ARNOLD & PORTER (UK) LLP

EUROPEAN TELECOMS NEWSLETTER

# WTO Panel Rules on US-Mexico Dispute

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On 2 April 2004, the WTO released the report of a panel appointed to consider US claims that Mexico has failed to comply with its GATS commitments relating to telecommunications services, and in particular the terms of the Annex on Telecommunications and the "Reference Paper" on regulatory principles. In the result, the Panel found against Mexico and recommended to the Dispute Resolution Body, which had appointed the Panel, to request that Mexico bring its regime into conformity with its GATS obligations.

The dispute that is the subject of the Panel Report is the first relating solely to trade in services to be referred to dispute resolution under Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU") and Article XXIII of the GATS.[1] The Panel Report is also the first occasion on which an independent body has construed the terms of the Annex on Telecommunications and the Reference Paper.

The Panel Report is over 200 pages in length and it is not practical, in the context of this note, to provide a complete summary. The following is a synopsis of what we consider the main points addressed by the Panel.

## I. Background

### *(a) Mexico's Regulatory Regime*

Prior to 1997, long-distance and international telecommunication services in Mexico were supplied on a monopoly basis by Teléfonos de México ("Telmex"). Since that date, Mexico has authorised multiple carriers to provide international services. Currently, there are 27 carriers allowed to provide long distance services, including two US-affiliated carriers: Avantel (an MCI affiliate) and Alestra (an AT&T affiliate). Telmex is the largest supplier of basic telecommunications services in Mexico.

Under Mexico's Rules for the Supply of International Long Distance Services (the "ILD Rules"), Mexican operators are required to apply a uniform settlement rate and to ensure proportionate return of incoming, as compared to outgoing, calls. The uniform settlement rate is implemented through a rule which gives the Mexican operator with the greatest share of outgoing calls to a particular country – in the case of the US, Telmex – the sole right to negotiate settlement rates with the operators of that country.

***(b) The GATS Obligations***

The General Agreement on Trade in Services ("the GATS"), which includes a special Annex on Telecommunications, is an integral part of the World Trade Organization ("WTO") Agreement. Both the main body of the GATS Agreement and the Annex are applicable to every WTO member.

Before 1998, GATS members had restricted the services subject to the full range of GATS "disciplines" to the provision of capacity for applications such as corporate networks and the supply of enhanced and value-added services by third parties. In 1998, however, a protocol to the GATS (the "Fourth Protocol") entered into force under which 69 (now more than 80) members agreed to extend the application of GATS to their basic services. The Fourth Protocol embodies what is sometimes referred to as the Basic Telecommunications Agreement, or "BTA". Most of the WTO members subscribing to the BTA agreed as part of their Schedules of Specific Commitments to comply with the terms of a common set of pro-competitive regulatory principles. These principles are embodied in the Reference Paper. Both the US and Mexico are parties to the BTA and have subscribed to the Reference Paper.

The interpretation and application of Sections 5 (a) and (b) of the Annex on Telecommunications and Sections 1 and 2.2 of Mexico's Reference Paper were at issue in the US-Mexico case.

Section 5 of the Annex is headed "Access to and use of Public Telecommunications Transport Networks and Services." In summary, section 5(a) provides that each member shall ensure that any service supplier of any other member is accorded access to and use of public telecommunications transport networks and services, on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule.

Section 5(b) provides that each member shall ensure that service suppliers of any other member have access to and use of any public telecommunications transport network or service offered within or across the border of that member, including private leased circuits, and to this end shall ensure (subject to certain conditions) that such suppliers are permitted, inter alia, to interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another service supplier.

Mexico committed, in Section 2.2(b) of its Reference Paper, to ensuring that interconnection with a "major supplier" in the domestic market can take place at any technically feasible point, on a timely basis on terms, conditions and cost-oriented rates that are transparent and reasonable.

In Section 1.1, Mexico committed to maintain appropriate measures for the purpose of preventing major suppliers from engaging in or continuing "anti-competitive practices." According to Section 1.2, these practices shall include anti-competitive cross-subsidisation; using information obtained from competitors with anti-competitive results; and not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

***(c) The US Claims***

In November 2000, the US requested the WTO Dispute Settlement Body to appoint a panel to consider claims by it that the ILD Rules operated in a way that was incompatible with Mexico's GATS obligations. In particular, the US claimed that:

- Mexico has failed to ensure that its major telecommunications supplier provides interconnection "on terms, conditions…and cost-oriented rates that are…reasonable" (in accordance with *Section 2.2(b) of Mexico's Reference Paper).*

- Mexico has not maintained appropriate measures to prevent Telmex from engaging in "anti-competitive" practices (in accordance with *Section 1 of Mexico's Reference Paper).*
- Mexico has failed to ensure "access to and use of" its public telecommunications transport networks and services, including private leased circuits, on "reasonable and non-discriminatory terms and conditions" (in accordance with *Section 5 of the GATS Annex on Telecommunications).*

Ten members intervened as "third parties," including the EU, Canada, Australia, Japan, India and several Latin American countries.

The Panel had the task of interpreting complex layers of GATS Articles, Annexes, Protocols and Schedules in order to make a decision on the US claims. The Panel based its decision on the "ordinary meaning" of the provisions concerned "in their context" and in light of the "object and purpose" of the agreements, using when necessary supplementary means of interpretation, including the preparatory work on the treaty and the circumstances of its conclusion, in accordance with Article 3.2 of the DSU and Articles 31 and 32 of the Vienna Convention on the Law of Treaties.

## II. The Panel's Findings

### *(a) Section 2.2 of the Reference Paper*

The US claimed that Mexico has failed to ensure that Telmex provides interconnection to United States basic telecommunications suppliers on a cross-border basis at cost-based rates and on reasonable terms and conditions. In considering this claim, the Panel addressed two questions: (1) whether Mexico has undertaken an interconnection commitment, and (2) whether Mexico has fulfilled that commitment.

In relation to the first question, the Panel examined which service sectors were included in Mexico's Schedule of Specific Commitments. The Panel concluded that Mexico had not committed itself in its Schedule of Specific Commitments to allowing foreign suppliers access to its markets for the cross-border supply of services over leased capacity (i.e. on a non-facilities basis). It found that Mexico had granted access to its markets for cross-border supply only on a facilities basis. It therefore restricted itself to addressing the application of Section 2.2(b) of the Reference Paper to situations where cross-border supply occurs on a facilities basis.

In relation to the second question, the Panel gave extended consideration to how to ascertain whether a particular company (Telmex in this case) is a "major supplier," how to ascertain whether interconnection rates are "cost-oriented", and how to judge whether a domestic major supplier's terms and conditions are "reasonable".

The Panel examined whether Telmex is a "major supplier" by examining the relevant market for basic telecommunications services and whether the company has the ability to materially affect the terms of participation in that market (i.e. having regard to price and supply). It concluded on this basis that Telmex is a "major supplier" with respect to the communication services at issue because it has the ability to materially affect the price of that service, as a result of its special position in the market, which allows it to set a uniform price applying to all its competitors terminating calls from the US.

The Panel also considered the meaning of "cost-oriented" rates. It concluded that the increasing and widespread usage of incremental cost methodologies among WTO members supports the interpretation of the term "cost-oriented" as meaning the costs incurred in supplying the service, and that the use of long term incremental cost methodologies, such as those required in Mexican law, is consistent with this meaning.

The Panel adopted several methods for assessing whether Mexico's interconnection rates are cost-based. These included looking at the price of the relevant network components paid by domestic suppliers and calculating the differences between these prices and the prices paid by foreign suppliers. The Panel also compared the interconnection rates with

the "grey market" prices on the Mexico-US route and with termination rates on other international routes. Finally, it considered the "proportionate return" procedures among the domestic operators.

The Panel found that the interconnection rate approved by Mexico was substantially above cost by these measures, and that that rate had been imposed as a uniform interconnection rate in a manner which excluded price competition in the relevant market. The Panel ruled that Mexico as a result has failed to ensure that interconnection with a major supplier is provided on "reasonable terms and conditions."

***(b) Section 1 of the Reference Paper***

The US claimed that Mexico has not maintained appropriate measures to prevent Telmex from engaging in "anti-competitive practices." The Panel considered: (1) what practices should be considered "anti-competitive," (2) whether the *Rules for the Supply of International Long-Distance Services* require a major supplier to engage in "anti-competitive practices," and (3) whether Mexico had maintained "appropriate measures" to prevent anti-competitive practices by a major supplier.

In relation to the first point, the Panel concluded simply that the term "anti-competitive practices" is broad in scope, suggesting actions that lessen rivalry or competition in the market. An examination of the object and purpose of the Reference Paper commitments led the Panel to the conclusion that the term "anti-competitive practices" includes, in addition to the specific practices mentioned in Section 1.2, other practices such as horizontal price fixing and market sharing agreements by suppliers.

The Panel next turned to consideration of whether practices *required* under a member's law can be "anti-competitive practices." The Panel reasoned that international commitments made under the GATS (like the one under discussion) 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. The Panel concluded that a requirement imposed by a member under its internal law on a major supplier cannot unilaterally erode its international commitments to other WTO members to prevent major suppliers from "continuing anti-competitive practices." The Panel noted that the pro-competitive obligations in Section 1 of the Reference Paper do not reserve any such unilateral right of WTO members to maintain anti-competitive measures. The Panel therefore concluded that practices required under Mexico's law, such as the ILD Rules, can be "anti-competitive practices" within the meaning of Section 1 of Mexico's Reference Paper.

The Panel then turned to the question of whether Mexico had maintained "appropriate measures" to prevent anti-competitive practices by Telmex. The Panel noted that the term "anti-competitive practices" may be interpreted differently by different WTO members. It said that its findings were limited to the interpretation of Mexico's GATS obligations under Section 1 of its Reference Paper.

The Panel said that, to be "appropriate," measures adopted by Mexico would need to forestall the occurrence of anti-competitive practices by major suppliers in every case. However, at a minimum, it reasoned, if a measure *legally requires* certain behaviour then it cannot be logically "appropriate" in *preventing* that same behaviour. Having found that the ILD Rules concerning uniform interconnection rates and proportionate return legally require anti-competitive conduct by a major supplier, the Panel concluded that Mexico has failed to maintain "appropriate measures" to prevent such acts.

***(c) Section 5 of the Annex on Telecommunications***

The US claimed that Mexico has failed to ensure "access to and use of" its public telecommunications transport networks and services, including private leased circuits, on "reasonable and non-discriminatory terms and conditions." Mexico submitted that the Annex does not cover supply of basic telecommunications services, and applies only to access to and use of public telecommunications transport networks and services as a *transport* means for other economic

activities, such as value-added services. The Panel noted that, while access to and use of public telecommunications transport networks and services may be important generally for the supply of services, such access is indispensable for the supply of basic telecommunications services. If the Annex did not apply to measures affecting such access, Members could effectively prohibit any supply other than that which originated and terminated within the same supplier's network, thereby rendering most basic telecommunications commitments without economic value. The Panel concluded that, if Members had intended to exclude basic telecommunications services from the application of the Annex, they would have made this clear in the same way that they specifically stated in Section 2 (b) that the Annex shall not apply to measures affecting the cable or broadcast distribution of radio or television programming.

Having disposed of this point, a question then arose about how Section 5 of the Annex applied to the basic telecommunications commitments scheduled by Mexico. The Panel noted its earlier finding that the cross-border supply of services on a non-facilities basis was not covered by Mexico's Schedule of Specific Commitments.

Consistent with its finding concerning the application of Section 2.2(b) of the Reference Paper, the Panel found that interconnection rates which exceed cost by a substantial margin, and whose uniform nature excludes price competition in the relevant market, do not provide access to and use of public telecommunications transport networks and services in Mexico "on reasonable…terms." Consequently, the Panel concluded that Mexico had failed to meet its obligations under Section 5(a) of the Annex by failing to ensure that service suppliers are accorded access to and use of public telecommunications transport networks and services in Mexico on reasonable terms.

The US had also claimed that Mexico was not in compliance with its commitment to ensure that non-facilities based foreign suppliers with a commercial presence in Mexico have access to leased circuits and interconnection, contrary to Section 5(b) of the Annex. Specifically, it was claimed that Mexico had failed to take the administrative steps required to ensure that resale could occur. The Panel upheld the US claim on this point.

## III. Conclusions of the Panel

In summary, the Panel concluded that Mexico has not met its GATS commitments under Sections 2.2(b) and 1.1 of its Reference Paper, and under Sections 5 (a) and 5(b) of the Annex on Telecommunications in relation to supply of services on a facilities basis.

However, contrary to the US claims, the Panel found that Mexico had not violated Section 2.2(b) of its Reference Paper or Sections 5(a) and 5(b) of the Annex on Telecommunications with respect to cross-border supply on a non-facilities basis.

1 Article XXIII of the GATS provides a mechanism for the settlement of disputes where it is alleged that a member has failed to carry out its obligations or specific commitments under the GATS, including provision for "adjustments" to reflect the injury a member has suffered as a result of non-compliance.

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