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February 3, 2004

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
ATTN: Section 1377 Comments
Office of the United States Trade Representative
600 17th St. NW
Washington, DC 20508

Re: 2004 Section 1377 Review: Reply Comments

Dear Ms. Blue:

BellSouth Corporation ("BellSouth") submits these reply comments to the United States Trade Representative ("USTR") in connection with its review pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. Section 3107, concerning compliance with telecommunications trade agreements. Our reply comments focus on the comments filed by AT&T on January 5, 2004 and by Comptel/ASCENT Alliance on January 7, 2004 on the issue of foreign mobile termination rates.

BellSouth International, Inc., a subsidiary of BellSouth, operates mobile radio systems in Argentina, Chile, Colombia, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela. The BellSouth-operated mobile systems ("the BellSouth Systems") provide mobile terminations in these countries. In Latin America, mobile termination rates are reasonable and non-discriminatory.

To the extent that the comments of AT&T and Comptel/ASCENT Alliance question mobile termination rates in Latin America,[1] where BellSouth operates, BellSouth has an ability and a strong interest in providing the USTR with a complete, accurate and fully substantiated description of the situation. BellSouth also attaches to these reply comments an economic study conducted by Charles River Associates (CRA), a leading economic consultancy in the U.S., on the issue of the mobile termination rates in Latin America that demonstrates that the regulation of mobile call termination rates is not warranted and would likely lead to reduced consumer welfare in both the short and long term.[2] This information confirms that mobile operators are not engaged in harmful acts, policies and practices in Latin America. Thus, BellSouth believes that it would be

[1] As BellSouth operates as a regional mobile company in the Latin America, its comments focus on the Latin America context.

[2] Economic Analysis of Fixed-To-Mobile Call Termination Charges, March 28, 2003.

appropriate for USTR to disregard the comments of AT&T and CompTel/ASCENT with respect to foreign mobile termination rates for this year's Section 1377 review.

The following sections identify the issue raised in the comments submitted to the USTR and substantiate BellSouth's position regarding the merits of the issue and why the comments of AT&T and CompTel/ASCENT fail to establish a basis for U.S. action with regard to international mobile termination rates.

A. Comments of AT&T and CompTel /ASCENT

AT&T's comments claim that market forces do not provide any constraint on foreign mobile termination rates in a Calling Party Pays ("CPP") environment and this is a direct result of mobile operators' market power. Comp Tel/ASCENT's comments also assert that mobile operators abuse their respective dominant positions by imposing high international mobile termination rates.

B. BellSouth's Position

In Latin America, the retail market for mobile services as a whole is sufficiently competitive, so that the regulation of mobile call termination rates is not warranted and would likely lead to reduced consumer welfare in both the short and long term. Competition in the local mobile services market, rather than regulatory intervention, is the better force to determine the appropriate level for calling party pays rates in Latin America. Market forces in Latin America's mobile markets are strong enough to preclude regulatory intervention in the mobile industry.

C. Explanation and Analysis

a) Mobile network operators in Latin America do not possess market power

As discussed in Section 2 of the CRA report:

> In almost all regulatory cases, rate regulation has been premised on a finding that the operators whose rates are to be regulated possess Significant Market Power (SMP) in a "relevant market" for call termination services. A finding of SMP in the relevant market is a desirable prerequisite for the regulation of rates in that market. In many cases, the fact that fixed-to-mobile call termination prices are greater than prices of outgoing mobile calls has been taken as evidence of SMP in the market for fixed-to-mobile call termination services.

That study also explained that a sounder analysis of Significant Market Power "should be based on fundamental principles of market definition developed for a wide

range of telecommunications services, and that a comparison of call termination prices to the corresponding incremental costs is not a substitute for such an analysis."

It continued:

> Using widely accepted, fundamental principles of market definition, we conclude that for a determination of SMP [Significant Market Power], the relevant market is the retail market for a basket of mobile services (handsets, access, outgoing calls, and incoming calls) rather than a more narrowly defined national market for mobile call termination, or the still narrower market for call termination on the network of each mobile operator. If the retail market for mobile services as a whole is sufficiently competitive, the regulation of mobile call termination rates is arguably unwarranted and would likely lead to reduced consumer welfare in both the short and long term.

In those circumstances where mobile termination rates are regulated in most of the Latin American countries such rates are reviewed and set by national regulatory bodies that have taken into account the public interest needs of their countries. Even if mobile operators were assumed to have market power it would be unreasonable to say they have the power to raise rates in a capricious manner. This is substantiated by the fact that the rates paid by AT&T are lower than or equal to the local traffic termination rates. (See "U.S. consumers are not being harmed and discriminated against" section)

b) Market power of mobile operators in the U.S.

AT&T's and CompTel/ASCENT's comments agree with the UK approach when stating that mobile operators have market power in the relevant market of mobile termination and are therefore "major suppliers." However, it is also important to take the U.S. approach into account when considering this issue.

In contrast to the UK approach, the U.S. government has determined that mobile markets in the U.S. are competitive. Competitive commercial mobile service suppliers (CMRS) are not required to comply with any cost-based regulation since the U.S. government, by applying a "Market Power" test, has found that mobile operators are not dominant in the relevant market of mobile termination. The United States Congress chose specifically in the 1996 Act not to impose any additional regulatory obligations upon CMRS providers so as to permit this market to continue to evolve in a competitive manner without any additional government-imposed regulatory constraints.

c) Mobile markets in Latin America are highly competitive

BellSouth believes that market forces in Latin America's mobile markets are strong enough to prevent any regulatory intervention in the mobile industry. In fact, all ten countries in Latin America in which BellSouth International Inc. operates have at least two mobile competitors, and eight have at least three competitors. Chile, Guatemala, and Peru each have four mobile competitors while Argentina has 5 mobile competitors. Therefore, mobile operators in the Latin American countries in which BellSouth operates do not have market power in their respective mobile markets but, in fact, operate in highly competitive markets.

d) Current mobile pricing schemes in Latin America maximize both static as well as dynamic economic efficiency

BellSouth concurs in the conclusions of the CRA with respect to this issue. That report is quoted extensively below, as it describes current pricing systems and their economic underpinnings.

(i) Static efficiency

The AT&T and CompTel comments neglect, as have earlier analyses by others (in varying degrees), to understand three fundamental features of telephone calls: (1) telephone calls are shared goods that provide benefits to both the calling and called parties, where the benefit to the nonpaying party is a call externality, (2) related pairs of users can, and often do, internalize the external benefits of the calls, and (3) calls between unrelated parties often result in negative benefits to the called party that cannot be internalized. These characteristics hold for any telephone call, including fixed-to-mobile calls both at the domestic as well as the international level. As the CRA report explains,

> When these features of telephone calls are accounted for, static efficiency is likely to require that fixed-to-mobile call termination be priced above incremental cost.
>
> The economic logic for this conclusion is straightforward. If the high FTM [fixed-to-mobile] call termination rate would inefficiently reduce the volume of calls to a mobile subscriber from a fixed subscriber with whom the mobile subscriber has some type of relationship, the mobile subscriber will have an incentive to reduce the cost to the related user using one or more *internalization mechanisms*. For example, the mobile subscriber may pay for some of the charges incurred by the fixed network caller. This arrangement is quite common in cases where both subscribers are businesses, and the fixed subscriber supplies a good or service to the mobile subscriber. In this case, the fixed subscriber can incorporate the high price of calls to the mobile subscriber in the price of its product, or even submit itemized invoices for telephone charges. ...

When an internalization mechanism is used, the effective price to the fixed subscriber is generally lower than the list price and, as a result, FTM calling volumes may not be inefficiently repressed. When retail markets for mobile services are competitive and FTM rates are high, mobile subscribers will experience lower rates for other components of mobile service, including lower per minute rates for outgoing calls. Among related users, the higher rates of FTM calls will be offset (at least partially) by the lower rates for outgoing mobile-to-fixed calls, allowing mobile users to increase the extent to which they subsidize communications with fixed subscribers. Calls from unrelated users will be repressed by a high list price, but there is considerable evidence that many of these calls are *unwanted calls*. Many subscribers to fixed and mobile networks prefer to keep their numbers private (often paying for unlisted numbers), expressing a strong preference to block calls from parties to whom they have not given their number. High rates for mobile call termination help mobile subscribers meet this objective, increasing (not reducing) economic efficiency. Finally, lower handset prices made possible by above-cost FTM call termination rates may help realize network externalities that are not easily internalized.

Economic analyses that do not fully account for the three features of telephone calls identified above are likely to lead to inefficient forms of regulation (such as cost-based regulation of call termination rates), *reducing* the welfare of consumers in the short run. Specifically, the focus of previous analyses on the relationship between the *list* price of FTM call termination and its incremental cost is not warranted when the full range of call externalities (negative and positive) are considered. Simple comparisons of FTM call termination rates to other mobile rates or to incremental costs are unlikely to be a useful basis for regulations promoting static efficiency. In addition, when the retail market for mobile services is competitive, the regulation of FTM call termination is *unwarranted.*

(ii) Dynamic efficiency

Mobile services play a special role in efforts to meet universal service goals in Latin America. Regulators have argued that the network externality is higher when penetration rates are low, but becomes less important as penetration increases. Briefly here, and as explained in more detail in the CRA report, a network externality arises when

> a new subscriber joining a network obtains benefits from calling and being called by other subscribers, and takes these benefits into account when deciding to subscribe to a service. However, the new subscriber is likely to ignore benefits obtained by other subscribers who can call or be called by the new subscriber. Some subscribers with private benefits below the cost of subscription will not join the network, even though the total benefits to all subscribers exceed those costs.

Networks are therefore likely to be too small. Universal service policy seeks to correct this market failure through subsidies targeted to particular consumers or through implicit cross-subsidies.

As noted by CRA,

When compared to Europe, the low penetration of both fixed and mobile networks in Latin America implies the need for higher universal service subsidies in Latin America. However, there are no external funds available to finance more rapid penetration of mobile services in Latin America.

Currently, low handset prices and the supply of relatively inexpensive prepaid packages to low-income consumers are financed, in part, by high termination rates for FTM. Like static economic efficiency, dynamic efficiency is promoted by above-cost FTM termination rates, and where there is effective competition in the retail market for mobile services, the public policy goal of universal service is likely to be set back by unnecessary regulation of fixed-to-mobile call termination rates.

The main policy consideration is to promote investment in infrastructure and ensure the availability of basic telecommunications capabilities at affordable rates to all citizens. But, the CRA report observes that

Economic analysis suggests that with significant network externalities, market forces may not be adequate to attain this goal. The earlier economics literature observes that mobile call termination rates that exceed the corresponding costs can be used to lower handset prices, monthly access fees, and outgoing charges, thereby correcting for the network externality.

It thus concludes:

... static and dynamic efficiency goals are not necessarily in conflict because above-cost rates for fixed-to-mobile call termination promote the goals of both static and dynamic efficiency.

A. <u>Comments of AT&T and CompTel</u>

CompTel/ASCENT's comments suggests that a Long Run Incremental Cost ("LRIC") model should be applied immediately to setup mobile termination rates in a Calling-Party-Pays (CPP) environment. AT&T's comments claims that mobile termination rates are unreasonable and far exceed cost-oriented levels when compared to the LRIC-based studies of the US and the UK.

B. BellSouth's Position

Regulation of fixed-to-mobile termination rates is unwarranted if the retail market is sufficiently competitive as it is the case in Latin America.

C. Explanation and Analysis

a) Long-run incremental cost regulation for mobile termination is unjustified in Latin America.

The comments of CompTel/ASCENT suggest that a Long Run Incremental Cost ("LRIC") model should be applied immediately to set up mobile termination rates in a Calling-Party-Pays (CPP) environment. However, no regulation of fixed-to-mobile termination rates is warranted if the retail market is sufficiently competitive as it is the case in Latin America.

When retail markets for mobile services are sufficiently competitive, regulation of fixed-to-mobile call termination rates is unnecessary, whereas with insufficient competition, some regulation of mobile rates is warranted. Even though they are competitive, an efficient price structure still may require fixed-to-mobile call termination rates that are higher than call origination rates.

There are various approaches to regulation of mobile termination calls. Both AT&T's and CompTel's comments call for long run incremental cost regulation. Long-run incremental cost approaches have a series of drawbacks: (i) usually they result in prices below costs, (ii) they are extremely expensive to develop, maintain, and update, and (iii) they give rise to protracted adversarial arguments in regulatory proceedings. In addition, the costs produced by these models are not related to the efficient prices in a simple way, so that simple markups of long run cost estimates for fixed-to-mobile call termination costs are unlikely to be efficient. Top-down models are difficult to develop, particularly for a multinational firm that does not maintain accounts in accordance with a prescribed regulatory system. The allocation of the firm's costs across countries, products, and market segments is likely to be arbitrary. BellSouth considers that if any regulation were warranted, the best and only appropriate alternative would be a light-handed regulatory approach.

b) The United States and UK LRIC-based studies cannot be used as a benchmark to evaluate and set rates in developing countries.

Cost studies conducted in developed countries must be adjusted for many relevant differences between countries before they can be used as a proxy benchmark for costs in developing countries. AT&T's allegation that mobile termination rates are unreasonable

and far above cost-oriented levels when comparing with those established by the United States and the UK in their LRIC-based studies is unreasonable. International benchmarks obtained from developed countries are difficult to use for evaluating and setting rates in developing countries, given the differences in fundamental aspects of demand and supply across countries. Some of the significant differences for which suitable adjustments are necessary are set forth in Annex A.

c) Regulatory authorities in each country are the legitimate venues to create and implement national telecommunications policies and regulations.

BellSouth believes and thinks that it should be the policy of the U.S. government that each national regulatory authority is entitled to determine which methodology to use if there was an identified need for regulation of mobile termination rates. Not only are the foreign regulatory authorities more familiar with local market conditions and with the carriers in their countries than the U.S. government, they also are the bodies empowered to create and implement their national telecommunications policies. As in the United States, these policies are not limited to promoting competition for interconnection among carriers, but may involve legislated obligations to promote foreign investment, the delivery of universal service, the creation of wireless-to-landline competition and, more fundamentally, the deployment of modern telecommunications infrastructure. Any action taken with respect to mobile termination rates should take these other factors into consideration. As such, BellSouth believes that it is inappropriate and potentially counterproductive to assume that national regulatory authorities have failed to implement their own policies and regulations.

A. Comments of AT&T and CompTel/ASCENT

The comments of both AT&T and CompTel claim that there is no legitimate justification for the difference between fixed and mobile termination rates for international traffic.

B. BellSouth's Position

Cost of termination of calls in mobile networks is higher than termination in fixed networks.

C. Explanation and Analysis

a) Cost of termination of calls in mobile networks is higher than termination in fixed networks

Higher mobile termination rates are legitimately justifiable. Contrary to the comments of AT&T and CompTel/ASCENT, there is legitimate justification for the difference between fixed and mobile termination rates for international traffic. Actually, Oftel, the regulatory body of the UK, has determined that mobile termination costs are usually 10 times greater than fixed termination costs.[3] Mobile costs are more traffic sensitive than landline termination costs. In addition, the mere fact that fixed termination rates may be lower than the mobile termination rates in Latin America and Europe does not prove that the mobile termination rates are unjustified, that they do not serve some desirable public policy in those countries, or that they are the result of market power by the foreign mobile carriers.[4]

A. Comments of AT&T and CompTel/ASCENT

U.S. consumers are paying high rates when calling mobile subscribers in Latin America.

B. BellSouth's Position

U.S. consumers are not being harmed since they pay similar or lower mobile termination charges than what domestic consumers pay.

C. Explanation and Analysis

a) U.S. consumers are not being harmed or discriminated against

In BellSouth's Latin American CPP markets, BellSouth charges similar rates for terminating domestic and foreign-originated (including US-originated) calls. BellSouth believes this is true for its competitors. In Colombia, Ecuador, Nicaragua, Panama, Peru, Venezuela, and Uruguay, BellSouth charges less for terminating foreign calls than their domestic CPP rates, and in Chile the charges are the same. In these cases, the carriers are not discriminating against US consumers.

A. Comments of CompTel/ASCENT regarding Peru

CompTel/ASCENT's comments raise issues specific to Peru, and claim that Peru's major suppliers for mobile termination have attempted to unilaterally increase

[3] According to Oftel's document entitled " The Setting of Fixed and Mobile Termination Charges" that can be found at Ofcom's website at http://www.ofcom.org.uk/.

[4] This is especially true where the mobile termination rates are reviewed and set by foreign regulatory bodies and where those bodies have taken into account the public interest needs of their countries.

international mobile termination rates by as much as 40 percent and that "cross-border interconnection rates for mobile networks being demanded by major suppliers in Peru are neither cost-oriented nor reasonable." They added that carriers in Peru have not offered any cost justification for the current and proposed rate increase.

B. BellSouth's Position

In Peru, mobile termination rates for international long distance calls are regulated since 2000. They are based on international benchmarking. Therefore, this is a regulated service.

C. Explanation and Analysis

a) Peru's mobile market is highly competitive with four mobile operators.

BellSouth has significant operations in Peru. In Peru, BellSouth faces competition from three mobile operators and the result is a highly competitive market. Given those market characteristics, it would appear that, in fact, market forces are working and that additional regulatory intervention from the U.S. is unwarranted.

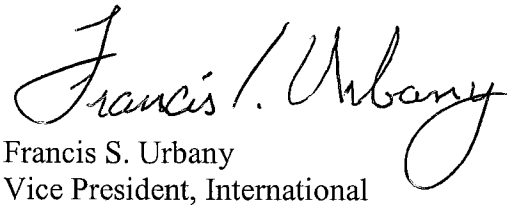
b) International mobile termination rates in Peru are regulated.

Mobile termination rates in Peru are non-regulated, with the exception of termination rates from international and domestic long distance calls, and pay phone calls. The regulatory body in Peru, OSIPTEL, set up mobile termination rates for long distance calls in 2000. BellSouth, as a mobile provider in Peru, was surprised by CompTel/ASCENT's statement that mobile operators have recently requested a 40 percent increase in mobile termination. BellSouth has made no such request, nor is it aware of any such request by other carriers. In contrast, the experience of BellSouth in Peru is that Peru's mobile termination charges are reasonable and non-discriminatory given the highly competitive nature of the Peruvian mobile market

* * *

For the above reasons, BellSouth submits that reliance on the comments of AT&T and CompTel/ASCENT with respect to foreign mobile termination rates for this year's Section 1377 review would be inappropriate and unjustified. As explained in these reply comments, assertions regarding harmful acts, policies and practices with respect to this issue are not substantiated by careful analysis. Mobile termination rates in Latin America are reasonable and non-discriminatory. We would welcome the opportunity to further respond to any questions that the USTR would have with regard to this matter.

Sincerely,



Francis S. Urbany
Vice President, International

Attachment

Annex A[5]

Differences for which suitable adjustments are necessary before making any cross-country comparison

Differences in teledensity. Developing countries have serving areas with lower teledensity (subscribers per square mile) than developed countries. It is well known that even within a country, unit costs are higher in areas with low teledensity than in areas with high teledensity. Since unit costs are driven by the teledensity of individual serving areas (i.e., area served by a switch), adjustments for differences in teledensity should be made on the basis of teledensity in each serving area, not on the basis of national population divided by national land area.

Differences in peak/off-peak traffic ratios. Networks are typically designed to offer acceptable service during peak periods. When the offered load is more sharply peaked, the cost per unit of the traffic is higher.

Differences in call duration. Differences in call duration across countries (including differences resulting from the use of wireless data services, and the technologies used to support data services, differences in the use of vertical services such as voice mail and conference calling, and other differences in the mix of services offered) can lead to differences in the per minute cost of switched services across countries.

Differences in usage volume. The cost-volume elasticity of providing many telecommunications services is quite low. That is, the percentage increase in costs corresponding to a 1% increase in usage tends to be quite close to zero. Therefore, the unit cost of a company serving customers with lower usage is likely to be higher than the unit cost of a company serving customers with higher usage.

Differences in input prices. For mobile networks, important inputs include interconnection to fixed networks, telecommunications equipment (handsets and network equipment), capital, labor, and the costs of collection and fraud. The prices corresponding to these inputs can vary significantly from one country to another and also from one period to another. Argentina is a case in point due to the abrupt changes brought about in exchange rate and other costs drivers. Taxes and regulations (including license fees and roll-out requirements) may also vary significantly from one country to another.

[5] Source: Economic Analysis of Fixed-To-Mobile Call Termination Charges, March 28, 2003.