing requirement. Mexico's argument that "None" should be interpreted as "Unbound" is thoroughly untenable. The requirement to route international traffic through the facilities of a Mexican concessionaire does not completely eviscerate Mexico's market access commitment for mode 1 - indeed, there would be no need for this or any other limitation if Mexico had left mode 1 unbound. The way in which U.S. suppliers complete calls into Mexico is by "rout[ing] through the facilities of an enterprise that has a concession" – an option specifically provided in Mexico's Schedule. Mexico ignores this aspect of its commitment in asserting that it has made no commitment for the supply of telecommunications services on a cross-border basis. As explained during our first oral statement, even if this limitation had any effect, it would still be a limitation on a commitment that Mexico undertook and would therefore still trigger the obligations in Section 2 of the Reference Paper and Section 5 of the Annex.

16. Moreover, as a legal matter, Mexico's routing requirement is not a market access limitation at all. We agree with the European Communities that the limitation scheduled by Mexico is superfluous and without legal effect because a routing requirement is not one of the limitations listed in Article XVI:2 of GATS. A note by the Secretariat supports this position, confirming that "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."[6] In the United States' view, Mexico did not need to schedule the requirement that cross-border suppliers route traffic through the facilities of a concessionaire to maintain that limitation for Article XVI purposes.

17. In response to oral questions from the Panel during the first panel meeting, Mexico asserted for the first time that the routing requirement falls within the limitations listed in GATS Article XVI:2(a) and (e). The United States disagrees. Nonetheless, even accepting Mexico's point solely for the sake of argument, classifying the routing requirement under subparagraphs (a)

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[5] Emphasis in original.

[6] MTN.GNS/W/164 (September 3, 1993), para. 4.

or (e) would not reduce Mexico's cross-border commitment to "unbound," and thus Section 2 of the Reference Paper and Section 5 of the Annex would still apply.

18. The United States' interpretation of Mexico's Schedule is reinforced by the contrast between the market access limitation for cross-border supply of telecommunications services (2.C.) and the corresponding limitation for the commercial presence mode of supply (mode 3) for facilities-based operators. To enjoy market access as a facilities-based operator in the commercial presence mode of supply, Mexico's Schedule states that "[a] concession from the SCT is required." In contrast, facilities-based operators and commercial agencies in the cross-border mode may "route[] through the facilities of an enterprise that has a concession granted by" the SCT. The contrast between these two commitments demonstrates that Mexico did indeed commit to the provision of telecommunications services on a cross-border basis, as long as traffic is "routed through" the facilities of a Mexican concessionaire.

19. Mexico asserts that it only intended to "freeze[] the level of market access to that prevailing at the time of the negotiations."[7] Specifically, Mexico contends that the level of market access at that time required international traffic to be routed through international ports under the existing accounting regime.[8]

20. To begin, the United States considers that whether or not Mexico was "freezing" the level of market access prevailing at the time of the negotiations is irrelevant; the ordinary meaning of Mexico's Schedule speaks for itself and should control.[9] The extent of a Member's commitments cannot depend upon what it alleges to have intended at the time of the negotiations. The ordinary meaning of Mexico's Schedule instead dictates its commitments. The same Secretariat's Explanatory Note on Scheduling relied upon by Mexico in footnote 89 of its First Written Submission emphasizes that, if a Member wished to bind the *status quo*, as Mexico now asserts was its intention, these so-called "standstill" commitments were to be scheduled no differently than any other market access commitments. Limitations were simply to be listed in the market access column. Thus, the fact that Mexico may have intended to bind the *status quo* at the time of negotiations does not alter the question before the Panel: does the routing requirement listed in Mexico's Schedule have the effect of reducing Mexico's cross-border

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[7] First Written Submission of Mexico, para. 129.

[8] As explained more fully in the U.S. answer to Panel Question 8, Mexico's current ILD rules provide for an interconnection regime. Mexico's ILD rules make no reference to the term "accounting rates" and refer throughout to "interconnection" and "international interconnection" agreements. In addition, Mexico's ILD rules, while compelling uniform rates and proportionate return, do not require the use of traditional accounting rates (for example, accounting rates need not be divided equally with the foreign correspondent) and do not restrict the compensation models that may be negotiated by the concession holder who holds the largest outgoing long distance market share.

[9] The customary rules of interpretation of public international law reflected in Article 31 of the *Vienna Convention on the Law of Treaties* provide that a treaty should be interpreted according to the ordinary meaning of its terms, in their context and in light of the object and purpose of the treaty.

commitment to a nullity, as Mexico argues? In this case, the language of Mexico's obligation is clear - the only limitation is that traffic must be routed through the *facilities* of an enterprise that holds a concession.[10]

21. Mexico also argues that it used the word "None" instead of "Unbound" based upon the Scheduling Note mentioned above. However, the Scheduling Note does not support Mexico's interpretation. The paragraph relied upon by Mexico provides an answer to the following question:

> 7. How relevant is a reservation for a residence requirement, nationality condition or commercial presence requirement under cross-border trade: does that not rather imply that cross-border trade is not allowed and therefore the correct entry should be 'unbound'?[11]

The relevant portion of the response is as follows:

> It is correct to use the term "unbound" for a mode of supply in a given sector where a Member wishes to remain free to introduce or maintain measures inconsistent with market access or national treatment. However, it has been pointed out by participants that in some cases there is advantage in inscribing a particular limitation (e.g., a residency requirement or a commercial presence requirement) instead of the term "unbound" in that trading partners have the certainty that there are no other limitations with respect to the cross-border mode. . . .[12]

22. Mexico's reliance on this response is misplaced, as the limitation included in Mexico's Schedule is not "a residence requirement, nationality condition or commercial presence requirement." It is instead a routing requirement. By its own terms, therefore, paragraph 7 of the Note is not applicable.

23. Mexico now asserts that the requirement to use the "facilities" of a concessionaire is equivalent to a requirement to route all traffic through the international switched "ports" that can be operated only by Mexican concessionaires.

24. Mexico's argument fails to recognize that "facilities" is in fact a much broader term than "ports," and embraces a variety of means that might be used to terminate cross-border traffic,

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[10] As described above, this 'limitation' is in any event not a limitation subject to scheduling under GATS Article XVI; in this paragraph the United States simply wishes to point out that even if it were subject to scheduling, this 'limitation' would not reduce Mexico's commitment to nothing.

[11] MTN.GNS/W/164/Add.1 (November 30, 1993), para. 7.

[12] *Id.*

including private leased circuits. Mexico's own laws and regulations recognize that the term "facilities" is broader than just "international ports." Article 47 of Mexico's Federal Law on Telecommunications requires a concession to install "telecommunications equipment and transmission means," a category of facilities obviously broader than merely international ports.[13] Likewise, Mexico's ILD Rule 4 clarifies that the facilities of an international concessionaire include the international port and "telecommunications equipment and means of transmission that cross the country's borders."[14]

25. These definitions are also consistent with the WTO's Telecommunications Services Glossary of Terms, which defines "networks or facilities" to include "the ensemble of equipment, sites, switches, lines, circuits, software, and other transmission apparatus used to provide telecommunications services." International switched ports are only one of the many types of telecommunications facilities embraced by this definition. Mexico's scheduled facilities routing requirement must therefore be interpreted to permit routing through *any* facilities. Nothing in Mexico's Schedule, with respect to services provided under mode 1, allows Mexico to preclude the termination of cross-border traffic using private leased circuits obtained from a Mexican concessionaire. This is the essence of International Simple Resale ("ISR").

26. The United States notes that, even if the term "facilities" is construed to mean just "international ports," this conclusion would only affect Mexico's right to prohibit the interconnection of private leased circuits at network points other than the international port, which is relevant to the U.S. claim under the Annex on Telecommunications. Mexico would still be required to allow private lines to be interconnected at the international port. Even if Mexico's Schedule were interpreted to allow Mexico to require international traffic to route through a switched port operated by a Mexican concessionaire, U.S. carriers would still be providing telecommunications services on a cross-border (mode 1) basis. Thus, the obligations of Section 2 of the Reference Paper would still apply.

27. As Question 3 from the Panel suggests, Mexico appears to dispute this point in paragraph 234 of its First Written Submission, where it implies that, to provide a service on a cross-border basis, the foreign supplier must be on both sides of the border. According to Mexico, it has reserved the right to impose this limitation through a combination of the schedule mode 1 requirement to route traffic through the facilities of a concessionaire, and the scheduled mode 3 limitation that the supplier must be a concessionaire.[15] This argument is flawed, for several reasons.

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[13] Mexico's Federal Telecommunications Law was attached as Exhibit US-16 to the First Written Submission of the United States.

[14] Mexico's ILD rules were attached as Exhibit US-1 to the First Written Submission of the United States.

[15] In making this argument, Mexico acknowledges that its mode 1 routing restriction for facilities-based operators does not include the commercial presence limitation scheduled for mode 3.

28. First, Mexico's argument that a limitation scheduled under one mode of supply can be "read together" or "in combination with" another limitation listed under a different mode is without any legal support. Indeed, to interpret Mexico's Schedule in this manner would amount to the Panel inserting a limitation on Mexico's mode 1 commitment that Mexico itself did not schedule. This would impermissibly diminish the rights of the United States in violation of Article 19.2 of the DSU.

29. Second, the cross-border supply of a service does not require that the service supplier operate on both sides of the border. Article I:2(a) of GATS defines the cross-border supply of a service as the supply of a service from the territory of one Member into the territory of any other Member. It is the service that crosses the border, not the supplier. Accepting Mexico's argument would mean that the provision of basic telecommunications services on a cross-border basis would only be possible if a service supplier also operated on a commercial presence basis. The result would be to render meaningless Mexico's mode 1 commitments in the basic telecommunications sector. Since U.S. and Mexican basic telecommunications suppliers currently interconnect at the border, accepting Mexico's argument would also mean that the supply of basic telecommunications services does not fit into any of the modes of supply under GATS. Such an interpretation would be contrary to the nature of basic telecommunications services. That basic telecommunications services can be, and indeed are, supplied on a cross-border basis is confirmed by the undisputed fact that billions of calls (i.e., signals) are actually transmitted between the United States and Mexico annually.

30. Mexico's argument is also contrary to the Scheduling Note discussed above. That Note explains that "international transport, the supply of a service through telecommunications or mail, and services embodied in exported goods (e.g. a computer diskette, or drawings) are all examples of cross-border supply, *since the service supplier is not present within the territory of the Member where the service is delivered.*"[16]

31. Finally, Mexico's own Schedule does not support its argument. Mexico's Schedule specifically permits market access in mode 1 as long as traffic is routed through the facilities of "an enterprise that has a concession. . . ." Mexico's Schedule does not limit market access in mode 1 to only those foreign service suppliers that route traffic through the facilities of a Mexican concessionaire that the foreign service supplier itself owns or controls. Thus, Mexico's own Schedule anticipates that a "service," within the meaning of the GATS, can be supplied on a cross border basis as long as traffic is routed through the facilities of *any* Mexican concessionaire.

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[16] MTN.GNS/W/164 (September 3, 1993), para. 19(a) (emphasis added).

B. Mexico Committed to Allow the Supply of Basic Telecommunications Services by Commercial Agencies through a Commercial Presence

32. As noted above, Mexico also included a specific commitment in its Schedule to permit the supply of basic telecommunications services by commercial agencies through a commercial presence (mode 3) in Mexico. As with mode 1, in the market access column, Mexico inscribed **"None"** for mode 3 limitations for commercial agencies, with the following notation: "[t]he establishment and operation of commercial agencies is invariably subject to the relevant regulations. The SCT will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued." (Note that the reference to issuance of regulations does not appear in the limitation inscribed by Mexico for *mode 1* commercial agencies).

33. In its First Written Submission, Mexico contends that it did not undertake any meaningful market access commitment for the supply of basic telecommunications services by a commercial agency in mode 3. Specifically, Mexico argues that "[t]he issuance of regulations is at the discretion of the Mexican authorities taking into account the transition occurring in the Mexican telecommunications market."[17]

34. Again, Mexico's position is untenable. As noted in the U.S. response to Question 6(c) from the Panel, Mexico's mode 3 commitment regarding commercial agencies does not allow it to suspend indefinitely what Mexico has termed its "discretion" to issue regulations and permits for the establishment and operation of commercial agencies. Such an interpretation would reduce Mexico's mode 3 commitment to commercial agencies to inutility.[18]

35. Moreover, such an interpretation would be inconsistent with statements by Telmex interpreting Mexico's commitments. Just three months after Mexico expanded the scope of its offer, in January 1997, to include this mode 3 commitment, Telmex's U.S. subsidiary, Telmex/Sprint Communications, Inc. ("TSC"), made the following statement to the U.S. Federal Communications Commission ("FCC"):

> TSC understands that Cofetel intends to issue its resale regulations and award resale permits by the end of this year – a period of time that clearly constitutes the 'the near future' under any definition of the phrase. The commencement of resale in this timeframe is further assured by Mexico's WTO commitments, which specifically include a commitment to competition in all market segments of public telecommunications on a *facilities and a resale basis by January 1, 1998*.[19]

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[17] First Written Submission of Mexico, para. 245.

[18] The Appellate Body has condemned interpreting a treaty in a manner that reduces certain provisions to inutility. *United States – Reformulated Gasoline*, pg. 22; *Canada – Dairy*, para. 133.

[19] Telmex/Sprint Communications, L.L.C., Consolidated Opposition of Telmex/Sprint Communications, L.L.C. (filed April 25, 1997), pg. 9 (emphasis in original) (Exhibit US-53).

36. As noted in paragraph 17 of the United States' Oral Statement at the First Meeting of the Panel, in December 1997, Telmex's U.S. subsidiary further informed the FCC that "[s]ince Mexico is bound by an international agreement to fulfill its commitments, *there is no basis for assuming that Mexico does not intend to comply fully with its WTO commitments and thus promptly adopt regulations allowing switched resale and grant permits to resellers*."[20] Telmex, through its U.S. subsidiary, thus assured the FCC that Mexico's WTO commitments required Mexico "promptly" to adopt the relevant regulations and issue reseller permits.

37. As a final clarification, the United States is not in this dispute claiming that Mexico's failure to issue permits for the establishment and operation of commercial agencies violates Article XVI of the GATS. The United States instead claims that Mexico's refusal – five years after having finalized its commitments – to adopt regulations necessary to issue commercial agency permits violates Mexico's obligation under Section 5(b) of the Annex on Telecommunications to ensure that service suppliers[21] have access to and use of private leased circuits.

38. In sum, the requirement to route traffic through the facilities of a concessionaire - regardless whether it is labeled a limitation under Article XVI:2 - does not reduce Mexico's market access commitment for the cross-border supply of basic telecommunications services (by *both* facilities-based and commercial agencies) to a nullity. Consequently, because Mexico undertook these specific commitments, Mexico must abide by the requirements of Section 2 of the Reference Paper and Section 5 of the Annex on Telecommunications. The notation that Mexico will not issue permits for the establishment of commercial agencies operating in mode 3 until the relevant regulations are promulgated also does not reduce Mexico's commitment to allow the supply of basic telecommunications services by commercial agencies on a mode 3 basis to a nullity. As a result of this specific commitment, Mexico is again obligated to adhere to the requirements of Section 5 of the Annex.

III. MEXICO HAS FAILED TO REBUT THE UNITED STATES' DEMONSTRATION THAT MEXICO'S MEASURES ARE INCONSISTENT WITH SECTION 2 OF THE REFERENCE PAPER

39. As explained in our First Written Submission, because Mexico has undertaken specific commitments with regard to the cross-border supply of basic telecommunications services for both facilities-based operators and commercial agencies, and because Mexico adopted the Reference Paper as an additional commitment under GATS Article XVIII, Mexico has

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[20] Telmex/Sprint Communications, L.L.C., Consolidated Opposition of Telmex/Sprint Communications, L.L.C. to Applications for Review (filed December 30, 1997), pg. 7 (emphasis added) (Exhibit US-54).

[21] In this context, the "service suppliers" at issue are locally-established commercial agencies acquired by a foreign supplier for the purpose of offering international (*e.g.*, between Mexico and the United States) telecommunications services over private circuits leased from a Mexican concessionaire.

committed to abide by the definitions, terms and conditions included in Section 2 of the Reference Paper.

40. Mexico's principal defense to the United States' demonstration that Mexico has failed to ensure that its major supplier, Telmex, provides interconnection at rates that are based in cost and on terms and conditions that are reasonable, is that the obligations in the Reference Paper extend only to "*domestic* interconnection." According to Mexico, "international interconnection" or accounting rate regimes are not "interconnection" as that term is defined in Mexico's Reference Paper. Mexico also argues that the United States has failed to show that Mexico's interconnection rates are not "*basadas en costos*," or that the terms and conditions of interconnection are unreasonable.

A. The Reference Paper Applies to All Forms of Interconnection

41. As the United States explained during the First Meeting of the Panel, Mexico has accepted a clear and unambiguous definition of the term "interconnection" in its Reference Paper. In addition, Mexico's argument that the Reference Paper applies only to "domestic" interconnection is not supported by the plain language of the Reference Paper or its negotiating history. A simple review of the text confirms that the definition of "interconnection" in Section 2.1 is not limited to "domestic" interconnection, or in other words, is not limited to interconnection provided only to suppliers operating in mode 3 (commercial presence). Rather, the Reference Paper defines "interconnection" broadly to include all "linking" of suppliers for the purpose of enabling users to communicate – whether the suppliers are operating on a cross-border basis or are commercially present. While the United States agrees that domestic interconnection is within the scope of the Reference Paper, that is not the full extent of the Reference Paper's reach.

42. Indeed, as the United States noted during the First Panel Meeting, Mexico's own laws and regulations refer repeatedly to the linking of foreign service suppliers to its international port operators as "interconnection." For example, Rule 3 of the ILD Rules states that "only international gateway operators shall be authorized to *interconnect* directly with the public telecommunications networks of the other countries' operators for the purposes of carrying international traffic." Likewise, Article 47 of Mexico's Federal Telecommunications Law provides that "*interconnection* of public telecommunications networks with foreign networks shall be carried out through agreements entered into by the interested parties."

43. From a technical perspective, Mexico also cannot dispute that a U.S. and Mexican carrier "interconnect" with each other to exchange traffic across the border, as the term "interconnection" is defined in the Reference Paper. The United States refers the Panel to its response to Question 8, in which the United States explains in detail that, while all interconnection arrangements, including "domestic" and "international" interconnection arrangements, cover a variety of different commercial, contractual and technical situations (and

may be subject to different regulatory requirements), all of the arrangements are "interconnection" under Section 2.1 of the Reference Paper.

44. Mexico's attempt to exclude the accounting rate regime from interconnection on the grounds that "international carriers connect at a border or some international mid-way point" is unfounded.[22] As noted above, such "linking" of networks is plainly interconnection under Section 2.1 of the Reference Paper, and also is similar to the "meet-point interconnection arrangements" that incumbent local exchange carriers in the United States are required to provide to new entrants. Meet-point arrangements are "arrangement[s] by which each telecommunications carrier builds and maintains its network to a meet point."[23] The FCC found in 1996 that meet-point arrangements for interconnection between carrier facilities, also known as "mid-span meets," were "commonly used between neighboring LECs [local exchange carriers] for the mutual exchange of traffic."[24]

45. Mexico contends in paragraph 24 of its First Written Submission that the "term 'accounting rate regime' refers to bilateral relationships between two carriers in two countries whereby they agree to compensate one another for transporting and terminating traffic that originates in the other country." Mexico provides no citation for this definition, and no definition – nor any reference to accounting rates – is included in Mexico's Schedule. In any event, Mexico's definition confirms that accounting rates are interconnection rates between carriers located in two different countries, and fails to show that these terms are mutually exclusive. The United States notes again that Mexico's ILD rules make no reference to accounting rates, and refer throughout to "interconnection" and "international interconnection" agreements.[25]

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[22] First Written Submission of Mexico, para. 155.

[23] 47 C.F.R. § 51.5, available at http://frwebgate.access.gpo.gov/cgi-bin/get-cfr.cgi?TITLE=47&PART=51&SECTION=5&YEAR=2002&TYPE=TEXT. *See id*. (defining a "meet point" as "a point of interconnection between two networks, designated by two telecommunications carriers, at which one carrier's responsibility for service begins and the other carrier's responsibility ends").

[24] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, paras. 546, 553 (1996) (Exhibit US-55).

[25] *See, e.g.*, Rule 1 ("The purpose of these Rules is to regulate the provision of international long distance service and establish the terms to be included in agreements for the *interconnection* of public telecommunications networks with foreign networks.") (emphasis added). *See also* Rule 3 ("Only international gateway operators shall be authorized to *interconnect* directly with the public telecommunications networks of other countries' operators for the purpose of carrying international calls.") (emphasis added); Rule 20 ("Such payments [between Mexican operators shall be paid] . . . in the currency in which the settlement rate is to be paid pursuant to the *interconnection* agreement concluded with the foreign correspondent.") (emphasis added); Rule 23 ("Long-distance service licensees seeking to establish *interconnection* agreements with foreign operators must submit such [interconnection] agreements to the Commission for approval.") (emphasis added); Rule 24 ("Any international *interconnection* agreement between a long-distance service licensee and a foreign operator shall be recorded.") (emphasis added); Fourth Transitory Provision (The Commission shall publish settlement rates for countries "with which any long-distance service licensee has international *interconnection* agreements.") (emphasis added).

46. Mexico continues to argue that, notwithstanding the broad and unambiguous language in Section 2.1, the negotiating history of the Reference Paper shows that the so-called "accounting rate regime" was intended to be excluded from the Reference Paper's obligations.

47. Mexico's argument is easily dismissed. To begin, Mexico's citation of an earlier draft of the Reference Paper does not support its argument that accounting rates (or international interconnection rates) were intended to be excluded from the definition of "interconnection." Mexico cites to a draft of the Reference Paper that included a definition of the term "accounting rate," and a provision regarding public access to accounting rates and explanations regarding those rates.[26] According to Mexico, the deletion of these provisions from the final text of the Reference Paper signals that "'accounting rates' were explicitly and deliberately excluded from the Reference Paper."[27] As explained during the U.S. Oral Statement at the First Meeting of the Panel, Mexico's argument ignores the rules of treaty interpretation included in the Vienna Convention. Whatever provisions were considered during the drafting process, the Panel is charged with interpreting the final version of the Reference Paper. Mexico's final version includes, in Section 2.1, a definition of "interconnection" that broadly covers "linking . . . to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier."

48. Furthermore, as noted by the European Communities ("EC"),[28] the requirement in that earlier draft of the Reference Paper that "a dominant supplier explain the reasons why an international accounting rate differs significantly from domestic interconnection rates" at the request of a Member indicates that the negotiators considered accounting rates and domestic interconnection rates to be charges for two types of interconnection. The former is a charge for international interconnection and the latter is a charge for domestic interconnection. The deletion of this provision merely demonstrates that Members did not undertake those specific obligations. It does not affect the remaining Reference Paper obligations, including the obligation of Mexico to ensure that its major supplier Telmex charges interconnection rates, including rates for international interconnection, that are *basadas en costos*.

49. Mexico also cites to the so-called "Chairman's Note"[29] as part of the Reference Paper's "negotiating history" which, according to Mexico, demonstrates that "WTO Members did not intend that accounting rates would be subject to the obligations of the GATS, including the Reference Paper."[30] As explained during our Oral Statement at the First Meeting of the Panel, this argument is also unsound.

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[26] First Written Submission of Mexico, para. 168.

[27] *Id.*, para. 169.

[28] Third Party Submission of the European Communities, para. 34.

[29] S/GBT/4 (February 15, 1997).

[30] First Written Submission of Mexico, para. 171.

50. First, the Chairman's Note is at best a non-binding statement that did not find its way into the GATS, the Reference Paper or Mexico's Schedule itself. This conclusion is reinforced by the statement in a report by the Group on Basic Telecommunications that "[t]he Chairman stressed that this was merely an understanding, which could not and was not intended to have binding legal force. It therefore did not take away from Members the rights they have under the Dispute Settlement Understanding. . . ."[31]

51. Second, as the above-cited report by the Group on Basic Telecommunications states, the Chairman's Note "was merely intended to give members who had not taken MFN exemptions on accounting rates some degree of reassurance."[32] As noted by the United States in its Oral Statement at the First Meeting of the Panel (at paragraph 27), the references in the Chairman's Note to "differential rates," the subsequent statement in the Note that "the application of such [*i.e.*, differential] accounting rates would not give rise to action by Members under dispute settlement," and the Article II exemptions actually taken by the five countries mentioned in the Note, make clear that the understanding has no application outside of Article II. Because the United States has not brought a claim under Article II, the Chairman's Note has no relevance to this dispute.

52. Mexico also wrongly seeks to imply, in paragraph 37 of its First Written Submission, that the regulation of interconnection rates is necessary only where interconnecting suppliers compete with each other. According to Mexico, because suppliers of basic telecommunications services on a cross-border basis are not competing with domestic carriers, it makes sense that international interconnection is not covered by the Reference Paper. Yet, Mexico goes on to acknowledge (at paragraph 41) that interconnection is an important concern in domestic markets where the interconnecting carriers do *not* compete with each other, such as where "a domestic long distance carrier (or inter-city or interexchange carrier) must interconnect with local carriers throughout a country in order to be able to reach all end user customers."[33] In these circumstances, the domestic long-distance carrier must interconnect with local carriers for both call termination *and* call origination. Mexico further acknowledges (again at paragraph 41) that the regulation of interconnection rates is necessary in such circumstances, not because the interconnecting carriers are targeting the same customers, but because "the local carrier has the incentive and ability to set interconnection rates as high as possible." For the same reasons, the regulation of interconnection rates is necessary for the cross-border supply of international basic telecommunications services, which are also dependent on interconnection arrangements for call termination with suppliers that have "the incentive and ability to set interconnection rates as high as possible."

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[31] S/GBT/M/9 (March 10, 1997) (cited in Third Party Submission of Japan, para. 7).

[32] *Id*.

[33] Mexico cites nothing in its Reference Paper or in its domestic interconnection regulations requiring competition between suppliers as a prerequisite for interconnection rights.

53. Mexico is also wrong to contend, at paragraph 157 of its First Written Submission, that a major supplier "has no interest in impeding calls or providing inferior quality service" to cross-border suppliers because these suppliers are not competitors. In fact, major suppliers are direct competitors with cross-border suppliers that originate services in-country through home-country direct and similar call reversal services. Moreover, a major supplier has an incentive to impose a competitive disadvantage on a foreign cross-border supplier if an affiliate of the major supplier competes with the cross-border supplier – as many such affiliates were expected to do following the successful outcome of the basic telecommunications negotiations.

54. Mexico also draws the irrelevant distinction in paragraph 36 of its First Written Submission between "interconnection rates" and "charges for use of a network for transport and termination of traffic that originates on another network." The requirements of Mexico's Reference Paper apply to all interconnection services – particularly call termination. Section 2.1 of the Reference Paper defines interconnection as "linking with suppliers providing public telecommunications transport networks or services in order *to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier*."[34] Call termination – allowing calls originated on the network of one supplier to be terminated on the network of another supplier – falls squarely within Mexico's definition of "interconnection" in Section 2.1.

55. The European Communities' Interconnection Directive defines "interconnection" in similar terms as those used in Section 2.1. The Interconnection Directive defines interconnection as "the physical and logical linking of telecommunications networks used by the same or a different organization in order to allow the users of one organization to communicate with users of the same or another organization, or to access services provided by another organization."[35] The European Commission has explained that "[t]he most basic interconnection service provided is that of *call termination* (i.e. delivering a call which originates on one network to its destination on another network)."[36]

56. Mexico's argument, in paragraph 36 of its First Written Submission, that U.S. law makes a "clear distinction" between interconnection and call termination is also irrelevant. In the United States, as in the European Communities, a key purpose of the regulation of interconnection is to ensure that carriers may terminate calls on other carriers' networks at cost-oriented rates. The FCC has made clear that "[t]he interconnection obligation of Section 251(c)(2) . . . allows competing carriers to choose the most efficient points at which to exchange

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[34] Emphasis added.

[35] Directive 97/33/EC, Interconnection in Telecommunications, Art. 2(1)(a), available at http://europa.eu.int/ispo/infosoc/telecompolicy/en/dir97-33en.htm.

[36] *Commission Recommendation on Interconnection in a Liberalised Market, Part 1 – Interconnection Pricing*, Explanatory Memorandum (January 8, 1998), Sect. 3.1 (emphasis in original), available at http://www.europa.eu.int/ISPO/infosoc/telecompolicy/en/r3148-en.htm.

traffic with incumbent LECs, *thereby lowering the competing carriers' costs of, among other things, transport and termination of traffic*."[37] U.S. law defines "transport and termination" separately from interconnection because U.S. local exchange carriers have *additional* obligations with respect to the transport and termination of calls, including the requirement to establish "reciprocal compensation arrangements" for the termination of calls originated on other local networks.[38] As described above, the Reference Paper definition of interconnection includes both interconnection and transport and termination, as each is defined under U.S. law.

57. As explained by the United States in its Oral Statement at the First Meeting of the Panel, Mexico's argument in paragraphs 155-163 of its First Written Submission that Section 2 of the Reference Paper does not apply to interconnection provided to cross-border suppliers merely because some provisions of Section 2 do not apply is mistaken. The fact that some of the requirements of Section 2 may not apply to cross-border interconnection does not mean that other requirements of Section 2 do not apply. Several of these requirements do in fact apply to such interconnection. The border is clearly a "technically feasible point" of interconnection under Section 2.2, in addition to other technically feasible points in the major carrier's network where cross-border suppliers might wish to interconnect. Requirements for non-discrimination and unbundling are equally relevant to the interconnection of international traffic as they are to the interconnection of domestic traffic.

58. Finally, although Mexico cites to a variety of ITU instruments that it argues limit its WTO commitments,[39] the United States explains in its response to Question 12 that no binding ITU resolutions would be violated by Mexico's compliance with the WTO obligations at issue in this dispute. In fact, the definition of "accounting rates" maintained by the ITU is consistent with the definition of interconnection included in Section 2.1 of the Reference Paper. The ITU has recognized that competition has changed the ways that international carriers compensate one another for interconnection, and that accounting rates are one, and only one, of the alternative charging mechanisms that are available for use between carriers in different countries to interconnect their networks.[40] Recently, the ITU issued a recommendation specifically listing

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[37] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* 11 FCC Rcd. 15499, para. 172 (1996) (emphasis added) (Exhibit US-55).

[38] *See* 47 U.S.C. § 251(b)(5) (Exhibit US-56). Traffic terminated under reciprocal compensation arrangements is subject to the same "forward-looking economic cost-based pricing standard" that governs other interconnection services provided by incumbent local carriers. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* 11 FCC Rcd. 15499, para. 1054 (Exhibit US-55).

[39] First Written Submission of Mexico, para. 21 *et seq.*

[40] ITU recommendations and numerous other publications have long recognized the validity of alternatives to the accounting rate system. *See* ITU, *Accounting Rate Reform undertaken by ITU-T Study Group 3*, para. 6 ("Perhaps as much as half of all international traffic now passes outside the accounting rate system."), available at http://www.itu.int/ITU-T/studygroups/com03/accounting-rate/index.html. *See also* ITU, *World Telecommunication Development Report 1996/7,* Section 6.2.3 (describing "alternative calling procedures," including international simple resale (ISR), international virtual private network services (IVPNS), and voice over data networks), Section

some of the new systems for accounting in international telephony, including but not limited to a flat rate procedure, traffic unit price procedure, accounting revenue division procedure, settlement rate procedure, and termination rate procedure.[41]

59. In sum, Mexico has failed to rebut the United States' showing that interconnection provided to cross-border suppliers falls within Section 2 of the Reference Paper. Neither the ordinary meaning of the text of the Reference Paper nor its negotiating history support Mexico's argument.[42] Having failed to rebut the United States' showing that Section 2 of the Reference Paper applies, Mexico must refute the United States' affirmative showing that Mexico has failed to ensure that the rates charged by Telmex for interconnection provided to cross-border suppliers are not *basadas en costos* and that the terms and conditions of interconnection with Telmex are unreasonable. As explained below, Mexico has failed to refute the United States' showing on these points.

B. Mexico Has Failed To Rebut the United States' Affirmative Showing that Telmex's Rates Are Not Basadas En Costos and that the Terms and Conditions of Interconnection with Telmex are Unreasonable

60. As noted in the U.S. Oral Statement at the First Meeting of the Panel, Mexico does not argue that its interconnection rates are *basadas en costos*. Specifically, Mexico has not challenged the factual evidence submitted by the United States that the rates charged for mode 1 interconnection substantially exceed the price charged to domestic suppliers for the exact same

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6.3.1 ("[I]f the main purpose of the settlements payment were to redistribute wealth, it would be a poorly designed tool," with several OECD countries, including Mexico, Canada, Japan and the Republic of Korea, receiving "net settlements in excess of US$100 million," while "sub-Saharan Africa as a whole received just US$ 125 million, or 2 percent of the total."), available at http://www.itu.int/osg/spu/intset/whatare/wtdr/chap_6.pdf.

[41] ITU-T Recommendation D.150, *New System for Accounting in International Telephony* (June 1999) (Exhibit US-57).

[42] Mexico also errs in suggesting, in paragraph 19, footnote 2 of its First Written Submission, that the FCC's "*Benchmarks Order*," which requires U.S. carriers to negotiate lower accounting rates, is inconsistent with the U.S. claim in this proceeding that Mexico's WTO Reference Paper obligations apply to settlement rates. The FCC recognized in the *Benchmarks Order* that "[t]he WTO Basic Telecom Agreement reached on February 15, 1997 will have profound effects on the accounting rate system," since 69 countries had agreed to open their markets, and 59 countries had agreed to implement the Reference Paper. *International Settlement Rates*, 12 FCC Rcd. 19806, para. 9 (1997), available at http://www.fcc.gov/Bureaus/International/Orders/1997/fcc97280.txt. The FCC went on to state that "the WTO Basic Telecom Agreement will fundamentally change the nature of relations between international telecommunications carriers," and expected that its benchmarks would be "moot for competitive countries and carriers." *Id*., paras. 10, 14. However, the FCC emphasized that "[n]onetheless, the benchmarks are necessary because many countries still will not be open to competition." *Id*. Thus, the FCC was particularly concerned by the failure to achieve meaningful accounting rate reform through the ITU, the 189-country membership of which includes the large majority of countries for which benchmark rates were established by the *Benchmarks Order*. The countries opening their markets and accepting the Reference Paper comprised less than twenty-five percent of the nearly 250 routes for which the FCC established benchmark accounting rates. The *Benchmarks Order* was necessary to fill this gap.

network components and services. Instead Mexico argues incorrectly that under the United States' methodology, "accounting rates negotiated between Mexican and U.S. carriers [must be] set no greater than domestic interconnection rates."[43]

61. As explained in the U.S. Oral Statement at the First Meeting of the Panel, the United States is not arguing that the costs of mode 1 interconnection must always be equal to the costs for domestic interconnection for commercially-present suppliers. The United States claims in paragraphs 121-140 of its First Written Submission that pursuant to Section 2.2(b) of the Reference Paper, the maximum cost that Telmex could incur for interconnection provided cross-border suppliers is the price charged to domestic suppliers for the exact same network elements. Since Mexican law requires that domestic interconnection rates must recover at least the total cost of all network elements,[44] interconnection rates for cross-border suppliers that exceed rates for domestic suppliers using the same network elements are by definition not based in cost.

62. To avoid any confusion, the United States is asking that the Panel determine that the rates currently charged by Telmex for interconnection provided to cross-border suppliers are not based in cost. The United States is **not** asking that the Panel determine a rate that would be considered *basadas en costos*. Given this limited request, in the view of the United States, the Panel need not define the term *basadas en costos* or otherwise catalog the specific types of costs that might be included in a cost calculation. In this dispute, it is uncontested that rates for international interconnection exceed rates for domestic interconnection by 127 to 283 percent (using the exact same network elements),[45] and that rates for domestic interconnection are required by Mexican law to be based in cost.[46] Whatever the definition of "*basadas en costos*," under these circumstances Mexico's international interconnection rates cannot be considered cost-based. The Panel's analysis need go no further than this.

63. The United States has provided substantial additional evidence that the rates currently charged by Telmex for interconnection provided to cross-border suppliers are not based in cost. For example, the United States has shown that the interconnection rates charged by Telmex greatly exceed the "grey market" retail rates for calls into Mexico[47] and that Telmex's rates exceed wholesale rates for the termination of calls into other countries.[48] In addition, the United States has shown that the rates charged by Telmex exceed the 1.5 to 4 cents per minute

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[43] First Written Submission of Mexico, para. 179.

[44] First Written Submission of the United States, para. 124.

[45] *See id.*, paras. 128-136.

[46] *See id.*, para. 124, note 118.

[47] *See id.*, paras. 141-145.

[48] *See id.*, paras. 146-147.

negotiated by U.S. carriers with carriers in numerous other countries where competitive conditions are allowed to govern rate negotiations.[49]

64. Lastly, the United States has shown that the financial compensation procedures required by Mexico's ILD rules among Mexican operators further demonstrate that Telmex's rates are above cost. ILD Rule 17 allows a Mexican operator that has not terminated international traffic (and hence has incurred no cost) to receive a share of the interconnection rate for a call terminated on another operator's network and for which another operator paid all the costs incurred. Indeed, the mere existence of the financial compensation procedures in Rule 17 should be regarded as an admission by Mexico that the interconnection rates charged to cross-border suppliers are not *basadas en costos*.[50]

65. Mexico makes only limited comments on the cost model presented in paragraphs 121-140 of the United States' First Written Submission. In paragraph 180 of its First Written Submission, Mexico criticizes the United States' reference, in paragraphs 141-145 of its own First Written Submission, to "grey market" retail rates for the transport and termination of international minutes into Mexico. These rates provide another estimate of what some operators are currently paying for the network components used to terminate calls in Mexico. Mexico argues that since these types of "grey market" - or bypass - arrangements are illegal in Mexico, they are not suitable as measures of true cost, just as (according to Mexico) illegally downloaded music is not a measure of the true cost of producing the music. Mexico's analogy is evidently flawed. In the case of illegally downloaded music, no one pays for the use of the downloaded music. On the other hand, in the case of illegal bypass, the users of bypass are paying for the use of those network elements. Mexico does not assert that bypass rates do not cover the costs of the various components involved in providing bypass service. Nor does it identify any cost that is not recovered by bypass rates.

66. Nor is Mexico assisted by its argument, in paragraphs 191-193 of its First Written Submission, that its accounting rates are consistent with ITU recommendations on benchmark rates. As the United States explains in its response to Question 12, neither ITU recommendations nor ITU benchmarks are relevant to Mexico's WTO obligations. In any event, Recommendation ITU D-140, included by Mexico as Exhibit MEX-11, expressly states, at paragraph E.3.2, that the benchmark levels discussed therein should not be "taken as cost-orientated levels."

67. Mexico also argues that the United States' claim must fail because it does not take into account the phrase "having regard to economic feasibility."[51] The United States explains in

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[49] *See id*., para. 121.

[50] *See id*., paras. 148 to 156.

[51] First Written Submission of Mexico, para. 181.

detail in response to Question 14 from the Panel that taking this phrase into account does not change the fact that Telmex's rates are substantially above cost and that, as a result, Mexico is not in compliance with Section 2 of the Reference Paper.

68. As explained in that response, the phrase "having regard to economic feasibility" must be read in the context of subparagraph 2.2(b) of the Reference Paper in its entirety, which requires "terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components and facilities that it does not require for the service to be provided." This phrase immediately follows the requirement for "reasonable" terms and conditions for interconnection, which prohibits the use of such terms and conditions to restrict the supply of a scheduled basic telecommunications service.

69. As illustrated in further detail in response to Question 14(a), under the ordinary meaning of the phrase "having regard to economic feasibility," a term or condition for interconnection will not be "*razonables*" if it restricts the supply of a scheduled telecommunications service where such interconnection is economically practical or possible - that is, where the resulting revenues are sufficient to cover the expenses of its operation or use. The phrase limits the obligation to provide interconnection on reasonable terms and conditions only where there is insufficient demand from interconnecting suppliers to generate sufficient revenue to cover the expenses of operation or use, or where a major supplier requires an additional period of time to install necessary switching capabilities or other required network components or facilities where more rapid installation would entail very high costs that could not be recovered from interconnecting suppliers. These circumstances are not present in the case of Mexico, as explained in detail in the U.S. response to Question 14(b).

70. As further explained in the U.S. response to Question 14(a), to the extent that the phrase "having regard to economic feasibility" limits the obligation to provide interconnection at rates that are "*basadas en costos*," it means that interconnection rates should be sufficient to cover the expenses of the operation and use of interconnection, which requires no more than that interconnection rates should cover both direct costs and common costs, and should permit a reasonable return on an operator's investment. As the United States explains in its response, both direct and common costs are already included in the long-run average incremental cost methodology used by Mexico to develop its interconnection rates. Thus, the U.S. cost model included in its First Written Submission already accounts for the direct and common costs that Mexican operators are entitled to under the "having regard to economic feasibility" language in Section 2.2(b) of the Reference Paper. Moreover, 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.[52]

71. The phrase "having regard to economic feasibility" does not "temper" a Member's obligation to provide interconnection at cost-oriented rates, in light of its "overall policy goals for expanding its telecommunications infrastructure," as Mexico suggests at paragraph 181 of its First Written Submission. As the United States notes in its response to Question 14(c), Section 2.2(b) of the Reference Paper requires a relationship between interconnection rates and the cost incurred in providing *interconnection*, rather than costs incurred in connection with telecommunications infrastructure roll-out. As further discussed in response to Question 14(c), the requirement of Section 2.2(c) that a supplier purchasing unbundled interconnection arrangements "need not pay for network components or facilities that it does not require for the [interconnection] service to be provided" offers relevant context, and further makes clear that the scope of all interconnection charges is limited to the specific network components and facilities required for interconnection, and does not include other unrelated costs. Additionally, Section 3 of the Reference Paper imposes separate and particular requirements for Members wishing to impose universal service obligations to fund the requirements of Members seeking to rollout their national telecommunications infrastructure. Mexico seeks to avoid the requirements of Section 3 (and to read Section 3 out of the Reference Paper) by justifying its rollout costs pursuant to the phrase "having regard to economic feasibility."

72. Mexico also argues that the United States' claim should fail because its interpretation of the term "reasonable" in Section 2.2(b) is "overly and blatantly simplistic."[53] Mexico offers no alternative interpretation, however.

73. The United States established the meaning of the term "*razonables*" in the context of Section 2.2 of the Reference Paper in paragraphs 158-166 of its First Written Submission. As also discussed in response to Question 23, the ordinary meaning of "reasonable" is general[54] and suggests that terms and conditions are reasonable if they are appropriate or sensible or rational. The context of the term as used in the Reference Paper, and the object and purpose of the Reference Paper itself, infuse concrete meaning into this term. The term "reasonable" in Section 2.2 of the Reference Paper appears in the context of interconnection. Section 2.2 requires

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[52] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, para. 677 (1996), *citing* William Baumol, ECONOMIC THEORY AND OPERATIONS ANALYSIS (Fourth Ed. 1977), pg. 290 ("The very long run is a period so long that all of the firm's present contracts will have run out, its present plant and equipment will have been worn out or rendered obsolete and will therefore need replacement, etc.") (Exhibit US-55). *See id.,* para. 700 (cost of capital is equal to a normal profit).

[53] First Written Submission of Mexico, para. 182.

[54] The ordinary meaning of "reasonable" is "in accordance with reason; not irrational or absurd . . . having sound judgement; ready to listen to reason, sensible . . . within the limits of reason; not greatly less or more than might be thought likely or appropriate; moderate." THE NEW SHORTER OXFORD ENGLISH DICTIONARY (Fourth Ed. 1993), pg. 2496.

Mexico to ensure that *interconnection* with its *major supplier* is on reasonable terms and conditions – that is, ensuring that the major supplier not abuse its market power to impose limitations on interconnection, or to extract non-cost-oriented prices for interconnection, that will reduce demand for and restrict the supply of basic telecommunications services.

74. Obviously, the United States is not arguing that *any* charge for interconnection or that *any* term or condition imposed upon interconnection is unreasonable. The determination of reasonableness must be made on a case-by-case basis. The facts of this dispute clearly show that Mexico has failed to ensure that the terms and conditions for interconnection with Telmex are reasonable - that is, Mexico has failed to ensure that those terms and conditions reign in Telmex's ability to abuse its market power and restrict the supply of basic telecommunications services. As explained in paragraphs 167-188 of the United States' First Written Submission, Mexico's failure is not just one of omission. Through its ILD rules (including Rules 3, 6, 10, 13, 22 and 23), Mexico enables Telmex to restrict the supply of scheduled basic telecommunications services through its exclusive negotiating authority and power to set interconnection rates for all Mexican carriers. This regime allows Telmex to set inflated interconnection rates by insulating it from any competitive pressure. This in turn undermines competition, harms consumers and represents a windfall to Telmex. U.S. carriers have no choice but to negotiate with Telmex, and cannot negotiate to use a more competitive rate with any other Mexican carrier. Indeed, as explained in paragraphs 177-181 of the U.S. First Written Submission, Mexico has denied every request by both U.S. and Mexican carriers to interconnect at rates other than those negotiated by Telmex. Mexico's denials of these requests reinforces that Mexico has taken affirmative steps to protect Telmex from competition, and to preserve unreasonable terms and conditions of interconnection.

75. The result of Mexico's failure to ensure interconnection on reasonable terms and conditions is that Telmex has indeed restricted the supply of scheduled services. It is undeniable that Mexico's ILD rules restrict Mexican suppliers from competing to terminate calls that originate in the United States. This results in an inflated interconnection rate which in turn reduces demand for the cross-border supply of services. As explained in paragraph 185 of the U.S. First Written Submission, typical retail rates for calls into Mexico from the United States for one representative carrier equal approximately 34 cents per minute. In contrast, it costs 6 cents per minute to call Canada from the United States and approximately 9 cents per minute to call the United Kingdom.[55]

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[55] Mexico's assertion in paragraph 17 of the Appendix to its First Written Submission that "U.S. carriers did not pass through to consumers all of the savings resulting from lower settlement rates" is belied by the data in the table in paragraph 15 of Mexico's Appendix. That table shows that, between 1992 and 2000, average rates that U.S. carriers paid to foreign carriers fell by 40 cents per minute, while U.S. prices fell by 57 cents per minute. Thus, Mexico's own data shows that U.S. carriers not only passed through to U.S. consumers all rate reductions in lower consumer prices, but also reduced consumer prices by a further 17 cents.

76. As also explained in paragraph 185 of the U.S. First Written Submission, the excessive interconnection rates charged by Telmex constitute an unfair windfall subsidy from U.S. consumers to Telmex. This subsidy can be used by Telmex to entrench its dominant position in Mexico and further stifle the supply of scheduled services.

77. In sum, through Mexico's ILD rules and Mexico's denial of all requests for alternative interconnection rates, Mexico has restricted the ability of U.S. suppliers to supply basic telecommunications services into Mexico on reasonable terms and conditions. Instead, Mexico insulates Telmex from competition which allows it to negotiate interconnection rates that the United States has demonstrated are not *basadas en costos*. Mexico has not even attempted to rebut this demonstration. As noted in our First Written Submission, Mexico's regime is the antithesis of the disciplines set forth in the Reference Paper, which are to provide safeguards that prevent a major supplier like Telmex from using the terms, conditions and rates of interconnection to thwart competition and undermine the competitive supply of scheduled services. For these reasons, the United States requests the Panel to find that Mexico has failed to ensure that Telmex provides interconnection on reasonable terms and conditions and at rates that are *basadas en costos*.

IV. CONTRARY TO SECTION 1 OF THE REFERENCE PAPER, MEXICO'S ILD RULES PROMOTE ANTI-COMPETITIVE PRACTICES, RATHER THAN PREVENT THEM

78. The United States established in its First Written Submission that Mexico's ILD rules violate Mexico's commitments under Section 1 of the Reference Paper. Mexico does not contest that Telmex is a "major supplier" under the Reference Paper, or that Mexico's ILD rules mandate the setting of uniform prices by Telmex for its smaller competitors, or that such conduct normally constitutes the anti-competitive practice known as "price-fixing."

79. The United States explained that, while the Reference Paper does not expressly define the term "anti-competitive practices," the term at least encompasses what are generally agreed to be the most egregious examples of anti-competitive behavior, including horizontal price-fixing agreements.[56]

80. The context in which the term "anti-competitive practices" appears helps interpret its meaning. Section 1.1 of the Reference Paper requires the adoption of appropriate measures to prevent anti-competitive conduct by suppliers who "alone or together" are a major supplier. The "or together" language in Section 1.1 indicates that the negotiators attached relevance to horizontal coordination between suppliers. Although this phrase has direct relevance to the definition of "major supplier," it also lends context to the interpretation of the term

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[56] Oral Statement of the United States at the First Panel Meeting, para. 34.

"anti-competitive practices," which the United States contends includes, at the very least, horizontal price-fixing agreements.

81. The interpretation of the term "anti-competitive practices" is also informed by the trade-liberalizing purposes of the GATS and the Reference Paper, other international sources, and the Parties' own domestic competition laws.[57] The Reference Paper was intended to ensure that new (foreign) entrants into previously monopolized basic telecommunications markets would not be blocked from market access by the former monopoly's exclusionary actions. Preventing new rivals from offering lower prices will greatly impede competition in almost any normal market.[58] Many WTO Members have competition laws, and nearly all of those laws (including those of Mexico and the United States) forbid horizontal collusion such as price fixing.[59] The OECD Council maintains a recommendation to Members (including Mexico) that they use available legal tools to prevent "hard core cartel" practices such as price fixing.[60]

82. Mexico responds that it is in compliance with Section 1 because it is not obligated under Section 1 to "guarantee that anti-competitive conduct will not occur or to stop all such conduct."[61] Mexico asserts that it has implemented appropriate measures in the form of Telmex's "concession" agreement, COFETEL's "dominant carrier" regulations (currently suspended, we understand), and the Federal law of Economic Competition, enforced by the Federal Competition Commission.[62] Mexico (and the European Communities) also argue that the price-setting activities called for under the ILD rules cannot be considered in violation of Section 1 of the Reference Paper - or even "anti-competitive" - because they are protected by

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[57] *See* First Written Submission of the United States, paras. 193-194; Response of the United States to Questions 17(a), 19(a).

[58] *See* J. Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION (1988), pg. 65 (exercise of monopoly power over price "leads to a price that is too high and to a 'dead-weight' welfare loss for society") (Exhibit US-58).

[59] *See* WTO Working Group on the Interaction between Trade and Competition Policy, *The Fundamental Principles of Competition Policy* (Exhibit US-42); WTO Working Group on the Interaction between Trade and Competition Policy, *Overview of Members' National Competition Legislation*, available at http://www.wto.org/english/tratop_e/comp_e/comp_e.htm (under "Working Documents"); Sherman Antitrust Act, 15 U.S.C. § 1 (Exhibit US-59); Mexico's 1992 Federal Law of Economic Competition, Article 9 (Exhibit US-60).

[60] OECD, *Recommendation of the Council Concerning Effective Action against Hard Core Cartels*, available at http://www.oecd.org/pdf/m00018000/m00018135.pdf.

[61] First Written Submission of Mexico, para. 203.

[62] Mexico's "FCC" ("CFC" in Spanish) has repeatedly determined that Telmex is "dominant" in various telecommunications markets, including international traffic. Its initial ruling was enjoined by "*amparo*" orders obtained by Telmex through Mexican courts on procedural grounds without addressing the substance of the dominance finding, but its more recent affirmation of that ruling in 2001 remains in effect and is not disputed by Mexico. *See* First Written Submission of the United States, para. 75. *See also* Dow Jones Business News, *Mexico's Antitrust Commission Rules Against Telmex, Again* (January 15, 2003) (Exhibit US-52).

Mexican law.[63] Finally, Mexico argues that, in any event, its ILD rules, including Rule 13, are actually pro-competitive, not anti-competitive, and were adopted to mirror the proportionate return system in the United States.

83. As explained during the first meeting of the Panel, the United States is not arguing that Mexico must guarantee that anti-competitive behavior does not occur. Rather, the United States agrees that the obligation under Section 1 requires only the maintenance of appropriate measures. The Reference Paper leaves Members with wide latitude as to the measures that may be maintained to prevent anti-competitive conduct, through general competition laws, or instead or in addition through regulatory measures (behavioral or structural),[64] or even administrative actions directed at officers of those "major suppliers" who might be government appointees. What matters is that a Party maintain measures of some sort to prevent, not stimulate or condone, anti-competitive marketplace conduct. As explained in the United States First Written Submission, however, in addition to the general competition measures cited by Mexico, Mexico actually maintains measures that *require* anti-competitive conduct. Mexico's measures do guarantee a result, but that result is anti-competitive. Under the ILD rules, Telmex is given the exclusive authority to negotiate the interconnection rate with cross-border suppliers, and all other Mexican carriers must use that rate. These measures perpetuate Telmex's control of interconnection for the origination and termination of international calls, and stifle market challengers by maintaining artificially high interconnection rates.

84. The fact that Telmex's anti-competitive behavior is compelled by Mexican law does not alter the analysis under Section 1 of the Reference Paper. As explained in the U.S. response to Question 17c), if price-fixing is anti-competitive, then it is anti-competitive even if required by law. Section 1 does not say that appropriate measures to prevent anti-competitive actions need be maintained only where those actions already happen to be illegal under general domestic competition laws. Mexico cannot say that because it may have immunized Telmex's conduct from Mexican competition law it has no further obligation under Section 1 to deal with such conduct. Nor can it credibly argue that its general competition law is its appropriate measure to prevent anti-competitive conduct in international long distance telephony if that market, or particular aspects of that market, are outside the scope of that very law. The United States notes that it is *Mexico's* failure to observe the obligations of Section 1 that is at issue in this dispute – *not Telmex's* failure to observe those obligations. If a WTO Member were able to immunize itself from the obligation incumbent upon it under Section 1 to take measures to prevent anti-competitive conduct by major suppliers by simply *requiring* anti-competitive conduct by major suppliers, the entire purpose of Section 1 would be undermined. Such an interpretation of

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[63] First Written Submission of Mexico, para. 206; Replies by the European Communities to the Questions of the Panel, paras. 46, 49.

[64] *See* First Written Submission of the United States, para. 193 and footnote 175 (examples of regulatory actions taken by the U.S. FCC against anti-competitive practices).

Section 1 would encourage Members affirmatively to maintain measures requiring anti-competitive conduct, rather than put in place measures to prevent anti-competitive conduct.

85. Finally, Mexico's extraordinary assertion that its ILD rules, including Rule 13, serve to "promote competition," and are based on the proportionate return system in the United States, should be rejected as contrary to basic economics and the facts. Mexico has failed to show any way in which its restrictions in issue, including uniform pricing, proportionate return and the exclusive authority given to the largest carrier (which has always been Telmex) to determine accounting rates for all Mexican carriers, have served to promote competition. Mexico's naked prohibition on competition on all international routes between firms that would otherwise be direct competitors is unique[65] among WTO Members that have opened their markets to competition. This prohibition accomplishes exactly the opposite of promoting competition.

86. The United States demonstrated in its First Written Submission that the actual effect of this prohibition on price competition is what would be expected under basic economic principles: prices for interconnection of cross-border traffic by Mexican carriers remain well above costs. While Mexico touts reductions that have occurred over the past several years, these reductions cannot reasonably be attributed to Mexico's ILD Rules, which provide for no possibility of competitive pressure on interconnection rates at all.

87. It is apparent that a principal reason for Mexico's continued maintenance of this ILD regime is to prevent the smaller Mexican international carriers, some of which are affiliated with U.S. or other foreign providers, from undercutting the above-cost prices charged by Telmex and thereby diverting more traffic to themselves. Mexico acknowledged in its First Written Submission this concern about smaller Mexican carriers engaging in a "price war" with Telmex,[66] and it reiterated its fear in responding to oral questions from the Panel. Mexico's maintenance of the ILD rules, in other words, is not directed at preventing harm to competition but rather is directed at preventing the natural results of competition. This can only be regarded as anti-competitive.

88. In light of this, Mexico's purported concern about protecting the smaller carriers from behavior by Telmex directed at colluding to excluding them or securing better terms for itself is specious. Mexico has offered no evidence that the smaller Mexican carriers need to be protected by the ILD rules from a competitive market or their principal rival Telmex. Rather, their best prospects of building market share and challenging Telmex's dominance 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

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[65] Mexico is the only WTO Member with competitive suppliers of international facilities-based services that prohibits competitive negotiations for the termination of international calls. *See* First Written Submission of the United States, para. 5.

[66] First Written Submission of Mexico, para. 79.

or predatory conduct, once the constraints of the ILD rules are lifted. The mere possibility of private collusion or other competitive misconduct cannot reasonably justify government-mandated collusion as a remedy, as Mexico has done.

89. Mexico also suggests that the ILD rules are needed to promote "investment."[67] A need to promote investment, however, does not alter Mexico's obligation under Section 1 of the Reference Paper. By virtue of its scheduled commitments, Mexico is not permitted to compel Telmex to engage in anti-competitive behavior in the hope that Telmex's profits (far in excess of costs) will be used for network investment.

90. If Mexico wished to promote "investment," it could do so under Section 3 of the Reference Paper, which provides for separate universal service obligations to fund the requirements of Members seeking to build out their national telecommunications infrastructure. Section 3 states that "[a]ny Member has the right to define the kind of universal service obligation it wishes to maintain," as long as that obligation is "administered in a transparent, non-discriminatory and competitively-neutral manner and . . . not more burdensome than necessary." Because the ILD rules allow only Telmex to negotiate settlement rates that are binding on all other carriers, they cannot be said to be competitively-neutral.

91. In any event, Mexico does not impose on Telmex any specific obligations to invest in network build-out. Telmex is free to use its above-cost profits for dividends to shareholders, high executive compensation, foreign acquisitions or any other business activity. As shown in Attachment A to the First Written Submission of the United States, at paragraph 7 and footnote 16, Mexico's teledensity has fallen behind not only most OECD members but numerous other Latin American countries, including ones such as Chile that are substantially more open to competition than is Mexico. At the same time that Telmex has continued to collect revenues well in excess of costs for interconnecting international traffic, it has also been imposing domestic telephone charges that are among the highest of any of the OECD countries.[68] This has predictably kept telephone service penetration low, and has helped to keep Telmex's profits and stock price high. The regime of the ILD rules, in sum, cannot be said to have any logical connection either to promoting competition or encouraging investment.

92. That Mexico's ILD rules promote anti-competitive conduct, rather than protect competition, is confirmed by a comparison to the international service rules in force in the United

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[67] First Written Submission of Mexico, para. 77.

[68] Mexico's comparison (in footnote 124 to its First Written Submission) of Telmex's share of international long-distance traffic to that of AT&T in domestic long-distance services when it was declared non-dominant in 1995 fails to acknowledge that Telmex continues to control 97 percent of the local exchange access lines in Mexico. In contrast, AT&T's former local exchange services were divested in 1984, and the FCC accordingly found in 1995 that "AT&T has not controlled local bottleneck facilities for over ten years." *Motion of AT&T Corp. To be Reclassified as a Non-Dominant Carrier,* 11 FCC Rcd. 3271, para. 70 (1995) (Exhibit US-61).

States. Although never mentioned by Mexico, there are numerous critical differences between the regulations of the U.S. Federal Communications Commission and the ILD rules.

93. Unlike Mexico's ILD rules, U.S. international telecommunications regulation is based on an explicit policy objective of cost-oriented rates for international interconnection, and no U.S. carrier has exclusive negotiating authority for the industry.[69] Indeed, no U.S. carrier had such authority at the time Mexico adopted its ILD rules either, and it is simply false to suggest that U.S. regulation served in any way as a model for the power given to Telmex under ILD Rule 13. The U.S. requirement for nondiscriminatory rates allows U.S. carriers to take advantage of rates negotiated by other carriers, but U.S. carriers negotiate independently and any U.S. carrier may always seek to negotiate a more favorable rate. Moreover, the U.S. policy also has been significantly reformed over the past several years, to reflect the evolution of a competitive international telecommunications environment on many routes.[70] Among other things, this reform responded to the effects of the WTO basic telecommunications service commitments of the United States, and many other Members. The United States recognized, unlike Mexico, that rules originally developed to protect against competitive abuses by foreign monopolies are no longer necessary, and indeed can prove anti-competitive, when applied to arrangements with foreign carriers that do not possess market power. For example, where the foreign counterparts of U.S. carriers lack the market power to set the conditions for the termination of international traffic, proportionate return obligations are not necessary as the risk of anti-competitive conduct is low. In those circumstances, requirements for proportionate return can deter price reductions by limiting the ability to gain an increased volume of traffic in return.

94. Accordingly, the United States currently applies requirements for proportionate return, as well as the other requirements of its International Settlements Policy, *e.g.*, for nondiscriminatory rates, *only* to U.S. carrier arrangements with cross-border suppliers that *both* (1) possess market power at the foreign end of the international route, *and* (2) maintain high settlement rates.[71] The

[69] As the United States noted in paragraph 41 of its Oral Statement at the First Panel Meeting, contrary to Mexico's statement in paragraph 208 of its First Written Submission that WorldCom would not allow other U.S. carriers to participate in recent negotiations with Telmex, WorldCom has no authority to prevent independent negotiations by other U.S. carriers, and Telmex has no obligation to comply with any such request by WorldCom.

[70] *See International Settlements Policy Reform*, IB Docket No. 02-324, Notice of Proposed Rulemaking (released October 11, 2002), paras. 4-6, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-02-285A1.pdf.

[71] *See id.*, para. 5 (International Settlements Policy, which requires proportionate return as well as equal division of accounting rates between the U.S. and foreign carrier and availability of rates to all U.S. carriers on a nondiscriminatory basis, does not apply where the foreign carrier lacks market power, and may be removed where settlement rates are 25 percent below FCC benchmarks). Additionally, the FCC authorizes ISR arrangements, which are exempt from proportionate return, with even dominant foreign carriers (*i.e.*, that possess market power at the foreign end of the international route) from WTO Member countries that have agreed to accept FCC benchmark rates (non-WTO members are also eligible if they provide equivalent treatment for ISR). The FCC has authorized ISR arrangements with dominant foreign carriers in 83 countries. *See* http://www.fcc.gov/ib/pd/pf/isr.html.

United States applies these rules to arrangements with dominant suppliers with high rates in order to prevent those dominant suppliers from using their market power to obtain additional concessions from competing U.S. suppliers. Except for dominant suppliers with high rates, cross-border suppliers into the United States are not subject to these U.S. international regulations. Thus, all suppliers, from all countries, that do not possess market power at the foreign end of the relevant international route, including all Mexican suppliers except Telmex, are not subject to these U.S. rules, and may send unlimited amounts of U.S.-bound traffic at any rates they negotiate with any U.S. supplier.

95. As explained in response to Question 19(d), it is pro-competitive rather than anti-competitive to apply a proportionate return system narrowly to prevent dominant suppliers with high settlement rates from using their market power to receive increased above-cost subsidies. However, Mexico does not apply proportionate return in this pro-competitive manner. Rather than use proportionate return to prevent the abuse of market power, Mexico requires all cross-border suppliers to comply with proportionate return, irrespective of whether they possess market power. As Mexico acknowledges at paragraphs 207-209 of its First Written Submission, its proportionate return requirement operates "in combination with" the Telmex monopoly on rate negotiations and the requirement for uniform rates to prevent one Mexican supplier "undercutting" any other Mexican supplier, or otherwise competing to increase its share of traffic received from U.S. cross-border suppliers. Given that eighty to ninety percent of Mexico's total international traffic is with the United States, as shown in the First Written Submission of the United States at paragraph 94 and footnote 79, the principal effect of the price-fixing scheme of the ILD rules is apparent. Mexico applies proportionate return broadly to all suppliers with the acknowledged purpose of preventing price competition and thereby ensures the continued payment of above-cost subsidies resulting from the abuse of market power by Telmex.

96. In sum, it is clear from Mexico's statements in this dispute and the design of the ILD rules themselves that the rules require anti-competitive behavior by Telmex, which serves to protect the profits Telmex garners from above-cost interconnection rates charged U.S. carriers. These rules do not in any way promote competition, and in fact actively frustrate it. As explained in our First Written Submission at paragraphs 202-203, these rules, particularly Rules 13 and 23, prevent Mexican and foreign suppliers from agreeing to alternative rates that could exert competitive pressure on the rate exclusively negotiated by Telmex. This situation is exacerbated by the fact that Mexico does not allow "resale" despite having taken a specific commitment to do so (*i.e.*, the use of private leased circuits). Thus, U.S. suppliers have no choice but to pay the Telmex negotiated interconnection rate if they want to supply scheduled services. Mexico's ILD rules are the antithesis of "appropriate measures" to prevent anti-competitive practices. As a result, the Panel should conclude that Mexico has failed to comply with its obligation under Section 1 of the Reference Paper.

V. MEXICO HAS FAILED TO ENSURE ACCESS TO AND USE OF PUBLIC TELECOMMUNICATIONS TRANSPORT NETWORKS AND SERVICES IN ACCORDANCE WITH SECTION 5 OF THE GATS ANNEX ON TELECOMMUNICATIONS

97. The United States established in paragraphs 216-246 of its First Written Submission that Mexico has failed to ensure that U.S. service suppliers have access to or use of public telecommunications networks or services in Mexico on reasonable terms and conditions, within the meaning of Section 5(a) of the Annex on Telecommunications. The United States also established in paragraphs 252-296 of its First Written Submission that Mexico has failed to ensure that U.S. facilities-based operators and commercial agencies have access to and use of private leased circuits as required under Section 5(b) of the Annex.

98. In response, Mexico argues that the Annex does not apply to suppliers of public telecommunications services in general, and does not apply specifically in Mexico due to limitations in Mexico's Schedule. Mexico also argues that, even if the Annex does apply, the U.S. claims should be rejected because, according to Mexico, the United States has failed to demonstrate that Mexico's measures are *not* justified under Section 5, subparagraphs (e) and (f).[72] For the reasons explained below, each of these arguments is defective and should be rejected by the Panel.

99. As noted during the U.S. Oral Statement at the First Meeting of the Panel and in response to Question 21 from the Panel, Mexico's first argument is without merit and simply not credible. In outlining the objectives for the Annex, Section 1 states that telecommunications has a "*dual role* as a distinct sector of economic activity and as the underlying transport means for other economic activities. . . ."[73] The Annex does not speak, therefore, solely to the role of telecommunications with respect to "other economic activities," as Mexico asserts. Furthermore, Section 2(a) states that the Annex applies to "*all* measures" affecting access to and use of public telecommunications transport networks and services, without exception.

100. Finally, Section 5(a) states that the obligations are imposed "for the supply of a service included in [a Member's] Schedule." As explained above, and in the U.S. First Written Submission, Mexico undertook specific commitments in its Schedule for the supply of basic telecommunications services in mode 1 for both facilities-based operators and commercial agencies, and in mode 3 for commercial agencies. Thus, it is plain from our written submissions that the United States agrees that the supply of a service is governed by a Member's Schedule. For this reason, Mexico is incorrect to argue that to accept the United States' claims, the Panel

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[72] First Written Submission of Mexico, paras. 214-217, 221-228.

[73] Emphasis added.

would have to find that the Annex "overrides" Mexico's Schedule. Rather, Section 5(a) of the Annex is triggered *because of* the commitments made in Mexico's Schedule.

101. Mexico also argues that it has no obligations under the Annex because it did not undertake a specific commitment to permit either facilities-based operators or commercial agencies to "use" its public telecommunications transport network or services within Mexico or across its border.[74] According to Mexico, this is reflected in the limitation inscribed in its Schedule under mode 3 (commercial presence) for facilities-based operators. That limitation states, in relevant part, "[a] concession from the SCT is required." The term "concession" is defined as "[t]he granting of title to install, operate, or use a facilities based public telecommunications network."

102. Mexico's argument is misplaced, as the United States is not relying upon Mexico's mode 3 commitment for facilities-based operators to invoke its rights under the Annex. Mexico's limitation that a concession granted by the SCT is required is scheduled only for mode 3 facilities-based suppliers and does **not** appear under mode 1 for either facilities-based operators or commercial agencies, and does **not** appear under mode 3 for commercial agencies. Thus, as explained during the first Panel meeting, Mexico's argument is contrary to the ordinary meaning of its Schedule. For mode 1, Mexico's Schedule includes a routing restriction that is not challenged by the United States. As explained above, the routing requirement does not eviscerate Mexico's market access commitment under mode 1. Cross-border suppliers may "access and use" public telecommunications transport networks and services in Mexico consistent with the requirement to route international traffic through the facilities of a Mexican concessionaire.

103. For mode 3 commercial agencies, Mexico inscribed a limitation that a permit is required from the SCT, not a concession.[75] Even the definition of "commercial agencies" included in Mexico's Schedule anticipates that a commercial agency would be leasing capacity from a concessionaire and would not hold the concession itself. Mexico defines "commercial agencies" as "Agencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire."

104. Thus, Mexico's argument that it has limited the category of suppliers that can "use" its public telecommunications networks and services to those that hold a concession is without any foundation in its Schedule. Mode 1 suppliers can "use" Mexico's public telecommunications network and services as long as they route traffic through the facilities of a concessionaire. The same is true for mode 3 commercial agencies. They can "use" Mexico's public

[74] First Written Submission of Mexico, para. 237.

[75] As discussed above, Mexico also inscribed a notation to the effect that it would have to issue relevant regulations. The United States explained above that this notation has no legal effect with regard to Mexico's market access commitment for mode 3 commercial agencies.

telecommunications networks and services as long as they lease the capacity from a concessionaire.

105. Having failed to establish that the Annex does not apply, Mexico must rebut the affirmative showing of the United States that it has failed to comply with Sections 5(a) and (b). In its First Written Submission, Mexico does not respond to the substantive arguments presented by the United States under Sections 5(a) and (b). Significantly, Mexico did not respond to the United States' showing that Mexico has failed to ensure that U.S. service suppliers may interconnect to the public telecommunications networks and services on reasonable terms and conditions under Section 5(a). Mexico did not attempt to rebut the demonstration by the United States that the requirements of the ILD rules, combined with interconnection rates that are not based in cost, prevent Mexico from complying with Section 5(a).

106. Similarly, other than relying upon the limitations in its Schedule, Mexico did not respond specifically to the United States' argument that U.S. service suppliers have no access to and use of private leased circuits in Mexico, and that this constitutes a violation of Section 5(b).

107. Instead, Mexico argues that the U.S. claims under the Annex should be rejected because the United States has not demonstrated that Mexico has failed to comply with Sections 5(e), (f) and (g) of the Annex.[76] As noted at paragraph 49 of the U.S. Oral Statement at the First Meeting of the Panel and in response to Question 26, the United States does not consider Sections 5(e) and (f) necessary to establish a *prima facie* claim under Sections 5(a) and (b) of the Annex.

108. Analogizing to Articles 3.1 and 3.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures,* Mexico makes the unsupported assertion, at paragraph 256 of its First Written Submission, that "there is no general rule-exception relationship" between Sections 5(a)-(b) and 5(e)-(f) of the Annex. Mexico's subsequent citation to Article XX(d) of the GATT as context for the interpretation of Sections 5(e) and (f) is telling.[77] Like Section 5(f), Article XX of the GATT includes a list of measures that may fall within the scope of the provision (Articles XX(a)-(j)). Furthermore, like Section 5(e), Article XX(d) requires that to fall within the scope of the provision, a measure must be deemed "necessary" to achieve a particular goal. In the context of Article XX(d), the Appellate Body has expressly found that the burden of satisfying the "necessity" test falls on the Member invoking the provision.[78]

109. In any event, to rebut Mexico's arguments that certain of its measures are consistent with Sections 5(e) and (f) of the Annex, the United States demonstrates below that, while Mexico may have imposed conditions on access to and use of public telecommunications transport networks

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[76] First Written Submission of Mexico, paras. 253-257.

[77] *Id.*, paras. 262-263.

[78] *See, e.g.,* Report of the Appellate Body in *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161/AB/R, WT/DS169/AB/R ("*Korea - Beef*"), adopted January 10, 2001, para. 157.

and services that fall within the meaning of Section 5(f), those conditions are "other than as necessary" to satisfy the criteria in Sections 5(e)(i)-(iii). Since the conditions do not "satisfy the criteria set out in paragraph [5](e)," Mexico is not permitted to maintain those conditions, pursuant to Section 5(f).

110. The United States challenges three Mexican conditions as inconsistent with Sections 5(a) or (b) of the Annex and as not necessary to achieve the goals listed in Section 5(e)(i)-(iii).[79] First, under ILD Rule 13, Mexico conditions U.S. suppliers' access to and use of public telecommunications networks and services on negotiating exclusively with Telmex. Moreover, as discussed in paragraphs 167-176 of the United States' First Written Submission, ILD Rules 3, 6, 10, 13, 22 and 23 together prohibit Mexican suppliers from concluding an agreement that contains an alternative to the Telmex-negotiated settlement rate for the cross-border supply of scheduled basic telecommunications services.

111. The second condition involves refusing to make private leased circuits available to U.S. facilities-based suppliers, U.S. non-facilities-based suppliers ("commercial agencies") and locally-established commercial agencies for the supply of scheduled voice telephone services.

112. The third condition involves limiting the authority to interconnect private leased circuits to international port operators. As explained in paragraphs 274-276, 285-290 and 295-296 of the United States' First Written Submission, even if U.S. facilities-based suppliers, U.S. non-facilities-based suppliers ("commercial agencies") and locally-established commercial agencies were granted access to and use of private leased circuits from Mexican suppliers, ILD Rule 3 prohibits them from interconnecting those leased circuits with foreign public networks and services. Rule 3 instead limits the authority to interconnect private leased circuits to an international port operator, which must be a Mexican entity.

113. Each of these three conditions is "other than as necessary" to satisfy the criteria of Section 5(e)(i)-(iii). The United States considers that the Panel does not need to define precisely what degree of "necessity" is required here. Rather, it is clear that Mexico's measure does not meet any reasonable degree of necessity.[80]

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[79] The United States also claims that Cofetel's approval of the U.S.-Mexico settlement rate, and the attendant requirement that Mexican suppliers charge foreign basic telecommunications suppliers rates that exceed the cost of providing access to the use of public networks and services, violates Section 5(a) of the Annex. Since the imposition of the above-cost settlement rates is not a "condition" listed in or similar to any of those listed in Section 5(f), however, the United States does not here discuss whether it is "other than as necessary" to achieve the goals listed in Section 5(e). Even if it were necessary to achieve the goals listed in Section 5(e), it is not a "condition" that could be justified pursuant to Section 5(f).

[80] The United States notes in any event that in the context of Section 5(e), while the term "necessary" could refer to a range of degrees of necessity, it would appear to be significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution to a particular goal." See *Korea - Beef*, para. 161, where the Appellate Body took a similar approach to the reading of "necessary" in the context of Article XX(d) of the GATT

114. We begin by demonstrating that the Mexican conditions on access to and use of public telecommunications networks and services discussed above are not necessary to achieve the goal in Section 5(e)(iii) - "to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in the Member's Schedule." This is the only reason offered by Mexico for the conditions imposed on U.S. suppliers. In paragraph 261 of its First Written Submission, Mexico notes that its conditions "are no more than necessary to ensure that foreign suppliers of facilities-based and non-facilities-based telecommunications transport services do not illegally bypass the accounting rate regime contrary to the clear intention of the limitations on market access set forth in Mexico's Schedule."

115. As the United States has already demonstrated, however, Mexico did in fact commit to permit the supply of basic telecommunications services in modes 1 and 3 over leased capacity (typically known as "resale" or, in Mexico's words, "bypass").[81] Since Mexico scheduled its commitment to permit the supply of basic telecommunications on this basis, it cannot justify conditions on access to and use of public telecommunications transport networks and services as "necessary" to prevent such supply. The Mexican conditions discussed above cannot therefore be justified as necessary to achieve the goal listed in Section 5(e)(iii).

116. Nor can the Mexican conditions on access to and use of public telecommunications transport networks and services be considered necessary "to safeguard the public service responsibilities" of Mexican suppliers to, in particular, "make their networks or services available to the public generally," pursuant to Section 5(e)(i).

117. Granting exclusive authority to negotiate interconnection rates to Telmex (and prohibiting other Mexican suppliers from applying anything other than the Telmex-negotiated rate), as well as restricting U.S. carriers from interconnecting private lines to by-pass the Telmex-negotiated rates, ensures that interconnection rates will not be *basadas en costos*. Despite the collection of above-cost rates, Mexico does not impose on Telmex any specific obligation to invest its above-cost profits from international interconnection in network build-out. Thus, there is no evidence that guaranteeing Telmex above-cost profits will contribute to the realization of the end pursued by Section 5(e)(i).[82]

118. Even if Telmex were required to invest its above-cost profits from international interconnection in network build-out, Mexico's measure is not necessary in this case. Mexico is the *only* WTO Member with a competitive market and cross-border commitments for the supply

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1994. The United States considers that the meaning assigned to the term "necessary" must depend on the particular context in which it is used and is not suggesting that there is a uniform meaning throughout the covered agreements.

[81] *See* First Written Submission of the United States, paras. 251-257.

[82] Although Mexico charged U.S. suppliers over $10 billion to interconnect calls into Mexico during the period 1991-2000, Mexico's teledensity has fallen behind not only most OECD countries, but numerous countries in Latin America. *See* First Written Submission of the United States, para. 4 (footnote 2), Appendix (para. 7).

of international facilities-based services to prohibit market-based negotiations for the termination of international traffic. In contrast, other Members that have opened their markets to competitive suppliers have safeguarded the public service responsibilities of their suppliers without requiring users to negotiate with only one supplier for the rates, terms and conditions of access to and use of the public telecommunications transport networks and services. The approach of those Members demonstrate that Mexico's approach is not necessary to safeguard the public service responsibilities of its suppliers. As discussed in the U.S. response to Question 14(c), Section 3 of the Reference Paper provides Members with guidelines and sufficient flexibility to meet any universal service requirement they may wish to impose without having to adopt the means employed by Mexico. Section 3 requires the "transparent, non-discriminatory and competitively neutral" administration of universal service obligations, whereas Mexico's alleged means of safeguarding Telmex's public service responsibilities offer no such protection.

119. Nor is there any evidence that the conditions on access to and use of public telecommunications transport networks and services maintained by Mexico serve to protect the "technical integrity" of those networks and services as required by section 5(e)(ii). Despite Mexico's acknowledgment, at paragraph 35 of its First Written Submission, that significant amounts of southbound traffic into Mexico is sent through what Mexico calls "illegal ISR," Mexico has provided no evidence demonstrating that the existing, albeit "illegal," use of private leased circuits by foreign service suppliers and locally-established commercial agencies actually harms the technical integrity of Mexico's networks and services.

120. Even if Mexico could do so, any concerns about loss of technical integrity caused by the use of interconnected international private lines can be readily addressed by other means, *e.g.*, through licensing conditions containing necessary quality standards. The United States allows ISR arrangements over resold private lines with nondominant foreign suppliers in all countries,[83] and also has authorized such arrangements with dominant foreign suppliers in 83 countries, without any harm to the technical integrity of its networks.[84] There is no reason why Mexico could not impose similar conditions and no reason that Mexico's current approach is "necessary."

121. Nor does the requirement that interconnection rates be negotiated with Telmex alone (or the concomitant requirement that all other Mexican suppliers apply those same rates) protect the technical integrity of Mexico's public telecommunications transport networks and services. If

[83] *See, e.g.*, 47 C.F.R. § 63.23(d)(2) (allowing use of "authorized resold private lines to provide switched basic services where the carrier is exchanging switched traffic with a foreign carrier that lacks market power in the country at the foreign end of the private line"), available at http://www.fcc.gov/ib/pd/pf/telecomrules.html#BM_63_23.

[84] *See* http://www.fcc.eov/ib/pd/pf/isr.html (listing 83 countries authorized for ISR arrangements with foreign dominant carriers).

anything, permitting competitive negotiations would provide incentives for Telmex and other Mexican carriers to seek a competitive edge by improving the quality of networks and services.

122. The United States also notes that if granting Telmex exclusive authority to negotiate interconnection rates and restricting U.S. carriers from interconnecting private lines to by-pass the Telmex negotiated rates were necessary to safeguard Telmex's public service responsibilities and to protect the technical integrity of public telecommunications transport networks or services, Mexico would surely apply those same conditions *domestically*. As noted by the United States in paragraph 264 of its First Written Submission, however, Mexican suppliers offer private leased circuits within or across Mexico's border. Mexico's failure to apply those same conditions domestically demonstrates that they are not necessary to achieve the goals of Sections 5(e)(i) and (ii).

123. Finally, at the end of its First Written Submission, Mexico invokes Section 5(g) of the Annex as authorizing its prohibition on the use of private leased circuits under the ILD rules. Section 5(g), which only applies to developing countries, provides that,

> Notwithstanding the preceding paragraphs of this section, a developing country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. Such conditions shall be specified in the Member's Schedule.

124. Thus, Section 5(g) explicitly requires that any conditions restricting access to and use of private leased circuits, as in Mexico, "shall be specified in the Member's Schedule." However, Mexico specified no such condition prohibiting the use of private lines in its Schedule. As explained above, Mexico's inclusion of a routing restriction under mode 1 does not provide a basis for Mexico to prohibit the use of private leased circuits. As long as the circuit is leased from a concessionaire, it is consistent with the requirement to route international traffic through the facilities of a concessionaire. For this reason alone, Mexico cannot rely on Section 5(g).

125. That being said, even assuming, *arguendo*, that Mexico had included such a condition in its Schedule, there is no basis to conclude that the prohibition on the use of private leased circuits in Mexico otherwise satisfies the criteria of Section 5(g). Mexico has offered nothing more than an unsupported assertion that this restriction is "necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services." Unsupported assertions cannot substitute for evidence and cannot form the basis for the factual findings that would be necessary to justify Mexico's invocation of this subparagraph.

126. In sum, Mexico has failed to ensure that foreign service suppliers are accorded access to and use of public telecommunications networks and services on *reasonable* terms and conditions for the cross-border supply of scheduled basic telecommunications services. The United States has demonstrated that Mexico has violated that obligation by maintaining measures that:

– require foreign suppliers to negotiate the terms and conditions of access to and use of public telecommunications networks and services exclusively with Telmex, Mexico's major supplier of such networks and services (ILD Rule 13);

– prevent foreign suppliers from negotiating alternative terms and conditions with any other Mexican supplier of such networks and services (ILD Rules 3, 6, 10, 13, 22, and 23 and the refusal of Mexican authorities to endorse alternative terms and conditions); and

– require Mexican suppliers to charge foreign basic telecommunications suppliers rates that exceed the cost of providing access to and use of public networks and services (Cofetel's approval of the U.S.-Mexico settlement rate).

For these reasons, Mexico has failed to abide by its commitments under Section 5(a) of the Annex.

127. With regard to Section 5(b), the United States demonstrated that Mexico committed to ensure that:

– mode 1 facilities-based suppliers,

– mode 1 commercial agencies (non-facilities-based suppliers), and

– mode 3 commercial agencies (non-facilities-based suppliers)

have access to and use of private leased circuits to supply scheduled international basic telecommunications services over such circuits and can interconnect such circuits with public telecommunications networks and services. Because Mexican suppliers offer private leased circuits to their customers, Mexico must therefore ensure that these circuits are available to all suppliers of scheduled basic telecommunications services.

128. However, as explained above and in our First Written Submission, foreign suppliers do not have access to and use of private leased circuits to supply scheduled basic telecommunications services. Mexican suppliers have refused to provide these circuits, Mexican law prevents foreign basic telecommunications service suppliers from using such circuits, and Mexican authorities continue to refuse to permit the supply of scheduled services over leased capacity. These restrictions prevent foreign service suppliers from accessing and using private

leased circuits to supply scheduled basic telecommunications services. Therefore, the Panel should find that Mexico has failed to honor its commitments under Sections 5(a) and (b) of the Annex.

VI. CONCLUSION

129. For the reasons stated above, in our Answers to the Questions of the Panel, and in the United States' earlier submissions to the Panel, the United States respectfully requests the Panel to find that:

- the Government of Mexico's failure to ensure that Telmex provides interconnection to U.S. basic telecommunications suppliers on a cross-border basis with cost-based rates and reasonable terms and conditions is inconsistent with its obligations under Sections 2.1 and 2.2 of the Reference Paper, as inscribed in Mexico's GATS Schedule of Commitments, GATS/SC/56/Suppl.2, and in particular, that:

  (a) Mexico's Reference Paper obligations apply to the terms and conditions of interconnection between Telmex and U.S. suppliers of basic telecommunications services on a cross-border basis;

  (b) Telmex is a "major supplier" of basic telecommunications services in Mexico, as that term is used in Mexico's Reference Paper obligations;

  (c) Mexico has failed to ensure that Telmex provides interconnection to U.S. suppliers at rates that are *basadas en costos* and terms and conditions that are *razonables* because:

    (i) Mexico allows Telmex to charge an interconnection rate that substantially exceeds cost, and

    (ii) Mexico allows Telmex to restrict the supply of scheduled basic telecommunications services and prohibits the use of any alternative to the Telmex negotiated interconnection rate through Mexico's ILD rules, specifically Rule 13 along with Rules 3, 6, 10, 22 and 23.

- the Government of Mexico's failure to maintain measures to prevent Telmex from engaging in anti-competitive practices is inconsistent with its obligations under Section 1.1 of the Reference Paper, as inscribed in Mexico's GATS Schedule of Commitments, GATS/SC/56/Suppl.2, and in particular, that Mexico's ILD rules (specifically Rule 13 along with Rules 3, 6, 10, 22 and 23) empower Telmex to operate a cartel dominated by itself to fix rates for international interconnection and restrict the supply of scheduled basic telecommunications services;

- the Government of Mexico's failure to ensure U.S. basic telecommunications suppliers reasonable and non-discriminatory access to, and use of, public telecommunications networks and services is inconsistent with its obligations under Sections 5(a) and (b) of the GATS Annex on Telecommunications, and in particular, Mexico failed to ensure that U.S. service suppliers may access and use public telecommunications networks and services through:

    (a) interconnection at reasonable terms and conditions for the supply of scheduled services by facilities-based operators and commercial agencies; and

    (b) private leased circuits for the supply of scheduled services by facilities-based operators and commercial agencies.

The United States requests that the Panel recommend that the Government of Mexico bring its measures into conformity with its obligations under the GATS.

Exhibit List

US-52	Dow Jones Business News, *Mexico's Antitrust Commission Rules Against Telmex, Again* (January 15, 2003).
US-53	Telmex/Sprint Communications, L.L.C., Consolidated Opposition of Telmex/Sprint Communications, L.L.C. (filed April 25, 1997).
US-54	Telmex/Sprint Communications, L.L.C., Consolidated Opposition of Telmex/Sprint Communications, L.L.C. to Applications for Review (filed December 30, 1997).
US-55	*Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 1 FCC Rcd. 15499 (1996).
US-56	47 U.S.C. § 251(b)(5).
US-57	ITU-T Recommendation D.150, *New System for Accounting in International Telephony* (June 1999).
US-58	J. Tirole, "The Theory of Industrial Organization" (1988).
US-59	15 U.S.C. § 1.
US-60	Article 9, Mexican Federal Law of Economic Competition (1992).
US-61	*Motion of AT&T Corp. To Be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271 (1995).
US-62	*National Association of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630 (D.C. Cir. 1976).
US-63	*Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, 11 FCC Rcd. 21905 (1996).
US-64	*SCT Regulations for Long Distance Concessions*, Mexican Official Gazette (September 4, 1995).
US-65	*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).