HOLDINGS, INC.

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Mercedes Barreras Vescovi
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December 20, 2004

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
ATTN: Section 1377 Comments
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Re: USTR Section 1377 Request for Comments Concerning Compliance with Telecommunications Trade Agreements.

Dear Ms. Blue:

On behalf of NII Holdings, Inc. ("NII Holdings"), I am pleased to respond to the November 24, 2004 Federal Register notice of the Office of the United States Trade Representative ("USTR") requesting comments pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. Section 3106, concerning compliance with the World Trade Organization ("WTO") Basic Telecommunications Agreement and other telecommunications trade agreements.[1]

NII Holdings is a publicly held U.S. company, providing mobile communications services to consumers in Latin America. Headquartered in Reston, Virginia, NII Holdings operates in Argentina, Brazil, Chile, Mexico, and Peru, and currently serves more than 1.4 million customers in the region's largest cities. In Peru, NII Holdings operates through its subsidiary, Nextel del Perú, S.A. ("Nextel"). Since commencing operations in Peru in 1998, Nextel has invested approximately US$400 million in the provision of high-quality mobile communications services and currently serves 180,000 subscribers.

NII Holdings is one of the few remaining U.S. companies operating mobile services in Latin America; and in Peru, Nextel is the only remaining U.S.-owned company providing mobile services.

[1] *See* 69 Fed. Reg. 68,439 (Nov. 24, 2004); Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, *codified at* 19 U.S.C. § 3106.

For purposes of this year's Section 1377 review, NII Holdings highlights the significantly above-cost mobile-to-mobile termination rates in Peru. These rates violate Peru's commitments under the WTO Basic Telecommunications Agreement, as well as other WTO obligations, *e.g.,* the WTO General Agreement on Trade in Services (''GATS''), including the Annex on Telecommunications and the Reference Paper on Pro-Competitive Regulatory Principles (the "WTO Reference Paper").

NII has made significant inroads into Latin America, but is confronting a major competitive barrier due to the failure of Organismo Supervisor de la Inversión Privada en Telecomunicaciones ("OSIPTEL"), the Peruvian telecommunications regulator, to implement existing regulations mandating cost-oriented termination rates.

Similar to many other countries, mobile services in Peru have experienced tremendous growth. Today, the number of wireless subscribers exceeds that of wireline subscribers. As of September 30, 2004, Peru had almost twice as many mobile lines in service as fixed lines.[2] The Peruvian mobile marketplace consists of three players: Nextel (5% market share); Telefónica Móviles S.A.C (Telefónica Móviles España S.A. and Telefónica Móviles S.A.C. are collectively referred to as "Telefónica")[3] (74% market share);[4] and TIM Perú, S.A.C. ("TIM") (21% market share).

Due to OSIPTEL's failure to impose a cap on mobile-to-mobile termination rates, Peru has one of the highest mobile termination rates in the world. The need to address this situation is even more critical now that Telefónica has increased its mobile services market share from 52% to 74% with its acquisition of BellSouth Corp.'s wireless operations in Peru on October 28, 2004.[5]

In its 1377 Reports for 2003 and 2004, USTR highlighted the problem of above-cost mobile termination rates and noted the need for national regulators to address these unreasonably high rates.[6] The regulator in Peru, OSIPTEL, has acknowledged the issue of high mobile termination rates but has failed to enforce existing regulations that mandate cost-oriented termination rates. OSIPTEL has instituted certain measures to

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[2] Based on statistics on OSIPTEL's website, as of September 30, 2004, there were 1,990,513 fixed lines in service, providing a fixed penetration rate of 7.2 and there were 3,769,608 mobile lines in service, providing a mobile penetration rate of 13.63. *See* http://www.osiptel.gob.pe/Index.ASP?T=P&P=2636.

[3] Telefónica Móviles S.A.C. is the mobile services subsidiary in Peru of Telefónica Móviles España S.A.

[4] This includes Telefonica's ownership in BellSouth Perú.

[5] Telefónica Moviles Completes the Acquisition of BellSouth's Cellular Operators in Venezuela, Colombia, Nicaragua, Peru and Uruguay, Forbes.com, BusinessWire, http://www.forbes.com/businesswire/feeds/businesswire/2004

[6] *See* USTR, Results of 2003 "Section 1377" Review of Telecommunications Trade Agreement (April 2, 2003). *See also* USTR, Results of 2004 "Section 1377" Review of Telecommunications Trade Agreement (April 7, 2004).

decrease fixed-to-mobile termination rates, but has not included mobile-to-mobile rates in these measures. Currently, OSIPTEL is considering adoption of a provisional wholesale mobile-to-mobile termination rate at US$0.2053 (thus unifying all mobile termination rates) to address the above-cost termination rates until a fully documented cost model can be developed and verified. This proposed uniform rate will not comply with Peru's WTO obligations because the proposed rate of US$0.2053 per minute is still significantly above-cost and based on a benchmark made in 2000. NII Holdings is very concerned that OSIPTEL will not act promptly to implement the cost model and institute a cost-based mobile-to-mobile termination rate.

I. Failure to Implement Cost-Oriented Mobile-to-Mobile Termination Rates Is Not In Compliance with WTO Interconnection Obligations

Mobile-to-mobile termination rates are payments made by mobile telecommunications operators to another mobile telecommunications operator for terminating a call on the latter's network.[7] In most jurisdictions in which NII Holding's subsidiaries operate, including Peru, the cost of mobile calls is borne solely by the customer (actually the operator of the originating network) who initiates the call, while the called party, who is a customer of the terminating mobile operator, is not charged for the termination (known as a calling party pays ("CPP") regime).[8] Thus, the calling party's telecommunications operator has no choice but to pay whatever rate is charged by the terminating mobile carrier. High above-cost mobile termination rates therefore prevent the calling party's telecommunications operator from charging cost-based rates, whereas calls within a mobile operator's network ("on-net calls") may be charged at substantially lower rates. In Peru, Telefónica's mobile retail price for on-net calls is more than six times below the lowest wholesale termination rate.[9] Telefónica's market power allows it to engage in margin squeeze tactics by setting on-net end-user rates at US$0.03 per minute and wholesale termination rates to other mobile providers above US$ 0.207.

A. Telefónica is a "Major Supplier" Under WTO Reference Paper

The WTO Reference Paper provides that interconnection with a major supplier must be provided on terms, conditions and cost-oriented rates that are non-discriminatory,

[7] Resolución de Consejo Directivo (OSIPTEL Board of Directors Resolution) No. 043-2003-CD/OSIPTEL Chapter II, (June 2, 2003).

[8] In Peru, CPP was introduced for mobile services on February 26, 1996 with the issuance of Resolution No. 005-96. Although mobile services operators are permitted to offer CPP and non-CPP (*i.e.*, receiving party pays) plans, the mobile market is predominantly under a CPP regime and, in the case of Nextel, 100% of its subscribers are under CPP plans.

[9] *See* Diario La República, at 15 (Economy Section) (Feb. 4, 2004) (Telefónica Moviles S.A.C.'s mobile services tariffs outlined as 1200 minutes at US$40.00, which amounts to US$0.03 per minute, effective as of February 4, 2004).

"transparent and reasonable, having regard to economic feasibility...."[10] A "major supplier" is a "supplier that has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of: (a) control over essential facilities; or (b) use of its position in the market."

These criteria conform to the recent European Commission ("EC") determination on significant market power and dominance in which the EC concludes that a 50% market share is a "very large" market share that presumptively indicates significant market power (*i.e.*, having a dominant position).[11]

With its 74% mobile services market share, Telefónica clearly has the "ability to affect the terms of participation" in Peru. Moreover, Telefónica has 82.3% of the total telecommunications services market share (fixed and mobile lines in services) in Peru.[12] Given this market situation, Telefónica clearly is a major supplier as defined in the WTO Reference Paper.

B. Mobile Termination Rates in Peru are Not Cost-Oriented, Transparent, or Reasonable

In the WTO Panel decision concerning Mexico's Measures Affecting Telecommunications Services, the WTO established that cost-oriented rates are those brought into a "defined relation to known costs or cost principles."[13] The WTO recognized that while cost-oriented rates do not need to equate exact costs, they should be "founded on cost."[14]

Peru's mobile termination rates are not "founded on cost." In fact, Peru's rates are dramatically higher than in many other countries around the world (see Chart 1 below). At US$0.25 per minute, Peru has the fourth highest mobile termination rate and second highest of any developing country.[15]

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[10] WTO, Fourth Protocol of the GATS, "Telecommunications Services: Reference Paper" (hereinafter "*WTO Reference Paper*"), at § 2.2 (Apr. 2, 1996), http://www.wto.org/english/news_e/pres97_e/refpap-e.htm.

[11] *See* http://europa.eu.int/information_society/policy/index [OJ C 372] and Framework Directive/SMP Guidelines.

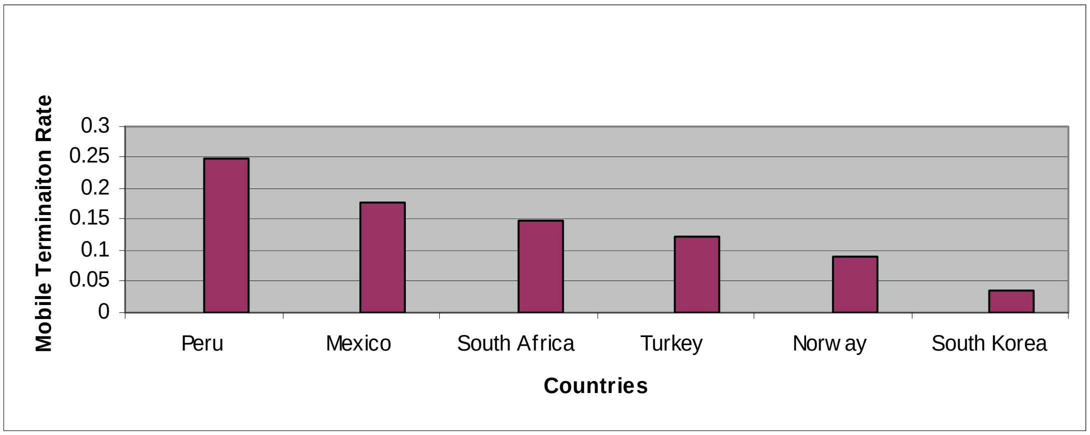
[12] *See* OSIPTEL website, available at www.osiptel.gob.pe.

[13] *See* WTO, Report of Panel "Mexico – Measures Affecting Telecommunications Services" (April 2, 2004) at 178.

[14] *Id*.

[15] According to the "Average Mobile Surcharge" for international calls from the United States to mobile numbers abroad. This data was compiled by the Federal Communications Commission and is an average of 2004 surcharges of four operators. Only Switzerland, with a rate of US$0.268, had a higher surcharge than

Chart 1: Global Comparison of Mobile Termination Rates in 2004[16]



There is no rationale for or transparent basis on how the mobile-to-mobile termination rate is set in Peru. As a fundamental principle, mobile carriers originating a call must terminate the call on the network of the called customer's mobile operator and, in so doing, pay the significantly above-cost termination rate. This result is not endemic to Peru, but exists in any country with a CPP regime.[17] No market pressure exists on the terminating carrier to bring mobile termination rates to cost because the called customers (its subscribers) are not paying the costs of call termination.[18] Given this dynamic, market forces cannot be relied upon to drive mobile termination rates to cost. For this reason, most regulators control termination rates, unlike OSIPTEL.

Peru. *See In the Matter of The Effect of Foreign Mobile Termination Rates on U.S. Consumers*, Notice of Inquiry, Federal Communications Commission, IB-Docket No. 04-398, Oct. 14, 2004.

[16] Data for South Africa refers to fixed-to-mobile rates and are the average of peak and off peak rates. 2004 data was converted to US$ by 2003 annual average exchange rates. If different rates prevail among operators, those for the largest (by subscriber market share) is used. Compiled from security filings filed with the U.S. Securities and Exchange Commission and OSIPTEL website by consulting firm Telecommunications Management Group, Inc.

[17] According to the Working Party on Telecommunications and Information Services Policies of the Organization for Economic Co-operation and Development's ("OECD"), "[a]n important reason for above cost termination is that, where a calling party pays system exists, mobile operators have market power in the termination of a call. The customer placing a call has no choice if they want to complete the call but to terminate the call on the network chosen by the mobile subscriber they are calling." *See* Organization for Economic Co-operation and Development (hereinafter "OECD"), *International Refile of Mobile Traffic (Tromboning)*, DSTI/ICCP/TISP (2000) 11/ FINAL, at 3 (Jun. 26, 2001).

[18] *See* AT&T Corporation's Comments on the USTR's Section 1377 Request for Comments Concerning Compliance with Telecommunication Trade Agreements (hereinafter "AT&T 1377 Filing"), at 3 (Jan. 5, 2004).

OSIPTEL has adopted a termination rate regime that is based on outdated data and which has no basis for the different rates between fixed-to-mobile and mobile-to-mobile. For purposes of establishing termination rates, OSIPTEL relied on a benchmarking study that took into account 19 countries, mainly in Europe and Latin America, and was based on data available in December 2000.[19] OSIPTEL capped the mobile termination rate at US$0.2053 per minute for various fixed line services: long-distance and international calls or calls originating from local payphones.[20] Mobile-to-mobile termination rates, on the other hand, are governed by a range of rates negotiated between mobile operators ranging from US$0.207 to US$0.25.[21]

No rational explanation exists for why the mobile termination rates, particularly the mobile-to-mobile rate, in Peru should be so high. Telefónica's own data suggests that its cost per minute to process a mobile call is US$0.13, almost half of its termination rate of US$0.25.[22] A nearly 50 percent markup on a termination rate does not conform to a "defined relation to known costs or cost principles" or to be "founded on cost," particularly when many similarly situated countries have wholesale mobile termination rates that are much lower than those offered in Peru.

As noted above, Peru's mobile termination rates are not uniform, but vary according to the network on which calls originate, despite the fact that the network elements used to terminate a call are essentially the same irrespective of the call type (international, long distance or local) or network originating the call (mobile or fixed) (see Table 1 below). In the case of mobile-to-mobile calls, the termination rates differ according to the

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[19] *See* Analysys Consulting Ltd., *Termination Charges on Networks in Peru* (Non-confidential Public Version of Final Report for Nextel del Peru S.A.) at 14 (Jan. 12, 2004).

[20] *See* OSIPTEL Resolutions Nos. 004-2001-CD/OSIPTEL (Feb. 23, 2001), 063-2000-CD/OSIPTEL (Nov. 30, 2000), 071-2000-CD/OSIPTEL (Dec. 15, 2000) and 042-2001-CD/OSIPTEL (Aug. 8, 2001).

[21] OSIPTEL Resolution No. 001-98-CD/OSIPTEL *(Interconnection Regulation),* at Article 13 (Jan. 16, 1998). *See also,* OSIPTEL, *Documento de Trabajo - Relación de las Llamadas Locales Fijo-Movil (*hereinafter *"OSIPTEL Working Document – Study on Fixed-to-Mobile Calls"),* at 11-12 (Jan. 2004).

[22] Average cost per minute based on Telefónica's operating costs (revenues – EBITDA) divided by total mobile minutes. Telefónica reported revenues of €247 million and Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) of €87 million in Peru for 2003. The difference between the two is operating costs of €160 million, equivalent to US$180 million converted by the average 2003 €/US$ exchange rate. OSIPTEL provides a breakdown of total mobile traffic by quarter and operator on its web site (http://www.osiptel.gob.pe). The data were summed to attain an annual total. OSIPTEL notes that Telefónica's outgoing traffic only includes billed traffic. Therefore an adjustment was made based on the average traffic per user of the other mobile operators. This results in an estimate of 1,419 million minutes of mobile traffic handled by Telefónica in 2003, equivalent to an average operating cost of US$0.13 per minute (US$180 million / 1,419 million minutes). Telefónica financial data from Telefónica Móviles *Financial Results October-December 2003*.

originating operator network, even though the service being offered (*i.e.*, termination of a call on a mobile network) is the same.

Table 1: Mobile Termination Rates in Peru[23]

Mobile Service Providers in Peru	***Mobile-to-Mobile termination rate***
Telefónica Móviles	US$0.25
TIM	US$0.25
Nextel	US$0.207 for Telefónica or US$0.2053 for TIM

These above-cost mobile-to-mobile termination rates not only violate Peru's WTO commitments, but they violate Peru's own Interconnection Regulations and Telecommunications Market Opening Policy Guidelines (the "Guidelines"). Resolution 001-98-CD[24] provides that interconnection charges comprise: (i) the costs of interconnection, (ii) the cost contribution of the local service provider, and (iii) a reasonable markup. In addition, the Resolution provides that mobile termination should be equal to direct costs. In addition, the Guidelines mandate a single termination rate for local, long distance, and international calls to avoid distorting the market and creating opportunities for arbitrage (*e.g.*, refiling).[25]

II. Failure to Introduce Anti-Competitive Safeguards Is Not in Compliance with WTO Obligations

The WTO Reference Paper provides that "[a]ppropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices."[26] As specified in the WTO Reference Paper, anti-competitive practices include engaging in cross-subsidization.[27] Telefónica's on-net pricing tactics involve cross-subsidization to support predatory pricing (the US$0.03 per minute is below any measure of cost available) as well as the creation of a "margin squeeze" for its competitors as no competitors can match that price

[23] *See* OSIPTEL Report, No. 031-GPR/2004, Inicio del procedimiento de oficio para la fijación del cargo o cargos de interconexión tope por terminación de llamadas en las redes de servicios móviles (Initiation of proceeding to establish the interconnection charge or charges to terminate calls on mobile service networks), Jun. 21, 2003 at 8.

[24] *See* OSIPTEL Resolution No. 001-98-CD/OSIPTEL, *supra* note 21.

[25] Supreme Decree No. 020-98-MTC, *Lineamientos de Políticas de Apertura del Mercado de Telecomunicaciones en Peru ("Telecommunications Market Opening Policy Guidelines for Peru*"), ¶ 48 (Aug. 4, 1998).

[26] *WTO Reference Paper*, *supra* note 10, § 1.1.

[27] *Id.*, § 1.2(a).

to a Telefónica customer – and pay the mobile termination charge – without incurring an explicit marginal loss.

OSIPTEL's failure to implement competitive safeguards in the mobile termination market provides Telefónica the ability, and incentive, to engage in these anticompetitive practices. This demonstrates that, although the mobile market has multiple providers, the lack of regulation and competition in the call termination market allows the dominant operator to maintain unreasonably high mobile termination rates.

Dominant mobile operators, such as Telefónica, use their market power to set high mobile termination rates that provide a substantial amount of their revenues, to the detriment of smaller mobile providers like Nextel. According to an OSIPTEL study, 71.5% of Peru's mobile service operators' revenues are attributed to termination of traffic.[28] With such a profitable regime, large mobile operators have no incentive to reduce their mobile termination rates and compete on a level playing field.

Through the CPP regime, dominant mobile operators, such as Telefónica, have the ability to use above-cost mobile termination rates to subsidize retail on-net prices for their own customers and expand their network, thereby making their network more attractive to subscribers of other networks. This form of strategic pricing, facilitated by above-cost mobile-to-mobile termination rates, "…is likely to result in high off-net and low on-net tariffs on the retail market which puts entrants with a small customer base at a disadvantage."[29]

Small carriers like Nextel suffer from the imposition of above-cost mobile termination rates because they have no alternative but to terminate a high proportion of their calls on the called party's network. If Nextel attempts to reflect the higher termination cost by discriminating between on-net and off-net calls, its service will be less competitive than that of the other mobile operators that are not forced to recoup costs in that way. This discrepancy between on-net and wholesale mobile termination rates places smaller competitors like Nextel at a tremendous competitive disadvantage in the Peruvian market. It is impossible to compete when Telefónica can offer US$0.03 per minute on-net tariffs while the competing mobile operator must pay Telefónica in excess of US$0.207 per minute to access Telefónica's network.

The concentration of the Peruvian mobile market, as measured by the Hirfindahl-Hirschman Index ('HHI'), demonstrates that Telefónica's dominance results in a high degree of concentration and therefore a low degree of competition. Moreover, the combination of Telefónica's dominance in the market for call origination and above-cost

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[28] *See OSIPTEL Working Document – Study on Fixed-to-Mobile Calls*, *supra* note 21, at 11.

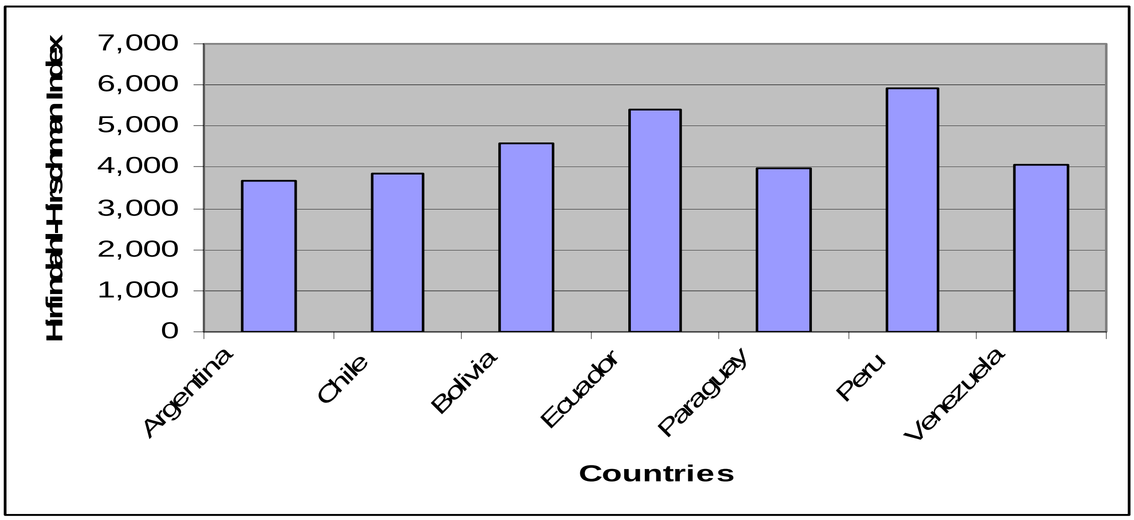
[29] European Commission, *Consultation Document on draft joint ERG/EC approach on appropriate remedies in the new regulatory framework*, at 19 (¶ 4.5.3) (Nov. 21, 2003).

termination rates permitted by OSIPTEL are factors that threaten NII Holdings' ability to continue to make competitive inroads into the Peruvian market.

The lack of competition in the Peruvian market can clearly be seen by examining the HHI for other markets in which anti-competitive activities and a high termination rates have been addressed.

An HHI analysis demonstrates that Peru has a high level of market concentration in the mobile services market with an index of 5,903 (see Chart 2 below), the highest in South America.[30] An HHI over 1,800 indicates some concentration that increases as the index rises towards a maximum value of 10,000.[31] In a comparative analysis, a difference of 100 points or more represents a measurable and statistically significant difference in the degree of market power.

Chart 2: Mobile Subscribers and Market Concentration in South America [32]



In many other jurisdictions, competitive safeguards would be imposed before – and definitely after – allowing a mobile operator to obtain such a dominant position in a particular market and resulting in such a high market concentration. However, the Peruvian Government has not yet imposed any anticompetitive safeguards on Telefónica. Peru's failure to institute such appropriate measures runs afoul of its commitments under the WTO Reference Paper.

[30] The HHI is determined by squaring the market share of each firm in a market, and then adding up the results. The figures were based on country data as of December 2003. *See* http://www.usdoj.gov/atr/public/testimony/hhi.htm

[31] *Id.*

[32] The figures were based on country data as of December 2003 obtained from country regulator websites.

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NII Holdings would be pleased to provide any further information that would be helpful to the Committee.

Respectfully submitted,

/s/

Mercedes Barreras Vescovi
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