

ADDITIONAL BACKGROUND PAPER

The Mexico – Telecoms Case: What Lessons Can Be Drawn for South Asian Countries?

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Introduction

Just as the interpretations of GATT provisions have evolved in response to the several hundred GATT dispute settlement procedures, so the interpretation of GATS provisions will evolve over time. The Mexico – Telecoms¹ case was the first case of the World Trade Organization Dispute Settlement Mechanism (WTO DSM) on telecommunications services and the first on services only. The findings of the Panel contain interpretations of the General Agreement on Trade in Services (GATS), especially in the Annex on Telecommunications and in the Reference Paper that sets regulatory principles. Although these interpretations strictly apply only to the case examined and affect only the parties to the dispute, they may have implications for other countries. For this reason, we will analyze the findings made by the Panel and identify the points relevant for South Asian countries that either have already made specific commitments in the Telecommunications sector under the GATS or may do so in the future.

A. Background of the Dispute

After many unsuccessful attempts to settle the issue through bilateral efforts, the United States (US) requested consultations under the aegis of the WTO in August 2000. Consultations did not solve the issues raised and in February 2002 the US formally requested the Dispute Settlement Body (DSB) the establishment of a Panel.

The specific public telecommunications services subject to the claims were voice telephony, circuit-switched data transmission and facsimile services, both “facilities-based” and by a “commercial agency”.² The US alleged that Mexico had failed to open its cross border telecommunications market as mandated by the GATS, on the grounds that Mexico:

- Failed to ensure that Telmex (its major telecommunications supplier) provides interconnection of US cross-border suppliers of these services on terms, conditions and cost-oriented rates that are reasonable, in accordance with Section 2 of its Reference Paper commitments.
- Failed to maintain appropriate measures to prevent Telmex from engaging in “anti-competitive practices”, since regulations empowered Telmex to fix rates for international interconnection on behalf of all suppliers in the market, resulting in a cartel, contrary to Section 1 of its Reference Paper commitments.
- Failed to ensure access by US suppliers to public telecommunications networks in Mexico, thus preventing them from providing non-facilities based services within Mexico (through commercial agencies) and international simple resale. This was inconsistent with Articles 5(a) and 5(b) of the GATS Annex on Telecommunications.

1 Panel Report, *Mexico – Measures Affecting Telecommunications Services*, WT/DS204/R, adopted 1 June 2004 (Hereinafter *Mexico – Telecoms*)

2 *Mexico – Telecoms*, par. 7.22-7.23.

B. The Panel's Findings

As previously stated, this was the first dispute to deal solely with trade in services under the GATS that was brought before the WTO DSM. For this reason, the interpretations reached by the Panel were the first ever made and may impact to some extent other countries that have already made commitments on the Telecommunications sub-sector.

i. Cross-Border Services

One of the key issues that the Panel had to address was whether the services at issue were supplied cross-border. The US claimed that Mexico had failed to ensure that Telmex provide interconnection to US basic telecommunications suppliers on a cross-border basis with cost based rates and reasonable terms.³ According to the US, the services at issue are supplied cross border within the meaning of GATS article I:2(a) because facilities-based operators in the territory of the US deliver traffic consisting of these services from US customers to the Mexican border where, under Mexican law, the traffic is transferred to Mexican operators, who then terminate the US operators' traffic, consisting of the services at issue, in Mexico. Regarding non-facilities-based operators (commercial agencies), if permitted by Mexican regulations, they would also supply services on a cross-border basis into Mexico. The US concluded by stating that the use or not of a supplier's own facilities in the market from which the service is supplied determines whether the service is facilities-based or non facilities based.⁴

Mexico's arguments were that its GATS schedule contains no specific commitments that would trigger the Section 2 commitments in the Reference Paper, and that in any case, the Reference Paper provisions on interconnection do not extend to services which originate abroad, or are subject to international accounting rates.⁵ Mexico continued to state that the services at issue were not supplied cross-border in accordance with the terms of GATS article I:2(a) because the essential nature of the services at issue is the transmission of customer data. According to Mexico, in order to transmit customer data cross-border "from" one Member "into" another Member, the supplier must *itself transmit* the customer data within the territory of that other member.

The Panel concluded that a telephone call originated in the US and terminated in Mexico was indeed a cross-border service irrespective of whether the US firm had its own facilities in Mexico or made arrangements with Mexican firms to carry the call from the border to its final destination. In other words, according to the Panel it was not necessary that the services be provided by the US supplier itself within Mexican territory.

The Panel explained that the supply of "...telecommunications services normally involve or require the linking with another operator to complete the service, and the operation, or presence in some way, of the supplier on both ends of the service cannot therefore be a necessary element of the definition of cross-border supply".⁶

³ *Ibidem*, par. 7.18.

⁴ *Mexico – Telecoms*, par. 7.25.

⁵ *Ibidem*, par. 7.18.

⁶ *Mexico – Telecoms*, par. 7.40.

The Panel continued with its reasoning and further stated that *“More generally, a supplier of services under the GATS is no less a supplier solely because elements of the service are subcontracted to another firm, or are carried out with assets owned by another firm. What counts is the service that the supplier offers and has agreed to supply to a customer”*.⁷

ii. Cost-Oriented Interconnection

Section 2.2 of the Reference Paper requires that *“Interconnection with a major supplier be ensured at...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 or facilities that it does not require...”*. The U.S. presented several estimations of the cost incurred in terminating international calls in Mexico, based on available information including Telmex’s domestic interconnection charges, and argued that the settlement rates that US companies were required to pay were above each of these cost estimates - on average 2.5 times higher.⁸

Mexico did not offer comments on the specific methods of evaluating costs and settlement charges presented by the US, nor did it take up the Panel’s invitation to submit its own calculations.⁹ Rather than challenge the cost figures presented by the US, Mexico argued that the settlement rates pertained to the international accounting rate regime, not an interconnection regime. At the time negotiations on basic telecommunications services came to closure in 1997, an unbinding understanding had been reached among the negotiating parties that accounting rates would not be used as a basis of disputes. Otherwise, most countries would have found it necessary to file exemptions to MFN treatment under GATS Article II.

The Panel concluded that the difference between these costs and the settlement rates was *“...unlikely to be within the scope of regulatory flexibility allowed by the notion of cost-oriented rates...”*¹⁰ of the Reference Paper. In reaching this conclusion, the Panel emphasized that only costs directly incurred in providing interconnection are relevant. The Panel did not endorse any particular costing model, and recognized that more than one costing methodology could be used.

The Panel, however, found that the accounting rate regime is subject to the discipline of cost-based interconnection for countries that have adopted the Reference Paper. While the 1997 understanding prevented disputes arising under the GATS framework agreement from different accounting rates with different countries, it did not exempt countries from any of their obligations, including cost-based interconnection, once they had also adopted the Reference Paper.

7 *Ibidem*, par. 7.42

8 *Ibidem*, Par. 7.187.

9 *Ibidem*, par. 7.188.

10 *Mexico – Telecoms*, par. 7.203.

iii. Anti-competitive Practices

Section 1.1 of the Reference Paper establishes that *“Appropriate measures shall be maintained for the purposes of preventing suppliers who, alone or together, are a major supplier from engaging or continuing anti-competitive practices”*. The US argued that the term “anti-competitive practices” encompasses, at a minimum, practices usually proscribed under national law: abuse of dominant position, monopolization and cartelization. The US also argued, far from proscribing such behaviour, Mexico maintains measures that require Mexican telecommunications operators to adhere to a horizontal price-fixing cartel led by Telmex.¹¹

On the other hand, Mexico’s arguments were that its Reference Paper commitments apply only to matters within its border, and not to services supplied under an accounting rate regime. In any case, Mexico contended that it had put in place “appropriate measures” to prevent anti-competitive practices under its general competition laws. According to Mexico, the ILD rules are aimed at increasing competition by stopping new entrants from being undercut on pricing, and by preventing foreign operators from dictating prices to their Mexican affiliates. Mexico continued to state that the US had not shown that Telmex was a “major supplier” in the relevant market, and behaviour legally required under Mexican law could not be an “anti-competitive practice”.¹²

The Mexican rules for international telephone service required that the Mexican operator with the largest outgoing traffic over an international route should negotiate the settlement rate for terminating incoming calls over that route, and required this rate to apply to all operators (‘uniform settlements rates’).¹³ Since Telmex had the most outgoing traffic in all routes to the US, it was in practice the sole negotiator of settlement rates that applied as well to its competitors. The rules also required that incoming calls be distributed for termination among Mexican operators in proportion to each operator’s outgoing traffic (‘proportional return’). Mexican operators being offered more than their share of incoming calls should route them over to another operator or compensate it for the difference in revenue.

The Panel found that uniform settlement rates and proportional returns required Mexican operators to engage in practices that were tantamount to a cartel and hence were anticompetitive and for this reason, Mexico had not taken measures to prevent such practices. Contrary to Mexico’s arguments, the Panel also clarified that the anticompetitive practices concerned fell within the scope of the Reference Paper even when they were mandated by internal law. The Panel referred to the importance of the commitments made by WTO members under the Reference Paper and it stated that *“International commitments made under the GATS ‘for the purpose of preventing suppliers... from engaging in or continuing anti-competitive practices’ are ... designed to limit the regulatory powers of WTO members. Reference Paper commitments undertaken by a Member are international obligations owed to all other Members of the WTO in all areas of the relevant GATS commitments.”*¹⁴ Moreover, the

11 *Ibidem*, par.7.222.

12 *Mexico – Telecoms*, par. 7.223.

13 Rule 13 of the “Rules for the Provision of International Long-Distance Service to be Applied by the Licensees of Public Telecommunications Networks Authorized to Provide this Service (ILD Rules)”, published in the Federal Gazette on 11 December 1996.

14 *Mexico – Telecoms*, par. 7.244.

Panel found that Telmex was a “major supplier” given the ability Telmex had to affect the terms of participation through use of its position in the relevant market, which the Panel found to be the termination in Mexico of the services at issue.¹⁵

iv. Application of the Annex on Telecommunications

The US claimed that Mexico had not met its obligations under Section 5 of the GATS Annex on Telecommunications because it had not ensured that US suppliers of basic telecommunications services have access to and use of Mexico’s public telecommunications transport networks and services. The US, in particular, argued that Mexico did not permit interconnection of US suppliers on reasonable terms and conditions, contrary to Section (a), and prohibited altogether access to private leased circuits, contrary to Section 5(b).¹⁶

Mexico argued that the Annex did not apply to the access to and use of public telecommunications transport networks and services for the supply of basic telecommunications services. Further, Mexico reiterated that it had not made any commitments on cross-border supply, either for facilities-based suppliers or commercial agencies, and that it therefore had no Annex obligations related to such services.¹⁷

The Panel noted that Section 5(a) of the Annex states that the obligation to ensure access to and use of public telecommunications transport networks and services shall apply for the benefit of “any service supplier of any other Member” for the supply of “a service included in its schedule”.¹⁸ This means that if a WTO member includes in its schedule of commitments basic telecommunication services, the annex will automatically apply to those services.

The Panel considered that access rates were not charged “reasonable”, and for this reason Mexico had not met its obligations under Section 5(a) to ensure that such access rates are “reasonable”. With regard to the US claims under Section 5(b), the Panel analyzed whether Mexico’s behaviour was allowed under the limitations recognized in Section 5(g). However, the Panel noted that Mexico’s Schedule of Specific Commitments did not include any limitations referring to Section 5(g) or to the development objectives mentioned therein. The Panel considered that without such limitations in Mexico’s Schedule, Section 5(g) does not permit a departure from specific commitments which Mexico has voluntarily and explicitly scheduled.¹⁹ The Panel concluded that, by failing to ensure that commercially present commercial agencies of the United States have access to and use of private leased circuits and are permitted to interconnect these circuits to public telecommunications transport networks and services or with circuits of other service suppliers, Mexico had failed to meet its obligations under Section 5(b) of the GATS Annex on Telecommunications.²⁰

15 *Ibidem*, par. 7.227.

16 *Ibidem*, par. 7.270.

17 *Ibidem*, par. 7.272.

18 *Mexico – Telecoms*, par. 7.281.

19 *Ibidem*, par. 7.388.

20 *Ibidem*, par. 7.389.

According to Sections 5(a) and 5(b) of the Annex on Telecommunications when a country commits to open up a particular market (e.g. financial services), foreign suppliers of these services are entitled to use the host country's telecommunications networks and services to pursue their business. The Panel clarified that interconnection and the ability to interconnect and lease circuits were forms of 'access' to the services at issue, and therefore the provisions in the Annex applied to them.

C. Implications for South Asian Countries

The following chart shows the South Asian countries that had made commitments under the telecommunications sector and whether they have also committed to the Reference Paper or not:

Country	Commitments on Telecommunications	Committed to Reference Paper
Bangladesh	Yes	No
India	Yes	Yes
Nepal	Yes	Yes
Pakistan	Yes	Yes
Sri Lanka	Yes	Yes
Maldives	No	No

As we can see, from the six countries included in the chart only the Maldives has not undertaken any commitment on the Telecommunications sector. And from the other five countries, India, Nepal, Pakistan and Sri Lanka have committed to the Reference Paper also.

What lessons can be drawn from the Panel's findings in the *Mexico – Telecoms* dispute?

First, the interpretation made by the Panel regarding cross-border services on telecommunications is rather important. In order to provide telecommunications services, it is not necessary for a supplier of these services to have a physical presence in the territory of a WTO member that has made commitments under this sector. As previously mentioned, a phone call originated in the country of one WTO member and terminated in the territory of another WTO member is deemed to be a cross-border service.

Second, even when the Panel did not have a clear stand on what type of costing model is more appropriate to follow when determining if interconnection costs are cost-oriented, it did emphasize that the relevant costs were those directly incurred in providing interconnection. This situation leaves the "major suppliers" of telecommunications in a very difficult position because sometimes their interconnection costs (like in the case of Telmex) include the return of the investment made on infrastructure. In other words, the Panel in the *Mexico – Telecoms*

dispute set forth a very low benchmark which could affect enormously the “major suppliers” because if future panels follow the same approach they will certainly have a huge discretionary power in deciding whether the actual interconnection costs are cost-oriented.

Third, South Asian countries must be aware that informal agreements among WTO members (e.g. Unadopted Negotiating Working Group Papers) that do not have the force of law under the WTO *acquis* cannot be used to justify a departure from their obligations contracted under the WTO legal framework.

Fourth, taking into account that the Dispute Settlement Body (DSB) can only enforce WTO law, South Asian countries should review commitments that may have been made under other international agreements that may be relevant to their commitments under the GATS Basic Telecommunication Annex and / or the Reference Paper. This is important, considering that in case a South Asian country engages in a WTO dispute, it may be difficult to justify before a WTO panel an action based on commitments made beyond the WTO legal framework, particularly if they are contrary to the GATS. Actual GATS rights and obligations are what matter in a dispute and not commitments made, for example, in an informal understanding or agreement.

Fifth, South Asian countries must review their competition legal framework. This is because an important finding of the Panel was that in which it stated that anticompetitive practices are deemed to be contrary to the Reference Paper even if they are allowed by one country’s internal law.

Sixth, the Panel considered the Annex on Telecommunications to be applicable automatically to all services listed on the schedule of commitments. This means that foreign suppliers pursuing business under the protection awarded by schedule of commitments will be able to use the host country’s telecommunications networks and services to pursue their economic activities.

Seventh, regarding the application of the Annex on Telecommunications, the panel interpreted article 5(g) of this annex in the sense that it gives developing countries sufficient room and flexibility to tailor their services commitments in order to limit or condition access to and use of public telecommunications. However, it is important to call South Asian countries' attention to the fact that the limitations referring to article 5(g) of the Annex must be incorporated in the country’s schedule of commitments in order to trigger the protection contained in article 5(g).