

***Mexico – Measures Affecting Telecommunications Services***

**(WT/DS204)**

**First Written Submission of the United States of America**

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**ATTACHMENT A**

**EXHIBIT LIST**

## I. PROCEDURAL BACKGROUND

1. On 17 August 2000, the United States requested consultations with the Government of Mexico pursuant to Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“Dispute Settlement Understanding,” or “DSU”) and Article XXIII of the *General Agreement on Trade in Services* (“GATS”) regarding measures affecting telecommunications services. This request was circulated to WTO Members on 29 August 2000 (WT/DS204/1). Pursuant to this request, the United States and the Government of Mexico held consultations on 10 October 2000. These consultations provided helpful clarification, but failed to resolve the dispute.

2. On 10 November 2000, the United States requested the establishment of a panel pursuant to Article 6 of the DSU (WT/DS204/2). The Dispute Settlement Body (“DSB”) considered this request at its meeting on 12 December 2000, at which time the Government of Mexico objected to the establishment of a panel. Also on 10 November 2000, the United States requested supplementary consultations with the Government of Mexico pursuant to Article 4 of the DSU and Article XXIII of the GATS regarding additional measures affecting telecommunications services (WT/DS204/1/Add.1). These consultations, held on 16 January 2001, provided additional clarifications and led to the Government of Mexico taking steps to address several of the issues raised therein, but they did not resolve the dispute.

3. On 13 February 2002, the United States Government requested the establishment of a panel (WT/DS204/3) pursuant to Article 6 of the DSU, which was established at the DSB meeting of 17 April 2002 (WT/DSB/M/123) with the following terms of reference:

To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS204/3, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

## II. FACTUAL BACKGROUND

4. U.S. carriers sent 5.5 billion minutes of telephone calls from the United States to Mexico in 2000, the world’s largest volume of one-way international traffic on any route.<sup>1</sup> These calls travel over U.S. carrier networks from the origination point in the United States to the U.S.-Mexico border, and over Mexican carrier networks to the termination point in Mexico. U.S. carriers were charged more than \$1 billion by Mexican carriers in 2000 for terminating these calls.<sup>2</sup>

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<sup>1</sup> U.S. Federal Communications Commission, 2000 Section 43.61 International Traffic Data Report, Dec. 2001, Table A1, <http://www.fcc.gov/wcb/iatd/intl.html>; *TeleGeography 2002*, International Traffic by Route, Figure 1 (Top 50 International Routes, 2000).

<sup>2</sup> FCC, 2000 Section 43.61 International Traffic Data Report, Dec. 2001, Table A1, <http://www.fcc.gov/wcb/iatd/intl.html>. U.S. carriers have been charged approximately \$1 billion or more for

(continued...)

5. Mexico has imposed unique restrictions on competition for the termination of international calls. Although multiple Mexican carriers have been authorized to provide international services over their networks since 1997, Mexico's former monopoly supplier, Teléfonos de México, S.A. de C.V. ("Telmex"), still has the exclusive right to establish the terms and conditions for the termination of all international calls. Mexico is the only WTO Member with competitive suppliers of international facilities-based services that prohibits competitive negotiations for the termination of international calls.

6. Mexico maintains this prohibition in its International Long Distance Rules ("ILD Rules"), which dictate that *only* the Mexican international operator with the largest share of international outbound traffic may negotiate rates for the termination of international calls with foreign (*i.e.*, non-Mexican) carriers.<sup>3</sup> Telmex remains by far the largest supplier of all basic telecommunications services in Mexico, including international outbound traffic.<sup>4</sup> Telmex presently has a market share of 62 percent of international outbound traffic, while its next largest competitor has no more than 20 percent.<sup>5</sup>

7. After five years of competition in Mexico, new entrant carriers have acquired only small shares of international outbound traffic, just as they have acquired only small market shares of all

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<sup>2</sup>(...continued)

terminating calls to Mexico each year since 1994, and more than \$10 billion in total for the period 1991-2000. *See id*; *see also* 1991 FCC Section 43.61 International Traffic Data Report, Dec. 1992, Table A1. Although per minute termination rates have decreased during this period, U.S. carrier payments to Mexican carriers have remained at a constant level because the volume of U.S.-Mexico traffic, stimulated by these lower rates, has steadily increased (by more than 300 percent since 1994). *See* 1992-2000 FCC Section 43.61 International Traffic Data Reports, Table A1. The amounts U.S. carriers ultimately pay reflect an offset of the amounts charged to Mexican carriers by U.S. suppliers for terminating services.

<sup>3</sup> International Long Distance Rules published by the Secretariat of Communications and Transportation in the *Diario Oficial* on 11 December 1996 ("*Reglas para prestar el servicio de larga distancia internacional que deberán aplicar los concesionarios de redes públicas de telecomunicaciones autorizados para prestar este servicio*") (hereinafter "ILD Rules"), Rule 13, Exhibit US-1.

<sup>4</sup> Telmex accounts for 73 percent of domestic long distance traffic, over 97 percent of the fixed local lines to consumers and business users, and has the only nationwide, ubiquitous telecommunications network, while a commonly-controlled Telmex affiliate, America Movil, has 78 percent of cellular (wireless) services in Mexico. *See Annual Report 2001*, Teléfonos De México, at 8 (fixed lines), 9 (domestic long distance & international long distance minutes), <http://www.telmex.com/internos/inversionistas/finanzas/pdf/Annual01.pdf>, Exhibit US-2; *See also* Comisión Federal de Telecomunicaciones, Area Económica, Estadísticas de Telecomunicaciones, [http://www.cft.gob.mx/html/5\\_est/graficas/lineastelfonicas\\_01.html](http://www.cft.gob.mx/html/5_est/graficas/lineastelfonicas_01.html) (total fixed lines in Mexico); [http://www.cft.gob.mx/html/5\\_est/graficas/traficold.html](http://www.cft.gob.mx/html/5_est/graficas/traficold.html) (total domestic long distance & international long distance minutes); America Movil Form 20 F, U.S. Securities and Exchange Commission, filed Jul. 2, 2002, at 5.

<sup>5</sup> *Id.* The two largest competitive carriers in Mexico are Alestra and Avantel, which are believed to have roughly similar market shares. Alestra's shares of international traffic were 14.56 percent for 1999, 13.51 percent for 2000 and 14.29 percent for 2001. *See* Alestra, S. de R.L. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission for fiscal year ended Dec. 31, 2001), at 37 (Alestra international long distance minutes for 1999-2000), Exhibit US-4; Comisión Federal de Telecomunicaciones, Area Económica, Estadísticas de Telecomunicaciones, [http://www.cft.gob.mx/html/5\\_est/graficas/traficold.html](http://www.cft.gob.mx/html/5_est/graficas/traficold.html) (total international long distance minutes).

other basic telecommunications services, and appear unlikely to exceed Telmex's share of international outbound traffic for many years to come, if at all. Therefore, Telmex will remain the largest supplier of international outbound traffic, and will retain the exclusive right to negotiate the terms and conditions for the termination of international calls for the foreseeable future.

8. The ILD Rules also require all Mexican carriers terminating international calls to apply the interconnection rates that are negotiated by Telmex, and thus prevent Telmex's competitors from offering any lower rates.<sup>6</sup> There is no competitive alternative to paying this rate because the ILD Rules also prohibit alternative arrangements for the delivery and termination of international calls in Mexico, such as those available in many other countries for the origination and termination of international traffic over international private lines -- also known as "international simple resale" or "ISR" services.<sup>7</sup> By barring competition among Mexican operators for the termination of international traffic, the ILD Rules ensure that interconnection rates for the termination of international calls in Mexico are maintained at artificially high levels, and far above the costs of providing these services.

9. In other countries, the introduction of competition in basic telecommunications services has brought a rapid reduction in interconnection rates for the termination of international traffic as new entrant carriers have offered lower rates and alternative arrangements to foreign carriers. This new competition is increasingly preventing former monopoly carriers in these countries from maintaining interconnection rates for international traffic at higher levels than are warranted by the costs of terminating international calls.<sup>8</sup> Consequently, U.S. carriers now pay rates no higher than 3-4 cents to terminate U.S. calls in Canada, which also merely require transmission across a terrestrial border just as U.S. calls to Mexico.<sup>9</sup> U.S. carriers pay similarly low interconnection rates for calls to competitive countries requiring transmission over thousands of miles of undersea cable.

10. The market for wholesale transportation and termination of international calls provides ample demonstration of the low international termination rates that have resulted from competition.<sup>10</sup> These publicly available per-minute rates are currently advertised on the Internet by a major traffic exchange company for transport from points of interconnection in Los Angeles, New York or London to a wide range of countries including Australia (1.7 cents), Canada (1.7

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<sup>6</sup> ILD Rules 10 and 13, Exhibit US-1.

<sup>7</sup> ILD Rules 22 and 23, Exhibit US-1

<sup>8</sup> The termination of international calls requires the provision of international transmission to the gateway switch, international switching, domestic transmission and domestic interconnection. *See* para. 122 below.

<sup>9</sup> *See AT&T and Concert Objection to International Settlements Policy Modification Request for a Change in the Accounting Rate for International Message Telephone Service with Mexico*, FCC File No. ARC-MOD-20010530-00123, filed Jun. 20, 2001, at 2.

<sup>10</sup> *See* further discussion and examples at para. 145 below.

cents), Chile (2.1 cents), China (2.3 cents), Germany (1.22 cents), Hong Kong (3.3 cents), Japan (2.2 cents), Korea (2.15 cents), Malaysia (2.49 cents), and Singapore (0.9 cents).<sup>11</sup>

11. As market forces reduce international interconnection rates to more cost-based levels, consumers and users benefit through lower calling prices, which encourage increasing calling volumes. Data of the U.S. Federal Communications Commission (“FCC”) show that U.S. carrier prices for international calling to all WTO Member countries declined by 28 percent between 1997 (the year before many WTO Member countries’ telecommunications markets were opened to competition) and 2000, and that the volume of U.S.-outbound international calls to all WTO Members increased in this period by 28 percent.<sup>12</sup>

12. To ensure that the market forces driving these improvements are not thwarted, Members negotiated the Reference Paper, a common set of regulatory principles developed during the Basic Telecommunications negotiations that was later attached by individual Members to their respective Schedules. Mexico’s Schedule provides, under “Additional Commitments,” that “Mexico undertakes the obligations contained in the reference paper attached hereto.” Among other things, Section 1 of the Reference Paper requires Mexico to maintain measures preventing Telmex from engaging in “*prácticas anticompetitivas*,” and Section 2 requires Mexico to ensure interconnection at rates that are “*basadas en costos*.”

13. The ILD Rules do exactly the opposite, ensuring that international termination rates remain far *above* cost-based levels in Mexico. Telmex charges U.S. carriers rates of 5.5 cents, 8.5 cents and 11.75 cents per minute to terminate traffic to the largest three cities, the 200 other large and medium sized cities, and all other destinations, respectively, which is equivalent to a weighted-average rate of approximately 9.2 cents (based on the distribution of calls from the U.S. to these destinations).<sup>13</sup> However, the prices established by Telmex or the Mexican regulator, the *Comisión Federal de Telecomunicaciones* (Cofetel), for the network components used by Telmex to terminate international calls, demonstrate that the maximum costs that Telmex can incur to terminate an international call to these destinations are no higher than 2.5 cents, 3 cents, and 9.2 cents per minute, respectively, which is equivalent to a weighted average cost of 5.2 cents per minute (again, based on the distribution of calls from the U.S. to these destinations).<sup>14</sup> This analysis demonstrates that Telmex’s international termination rates are more than 75 percent higher than its prices to Mexican carriers for the same network components and functions.<sup>15</sup>

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<sup>11</sup> See [www.arbinet.com](http://www.arbinet.com) and paras. 145-147 below.

<sup>12</sup> See FCC Section 43.61 International Traffic Data Reports 1997-2000, Table A1, <http://www.fcc.gov/wcb/iatd/intl.html>, Exhibit US-6 (showing a decline in U.S. carrier average revenue per minute to all WTO Member destinations from \$0.65 in 1997 to \$0.47 in 2000, and increased U.S. billed minutes to all WTO Member destinations from 21,654 million minutes in 1997 to 27,742 million minutes in 2000).

<sup>13</sup> See paras. 118-121 below.

<sup>14</sup> See *Id.*

<sup>15</sup> Mexico has not shown that the rates charged by Telmex for these network components are ‘*basadas en*’ (continued...)

14. Similarly, contrary to the obligation contained in the Reference Paper to ensure interconnection at reasonable rates, the ILD Rules encourage Telmex to establish rates at artificially high levels that restrict the supply of scheduled services. The ILD Rules also fly in the face of Mexico's obligation under the Reference Paper to maintain measures preventing Telmex from engaging in or continuing anti-competitive practices by mandating that all Mexican carriers must adhere to a Telmex-led horizontal price-fixing cartel – the type of arrangement that is universally viewed as anti-competitive.

15. The Government of Mexico has acknowledged to the Organisation for Economic Co-operation and Development (OECD) that the ILD Rules “might not be the optimum for competition,” but has taken no steps to reform those rules or to require Telmex to provide lower international termination rates.<sup>16</sup> Indeed, the Mexican authorities have ignored or rejected repeated requests by U.S. and other Mexican carriers to permit competitive, cost-based alternatives to the termination rates established by Telmex.

16. In July 1998, U.S. telecommunications service supplier, American Telegraph & Telephone (AT&T) requested cost-based interconnection rates from Telmex and Cofetel, but Telmex refused AT&T's request, and Cofetel did not respond.<sup>17</sup> In November 1998, Cofetel declined to authorize a coalition of competitive Mexican long distance suppliers to enter into alternative interconnection arrangements with foreign operators that did not incorporate the Telmex-negotiated settlement rate.<sup>18</sup> Cofetel responded by emphasizing the requirements of the ILD Rules and promising to review these rules “in the coming year” in order to determine the usefulness of modifying the “uniform settlement rate system,” but no modifications were ever made.<sup>19</sup>

17. In July 1999, Cofetel summarily rejected an agreement between AT&T and Mexican long distance carrier Alestra to provide cross-border interconnection at rates far below the Telmex-negotiated rate.<sup>20</sup> The following year, Mexico's Secretaría de Comunicaciones y Transportes

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*costos.*” The United States believes that prices for some of these components, particularly Telmex's *venta* rates, significantly exceed Telmex's costs.

<sup>16</sup> Submission by Mexico to the OECD Working Party No. 2 on Competition and Regulation, *Competition and Regulation Issues in Telecommunications*, DAF/CLP/WP2/WD(2001)25 (18 May 2001), para. 8, Exhibit US-7.

<sup>17</sup> Letters from George Foyo (AT&T) to Jaime Chico Pardo (Telmex) and Javier Lozano Alarcón, 31 July 1998, Exhibit US-8; Letter from Jaime Chico Pardo (Telmex) to George Foyo (AT&T), 31 August 1998, Exhibit US-9

<sup>18</sup> Letter to Cofetel by six Mexican basic telecom service suppliers, 19 November 1998, Exhibit US-10.

<sup>19</sup> Letter from the then-President of Cofetel, Javier Lozano Alarcón, 27 November 1998, Exhibit US-11

<sup>20</sup> Letter from Salma Jalife Villalon (Cofetel) to Rolando Zubiran (Alestra), 1 July 1999, Exhibit US-12. Cofetel rejected the AT&T/Alestra agreement on the basis that it did not comply with the relevant ILD Rules, including Rules 2, 10, 13, 22, and 23 (i.e., those that require suppliers to incorporate the Telmex-negotiated “uniform settlement rate” in all international interconnection agreements).

(SCT) made no response to an October 2000 request by AT&T's affiliate, Concert, that SCT should ensure that Telmex provides foreign operators cross-border interconnection at cost-oriented rates and remove the ILD Rules.<sup>21</sup> In May 2002, Cofetel rejected efforts by the border towns of Laredo, Texas (United States) and Nuevo Laredo, Tamaulipas (Mexico) to obtain lower prices for calls between the two border cities as being contrary to the ILD Rules.<sup>22</sup>

18. Telmex has now agreed with several U.S. carriers that it will seek the modification, effective by January 1, 2004, of laws and regulations “that prevent negotiation of competitive market-based international termination rates in Mexico.”<sup>23</sup> Telmex has requested Cofetel to make those modifications in a letter filed earlier this year, but Cofetel has thus far failed to respond even to this limited request.

19. Each WTO Member is required by the GATS Annex on Telecommunications to ensure that foreign service suppliers have reasonable and nondiscriminatory access to and use of public telecommunications networks and services to supply all services inscribed in that WTO Member's Schedule, including basic telecommunications services. The ILD Rules prevent reasonable and non-discriminatory access to and use of public telecommunications networks and services in Mexico by requiring foreign suppliers to negotiate exclusively with Telmex and to pay unreasonable, above-cost interconnections rates.

20. The ILD Rules also prevent foreign suppliers from interconnecting private leased circuits with foreign public networks for the supply of international circuit switched telecommunications services. Although specifically requested, Mexican suppliers will not even make private leased circuits available to U.S. suppliers. In 1998, AT&T requested Telmex to provide access to and use of private leased circuits for the provision of voice telephone services on a cross-border basis, and AT&T notified the President of Cofetel of this request by letter.<sup>24</sup> Telmex denied AT&T's request and Cofetel took no action in response to the AT&T letter.<sup>25</sup>

21. Notwithstanding Mexico's scheduled commitments for “commercial agencies” (which supply basic telecommunications services over leased (or “resold”) capacity), the policy of the Mexican government is to refuse to permit any foreign carrier from supplying such services. Eight months after making this commitment, the then-Secretary of Mexico's Secretariat of Communications informed the then-Chairman of the FCC that the impossibility of reselling long-

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<sup>21</sup> Letter from Eloisa Regalado of Concert to Carlos Ruiz Sacristan (former Secretary of the SCT), 27 October 2000, Exhibit US-11.

<sup>22</sup> Letter from Cofetel President Jorge Arredondo Martinez to Jose Manuel Suarez Lopez, Cofetel Document Number CFT/DO1/P/146/02, 20 May 2002, Exhibit US-15.

<sup>23</sup> 2001 Agreement on Principles of Settlement by and between Telefonos de Mexico, S.A. de C.V. and MCI International, Inc. and IDB WorldCom Services, Inc.

<sup>24</sup> Letter from George Foyo (AT&T) to Jaime Chico Pardo (Telmex), 31 July 1998, Exhibit US-8; Letter from George Foyo (AT&T) to Javier Lozano Alarcón (Cofetel), 31 July 1998, Exhibit US-8.

<sup>25</sup> Letter from Jaime Chico Pardo (Telmex) to George Foyo (AT&T), 31 August 1998, Exhibit US-9.

distance public network capacity has been and will continue to be the internal policy of the Mexican government.

22. In addition to the restrictions on the supply of services over leased capacity contained in the ILD Rules, Mexico has refused to permit local establishment of commercial agencies to supply international services using leased circuits. As described more fully below, over five years after finalizing its commercial agencies commitment, which conditioned the mode 3 supply of commercial agencies on the issuance of “the corresponding regulations,” Mexico still has not issued the relevant regulations.

### III. SUMMARY OF LEGAL ARGUMENT

23. Through the ILD Rules and other action of the Mexican government, Mexico has failed to implement its obligations under both the basic telecom Reference Paper and the GATS Annex on Telecommunications.

24. Mexico inscribed specific market access and national treatment commitments for basic telecommunications services in its GATS Schedule of Commitments, GATS/SC/56/Suppl.2 (“Schedule”). Mexico also incorporated the basic telecom Reference Paper into its Schedule as an additional commitment. The basic telecom services scheduled by Mexico that are at issue in this case include Mexico’s commitment to permit foreign basic telecom service suppliers to provide (1) “facilities-based” (companies that provide basic telecom services over facilities that they own) voice telephony, circuit-switched data transmission, and facsimile services on a cross-border basis, and (2) “commercial agency” (companies that provide basic telecom services over lines they lease from “facilities-based” suppliers, such as Telmex) services on a cross-border basis and through a commercial presence.

25. Sections 2.1 and 2.2 of the Reference Paper require Mexico to impose certain disciplines on its major supplier of basic telecom services (“Telmex”) in its dealings with other suppliers of basic telecom services that seek to interconnect with its network for the purpose of supplying scheduled services. In particular, Sections 2.1 and 2.2 require Mexico to ensure that Telmex provides interconnection at rates that are “*basadas en costos*” and “*razonable*.”

26. Mexico does not comply with Sections 2.1 and 2.2 of the Reference Paper in connection with the basic telecom commitments that Mexico undertook in the GATS. Specifically, the interconnection rates – approved by Mexico’s telecommunications regulatory body (“Cofetel”) – that Telmex charges basic telecom service suppliers in the United States for interconnection are not “*basadas en costos*.” Telmex’s U.S.-Mexico interconnection rates are 27 to 183 percent higher than the maximum rates Telmex charges Mexican basic telecom suppliers for the same network components. That Telmex’s rates are above-cost is confirmed by the fact that “grey market” rates for calls into Mexico, and wholesale rates for the termination of calls into other countries are both lower than Telmex’s rates. Finally, the financial compensation procedures under the ILD Rules provide incontrovertible evidence that Telmex’s interconnection rates are



not “*basadas en costos*.” As explained more fully in paragraphs 148-156 below, there would be no need for such financial compensation provisions if the interconnection rates set by Telmex were based in cost.

27. Mexico has also failed to ensure that Telmex’s interconnection rates are “*razonable*” as required by Section 2.2(b) of Reference Paper. Mexico’s ILD Rules provide Telmex with *de jure* monopoly power to set the interconnection rates charged by *all* Mexican carriers to foreign suppliers. These rules allow Telmex to set artificially high rates that restrict the supply of scheduled services. Furthermore, Mexico has rejected proposals by U.S. and Mexican suppliers to approve alternative interconnection agreements that would exert competitive pressure on the Telmex-negotiated rate. An interconnection rate that is exclusively negotiated by the major supplier and for which no other alternatives are permitted is, on its face, unreasonable.

28. For these reasons, the United States considers that Mexico has failed to honor its commitments under Sections 2.1 and 2.2 of the Reference Paper.

29. Mexico has also failed to honor its commitments under Section 1 of the Reference Paper. Section 1.1 requires Mexico to maintain appropriate measures to prevent Telmex from engaging in or continuing anti-competitive practices. Contrary to this obligation, Mexico maintains measures which actually require anti-competitive conduct on the part of its major supplier, Telmex.

30. Specifically, the ILD Rules give Telmex exclusive authority to negotiate the rate that foreign basic telecom service suppliers must pay to their Mexican counterparts for interconnection. By law, all Mexican basic telecom suppliers, including Telmex, must incorporate that rate in their interconnection contracts with foreign cross-border basic telecom suppliers. The ILD Rules also ensure that Telmex receives the greatest share of the revenue generated from this charge, regardless of how many calls it interconnects from abroad.

31. Far from preventing Telmex from engaging in anti-competitive activities, Mexico’s rules empower Telmex to engage in monopolistic practices with respect to interconnection rates for basic telecom services supplied on a cross-border basis and to create an effective cartel dominated by Telmex to set rates for such interconnection. For these reasons, the United States considers that Mexico has failed to honor its commitments under Section 1.1 of the Reference Paper.

32. Mexico has also failed to honor its commitments under the GATS *Annex on Telecommunications* (“Annex”). The Annex requires Mexico to ensure that service suppliers of other Members can access and use public telecommunications transport networks and services (“public networks and services”) on reasonable and non-discriminatory terms and conditions to provide a scheduled service. To this end, Section 5(b) of the Annex specifically requires Mexico to ensure that U.S. suppliers can access and use private leased circuits within and across Mexico’s border and interconnect those circuits with Mexico’s public networks and services.

33. The United States considers that Mexico has not fulfilled its commitments under either Section 5(a) or (b) of the Annex for the provision of these scheduled services. Interconnection is the means by which U.S. service suppliers access and use Mexico’s public telecom networks and services. U.S. suppliers must interconnect with the Mexican network in order to ensure that they can transport their scheduled service to its final destination. As described above, through the ILD Rules, Mexico permits and even requires that Telmex and other Mexican carriers charge uniform interconnection rates that are exclusively negotiated by Telmex. These requirements combined with the fact that the rates are above-cost have prevented Mexico from honoring its commitment to provide access to and use of Mexico’s public telecom networks and services on reasonable terms and conditions.

34. Second, Mexico has failed to honor its commitment under Section 5(b) to provide access to and use of private leased circuits offered within and across Mexico’s border. Mexico refuses to permit U.S. service suppliers (both facilities-based and commercial agencies) to access and use private leased circuits for the supply of scheduled basic telecom services. In response to requests by U.S. suppliers, both the Mexican government and Telmex have refused to make private leased circuits available to U.S. suppliers so that they can supply scheduled basic telecom services on a cross-border basis from the United States into Mexico, or through the commercial presence of a non-facilities-based supplier. Indeed, the ILD Rules, together with other Mexican law and regulations, effectively prevent Mexican firms from doing so. Even if Mexican suppliers would supply private leased circuits, under ILD Rule 3, U.S. suppliers could not connect those circuits directly into the U.S. or Mexican network, thus preventing them from providing cross-border services over such lines.

35. Mexico’s failure to ensure that foreign service suppliers have access to and use of private leased circuits for the purposes of supplying scheduled services is a violation of Mexico’s obligation to provide access to and use of private leased circuits in the first instance.

#### **IV. LEGAL ARGUMENT**

##### **A. Mexico Has Failed to Ensure that Telmex Provides Interconnection to U.S. Cross-Border Basic Telecom Suppliers Consistent with Mexico’s Reference Paper Obligations.**

###### **1. Introduction**

36. Sections 2.1 and 2.2 of the Reference Paper – which Mexico has undertaken as “additional commitments” pursuant to GATS Article XVIII – require Mexico to impose certain disciplines on its major supplier of basic telecom services (“Telmex”) in its dealings with other suppliers of basic telecom services that seek to interconnect with its network. In particular, these provisions require Mexico to ensure that Telmex provides interconnection to U.S. suppliers of scheduled basic telecom services on terms, conditions and cost-oriented rates that are transparent,

reasonable, and sufficiently “unbundled” so that suppliers need not pay for network components or facilities they do not require.

37. The United States considers that Mexico has not complied with these obligations in connection with the basic telecom commitments that Mexico has undertaken in the GATS. The United States will demonstrate in this section that:

- (1) Mexico’s Reference Paper obligations apply to the terms and conditions of interconnection between U.S. suppliers of basic telecom services on a cross-border basis and Telmex;
- (2) Telmex is a major supplier of basic telecommunications services in Mexico;
- (3) Mexico has failed to ensure that Telmex provides interconnection to U.S. suppliers at rates that are based in cost and on terms and conditions that are reasonable. In particular, Mexico has allowed Telmex to charge an interconnection rate that exceeds cost and to restrict the supply of scheduled basic telecom services. Mexico also prohibits the use of any alternative to this rate.
- (4) Mexico has adopted measures (such as the ILD Rules) and taken other official actions that are incompatible with Section 1 of the Reference Paper.

38. Before turning to the specific obligations and Mexico’s violations, however, it is necessary to understand the concept of “interconnection.”

## 2. What is Interconnection?

39. The seemingly technical term “interconnection” actually describes a simple concept. Interconnection consists of the linking of the networks of two different suppliers of telecommunications services for the purpose of exchanging traffic. Interconnection is the necessary intermediary step that enables a phone call to travel from the network used by the person placing the call (the “calling party”) to the network used by the person receiving the call (the “receiving party”). Without interconnection, a supplier of basic telecom services would not be able to complete a phone call to the receiving party (unless the receiving party was on the same network as the calling party). Therefore, basic telecom service suppliers purchase interconnection from each other as the key wholesale input in supplying a basic telecom service to a customer.

40. Basic telecom suppliers interconnect with each other to “originate” or “terminate” a call. Because originating interconnection is not the primary focus of this dispute, the United States

will limit this discussion to termination.<sup>26</sup> No telecom supplier has a worldwide ubiquitous network, and all telecommunications service suppliers therefore rely on another service supplier to deliver (or “terminate”) the phone call to the receiving party when the receiving party is not on the network of the calling party’s supplier. To do so, the calling party’s service supplier must link to the network of the receiving party’s service supplier and hand-off the call for delivery to the receiving party. In other words, the calling party’s service supplier interconnects its network with that of the receiving party’s service supplier to enable users of both networks to communicate with each other.

41. Whether for the purpose of origination or termination, interconnection is generally understood as the linking between the networks of different basic telecom suppliers for the purpose of allowing users of one supplier to communicate with users of another. The Reference Paper defines interconnection in this manner. In particular, 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.

Mexico’s domestic definition of interconnection is very similar.<sup>27</sup>

42. U.S. basic telecom suppliers interconnect with the network of Telmex at the border, a technically feasible point of interconnection. For example, for the cross-border supply of basic telecom services, Telmex/Telnor (Telnor is a wholly-owned subsidiary of Telmex) and AT&T have established six locations through which all traffic will pass: (1) San Diego to Tijuana, (2) Calexico to Mexicali, (3) Nogales to Nogales, (4) El Paso to Juarez, (5) Laredo to Nuevo Laredo, and (6) Hidalgo to Reynosa.<sup>28</sup> Telmex then uses its network to carry the call to the ultimate destination.<sup>29</sup>

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<sup>26</sup> Origination is relevant to the U.S. claims under the Annex on Telecommunications for the supply of voice, telephony, circuit switched data transmission and facsimile services through a commercial presence by a non-facilities-based operator and will be discussed in that section.

<sup>27</sup> See, e.g., Cofetel’s glossary of telecommunications terms, available at [http://www.cft.gob.mx/frame\\_inf\\_telecom\\_glosario.html](http://www.cft.gob.mx/frame_inf_telecom_glosario.html). This glossary defines *interconexión* (interconnection) as “*Conexión física y lógica entre dos redes públicas de telecomunicaciones, que permite cursar tráfico público conmutado entre las centrales de ambas redes. La interconexión permite a los usuarios de una de las redes conectarse y cursar tráfico público conmutado a los usuarios de la otra y viceversa, o utilizar servicios proporcionados por la otra red.*” (“Physical and logical connection between two public telecommunications networks, that allows the exchange of switched public traffic between the switching central offices of both networks. The interconnection allows the users of one of the networks to interconnect and exchange public switched traffic with the users of the other network and vice versa, or to use the services provided by the other network.”)

<sup>28</sup> Other U.S. operators hand off traffic to Telmex at different cross-border locations.

<sup>29</sup> While the majority of traffic provided by U.S. cross-border suppliers requires only terminating interconnection with a Mexican supplier, many additional services require originating interconnection. International  
(continued...)

43. Section 2 of the Reference Paper covers the factual scenario raised in this dispute, namely the interconnection between the networks of U.S. basic telecom suppliers and Telmex for the purpose of allowing the users of U.S. suppliers to communicate with users of Telmex’s network.

3. Section 2 of the Reference Paper applies to the terms and conditions of interconnection between U.S. suppliers of scheduled basic telecom services and Telmex.

44. Section 2 of the Reference Paper requires Mexico to ensure that Telmex – Mexico’s major supplier of basic telecommunications – provides interconnection to foreign suppliers of basic telecom services according to specific terms and conditions. In this section, the United States will demonstrate that these interconnection obligations apply (1) as legally binding GATS commitments, (2) on the basis of the specific commitments Mexico has undertaken in its GATS Schedule, and (3) to the circumstances at issue in this case, namely the interconnection between U.S. service suppliers and Telmex for the purpose of delivering their basic telecom services from the United States into Mexico.

- a. Mexico undertook the interconnection obligations of Section 2 of the Reference Paper as additional binding commitments under GATS Article XVIII.

45. Mexico inscribed the basic telecom “Reference Paper” into its Schedule as an additional commitment pursuant to GATS Article XVIII.<sup>30</sup> That Article makes binding under the GATS the commitments so inscribed: “Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Article XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member’s Schedule.”<sup>31</sup>

46. Mexico included the entire text of the Reference Paper as additional commitments.<sup>32</sup> In so doing, Mexico undertook legally binding commitments with respect to competitive safeguards

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<sup>29</sup>(...continued)

800 (freephone service), collect calls, calling card calls, and Country Direct calls are all existing forms of the cross-border supply of a scheduled service where U.S. suppliers require originating interconnection with a Mexican supplier. In some cases, U.S. suppliers use these originating service arrangements to provide services that both originate and terminate within Mexico. For example, a call originated in Mexico via a Country Direct service arrangement with a U.S. supplier can pass through the network of the U.S. supplier for ultimate termination in Mexico. In this case, the U.S. cross-border supplier bills the originating caller in Mexico for a domestic long distance call within Mexico.

<sup>30</sup> The additional commitments column in Mexico’s Schedule states that “*México adopta las obligaciones contenidas en el documento de referencia anexo a la presente.*” Mexico’s Schedule, GATS/SC/56/Suppl.2, p. 2, Exhibit US-14.

<sup>31</sup> GATS Article XVIII.

<sup>32</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2, pp. 7-9, Exhibit US-14.

(Section 1), interconnection (Section 2), universal service (Section 3), licensing criteria (Section 4), independent regulation (Section 5), and allocation and use of scarce resources (Section 6).

47. Therefore, pursuant to GATS Article XVIII, Mexico committed to the United States (and all other WTO Members) that it would abide by the strict terms and conditions contained in Section 2 of the Reference Paper. In particular, Mexico committed that it would ensure that its major supplier of basic telecom services (“Telmex”) provides interconnection at rates that are based in cost and are reasonable. However, as the United States will now argue, Mexico has failed to honor these Article XVIII commitments.

- b. Interconnection between Telmex and U.S. suppliers of scheduled basic telecom services on a cross-border basis falls within the scope of Mexico’s GATS Article XVIII additional commitments on interconnection.

48. Section 2.1 of the Reference Paper, as inscribed in Mexico’s Schedule as additional commitments, defines the scope of Mexico’s interconnection obligations:

*Esta sección es aplicable a la conexión con los proveedores de redes públicas de telecomunicaciones de transporte o de servicios a fin de permitir a los usuarios de un proveedor comunicarse con los usuarios de otro proveedor y tener acceso a los servicios suministrados por algún otro proveedor, respecto de los cuales se contraigan compromisos específicos.”<sup>33</sup>*

As explained more fully below, Mexico’s obligations under Section 2 apply to the interconnection between Telmex and U.S. suppliers of basic telecom services on a cross-border basis because such interconnection (1) involves the specific market access and national commitments that Mexico undertook in its Schedule for basic telecommunications services and (2) links suppliers of public telecom networks and services (a U.S. supplier of basic telecom services and Telmex) to enable users of the U.S. supplier to communicate with users of Telmex and to access Telmex’s services.

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<sup>33</sup> Mexico’s Schedule, Reference Paper, sec. 2.1, GATS/SC/56/Suppl.2, p. 7 (emphasis supplied). According to the WTO’s English language version of Mexico’s Schedule, “[t]his section applies, on the basis of the specific commitments undertaken, to 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,” Exhibit US-14.

- i. Mexico committed to accord foreign suppliers market access and national treatment for the cross-border supply of public basic telecom services.

49. Mexico undertook a wide array of market access and national treatment commitments for basic telecom services. These include local, domestic and international long distance voice telephone services, packet-switched data transmission services, circuit-switched data transmission services, facsimile services, and private leased circuit services.<sup>34</sup>

50. Mexico chose to inscribe these basic telecom commitments based on whether the service supplier owned telecommunications facilities (“facilities-based operator”) or leased such facilities from another operator (“non-facilities-based operator”). Moreover, with few limitations, Mexico permitted the supply of these services on a cross-border basis (mode 1) and locally, through a commercial presence (mode 3).

51. Therefore, as the United States explains below, Mexico’s interconnection obligations under Section 2 of the Reference Paper apply to the cross-border supply of international basic telecom services by facilities-based and non-facilities-based operators.

- (a) Mexico scheduled cross-border commitments for basic telecom services supplied by a facilities-based operator.

52. Mexico undertook market access and national treatment commitments for basic telecom services supplied by “facilities-based” operators: “*los servicios de telecomunicaciones, suministrados por una red pública de telecomunicaciones basada en infraestructura (alámbrica y radio-eléctrica) a través de cualquier medio tecnológico actual, incluidos en las literales a), b), c), f), g) y o).*”<sup>35</sup>

53. Not all of these services are relevant to the U.S. claims in this section. Instead, the United States will focus its analysis on those services for which U.S. service suppliers seek to interconnect with Telmex. Mexico inscribed these services as: a) (“*servicios de telefonía*” or

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<sup>34</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2, pp. 2-6, Exhibit US-14. Members negotiated basic telecom commitments on the basis of the list of services set forth in the *Services Sectoral Classification List*, MTN.GNS/W/120, 10 July 1991. This list categorizes telecommunications services into 15 separate services including an “other” category. Basic telecommunications encompasses the first seven of the 15 services on this list, and value-added telecommunications encompasses the remaining eight. Mexico did not undertake commitments for telex and telegraph services.

<sup>35</sup> The WTO’s English version of Mexico’s Schedule translates this phrase as “[t]elecommunications services supplied by a facilities-based public telecommunications network (wire-based and radioelectric) through any existing technological medium, included in subparagraphs (a), (b), (c), (f), (g) and (o).”

“voice telephony”),<sup>36</sup> c) (“*servicios de transmisión de datos con conmutación de circuitos*” or “circuit-switched data transmission services”),<sup>37</sup> and d) (“*servicios de facsímil*” or “facsimile services”).<sup>38</sup> For ease of reference, the United States will refer to these services as “facilities-based services” or “basic telecom services supplied by a facilities-based operator.”

54. Mexico undertook these public basic telecom commitments for these facilities-based services on a cross-border (mode 1) basis, which GATS Article I:2(a) defines as the supply of a service “from the territory of one Member into the territory of any other Member.”<sup>39</sup> Mexico limited this commitment to ensure that service suppliers route international traffic through the facilities of an entity licensed in Mexico (known as a “concessionaire”), thus confirming its specific intention to include international services within the scope of these commitments.<sup>40</sup>

55. The U.S. companies that interconnect with Telmex provide these international facilities-based services. For instance, AT&T, WorldCom, or Sprint use their own networks in the United States to offer voice telephony, circuit-switched data, and facsimile services between the United States and Mexico. Because Mexican law prevents these service suppliers from owning facilities in Mexico,<sup>41</sup> they must interconnect their networks with that of Telmex (or another Mexican supplier) at the border in order to ensure delivery of their service to the final user in Mexico.

- (b) Mexico scheduled cross-border commitments for non-facilities-based telecom services (“commercial agencies”).

56. Mexico also undertook market access and national treatment commitments for basic telecom services supplied by “non-facilities-based” operators to third parties. Mexico’s Schedule identifies such suppliers as “*comercializadoras*” (“commercial agencies”) and defines this terms as: “*empresas que, sin ser propietarias o poseedoras de medios de transmisión, proporcionan a terceros servicios de telecomunicaciones mediante el uso de capacidad arrendada de un*

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<sup>36</sup> Mexico used United Nations Central Product Classification (“CPC”) codes 75211 and 75212 to describe this service, which is essentially basic telephone service.

<sup>37</sup> Mexico used CPC codes 7523\*\* to describe this service. CPC 75231 covers “data network services,” which the CPC defines as “network services necessary to transmit data between equipment using the same or different protocols.”

<sup>38</sup> Mexico used CPC codes 7521\*\* and 7529\*\* to describe this service. As discussed in footnote 36, 7521\*\* encompasses public telephone services defined in CPC codes 75211 and 75212. This category also includes CPC code 75213 (“mobile telephone services”). CPC code 7529\*\* incorporates “paging services” (defined as “the summoning of a person to the telephone through the use of an electronic pager.”)

<sup>39</sup> GATS, art.I:2(a).

<sup>40</sup> Mexico inscribed the following mode 1 limitation for facilities-based services: “*el tráfico internacional debe ser enrutado a través de las instalaciones de una empresa con una concesión otorgada por la Secretaría de Comunicaciones y Transportes (SCT).*” (The WTO’s English version states that “International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).”) Mexico’s Schedule, GATS/SC/56/Suppl.2., p. 2, Exhibit US-14.

<sup>41</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2.



*concesionario de redes públicas de telecomunicaciones.*<sup>42</sup> The supply of basic telecom services over leased capacity is typically known as “resale.”<sup>43</sup> However, Mexico chose to use the term *comercializadoras* in its Schedule.

57. As with “facilities-based services,” Mexico undertook its resale commitments for *comercializadoras* on a cross-border (mode 1) basis with the same limitation to require service suppliers to route international traffic through the facilities of a “concessionaire.”<sup>44</sup> In other words, Mexico committed to accord market access and national treatment to U.S. suppliers, which do not themselves own facilities, but instead provide telecommunications services over capacity (such as a line) that they lease from a concessionaire.

58. As the United States will discuss in more detail in paragraphs 278-290, Mexico maintains measures that prevent foreign service suppliers from offering basic telecom services as *comercializadoras*. As a result, there are no U.S. suppliers providing switched basic telecommunications services from the United States into Mexico over leased capacity that seek to interconnect with Telmex. Mexico’s interconnection obligations nonetheless apply to scheduled services by commercial agencies on a cross-border basis. Accordingly, Mexico must ensure that a U.S. operator providing telecommunications over leased facilities (such as a private leased circuit) can interconnect those facilities with Telmex under the terms and conditions required by Section 2 of the Reference Paper.

- ii. Section 2 applies because U.S. suppliers of basic switched telecom services seek to link with Telmex to connect calls by their users originating in the United States to Telmex’s users in Mexico.

59. For Mexico’s interconnection obligations to apply, Section 2.1 of the Reference Paper also requires there to be a *conexión* (linking) between *proveedores de redes públicas de telecomunicaciones de transporte o de servicios* (suppliers of public telecommunications transport networks and services) in order to allow *usuarios* (users) of one supplier to communicate with users of another supplier and to access services provided by another supplier.<sup>45</sup> As discussed below, interconnection between U.S. service suppliers and Telmex constitutes linking between suppliers of basic telecom services in order to allow users of a U.S.

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<sup>42</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2., note 2. The WTO’s English version of the Schedule defines “commercial agencies” as “[a]gencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire.” The United States will discuss the precise meaning of this commitment in more detail in paras. 56-58.

<sup>43</sup> The WTO website contains a glossary of telecommunications terms, including a definition of a “resale-based service supplier” as “a company that leases bulk-rated plant (e.g. transmission) capacity from a facilities-based carriers and uses that capacity to provide a service to individual customers.”  
<http://www.wto.org/wto/services/te112.htm>.

<sup>44</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2. Mexico also undertook commitments for “commercial agencies” on a mode 3 basis. However, this mode is not relevant to U.S. claims under the Reference Paper.

<sup>45</sup> Mexico’s Schedule, Reference Paper, sec. 2.1. GATS/SC/56/Suppl.2.

service supplier to communicate with users of a Mexican supplier and to access services provided by such Mexican supplier.

- (a) Telmex and U.S. basic telecom suppliers are *proveedores de redes públicas de telecomunicaciones de transporte o de servicios* (“suppliers providing public telecommunications transport networks or services”) (“PTTNS”).

60. Telmex and U.S. basic telecom providers (such as AT&T and WorldCom) are “suppliers providing public telecommunications transport networks or services” (“PTTNS”). Section 3(c) of the GATS *Annex on Telecommunications* (“Annex”) defines “public telecommunications transport network” as “the public telecommunications infrastructure which permits telecommunications between and among defined network termination points.” Section 3(b) of the Annex defines “public telecommunications transport service” as:

any telecommunications transport service required, explicitly or in effect, by a Member to be offered to the public generally. Such services may include, *inter alia*, telegraph, *telephone*, telex, and *data transmission* typically involving the real-time transmission of customer-supplied information between two or more points without any end-to-end change in the form or content of the customer’s information. (Emphasis supplied)

61. As discussed above, the specific services commitments at issue are “facilities-based services” (i.e., voice telephony, circuit-switched data transmission, and facsimile services) and non-facilities-based services (i.e., “commercial agencies”). Each of these services – which Telmex and U.S. basic telecom service providers supply<sup>46</sup> – is an example of a public telecommunications transport network and service.

62. The basic telecom services that Mexico inscribed in its Schedule are “telecommunications transport networks and services.” The negotiations on basic telecom services substituted the cumbersome term “telecommunications transport networks and services”

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<sup>46</sup> Telmex’s concession requires Telmex to provide local, national, and international public service network services (including voice and data) and public voice telephony. Telmex’s concession also authorizes it to provide telecommunications services over on the networks of other concessionaires. *Modificación al Título de Concesión de Teléfonos de México, S.A. de C.V.*, August 10, 1990, pp. 3, 4-7, 20, Exhibit US-17. For U.S. service suppliers (such as AT&T and MCI WorldCom), see FCC, *2000 International Telecommunications Data*, December 2001, pp. 4, 14, 19, 22, available at <http://www.fcc.gov/wcb/iatd/intl.html>.

with the term “basic telecommunications.”<sup>47</sup> Therefore, all basic telecommunications are “telecommunications transport networks and services.”

63. These services can be either “public” (“any telecommunications transport service required, explicitly or in effect, by a Member to be offered to the public generally”)<sup>48</sup> or non-public. The Chairman’s Note underscores that basic telecom services listed in the sector column “encompasses local, long distance, and international services for public and non-public use.”<sup>49</sup> Moreover, the CPC codes that Mexico used to describe its commitments refer to “public” services.<sup>50</sup> Therefore, the facilities-based and commercial agencies services that Mexico inscribed in its Schedule – which U.S. operators and Telmex supply – are “public telecommunications transport networks and services.”

- (b) U.S. basic telecom suppliers must link to their Mexican counterparts (e.g., Telmex) *a fin de permitir a los usuarios de un proveedor comunicarse con los usuarios de otro proveedor y tener acceso a los servicios suministrados por algún otro proveedor* (i.e., in order to allow users of one supplier to communicate with users of another supplier and to access services provided by another supplier).

64. The supply on a cross-border basis of basic telecom services between the United States and Mexico requires “linking” (*conexión*)<sup>51</sup> between U.S. suppliers (e.g., AT&T) and Mexican suppliers (e.g., Telmex) in order to allow users of the U.S. supplier to communicate with users of the Mexican supplier and to access services provided by the Mexican supplier. The term “linking” is very broad and covers all forms of linking, included the linking between two facilities-based networks (e.g., for the purpose of supplying facilities-based services) and the linking of leased lines (e.g., for the purpose of supplying non-facilities-based services).

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<sup>47</sup> Trade Negotiations Committee, *Decision on Negotiations on Basic Telecommunications*, TS/NGBT/W/1 (2 May 1994), p. 4, para. 1 (“Negotiations shall be entered into on a voluntary basis with a view to the progressive liberalization of trade in telecommunications transport networks and services (hereinafter referred to as ‘basic telecommunications’) within the framework of the General Agreement on Trade in Services.”) (Emphasis supplied).

<sup>48</sup> GATS Annex, Section 3(b).

<sup>49</sup> Group on Basic Telecommunications, *Note by the Chairman, Notes for Scheduling Basic Telecom Services Commitments*, S/GBT/W/2/Rev.1.

<sup>50</sup> See, e.g., the CPC codes (75211 and 75212) that Mexico used to describe its voice telephony commitments.

<sup>51</sup> “Linking” means “connecting” two things together. *The New Shorter English Oxford Dictionary* defines “link” as “connect or join (two things or one thing to another) with or as with a link.” Lesley Brown (ed.) (Vol. 1) (1993), p. 1598. *The Oxford Spanish Dictionary* similarly defines “conexión” as “connection” (2001), p. 177.

65. Without such a *conexión*, a U.S. supplier of basic telecom services could not provide the basic telecom services inscribed in Mexico’s Schedule on a cross-border basis. This is because, under Mexican law, U.S. basic telecom suppliers may not own telecommunications facilities in Mexico and thereby extend their public telecommunications networks from the United States into Mexico.<sup>52</sup> The networks of U.S. basic telecom suppliers end at the U.S.-Mexico border. Therefore, when a U.S. basic telecom supplier provides telecommunications services from the territory of the United States into the territory of Mexico, it must link its network or a leased line to the network of a Mexican service supplier (such as Telmex) and pay that Mexican service supplier to “terminate” (i.e., deliver) the phone call to the end user in Mexico.

66. In other words, without such a *conexión* it would be impossible for *usuarios* (i.e., users) of a U.S. supplier to (1) communicate with *usuarios* of a Mexican supplier and (2) access services provided by the Mexican supplier. Both U.S. basic telecom suppliers and their consumers are *usuarios*, which Mexico’s Reference Paper defines as both service suppliers and service consumers.<sup>53</sup> U.S. basic telecom suppliers supply a service, and their consumers receive or use such services.

67. The *conexión* allows the consumers of the U.S. basic telecom supplier (“users of one supplier”) to communicate with Telmex’s consumers in Mexico (“users of another supplier”). The *conexión* also allows the U.S. service supplier (“user”) to access services provided by Telmex (“another supplier”), namely the services involved in delivering a call that originated in the United States to its final destination in Mexico.

#### 4. Telmex is a major supplier within the meaning of the Reference Paper

68. Section 2 of the Reference Paper applies to the terms and conditions of interconnection between a “major supplier” and another supplier of public telecommunications networks or services. The Reference Paper defines “major supplier” as a “supplier which *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.*” (emphasis added).

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<sup>52</sup> Mexico included this restriction as a limitation for its mode 3 facilities-based services commitments: “*Se permite la participación de la inversión extranjera directa hasta 49 por ciento en una empresa constituida conforme a las leyes mexicanas.*” Mexico’s Schedule, GATS/SC/56/Suppl.2. The WTO’s English version of Mexico’s Schedule describes this mode 3 limitation as “Direct foreign investment up to 49 per cent is permitted in an enterprise set up in accordance with Mexican law.”

<sup>53</sup> According to Mexico’s Reference Paper, *usuarios significa consumidores del servicio y proveedores del servicio*. Mexico’s Schedule, Reference Paper, “Definiciones,” GATS/SC/56/Suppl.2, p. 7. (The WTO’s English version defines “users” as “service consumers and service suppliers.”) GATS Article XXVIII(g) defines a service supplier as “any person that supplies a service,” and Article XXVIII(i) defines “service consumer” as “any person that receives or uses a service.”

69. The Reference Paper definition thus requires the determination of the “relevant market for basic telecommunications services” and whether, in that market, the supplier in question can use either control over essential facilities or its position in the market to materially affect terms of participation. “Control over essential facilities” and “use of its position in the market” are in the disjunctive, so that either is sufficient to meet the definition.

70. As explained more fully below, in this dispute, the relevant market is the termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the United States into Mexico. This market is encompassed within the broader category of all international long distance telecommunications services between other countries and Mexico.

71. Under Mexican law, Telmex has the exclusive authority to determine the price charged by all suppliers for the termination of services provided on a cross-border basis into Mexico. Additionally, Mexico’s competition authority has determined that Telmex has significant market power in the broader international market. As a result of these and other market indicia, Telmex satisfies the Reference Paper definition of “major supplier” because it has the ability, in this market, to use its position to materially affect the prices charged and the supply of services.

- a. The relevant market is the termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the United States into Mexico.

72. Mexico’s scheduled commitments for basic telecommunications services provide a starting point for identifying the “relevant market for basic telecommunications services,” as required by the Reference Paper. As explained above, Mexico undertook commitments for several basic telecommunications services, not all of which are relevant to this dispute. The services for which U.S. suppliers interconnect with Telmex include voice telephony, circuit-switched data transmission, and facsimile services supplied on a cross-border basis from the United States into Mexico. Voice telephony, circuit-switched data transmission, and facsimile services are properly analyzed together, because Telmex and other Mexican carriers provide termination for these services using the same facilities and charging the same settlement rates.

73. The definition of the relevant market as the termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border (*i.e.*, international) basis from the United States into Mexico is demonstrated by well-accepted principles of market analysis which derive from competition law. The basic principles underlying market definition are similar in U.S. antitrust and Mexican competition law. Markets are defined in terms of substitution, looking at the alternatives available and acceptable to consumers. Under U.S. antitrust analysis, market definition focuses on demand substitution factors. A “market” is defined as “a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a

‘small but significant and non-transitory’ increase in price, assuming the terms of sale of all other products are held constant.”<sup>54</sup>

74. Similarly, Mexican competition law provides that in order to determine a relevant market, it is necessary to evaluate “[t]he possibilities of substituting the goods or services in question, with others of domestic or foreign origin, considering technological possibilities, and the extent to which substitutes are available to consumers and the time required for such substitution.”<sup>55</sup> Significantly, one of the factors that must be evaluated under Mexican competition law is “[f]ederal, local or international regulatory restrictions which limit access by users or consumers to alternate sources of supply, or the access of suppliers to alternate customers.”<sup>56</sup>

75. As a general matter, international telecommunications services, whether involving termination of cross-border supply or origination through a commercial presence in the country, are distinct from domestic telecommunications services and not substitutes. It is readily apparent that the ability to call between Guadalajara and Mexico City is not an effective substitute for the ability to call between San Antonio, Texas and Mexico City. The Mexican competition authority, the Comisión Federal de Competencia (“CFC”), determined in 1998 and reaffirmed in 2001 that international long distance service is a relevant market for which there are “no close substitutes,” and that such service is distinct from domestic local, access, long distance or carrier

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<sup>54</sup> U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, § 1.0 (rev. ed. 1997).

<sup>55</sup> Federal Law of Economic Competition, Chapter II, Article 12 (issued December 24, 1992) (unofficial translation). The official Spanish text states: “*Las posibilidades de sustituir el bien o servicio de que se trate por otros, tanto de origen nacional como extranjero, considerando las posibilidades tecnológicas, en qué medida los consumidores cuentan con sustitutos y el tiempo requerido para tal situación.*” Ley Federal de Competencia Económica, Artículo 12.I, available at <http://www.cfc.gob.mx/Legislacion/Ley/cap2.htm>.

<sup>56</sup> Federal Law of Economic Competition, Chapter II, Article 12 (issued December 24, 1992) (unofficial translation). The official Spanish text states: “*Las restricciones normativas de carácter federal, o internacional que limiten el acceso de usuarios o consumidores a fuentes de abasto alternativas, o el acceso de los proveedores a clientes alternativos.*” Ley Federal de Competencia Económica, Artículo 12.I, available at <http://www.cfc.gob.mx/Legislacion/Ley/cap2.htm>, Exhibit US-18. This analysis is also reflected in the CFC’s regulations. “Likewise, those economic and normative restrictions of a local, federal or international nature which prevent access to the said substitute goods or services, or which prevent the access of users or consumers to alternative sources of supply, or the access of the suppliers to alternative customers, shall be considered.” Code of Regulations, Chapter III, Article 9 (issued March 4, 1998). The official Spanish text states: “*Además, se considerarán las restricciones económicas y normativas de carácter local, federal o internacional que limiten el acceso a dichos bienes o servicios sustitutos, o que impidan el acceso de usuarios o consumidores a fuentes de abasto alternativas, o el acceso de los proveedores a clientes alternativos.*” Reglamento de la Ley Federal de Competencia Económica, Capítulo III, Artículo 9, available at [http://www.cfc.gob.mx/legislacion/regla\\_ley/cap3.htm](http://www.cfc.gob.mx/legislacion/regla_ley/cap3.htm), Exhibit US-19. Similarly, competition principles applied in Europe that are applicable to the telecommunications sector recognize that “[t]he extent to which the supply of a product or the provision of a service in a given geographical area constitutes the relevant market depends on the existence of competitive constraints on the price-setting behavior of the producer(s) or service provider(s) concerned.” European Commission, *Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*, 2002 O.J. (C 165/03) 6 (published July 11, 2002), ¶ 38.

toll services.<sup>57</sup> This determination was made for the purpose of identifying the broad categories of service in which Telmex would be subject to regulation as a dominant carrier. Accordingly, the CFC's category of international services included several types of switched and non-switched telecommunications services, among which, significantly, were international port services for switching and routing of both originating and terminating international traffic. The CFC's analysis clearly applied to termination of cross-border traffic, as the CFC recognized that the international ports "permit the accounting of international traffic and compliance with the proportional return scheme set forth in the regulations,"<sup>58</sup> that is, Mexico's requirements for termination of international traffic, as discussed below. The CFC also recognized that each international route between Mexico and another country, such as the U.S., "constitutes a geographic market."<sup>59</sup>

76. Within the broad category of international services, it is necessary to distinguish the markets for originating traffic and for terminating traffic. International services necessarily include in Mexico both (1) the supply at the originating end of international telecommunications services to end users or other service providers in Mexico, and (2) the supply of termination for telecommunications services originating in countries other than Mexico and supplied on a cross-border basis into Mexico. Substitution analysis makes clear that these are separate markets. Because a U.S. carrier cannot own its own facilities in Mexico and is required to hand off its cross-border telecommunications traffic into Mexico to a Mexican concessionaire at the international border, termination by Telmex (and other Mexican carriers authorized to operate international ports) is needed by U.S. and other foreign carriers to complete their international telecommunications traffic into Mexico. Therefore, the origination of international voice telephony, facsimile or circuit-switched data transmission in Mexico cannot be considered a substitute for the termination of such services supplied on a cross-border basis from the United States into Mexico.

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<sup>57</sup> CFC, *Teléfonos de Mexico, Declaratoria de poder sustancial en diversos mercados relacionados con la telefonía* (Statement of substantial power in different telephone markets), File No. AD-41-97 (May 21, 2001) (hereinafter referred to as "CFC 2001 Decision re Telmex's Substantial Power"), at 18-19 (24-26 in Spanish original)(International long distance market), appeal pending (filed Sept. 24, 2001), Exhibit US-20. The quoted passage at 19, in original Spanish text at 26, states that "*los servicios de larga distancia internacional no cuentan con sustitutos cercanos.*" This 2001 decision reaffirmed an earlier 1998 ruling by the CFC, which the Mexican courts have blocked from taking effect solely on procedural grounds, without questioning the substance of the CFC's market analysis. CFC, Ruling by Full Meeting (Dec. 4, 1997), ratified, AD-41-97 (Feb. 19, 1998), confirmed on reconsideration, RA-15-98 (July 17, 1998), rev'd and remanded on procedural grounds, No. P-533/98, I.A. - 13/2001-241, First Collegiate Tribunal in Administrative Matters of the First Circuit Court (May 27, 2002), Exhibit US-21.

<sup>58</sup> CFC 2001 Decision re Telmex's Substantial Power, at 19. The original Spanish text, at 25, states: "*Los puertos internacionales permiten la contabilidad de tráfico internacional y la aplicación del cumplimiento del esquema de retorno proporcional que establece la reglamentación.*"

<sup>59</sup> *Id.*, at 18. The original Spanish text, at 25, states that "*en este servicio cada ruta constituye un mercado geográfico.*"

77. It is also significant for market analysis purposes that Mexican law does not permit the use of private leased circuits by either a foreign facilities-based operator or a commercial agency (either foreign or Mexican) for the purpose of carrying cross-border switched traffic. Thus, U.S. suppliers have no choice but to rely on Telmex (and other Mexican concessionaires authorized to operate international ports) to terminate their cross-border switched telecommunications traffic in Mexico. This limitation is clearly relevant for market definition analysis under the established Mexican competition law, which takes into account restrictions on using alternate sources of supply.

78. For these reasons, the “relevant market for basic telecommunications services” in this dispute is the termination of voice telephony, circuit-switched data transmission and facsimile services supplied on a cross-border basis from the United States into Mexico.

- b. Through its position in the market, Telmex can materially affect the price and supply of termination of circuit switched telecommunications traffic supplied on a cross border basis from the U.S. into Mexico.

79. The Reference Paper’s definition of a major supplier as having the ability to materially affect the terms of participation in a market, regarding price or supply, through “its position in the market,” is based on the concept of market power that is widely recognized by competition authorities in the United States, Mexico and elsewhere. U.S. antitrust authorities define “market power” of a seller as “the ability profitably to maintain prices above competitive levels for a significant period of time,” as well as to lessen competition on dimensions other than price such as product quality, service or innovation.<sup>60</sup> There are two dimensions of significant market power: (1) the ability of a firm to maintain prices well above its costs; and (2) the existence of some measure of protection against a rival’s entry or expansion that would erode prices and profits, either due to market circumstances or governmental limitations, so that the firm can persist in maintaining prices well above cost for a significant period of time.<sup>61</sup> In determining whether market power exists, U.S. antitrust authorities consider market share and other factors bearing on the ability of a firm to maintain prices above competitive levels, such as ease of entry or barriers to entry, capacities of the firms in the market, availability of good substitutes, and opportunities for coordinated behavior among firms.<sup>62</sup>

80. Similarly, Mexican competition law, in determining whether an economic agent has “substantial power in the relevant market,” considers “the possibility to fix prices unilaterally or to restrict supply in the relevant market, without competitive agents being able, presently or potentially, to offset such power,” and other factors including “existence of entry barriers,”

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<sup>60</sup> U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, § 0.1 (rev. ed. 1997), Exhibit US-22.

<sup>61</sup> P. Areeda, H. Hovenkamp, & J. Solow, *IIA Antitrust Law* ¶ 501 (2d ed. 2000), Exhibit US-23.

<sup>62</sup> U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, §§ 1, 2, 3 (rev. ed. 1997), Exhibit US-22.



“existence and power of . . . competitors,” and “possibility of access . . . for sources of inputs.”<sup>63</sup> Significantly, the Mexican regulations implementing Mexico’s competition law explicitly recognize, among the factors that may be regarded as entry barriers, “limitations on competition in international markets.”<sup>64</sup>

81. Telmex has “market power” or “substantial power” in the relevant market for termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the U.S. into Mexico, based on the special rights given to it by Mexico’s ILD Rules as well as the findings of Mexico’s own Federal Competition Commission, and the evidence of Telmex’s continuing dominance in this area and persistent ability to maintain international settlement rates well above cost.

82. Telmex’s market power with respect to the provision of termination for voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the U.S. into Mexico stems most directly from the special and exclusive legal right conferred on it under Mexico’s ILD Rules. In particular, Rule 13 provides that “[t]he long distance concessionaire with the greatest percentage of the outgoing long distance market in the last six months prior to negotiation with a determined country, shall be the one to negotiate the liquidation tariffs with the operators of such country.”<sup>65</sup> Rule 10 also provides that this rate shall be the uniform rate charged by all Mexican carriers.<sup>66</sup> As the largest carrier, Telmex is granted the exclusive right to determine the settlement rates for cross-border termination for *all* Mexican carriers. Even though there are other Mexican telecommunications carriers that have their own

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<sup>63</sup> Federal Law of Economic Competition, Chapter II, Article 13 (issued December 24, 1992) (unofficial translation). The official Spanish text states: “*Para determinar si un agente económico tiene poder sustancial en el mercado relevante, deberá considerarse . . . si puede fijar precios unilateralmente o restringir el abasto en el mercado relevante sin que los agentes competidores puedan, actual o potencialmente, contrarrestar dicho poder . . . [l]a existencia de barreras a la entrada . . . [l]a existencia y poder de sus competidores . . . [l]as posibilidades de acceso . . . a fuentes de insumos.*” Ley Federal de Competencia Económica, Artículo 13.I-IV, available at <http://www.cfc.gob.mx/Legislacion/Ley/cap2.htm>, Exhibit US-18.

<sup>64</sup> Code of Regulations, Chapter III, Article 11 (published Mar. 4, 1998). The original Spanish text states that “*son elementos que pueden considerarse como barreras a la entrada, entre otros . . . [l]as limitaciones a la competencia en los mercados internacionales.*” Reglamento de la Ley Federal de Competencia Económica, Capítulo III, Artículo 11.V, available at [http://www.cfc.gob.mx/legislacion/regla\\_ley/cap3.htm](http://www.cfc.gob.mx/legislacion/regla_ley/cap3.htm), Exhibit US-19.

<sup>65</sup> ILD Rule 13. The original Spanish text states: “*El concesionario de servicio de larga distancia que tenga el mayor porcentaje del mercado de larga distancia de salida de los últimos seis meses anteriores a la negociación con un país determinado, será quien deba negociar las tarifas de liquidación con los operadores de dicho país.*” Exhibit US-1.

<sup>66</sup> ILD Rule 10 provides that “[t]he international port operators shall carry incoming and outgoing international traffic using the systems of uniform rates of liquidation and proportional rates.” The original Spanish text states that: “*Los operadores de puerto internacional deberán cursar el tráfico internacional de entrada y de salida utilizando los sistemas de tarifas de liquidación uniformes y de retorno proporcional.*” See also ILD Rule 2(XII) (defining tariffing system for uniform rates of liquidation), 2(XIII) (defining proportionate return system for distribution of incoming international call revenues and traffic based on proportions of settlements for outgoing traffic).

networks, they are prohibited from competing on the price of terminating cross-border traffic into Mexico by operation of Mexican law.

83. The exclusive legal power conferred by these rules on one supplier, Telmex, to determine prices for all suppliers in the market is the most graphic case of market power imaginable, and clearly satisfies the Reference Paper's test without any additional evidence. By law in Mexico, Telmex has a market position enabling it to materially affect terms of participation in the relevant market, so long as it remains the largest Mexican international carrier. This holds true regardless of whether or not Telmex also has the *significant* market power in originating traffic. In other words, Telmex needs only the *plurality of originating traffic*, not the majority share.

84. The extent of Telmex's market power has also been substantiated by Mexico's own competition authority, the *Comisión Federal de Competencia* ("CFC"). In 2001, the CFC reaffirmed its earlier conclusion that Telmex had "*poder sustancial*" (substantial power) in five relevant telecommunications markets, including international services.<sup>67</sup> In finding that Telmex has substantial power in international long distance services, the CFC relied on several types of evidence widely used in competition analyses in the United States, Mexico and other countries.

85. First, the CFC recognized that Telmex had a market share of about 74% in international traffic, while competitors still had insignificant market shares and their competitive power was reduced by their dependency on Telmex for interconnection and negotiation of settlement charges.<sup>68</sup>

86. Second, the CFC found that Telmex continued to control most of the international port capacity, a total of 23 ports (nearly 75% of the total), with the remaining existing or planned eight ports operated by the two largest competitors, Alestra and Avantel, and no additional ports expected in the medium term. This meant that the competing carriers would have little ability to respond to unexpected changes in demand or to absorb significant new volumes of traffic. Long distance concession holders must apply to Cofetel for authority to operate new international ports, and Cofetel can deny such authority depending on how the concessionaire has met other

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<sup>67</sup> CFC 2001 Decision re Telmex's Substantial Power, at 30-34 (40-46 in original Spanish text) (Evaluation of Telmex's substantial power in the international long distance service market). This decision reaffirmed the CFC's 1998 findings on Telmex's substantial power, which the Mexican courts have blocked from taking effect solely on procedural grounds, without questioning the substance of the CFC's market analysis. CFC, Ruling by Full Meeting (Dec. 4, 1997), ratified, AD-41-97 (Feb. 19, 1998), confirmed on reconsideration, RA-15-98 (July 17, 1998), rev'd and remanded on procedural grounds, No. P-533/98, I.A. - 13/2001-241, First Collegiate Tribunal in Administrative Matters of the First Circuit Court (May 27, 2002), Exhibit US-21.

<sup>68</sup> CFC 2001 Decision re Telmex's Substantial Power, at 30 (40 in original Spanish text) (Evaluation of Telmex's substantial power in the international long distance service market), Exhibit US-21. The CFC used presubscription registration percentages, as well as data Telmex had presented to Cofetel, to measure market share due to a shortage of data available to the CFC on volumes of international traffic at the time. Telmex's current international market share measured by traffic volumes remains high at 62%, and its share of presubscribed lines in 2001 was still as high or higher than the share the CFC identified, as discussed below.

obligations such as facilities buildout within Mexico, and whether the concessionaire has received approval for agreements with foreign operators. Expansion of ports can thus represent a significant expense giving rise to entry barriers.<sup>69</sup>

87. Third, under Mexico's ILD rules and in light of Telmex's market share, the CFC determined that Telmex has the ability to set prices in the market owing to the right of the concession holder with the largest international long distance market share for the preceding six months to negotiate the settlement rates with all carriers, the imposition of the same settlement payment for incoming calls on all operators as well as outgoing calls, and the proportionate return mechanism.<sup>70</sup>

88. Fourth, the CFC observed that Telmex has the ability to restrict the price and supply of cross-border dedicated links, through use of discriminatory delaying tactics in delivery of equipment needed for other operators, limiting competitors' capacity to provide services and affecting their competitiveness.<sup>71</sup>

89. Fifth, the CFC found that Telmex could uniquely offer integrated packages of local and long distance services, given its share of almost 100% in the provision of local telephone services in Mexico. Telmex's monopoly control over the local network in Mexico, and the resulting unique ability to provide a bundled local and long distance service package, confer an advantage on Telmex over other operators in selling originating international telecommunications services in Mexico. Moreover, under the ILD Rules, Telmex's possession of the largest market share in such originating services in turn translates into an ability to control other operators' prices for termination of cross-border switched traffic under the applicable Mexican regulations.<sup>72</sup>

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<sup>69</sup> *Id.*, at 30-32 (40-42 in original Spanish text).

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*, at 31 (41 in original Spanish text).

<sup>72</sup> *Id.*, at 19, 32 (26, 43 in original Spanish text). Telmex's local network in Mexico is the only ubiquitous local landline network in Mexico, so that it is "exclusively" provided by Telmex, and it would be physically and financially impossible for another operator to duplicate this network by establishing separate facilities throughout Mexico for the foreseeable future. Telmex acknowledges that it is "the only nationwide provider of fixed-line telephony services" in Mexico. Telefonos de Mexico, S.A. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission June 27, 2002), at 4, Exhibit US-24. Telmex has 97% of the fixed lines in service in Mexico, 13.372 million out of 13.774 million as of 2001. Telmex, *Annual Report* at 8 (2001), Exhibit US-2; Cofotel, "Lineas Telefonicas Fijas en Servicio por Entidad Federativa, Miles 1990-2002," FR-CFT-DGTE-DIE-PO-01-15, Exhibit US-3. As the CFC has found, "Telmex's local networks cover more than 22,000 localities throughout the country and were built up over a period of decades through significant investment," and "[n]ew long distance competitors cannot match the universal coverage of the Telmex network in the short or medium terms." CFC 2001 Decision re Telmex's Substantial Power, at 10 (Local telephone market), Exhibit US-21. The quoted text in the Spanish original, at 12-13, states: "*Las redes locales de Telmex cubren más de 22,000 localidades a lo largo de todo el territorio nacional, las cuales fueron construidas durante décadas, requiriendo montos de inversión significativos . . . [l]as empresas que hasta la fecha han obtenido concesión para proveer el servicio de telefonía local, así como otras compañías que en el futuro pudieran ofrecerlo, no puedan igualar, en el corto o mediano plazo, la cobertura de la red local de Telmex . . .*" Unlike the United States and most other OECD member

(continued...)

90. In sum, the CFC determined that Telmex “has substantial power in the international long distance market” in light of its “large share of the international long distance market,” “its ability to set payment charges applicable to international traffic,” and its “advantages arising from its vertical integration that enable it to set prices for cross-border dedicated circuits and enjoy significant advantages from the resale of international port services.”<sup>73</sup>

91. The CFC’s conclusion regarding international services is also applicable to the market for termination of switched cross-border traffic as a subset of the broader international services market analyzed in the CFC decision. Under Mexican law, the market share of a carrier in terminating cross-border switched telecommunications traffic into Mexico is necessarily linked to its market share in origination of international switched traffic in Mexico. Mexico’s ILD Rules require the proportional allocation of terminating traffic among Mexican network operators according to each operator’s share of originating traffic, rather than allowing each operator to compete freely to terminate any amount of incoming international traffic.<sup>74</sup> Therefore, if an operator has “substantial power” in providing international services originating within Mexico, it will have at least a comparable position in the market for termination of cross-border switched traffic into Mexico.

92. Like the CFC, the independent telecommunications regulatory agency in the United States, the Federal Communications Commission, has also found that both Telmex and its U.S. affiliate are dominant in the provision of international services between the United States and Mexico. The FCC determined that Telmex continues to control “bottleneck” facilities, including the only ubiquitous local network and ubiquitous inter-city facilities that are needed for carriers to terminate international switched services into Mexico, giving it the ability to discriminate

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<sup>72</sup>(...continued)

countries, Mexico does not even require that components of this network be unbundled and made available to competitors, so that competitive local entry by this means is also foreclosed. See OECD, Working Party on Telecommunications and Information Service Policies, *Developments in Local Loop Unbundling*, DSTI/ICCP/TISP (2002)5, at 4, 16, 46 (May 2, 2002) (23 OECD countries have introduced or legislated local loop unbundling and only seven, including Mexico, have not implemented unbundling), Exhibit US-25.

<sup>73</sup> CFC 2001 Decision re Telmex’s Substantial Power, at 32 (Evaluation of Telmex’s substantial power in the international long distance service market). The quoted text in the Spanish original, at 44, states: “*Lo antes expuesto sugiere que Telmex tiene una elevada participación en el mercado de larga distancia internacional; además, se prueba que esta empresa tiene la capacidad de fijar las tarifas de liquidación aplicables en el tráfico internacional, que tiene ventajas derivadas de su integración vertical que le permiten fijar los precios de los enlaces dedicados transfronterizos y que tiene ventajas importantes en la reventa de servicios de puertos internacionales. Por lo anterior, se concluye que cuenta con poder sustancial en el mercado de larga distancia internacional.*” Exhibit US-21.

<sup>74</sup> ILD Rule 2(XIII) (defining proportionate return system for distribution of incoming international call revenues and traffic based on proportions of settlements for outgoing traffic), ILD Rule 10 (“[t]he international port operators shall carry incoming and outgoing international traffic using the systems of uniform rates of liquidation and proportional rates”), Exhibit US-1.

against unaffiliated U.S. carriers.<sup>75</sup> It has also recognized that, as the carrier with the largest market share, Telmex's exclusive authority to negotiate all cross-border interconnection rates for Mexican carriers inhibits the development of competition and keeps prices higher than actual costs.<sup>76</sup>

93. Finally, current market evidence indicates that Telmex continues to have, and has exercised, market power with respect to the markets for termination of cross-border voice telephony and circuit-switched data transmission services from the United States into Mexico. Although not the sole determining factor, a large market share on the order of 50% or more, particularly when sustained over time, is well recognized by competition authorities and telecommunications regulators as relevant evidence of a firm's market power, though not the sole determining factor, and the higher the market share, the more readily it will support a presumption of market power.<sup>77</sup> Based on the annual volume of international long distance minutes reported by Telmex in its annual report, and the total volumes of international long distance minutes of all carriers for the same period reported by Cofetel, Telmex's annual international long distance switched services market share for the year 2001 was 61.69% (4,404 million minutes out of 7,138 million). Indeed, Telmex's international switched services market

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<sup>75</sup> About 11-12% of Mexico's local access lines are not subject to equal access, so that Telmex remains effectively the monopoly provider of long distance connections to serve those lines. See Telmex, *Annual Report* at 8 (2001), Exhibit US-2 (cities covered by the presubscription process allowing long distance competition accounted for 88.9% of lines in service).

<sup>76</sup> FCC, *Telmex/Sprint Communications L.L.C. Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier between the United States and International Points, Including Mexico*, Order, Authorization and Certificate, ITC-97-127, DA 97-2289, 12 FCC Rcd. 17,551, at ¶¶ 14, 64, 87 (released Oct. 30, 1997), stay denied, DA 98-1678, 13 FCC Rcd. 15,678 (1998), Exhibit US-26. Telmex has not appealed the FCC's finding of its dominant status.

<sup>77</sup> For example, in the European Union, concerns that a telecommunications provider has significant market power or market dominance (the terms now will have comparable meaning in Europe) normally arise where the firm has a market share of over 40%, and a very large market share, in excess of 50%, is in itself evidence of a dominant position save in exceptional circumstances, allowing market power to be presumed if the share has remained stable over time. European Commission, *Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*, 2002 O.J. (C 165/03) 6 (published July 11, 2002), ¶ 75, Exhibit US-27. U.S. antitrust law does not have a specific market share threshold test for significant market power as does European competition and telecommunications regulatory policy, but U.S. courts, antitrust agencies and leading authorities also recognize that market shares constitute one important measure of a company's market position and power, with higher shares creating a stronger basis for finding market or monopoly power. Under Section 2 of the Sherman Act, the anti-monopolization provision, court decisions and authorities tend to consider shares below the 50-60% range as providing insufficient evidence of the power to control prices or exclude competitors, with a 50% share often being regarded as a threshold below which monopoly power is infrequently found, while monopoly power can be found with a share of 50-70% and a share above 70% provides an even stronger basis for inferring such power. See P. Areeda, H. Hovenkamp, & J. Solow, *IIA Antitrust Law* ¶ 532 (2d ed. 2000), Exhibit US-23. However, it is possible for a firm to exercise market power at even lower shares depending on factual circumstances. Under U.S. antitrust policy, evidence that a combination of two firms in a merger would give rise to the ability to impose unilateral price increases can be considered where the combined firm would have a market share of 35% or higher. *Horizontal Merger Guidelines*, § 2.211, Exhibit US-22.

share has been high, consistently in excess of 60% and usually over 70%, since the entry of other Mexican long distance carriers into international services.<sup>78</sup>

94. While this market share data includes traffic to all international points, it is a reasonably good reflection of shares on the U.S.-Mexico route, since this one route accounts for the great majority of all Mexican international traffic, between 80-90%.<sup>79</sup> Because of Mexico's proportionate allocation requirements for incoming traffic based on outgoing shares, it is not necessary to separate inbound and outbound minutes in calculating shares; Telmex's share of inbound termination traffic will be no less than its share of outbound origination traffic. Telmex's market shares with respect to the termination of switched telecommunications services from the United States, including voice telephony, facsimile, and circuit-switched data transmission services, would be the same as its outbound traffic shares to the United States. Based on pre-subscribed customer lines, Telmex's market share in domestic and international long distance services was even higher, at 82% in 2001.<sup>80</sup> These market share levels are sufficient to support a finding of market power under competition standards applied in major jurisdictions worldwide, given that other available evidence is also consistent with a finding of Telmex's market power.<sup>81</sup>

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<sup>78</sup> Telmex's international market share based on minutes of switched traffic for 2000 was 70.97% (5,521 million minutes out of 7,779 million), for 1999 was 75.26% (4,192 million minutes out of 5,570 million), for 1998 was 76.66% (3,286 million minutes out of 4,286 million), and for 1997 was 93.42% (3,768 million minutes out of 4,033 million). Cofetel, *Trafico de Larga Distancia Internacional, Millones de minutos y crecimiento anual*, FR-CFT-DGTE-DIE-PO-03-04 (data on Mexico's international long distance minutes by year 1991-2001); Telmex, *Annual Report* at 9 (2001), Exhibit US-2 (Telmex annual international minutes from 1997 through 2001).

<sup>79</sup> As the CFC has recognized, the Mexico - U.S. route is by far the most important geographically for Mexico, accounting for almost 90% of Mexico's global traffic in 1995. CFC 2001 Decision re Telmex's Substantial Power, at 18 (25 in Spanish original) (International long distance market), Exhibit US-21. As of 2000, based on FCC data, Mexican carriers delivered to their U.S. counterparts 1,574,480,455 minutes of message telephone service traffic. Federal Communications Commission, *2000 International Telecommunications Data*, Table A1 (December 2001). Data published by the Mexican regulator Cofetel indicates that the total volume of international minutes outgoing from Mexico to all destinations was 1,833 million for 2000. Cofetel, "Trafico de Larga Distancia Internacional de Salida, Millones de minutos y crecimiento anual," FR-CFT--DGTE-DIE-PO-03-04. Based on these volumes of traffic, international switched traffic from Mexico to the United States accounted for 83.6% of all Mexican international switched traffic in 2000, the most recent year for which this can be determined from available data.

<sup>80</sup> Data sourced from Cofetel website, <http://www.cft.gob.mx> (Telmex had 8,337,100 presubscribed lines out of 10,226,300 total presubscribed lines as of February 25, 2001).

<sup>81</sup> Notwithstanding this clear evidence, Mexico's Secretary of Communications and Transport has sought to artificially lower Telmex's market shares to 6-10%, claiming that Telmex is not dominant because overall telephone penetration in Mexico is only 12-13%, and that Telmex's share should be deflated below the 50% level that would ordinarily signal market dominance by counting in the relevant markets the 88% of the population that have no telephone service at all. See, e.g., David Luhnow, "Telmex Defends Its Phone Empire Amid Widespread Telecom Slump," *Wall Street J.*, at 1 (May 16, 2002), Exhibit US-28. This nonsensical approach to analyzing market share is contrary to the established methods used by all competition agencies, including the CFC in its own analysis of Telmex, which base shares on actual observed market performance of individual firms compared to the total purchases made by consumers from all providers, and do not include hypothetical consumers that have not purchased

(continued...)

95. Taken together with Telmex's market share, another indication of Telmex's significant market power is the absence of significant new suppliers of international telecommunications services in Mexico during the past few years. While Cofetel identifies nine Mexican public network concessionaires offering presubscribed long distance services in addition to Telmex and its wholly owned affiliate Telnor,<sup>82</sup> the same two carriers that originally began providing international long distance services in competition with Telmex in 1997, Avantel and Alestra, have consistently remained the largest competitors to Telmex. The international long distance market shares of even Alestra and Avantel are relatively small compared with that of Telmex. For example, Alestra's annual international service market shares based on minutes for all international routes were 14.56% for 1999, 13.51% for 2000 and 14.29% for 2001, so that Alestra's share has not grown at all during the 1999-2001 period, and Alestra had an even smaller share of presubscribed domestic and international long distance lines in 2001, at about 7.4%.<sup>83</sup> In light of Telmex's continued control of the bulk of the international traffic, it does not appear that any other carrier has been able to gain a share of more than 20% of international telecommunications service traffic in Mexico at any time, and generally the shares of even the largest competing carriers, as reflected by Alestra's data, were lower.

96. None of the seven other carriers that are offering presubscribed international services appear to have attained a size comparable even to Alestra or Avantel, let alone Telmex/Telenor. Given the proportionate return requirements in Mexico, the competitors' small overall shares ensure that Telmex will also continue to receive the revenues from the majority of southbound international switched traffic from the United States terminating in Mexico, and that it will continue to retain the right to set the southbound interconnection rate for all Mexican carriers.

97. Telmex's market power is also demonstrated by its ability to maintain prices for a sustained period of time well above the levels that could be expected to prevail in a competitive environment. Mexican competition law, as noted above, focuses on "the possibility to fix prices unilaterally or to restrict supply in the relevant market, without competitive agents being able,

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<sup>81</sup>(...continued)

services from any supplier. For example, the U.S. *Horizontal Merger Guidelines*, § 1.41, base market shares primarily on actual sales volumes and, where appropriate, capacity devoted to the relevant market or that would be used in response to a price increase. The SCT's approach would lead to the paradoxical result of lowering Telmex's market share and treating it as nondominant when its own exercise of market power has led to the artificial suppression of demand in Mexico.

<sup>82</sup> Cofetel identifies the Mexican concessionaires providing presubscribed long distance services as Telmex and its affiliate Telnor, Alestra, Avantel, Marcatel, Iusatel, Miditel, Protel, RSL COM, Bestel and Maxcom. Cofetel, Servicios de Telecomunicaciones, "Concesionarios de redes públicas interestatales para prestar el servicio de telefonía de larga distancia bajo la modalidad de selección por prescripción de operador de larga distancia" (July 30, 2002), available at <http://www.cft.gob.mx/conse/prescripcion.htm>.

<sup>83</sup> See Alestra, S. de R.L. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission for fiscal year ended Dec. 31, 2001), at 37 (Alestra had 811,116,411 international minutes in 1999, 1,051,399,693 international minutes in 2000, and 1,020,526,889 international minutes in 2001, as well as 760,639 lines in service as of December 31, 2001), Exhibit US-4.

presently or potentially, to offset such power,”<sup>84</sup> as key evidence of market power, as do U.S. and other competition authorities. Notwithstanding reductions over the past several years, the settlement rate imposed by Telmex for the termination of switched traffic from the United States into Mexico, including voice telephony, facsimile and circuit-switched data transmission services, has remained consistently well above cost. As explained in the next section, the current settlement rate for the termination of switched traffic supplied on a cross-border basis from the United States into Mexico is 5.5 cents, 8.5 cents or 11.75 cents, depending upon the final destination of the call. As demonstrated below, Telmex’s average current settlement charges for termination of traffic from the United States into Mexico are still far above the cost of providing such interconnection based on Telmex’s own prices charged for the same network components within Mexico, which total *at most* 5.2 cents per minute. This is a cost-ceiling. As noted in the next section, Telmex’s actual cost is likely much lower.

98. In a competitive environment free of the exercise of market power, these prices well in excess of costs would signal an opportunity for profit that could normally be expected to stimulate a rapid response by other suppliers. That this has not occurred in Mexico demonstrates Telmex’s enduring market power for the provision of termination for voice telephony, facsimile and circuit-switched data transmission services from the United States into Mexico, as well as international services in Mexico generally. This market power is sustained (indeed guaranteed) by the Mexican regulations precluding price competition with Telmex and giving it unilateral power to set settlement rates so long as it retains the largest originating market share. In turn, Telmex has consistently retained most of the market for international services originating within Mexico as a result of various competitive advantages, including its vertical integration with its ubiquitous and irreplaceable local network and inter-city facilities to parts of Mexico without equal access, its ability to discriminate against competitors in providing leased lines and interconnection within Mexico, and its control of the largest share of the capacity available to provide international services of any Mexican carrier. Telmex’s market power generally, and specifically in international services, is also evidenced by its ability to set prices to consumers for origination of international traffic well above what other Mexican carriers charge or what U.S. carriers charge for identical traffic in the opposite direction, by the relative inelasticity of demand for both originating and terminating international services in Mexico, and by Telmex’s consistently high profitability.<sup>85</sup>

99. For the above reasons, Telmex is a “major supplier” within the meaning of the Reference Paper, both in international services generally and in the relevant market for termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the United States into Mexico.

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<sup>84</sup> Federal Law of Economic Competition, Chapter II, Article 13 (issued December 24, 1992) (unofficial translation), Exhibit US-18.

<sup>85</sup> Attachment A to this submission contains additional evidence regarding price comparisons for originating services, demand elasticity and profitability which support the conclusion that Telmex retains significant market power.



5. Mexico’s measures breach its obligation under Section 2.2 of the Reference Paper to ensure that Telmex provides interconnection at rates that are *basadas en costos* and *razonables*.

100. Mexico committed under Section 2.2 of the Reference Paper to impose certain disciplines on Telmex in its dealings with other suppliers of basic telecom services that seek to interconnect with its network. In particular, this provision requires Mexico to ensure interconnection with Telmex according to specific terms and conditions:

2.2. *Interconexión a ser garantizada*

*La interconexión con un proveedor principal quedará asegurada en cualquier punto técnicamente factible de la red. Tal interconexión se llevará a cabo . . .*

(b) *de manera oportuna, en términos, condiciones . . . y tarifas basadas en costos que sean transparentes, razonables, económicamente factibles y que sean lo suficientemente desagregadas para que el proveedor no necesite pagar por componentes o recursos de la red que no se requieran para que el servicio sea suministrado . . .*<sup>86</sup>

101. In this section, the United States will demonstrate that Mexico has failed to meet this obligation. Specifically, the United States will show that the rates that Telmex charges U.S. suppliers to interconnect – rates that Mexico’s telecommunications regulatory body has approved – are not:

- *basadas en costos* (based in cost) because they exceed the costs that Telmex incurs to provide such interconnection by roughly 77 percent; and
- *razonables* (reasonable) because they undermine the competitive supply of scheduled basic telecom services.

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<sup>86</sup> Mexico’s Schedule, Reference Paper, Section 2.2, GATS/SC/56/Suppl.2. According to the WTO’s English language version of the Reference Paper:

2.2 Interconnection to be ensured

Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided . . . on 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 or facilities that it does not require for the service to be provided. (Emphasis supplied)

102. In so doing, the United States will demonstrate that Mexico’s ILD Rules fail to ensure that Telmex provides cross-border interconnection in accordance with Section 2.2 of the Reference Paper. These rules give Telmex, alone among Mexican basic telecom service suppliers, the authority to negotiate the charge that foreign basic telecom suppliers must pay their Mexican counterparts to interconnect telephone calls originating abroad. These rules also require all Mexican basic telecom suppliers to incorporate this rate in their interconnection agreements with foreign cross-border basic telecom service suppliers and prevent *any* alternative to this interconnection rate.

103. The obligation placed on Mexico by Section 2.2 is substantial. Mexico’s duty is to “ensure” that Telmex provides interconnection to foreign service suppliers consistent with the conditions set by Section 2.2. The ordinary meaning of the word “ensure” is to “guarantee, warrant,” or to “make certain the occurrence of (an event, situation, outcome, etc.).”<sup>87</sup> The burden is similarly substantial under the Spanish version of Section 2.2, which uses the word “*asegurada*” to describe Mexico’s duty. The ordinary meaning of the word “*asegurada*” (or the infinitive “*asegurar*”) is “*dejar seguro de la realidad o certeza de algo*.”<sup>88</sup> This obligation places the burden on Mexico to take affirmative action that guarantees and makes certain Telmex’s adherence to Section 2.2.

104. Mexico has failed to make any such effort to comply with the “ensure” standard in Section 2.2. To the contrary, Mexico’s ILD Rules encourage Telmex to provide interconnection in a manner that is incompatible with Section 2.2. They give Telmex, alone among Mexican basic telecom service suppliers, the authority to negotiate the charge that foreign basic telecom suppliers must pay their Mexican counterparts to interconnect telephone calls originating abroad. These rules also require all Mexican basic telecom suppliers to incorporate this rate in their interconnection agreements with foreign cross-border basic telecom service suppliers. At the same time, no provision of Mexican law requires Telmex to keep this rate in line with the requirements of Section 2.2, *inter alia*, that it be *basadas en costos*, and *razonables*. Because the ILD Rules also prevent *any* alternative to this interconnection rate, U.S. suppliers have no choice but to pay Telmex an interconnection rate that fails to comply with Section 2.2.

105. For such reasons, Mexico has failed to ensure that Telmex provides interconnection according to the requirements of Section 2.2 of the Reference Paper. As such, Mexico’s measures – which include the above-cost interconnection rates and specific provisions of Mexico’s ILD Rules – are inconsistent with that provision.

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<sup>87</sup> *New Shorter Oxford English Dictionary*, Lesley Brown (ed), (vol. 1) (1993), p. 827.

<sup>88</sup> *Diccionario de la Lengua Espanola* (2001), (vol. 1), p. 225 (“To verify the reality or certainty of something”).

- a. Mexico has failed to ensure that Telmex provides interconnection at *tarifas basadas en costos*.

106. Telmex currently charges U.S. basic telecom providers interconnection rates of either 5.5 cents, 8.5 cents or 11.75 cents per minute for terminating calls to their final destination within Mexico.<sup>89</sup> Telmex charges (1) 5.5 cents per minute for traffic terminating in the three largest cities in Mexico (Mexico City, Guadalajara, and Monterrey); (2) 8.5 cents per minute for the other roughly 200 medium sized cities in Mexico; and (3) 11.75 cents per minute for traffic terminating in all other locations in Mexico.<sup>90</sup> These exorbitant rates, which have been approved by Cofetel, are not based in cost. As the United States will demonstrate below, these rates are, on average, roughly 77 percent higher than the cost Telmex incurs to provide cross-border interconnection – which, based on published Mexican price data, is no more than 5.2 cents<sup>91</sup>

- i. Section 2.2(b) requires Mexico to ensure that Telmex provides interconnection at *tarifas basadas en costos* (i.e., based in cost).

107. Under Section 2.2(b), Mexico committed to ensuring that Telmex provides interconnection at rates that are *basadas en costos*, or based in cost.<sup>92</sup> The Reference Paper does not define “based in cost”. The ordinary meaning of *basadas en costos* – “based in cost” – suggests that the “cost” at issue must be related to the *cost incurred* in providing the good or service.

108. The ordinary meaning is amplified by the sense in which the terms “cost-oriented” and “*basadas en costos*” are used in the telecommunications law and regulation of WTO Members. This usage could be termed a “special meaning,” which Article 31(4) of the *Vienna Convention on the Law of Treaties* (the “Vienna Convention”) provides “shall be given to a term if it is established that the parties so intended.” In accordance with both the ordinary and special meanings of the term, the Panel should interpret “*basadas en costos*” to mean the *cost incurred*

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<sup>89</sup> Telmex set the current three-zone rates in its negotiations with one U.S. supplier, WorldCom. Telmex refused to negotiate with other U.S. suppliers while it conducted its negotiations with WorldCom. Telmex subsequently required other U.S. suppliers to incorporate the WorldCom negotiated rates into their agreements.

<sup>90</sup> See *WorldCom Petition for Waiver of the International Settlements Policy* filed with the FCC on March 21, 2002, File No. ISP-WAV-20020322-00012, Exhibit US-29.

<sup>91</sup> Based on current traffic distribution from the U.S. to Mexico, the U.S. estimates the three zone rate schedule charged by Telmex yields a blended average of approximately 9.2 cents.

<sup>92</sup> Reference Paper, Mexico’s Schedule, GATS/SC/56/Suppl.2, Section 2.2. The WTO’s English language version of the Reference Paper uses the term “cost-oriented” for “*basadas en costos*.” However, to track as closely as possible to the terms Mexico chose to use in the Spanish language version of its Schedule (which, according to Mexico’s Schedule, is authentic only in Spanish), the United States will refer to “*basadas en costos*” as “based in cost.” See the cover page of Mexico’s Schedule, GATS/SC/56/Suppl.2 (“*Esta lista es auténtica en español únicamente*”).

in providing interconnection. The WTO Website captured the essence of this meaning in defining “cost-based pricing” as “the general principle of charging for services in relation to the cost of providing these services.”<sup>93</sup>

109. This definition accords with practice in many WTO Members. For instance, according to the European Commission, cost-oriented rates reflect the cost of providing interconnection.

The Interconnection Directive imposes cost-oriented interconnection charges on certain network operators with significant market power. The principle of cost orientation implies that the price charged for provision of a service should reflect the underlying costs incurred in providing that service. Thus in arriving at principles for interconnection pricing, it is necessary to analyse the way in which the act of interconnection imposes costs on a network.<sup>94</sup>

110. Mexican law requires interconnection rates to reflect “long run average incremental costs,”<sup>95</sup> in line with the general principle that interconnection rates must relate to the cost of providing that service. Reflecting its domestic requirements, Mexico explained to the WTO Negotiating Group on Telecommunications in February 1995 that interconnection charges must be determined on the basis of the true costs of the service provider:

*Conforme a las reglas establecidas en la regulación, los cargos de interconexión deberán fijarse bajo la premisa de no discriminación entre operadores y determinarse con base a los verdaderos costos del proveedor del servicio, para lo cual utilizarán bases internacionalmente reconocidas. Asimismo, los cargos de interconexión se deben hacer del conocimiento público.*<sup>96</sup>

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<sup>93</sup> WTO, *Telecommunications Services: Glossary of Terms*, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/tel12\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel12_e.htm)

<sup>94</sup> European Commission, *Commission Recommendation on Interconnection in a Liberalised Telecommunications Market, Part 1- Interconnection Pricing*, C(97) 3148, 15 October 1997, section 3.2. (Emphasis supplied) Available at <http://europa.eu.int/ISPO/infosoc/telecompolicy/en/r3148-en.htm>.

<sup>95</sup> Article 63 of Mexico’s 1995 Federal Law on Telecommunications provides the authority to apply cost-based interconnection rates on Telmex: *La Secretaria estará facultada para establecer al concesionario de redes públicas de telecomunicaciones, que tenga poder sustancial en el mercado relevante . . . obligaciones específicas relacionadas con tarifas . . . La regulación tarifaria que se aplique buscará que las tarifas de cada servicio, capacidad o función, incluyendo las de interconexión, permitan recuperar, al menos, el costo incremental promedio de largo plazo* (“The Secretary shall be authorized to impose on any public telecommunications licensee, who has substantial power in the relevant market . . . specific obligations related to rates . . . The rate control applied shall seek that the rates for each service, capacity or function, including those for interconnection, allow recovery, at least, of the long run average incremental cost.”).

<sup>96</sup> Communications from Mexico, Response to Questionnaire on Basic Telecommunications, Revision, S/NGBT/W/3/Add.4/Rev.1 (Feb 23, 1995), para 17. (Emphasis supplied). The WTO’s English language version of this paragraph states that “In accordance with the rules laid down in the regulations, interconnection charges must be set in accordance with the principle of non-discrimination between operators and determined on the basis of the true

Since that time, the Mexican Government has underscored on several occasions that Mexico requires interconnection rates to be based in cost, reflecting the cost an efficient enterprise would incur in providing interconnection.<sup>97</sup>

111. Merely having these laws on the books, however, is not sufficient to satisfy Mexico’s burden to “ensure” cost-based interconnection. As noted above, the term “ensure,” or “*asegurar*,” imposes on Mexico the duty to guarantee and make certain that Telmex adheres to Mexican law. As discussed below, Mexico has failed to do so.

112. In establishing their regulatory regimes, the laws and regulations of other WTO Members contain similar definitions with respect to establishing or identifying cost-based interconnection prices. As examples, Argentina, Australia, Hong Kong, and Singapore have also found the use of incremental pricing to be the standard for identifying and recovering the cost of providing interconnection services.<sup>98</sup> Similarly, in the United States local interconnection rates must reflect the forward-looking economic costs of providing interconnection.<sup>99</sup>

113. In sum, there appears to be consensus among many WTO Members - including Mexico – that interconnection rates should be based on the cost of providing interconnection. In other

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<sup>96</sup>(...continued)

costs of the service provider, for which purpose internationally recognized sources are used. In addition, the interconnection charges must be in the public domain.” (Emphasis supplied)

<sup>97</sup> See, e.g., Submission by Mexico to the OECD Working Party No. 2 on Competition and Regulation, *Access Pricing (with a focus on telecommunications)*, DAF/CLP/WP2/WD(2001)33 (5 October 2001), para. 7 (“Interconnection rates must be cost-based and must not discriminate among carriers. They are meant to allow the supplier to recover long term total incremental costs [footnote omitted] as well as imputable common costs. Incremental costs should be comparable to those of an efficient enterprise.”).

<sup>98</sup> See Hong Kong OFTA “Review of the Telecommunications Authority’s Statements No. 4, 5, 6, 7 (Revised) and 8 on Interconnection and Related Competition Issues, Consultation Paper Issued September 11, 2001 (Para. 5 “Under the existing interconnection charging framework, the relevant costs of interconnection and other related transactions are measured as the LRAIC, including a cost of capital for the assets used.”); Republic of Singapore Info-Communications Development authority, Code of Practice for Competition in the Provision of Telecommunications Services, dated June 30, 2000 (Section 5.3.5.8 “The prices that the Dominant Licensee offers for all interconnection-related services must be established using a methodology based on incremental forward-looking economic cost (“FLEC”); Argentina National Interconnection Regulations, Chapter II, Section 5 para. 7 (“Prices and charges based on long run incremental costs: those providers requesting interconnection have the right for the prices and charges corresponding to the essential network functions and elements, provided by incumbents, to be defined according to the long run incremental costs.”); Australia Competition and Consumer Commission, *Access Pricing Principles – Telecommunications*, issued July 1997, chapter 6 (the Commission’s view is that for the types of services mentioned above, the access price should, in general, be based on the total service long-run incremental cost of providing the service.”)

<sup>99</sup> See Communications Act of 1934, § 252(d)(1), 47 U.S.C. § 252(d)(1) (“determinations . . . of the just and reasonable rate for interconnection . . . shall be . . . based on the cost . . .”); 47 C.F.R. § 51.501 *et seq.* (1997) (FCC regulations based on forward-looking economic cost standard); Verizon Communications, Inc. v. Federal Communications Commission, 122 S.Ct. 1646 (2002) (U.S. Supreme Court upholds FCC regulations requiring forward-looking economic cost standard).

words, it appears that WTO Members intended to give the term “cost-oriented” and “*basadas en costos*” this “special meaning.” Therefore, in accordance with generally accepted principles of treaty interpretation reflected in Article 31(4) of the Vienna Convention, the Panel should interpret the term *basadas en costos* on this basis.<sup>100</sup>

114. This “special meaning” is also in line with the meaning derived from Article 31(1) of the Vienna Convention, which states that a “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”<sup>101</sup> The ordinary meaning of *basadas en costos* – “based in cost” – suggests that the “cost” at issue must be related to the cost incurred in providing the good or service.

115. This interpretation is all the more evident when the term *basadas en costos* in the Reference Paper is examined in its context and in light of the object and purpose of the agreement. Such an examination must take account of the fact that Section 2’s interconnection obligations are one part of the set of pro-competitive regulatory commitments embodied in the Reference Paper.

116. They impose a series of strict disciplines on the provision of interconnection by a major supplier in order to ensure that the major supplier does not manipulate the terms and conditions of interconnection to restrict competition. As governments around the world that have opened their basic telecommunications services markets to competition have recognized, one principal way of preventing a major supplier from restricting competition is to require major suppliers to charge interconnection rates based on the cost that the major supplier incurs in providing interconnection. Such an obligation helps ensure that both the major supplier and its competitors are on a more equal competitive footing.

117. Thus, *tarifas basadas en costos* – in light of the ordinary meaning of these words, in their context and in light of the object and purpose of the Reference Paper, as well as the special meaning of these terms in the telecommunications law and regulations of Mexico, the United States, and other WTO Members – means interconnection rates that are based in the cost that the major supplier incurs in providing interconnection to a competitive supplier.

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<sup>100</sup> According to this provision, a “special meaning shall be given to a term if it is established that the parties so intended.” Vienna Convention, Article 31(4).

<sup>101</sup> Vienna Convention, Article 31(1).

- ii. The current Cofetel approved interconnection rates that Telmex charges U.S. cross-border suppliers are not *basadas en costos* because they are over 75 percent higher on average than the prices charged to other users by Telmex for the network components used to provide such interconnection.

118. In August 2002, Cofetel approved a Telmex proposal to charge U.S. suppliers' settlement rates based on three zones within Mexico. The "settlement rate" is the interconnection rate that Telmex (and other Mexican suppliers) charge U.S. cross border suppliers to connect their calls to their final destination in Mexico.<sup>102</sup> Telmex charges 5.5 cents per minute for traffic terminating in the three largest cities in Mexico (Mexico City, Guadalajara, and Monterrey) (Zone 1); 8.5 cents per minute for the other roughly 200 medium sized cities in Mexico (Zone 2); and 11.75 cents for traffic terminating in all other locations in the rest of Mexico (Zone 3).<sup>103</sup> The United States demonstrates below that the interconnection rate for each of the three Telmex zones is not *basados en costos*.

119. Neither Cofetel nor Telmex claim that these or past interconnection rates are cost oriented. To the contrary, Telmex recently accepted the obligation, in agreements with several U.S. carriers, to "...take all actions necessary to encourage the Mexican government, including the Secretary of Communications and Transportation and the Federal Telecommunications Commission, to modify, effective on or before January 1, 2004, such statutes, rules and/or regulations in Mexico *that prevent negotiation of competitive market-based international termination rates in Mexico...*" (Emphasis added.) Telmex also filed a letter with Cofetel asking it to modify its existing regulations to allow the negotiation of market based termination rates for traffic between Mexico and the United States. Such admissions by Telmex, a major supplier (and the dominant provider) of interconnection to cross-border suppliers, that the current regulations in Mexico prevent the negotiation of competitive market based rates, are compelling

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<sup>102</sup> Under Mexico's ILD Rules, the "settlement rate" is the rate for interconnection provided to cross-border suppliers. Mexico's ILD Rules – which define and require the use of this rate – apply to interconnection between Mexican and foreign telecom suppliers. According to Rule 1, "*las presentes Reglas tienen por objeto regular la prestación del servicio de larga distancia internacional, y establecer las modalidades a que deberán sujetarse los convenios de interconexión de redes públicas de telecomunicaciones con redes extranjeras*" ("these Rules are aimed at regulating the offering of international long distance service and establishing the modalities governing interconnection agreements between public telecommunications networks and foreign networks.") (emphasis supplied). These rules define the "settlement rate" as the rate that "*cobra un operador de puerto internacional a un operador extranjero por recibir tráfico proveniente de un país determinado*" ILD Rule 2(XIV)(a) ("the rate that an international port operator charges to a foreign operator for receiving traffic from a determined country.") In addition, these rules require Mexican operators to conclude "interconnection" agreements with foreign operators that incorporate the "settlement rate" approved by Cofetel. ILD Rule 23 ("*Los concesionarios de servicio de larga distancia que pretendan celebrar convenios de interconexión con operadores extranjeros deberán presentar a la Comisión, previamente a su formalización, dichos convenios para su autorización. Los convenios deberán observar las siguientes condiciones . . . VII. Incorporar tarifas de liquidación aprobadas por la Comisión . . .*"), Exhibit US-1.

<sup>103</sup> For a complete description of Telmex's interconnection rates provided to U.S. suppliers *see WorldCom Petition for Waiver of the International Settlements Policy* filed with the FCC on March 21, 2002, FCC File No. ISP-WAV-20020322-00012, Exhibit US-29.

evidence that the 5.5, 8.5 and 11.75 cent rates negotiated by Telmex and approved by Cofetel are *not* “competitive market based international termination rates,” and, accordingly, that they are not *basadas en costos*.

120. Although Mexico declined to make Telmex’s interconnection cost data available to the United States,<sup>104</sup> ample relevant public data in Mexico exists that can be used as reliable proxies for measuring the cost of interconnection provided to U.S. cross-border suppliers.<sup>105</sup> These include (1) published Mexican price data on maximum rates that Telmex charges for the network components used to provide interconnection; (2) grey market rates for calls between the United States and Mexico; (3) international proxies; and (4) rates Mexican carriers charge each other for settling accounts relating to international calls. Each of these proxies confirms that the rates that Telmex charge U.S. suppliers for interconnection substantially exceed cost.

- a. The maximum blended average cost that Telmex could incur to terminate a call in Mexico is no more than 5.2 (U.S.) cents per minute.

121. In the absence of independent competitive negotiations on interconnection rates and in the absence of Telmex cost data, the maximum cost that Telmex could incur to provide interconnection to U.S. suppliers can be estimated by identifying the network components Telmex uses to terminate a call from the United States and then adding together the corresponding prices that either Cofetel or Telmex established for these components. Because it is reasonable to assume that the component prices established by Cofetel or Telmex are sufficient to cover the component costs, the sum total of those component prices can be regarded as a “cost ceiling” for the aggregate network components. Under this analysis, which is explained in the following section, the maximum average cost that Telmex incurs to provide interconnection to U.S. suppliers is 5.2 (U.S.) cents per minute. The blended average rate of approximately 9.2 cents per minute that Telmex charges exceeds this maximum average cost by more than 75 percent.<sup>106</sup> Because the U.S. bases these estimates of cost on *prices* charged by Telmex, *costs* incurred by Telmex, especially for the very large volumes of traffic generated by U.S. carriers, would be substantially lower.<sup>107</sup> In contrast to the blended average rate of 9.2 cents charged to

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<sup>104</sup> The United States requested this information from the Government of Mexico during WTO consultations held in October 2000.

<sup>105</sup> Mexico has published a wealth of public data relating to the allowable prices of using part or all of Telmex’s network for transporting calls within Mexico. The United States relies on this public price data to approximate the maximum cost that Telmex could incur to provide interconnection to U.S. suppliers.

<sup>106</sup> The blended average will vary based on traffic distribution between the three zones. The United States bases its estimate of 9.2 cents on payment data for AT&T traffic to Telmex for the months of March, April and May of 2002.

<sup>107</sup> A study using 2001 Telmex prices, was filed with the FCC on June 20, 2001 detailing the background, traffic distributions and assumptions supporting a 2001 price level of no more than 3.26 to 4.46 cents per minute for the network components used by Telmex to provide interconnection to United States cross border suppliers. See *AT&T and Concert Objection to International Settlement Policy Modification Request for a Change in the Accounting Rate for International Message Telephone Service with Mexico*, File No: ARC-MOD-20010530-00123,



U.S. suppliers by Telmex, U.S. suppliers have negotiated interconnection rates (i.e. nationwide termination rates) ranging from 1.5 to 3.5 cents per minute with carriers in Canada, Chile, Hong Kong, Jamaica, Malaysia, Russia, Singapore and Germany.<sup>108</sup> For numerous other countries where competitive conditions are allowed to govern rate negotiations, U.S. carriers frequently negotiate rates for traffic termination in the range of 2 to 4 cents per minute.

- (i) Network components used to provide interconnection to U.S. suppliers.

122. U.S. cross-border suppliers of basic telecom services interconnect with Telmex's network at the US/Mexico border.<sup>109</sup> Telmex then uses its network in Mexico to complete ("terminate") the international call to its final destination in Mexico. Telmex uses the following four Telmex network components to provide interconnection and terminate in Mexico calls that originate in the United States<sup>110</sup>:

- (1) international transmission and switching: this network component includes transport from the U.S.-Mexico border to and through the Telmex/Telnor international gateway switch.<sup>111</sup>
- (2) local links: this network component consists of those facilities utilized to transport a call from the international gateway switch to an entry point in the Telmex/Telnor domestic network.

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Exhibit US-33. Although Telmex participated in the FCC proceeding, it did not object or rebut the study methodology, the price/cost calculations or the study's conclusions. The prices indicated in the body of this brief utilize a similar study methodology but have been amended to reflect Telmex 2002 prices and traffic distribution according to the current 3 Zone agreement. While these changes raise the cost-ceiling proxy for the network components used to provide such interconnection, it is unlikely that Telmex's costs have actually increased.

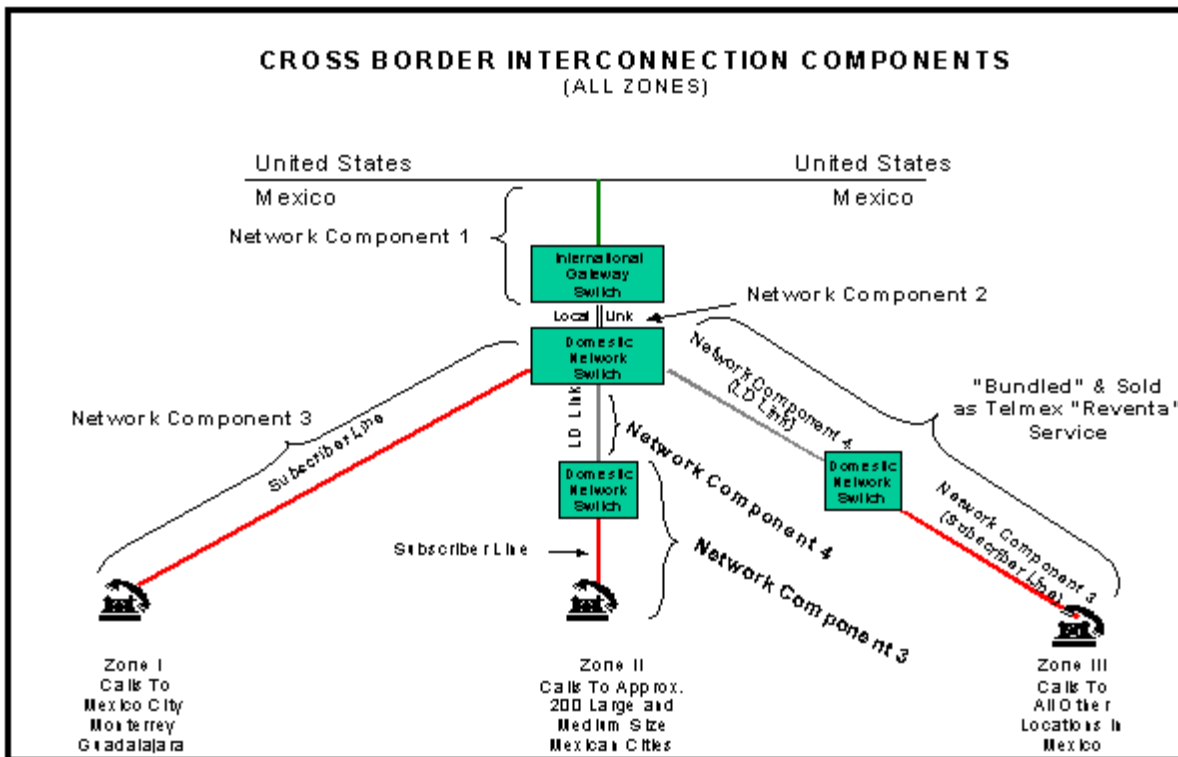
<sup>108</sup> Affidavit of Thomas R. Luciano, Vice-President, Global Voice Operations, AT&T Corp., Exhibit US-5.

<sup>109</sup> For example, the January 9, 1952 Operating Agreement between AT&T and Telmex describes AT&T facilities as being within the United States and Telmex facilities in Mexico and states the parties desire to "continue the interconnection of their facilities upon the terms and conditions hereinafter set forth". Recent interconnection rate changes between Telmex and AT&T are considered amendments to this 1952 agreement.

<sup>110</sup> While the focus of this section is on the prices charged by Telmex for the network components used to terminate a call from the United States, the same network components are also used to originate a call from Mexico to the United States.

<sup>111</sup> Telmex/Telnor have historically maintained 22 international gateway switches in 11 cities, most of which are located in or close to major population centers. However, Telmex is in the process of reconfiguring its network. Currently Telnor maintains two pairs of international gateway switches in Tijuana and Mexicali. Telmex maintains pairs of international gateway switches in Guadalajara, Monterrey, and Mexico City. These international gateway switches are the first point where U.S. originated calls are routed to different destinations throughout Mexico. In addition to initial routing, these switches keep track of incoming and outgoing calls (i.e., minutes of traffic) for administration of the settlement rate accounts.

- (3) subscriber line: this network component includes switching in the terminating city and transmission over facilities (such as a local loop) to the receiving telephone.
- (4) long distance links: this network component consists of those facilities utilized to transport traffic from the entry point in the Telmex/Telnor domestic network to the last switch in the network chain.



123. These network components reflect the guidelines promulgated by the International Telecommunications Union (“ITU”) for identifying the costs incurred in terminating international calls.<sup>112</sup> According to the ITU, the network components used to provide international telephone services are international transmission and switching facilities (component 1 identified above)<sup>113</sup> and national extension (which incorporates components 2

<sup>112</sup> International Telecommunication Union, Recommendation D.140 (Accounting Rate Principles for the International Telephone Service) (“D.140”), October 2000, Annex A, Exhibit US-30.

<sup>113</sup> D.140 defines “international transmission facilities” as “international terrestrial transmission or international submarine cables, or international satellite transmission or a combination of these.” *Id.*, Annex A.1.1. D.140 defines “international switching facilities” as “international switching centres and their associated transmission and signalling equipment.” *Id.*, Annex A.1.2. Therefore, “international transmission and switching” consists of transport facilities from the U.S.-Mexico border to the international gateway switch as well as the

(continued...)

through 4 identified above).<sup>114</sup> The ITU also includes related “direct” and “indirect” costs as part of the costs incurred in providing international telephone service.<sup>115</sup> As discussed in the next section, Mexico’s published rates for these network components include these direct and indirect costs.

(ii) Published Telmex prices for these network components.

124. Either Cofetel or Telmex has established the rates for each of these network components. Cofetel has approved charges for several of these network components (international transmission and switching and terminating interconnection to cities where both Telmex and its competitors are permitted to provide long distance service<sup>116</sup>) and has published these charges in several resolutions.<sup>117</sup> Mexican law requires these Cofetel-approved rates to recover *at least* the total cost of these network components<sup>118</sup> and therefore include at least the true costs of these network components, including direct and indirect costs.

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(...continued)

international gateway switch itself.

<sup>114</sup> D.140 defines “national extension” as “national exchanges, national transmission facilities and, if appropriate . . . the local loop.” *Id.*, Annex A.1.3. Therefore, “national extension” incorporates local links, long distance links, and terminating interconnection.

<sup>115</sup> *Id.*, Annex A.2. Direct costs include investment and operation costs; indirect costs include administrative costs and taxes.

<sup>116</sup> Telmex provides terminating interconnection to Mexican suppliers according to two distinct pricing methods. For those cities where Telmex has allowed customers to chose their long distance carrier for originating calls, Telmex provides terminating interconnection at a Cofetel-approved rate of 1.003 cents per minute (including a call attempts surcharge). This 1.003-cent rate is referred to as “on-net” interconnection. For other areas of the country where Telmex does not allow customers to chose their long distance carrier, Telmex refuses to provide terminating interconnection at on-net rates and requires Mexican carriers to use Telmex commercial tariffs with a negotiated discount, currently 25%. This negotiated discount from normal commercial long distance rates is referred to as “off-net” interconnection.

<sup>117</sup> Cofetel Resolution P/171297/0254 establishes the charge for international transmission and switching. Cofetel Resolution P/EXT/111000/008 (October 11, 2000) establishes the interconnection rates for terminating interconnection in cities where Telmex and competitors own facilities. Exhibit US-31. After Cofetel issued this resolution, Telmex concluded interconnection agreements with Mexican carriers that incorporated these interconnection rates.

<sup>118</sup> 1995 Federal Telecommunications Law, art. 62 (“*La regulación tarifaria que se aplique buscará que las tarifas de cada servicio, capacidad o función, incluyendo las de interconexión, permitan recuperar, al menos, el costo incremental promedio de largo plazo.*”) (“The rate control applied shall seek that the rates for each service, capacity or function, including those for interconnection, allow the recovery of at least the long term average incremental cost.”) (emphasis supplied), Exhibit US-16. Mexico has defined “long term average incremental costs” as all the costs Telmex incurs to provide a service. Modification to Telmex’s Title of Concession, August 10, 1990, section 6-2 (“*Se entiende por costo incremental promedio de largo plazo la suma de todos los costos en que ‘Telmex’ tiene que incurrir para proveer una unidad de capacidad adicional del servicio correspondiente.*”) (emphasis supplied) Therefore, the rates Cofetel has established incorporate *all* relevant costs. See also ILD Rule 19 (authorizes Cofetel to establish the fees that international port operators may receive for switching, routing and accounting services on the basis of long term average incremental costs), Exhibits US-17 and US-32.

125. Telmex has published retail prices for the other network components (local and long distance links).<sup>119</sup> These various network components are furnished to users in Mexico, pursuant to tariffs filed by Telmex with Cofetel.<sup>120</sup> These retail prices also permit Telmex to recover at least the total cost of these network components.<sup>121</sup> Moreover, Telmex has agreed to rates with other Mexican carriers for terminating interconnection to cities where Telmex competitors are precluded from providing long distance service (“off-net” interconnection).<sup>122</sup> These commercially negotiated rates permit Telmex to recover at least the cost it incurs to provide this service and, in the view of the United States, are substantially *above cost*.

126. Therefore, in determining the maximum cost Telmex incurs to provide each network component, the United States is relying on publicly-available price data that accounts for *at least all* possible costs that Telmex incurs. Moreover, for certain network components, the United States is relying on either Telmex’s retail prices or on certain non-cost-oriented wholesale rates that Telmex charges. As such, Telmex prices set an upward limit (cost ceiling) of cost; rates above this cost ceiling cannot be *basadas en costos*. The United States discusses the specific prices of these network components, depending on the destination of a call into Mexico, in the next subsection.

1. The sum of the prices for individual network components places a ceiling on the maximum cost that Telmex could incur to terminate calls that originate in the United States.

127. Cross-border suppliers of basic telecom services interconnect with Telmex in order to terminate calls to three “zones” in Mexico. Each successive calling zone reflects progressively more extensive use of Telmex’s network (and hence progressively higher prices, based on Telmex’s current pricing practices). These three zones are: (1) calls terminating in Mexico City, Guadalajara, and Monterrey; (2) calls terminating in approximately 200 medium cities in Mexico; and (3) calls terminating in all other locations in Mexico. In the following paragraphs, the United States will discuss Telmex’s prices for the network components used for each of the three calling zones.

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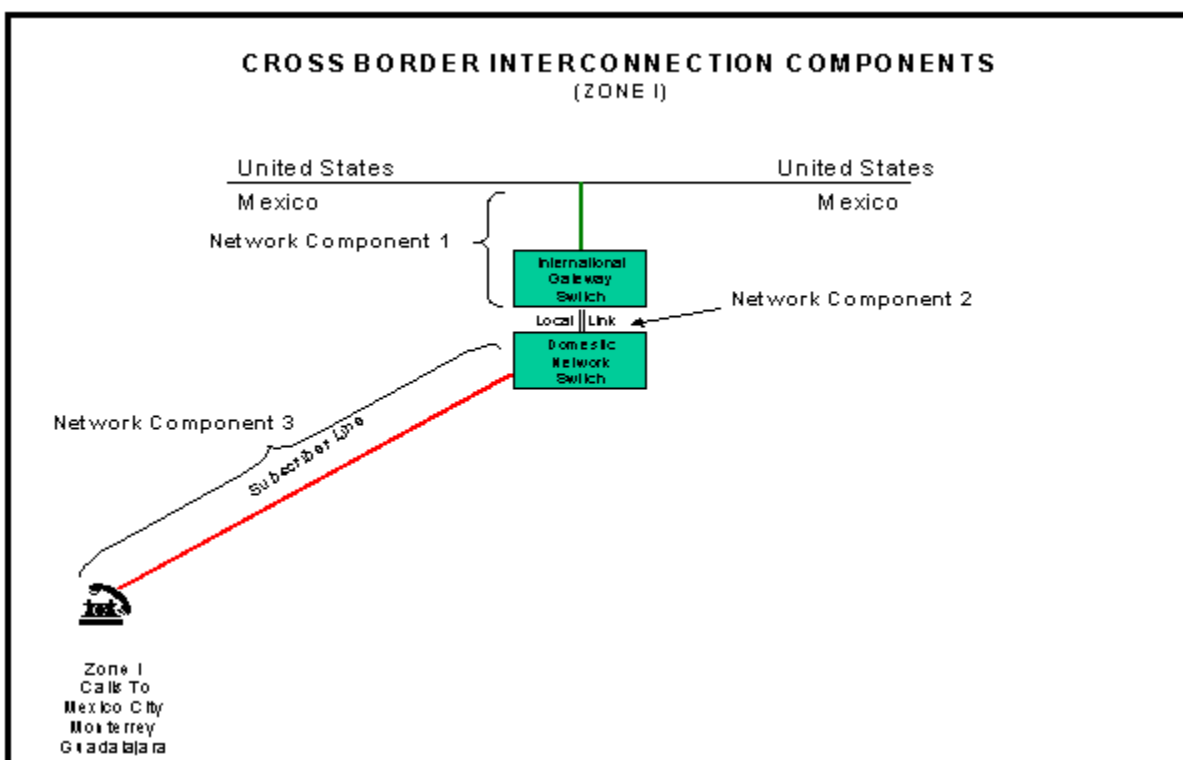
<sup>119</sup> Cofetel publishes these tariffs on its website. Available at [http://www.cft.gob.mx/frame\\_marc\\_juridico\\_reglamentos.html](http://www.cft.gob.mx/frame_marc_juridico_reglamentos.html) (SECCION No. 8B TARIFAS PARA LADAENLACES (Folio 1474)).

<sup>120</sup> Under Cofetel regulations, Telmex must provide its tariffed services to users requesting to purchase those services on a non-discriminatory basis. However, Telmex has refused to provide its tariffed private lines and Cofetel approved interconnection rates to AT&T. (*See* letter from J.C. Pardo, (Telmex) to AT&T dated 31 August 1998.

<sup>121</sup> *Supra*, footnote 118.

<sup>122</sup> The United States discussed this off-net rate in the previous section.

- (a) The maximum cost that Telmex could incur to terminate a call in a Zone 1 city is 2.5 (U.S.) cents per minute; however Cofetel allows Telmex to charge cross-border suppliers 5.5 cents or 220% of that cost-ceiling.



128. Calls requiring the least extensive use of Telmex’s network are those whose final destination is in Zone 1, *i.e.*, Mexico City, Guadalajara or Monterrey. Telmex has an international gateway switch in each of these three cities. In addition, for all subscriber lines in these three cities, Telmex provides terminating interconnection at the Cofetel approved rate of 0.975 cent (the “on-net” rate).

129. Telmex charges U.S. suppliers an interconnection rate of 5.5 cents to terminate a call in a Zone 1 city. Terminating a call in any of the three Zone 1 cities requires the use of three network components. However, the price that Telmex charges numerous Mexican users for the individual network components totals only 2.5 cents per minute.

<b>Network Component</b>	<b>Purpose</b>	<b>Cost Ceiling and Basis</b>
International Transmission and Switching	transport a call from the U.S.-Mexico border to the international gateway switch and use the international gateway switch	1.5 cents per minute
Local Link	transport call from the international gateway switch to an entry point in the domestic network	.022 cents per minute
Subscriber Line	transport call through the domestic switch in the terminating city and transmission to the receiving telephone (in cities where Telmex has opened to competition)	1.003 cents per minute
<b>TOTAL</b>		<b>2.525 cents per minute</b>

130. Therefore, Telmex’s costs can be no more than 2.5 cents per minute (1.5 cents<sup>123</sup> plus .022 cents<sup>124</sup> plus 1.003 cents<sup>125</sup>) for the network components to interconnect a call from the

<sup>123</sup> Cofetel established this rate in Resolution of December 18, 1997 P/171297/0254. However, this 1.5 cent rate is an inflated measure of cost. International gateway switches have limited functions and handle enormous volumes of traffic, and therefore the cost attributed to them per minute of traffic should be minimal. As early as 1996, the ITU Secretary General stated that: “Recommendation D.140 notes that there are three main cost components necessary to provide international telephone service: international transmission facilities, international switching facilities and national extension. Substantial cost reductions have been realized in the first two areas to such an extent that they are no longer a major component in the cost of delivering international service.” Available at [http://www.itu.int/osg/spu/intset/ITUpap/sg\\_com3.html](http://www.itu.int/osg/spu/intset/ITUpap/sg_com3.html), Exhibit US-30.

<sup>124</sup> This per minute rate for local links is calculated by dividing Telmex’s monthly price for a private leased circuit by a conservative estimate of the number of minutes that use the private leased circuit. The private line monthly price is Telmex’s published “Ladenlace” rates for private leased circuits (34 Mbps). Telmex charges 63,852 pesos per month for such circuits and offers long-distance carriers a 45 percent discount (USD 3639, based on a 9.65 peso/\$ rate). Cofetel publishes these tariffs on its website. Available at [http://www.cft.gob.mx/frame\\_marc\\_juridico\\_reglamentos.html](http://www.cft.gob.mx/frame_marc_juridico_reglamentos.html) (SECCION No. 8B TARIFAS PARA LADAENLACES (Folio 1474)). It is necessary to convert this monthly rate into a per-minute rate. To do so, the United States relies on the approach used by the FCC in its 1997 order on international telecommunications rates. See *International Settlement Rates*, 12 FCC Rcd. 19806 19982 (1997) Appendix E. This approach adopts a conservative assumption that a service provider uses a link 18.5 percent of the time (8,000 minutes per circuit). Based on conservative use of transmission technology (multiplexing 4:1), such a line would comprise 2,040 voice

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United States border to a city in Zone 1. However, Telmex currently charges a Cofetel-approved rate of 5.5 cents to connect these calls. Thus, Telmex charges U.S. suppliers an interconnection rate that is approximately 220% of the maximum cost it incurs to terminate a call in Zone 1.

- (b) The maximum cost that Telmex could incur to terminate a call in a Zone 2 city (approximately 200 medium sized cities) is 3.0 (U.S.) cents per minute; however Cofetel allows Telmex to charge cross-border suppliers 8.5 cents or 283% of that cost-ceiling.

131. The second calling pattern involves calls to approximately 200 medium-sized cities that do not have an international gateway switch, but where Telmex allows its competitors to purchase “on-net” interconnection.<sup>126</sup> As previously shown, Telmex charges its domestic competitors differing terminating interconnection rates according to whether Telmex classifies the city as “on-net” or “off-net.” Compared to calls terminating in Zone 1 cities with their own international gateway switches, calls to these Zone 2 (non-gateway) cities involve one additional network element – a “long distance link” used for transport within Mexico between the international gateway switch and the switch in the destination city .

132. Telmex charges U.S. suppliers an interconnection rate of 8.5 cents to terminate a call in a Zone 2 city. However, the price that Telmex charges for the individual network components used to terminate a call totals only 3.0 cents per minute.

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<sup>124</sup>(...continued)

circuits. Thus, the per-minute rate would be  $\$3639 / (2,040 * 8,000)$  or .022 cents. Similar data provided by the Canadian operator Telus, estimating the cost of high-capacity transmission estimates such circuits are used between 12,000 and 14,000 minutes per month. (See Costquest Associates, April 5, 2002 Study, International Benchmarking: Review of Interconnection and Retail Minus Wholesale Discounts, Appendix B, page 7. ([http://www.comcom.govt.nz/telecommunications/Rep\\_Doc.cfm](http://www.comcom.govt.nz/telecommunications/Rep_Doc.cfm)). An ITU study of international interconnection rates uses a similar methodology (multiplexing 4:1, and using a 25% capacity usage assumption, or over 10,000 minutes per circuit per month). See ITU’s 1996 Publication *Direction of Traffic*, Chapter 2, p. 9 at <http://www.itu.int/osg/spu/intset/whatare/dot/chapter2.pdf>.

<sup>125</sup> In October 2001, Cofetel authorized Telmex to charge 1.25 cents for interconnection for 2001 and .07 cent charge for uncompensated call attempts. Cofetel resolution P/EXT/111000/008 (October 11, 2000), Exhibit US-31. Telmex and Mexican operators concluded an interconnection agreement in December 2000 that incorporated these rates. In December 2001, Telmex and Mexican operators concluded a new agreement to lower local interconnection rates for 2002 to .975 cents and a reduced .028 cents surcharge for call attempts. As a result, the current rate that Telmex charges for terminating interconnection is 1.003 cents per minute.

<sup>126</sup> The Zone 2 cities are listed by their associated three digit Mexican Numbering Plan Area Code (MNPA) in the Telmex WorldCom agreement on file with the FCC. See *WorldCom Petition for Waiver of the International Settlements Policy* filed with the FCC on March 21, 2002, Exhibit US-29.

<b>Network Component</b>	<b>Purpose</b>	<b>Cost Ceiling and Basis</b>
International Transmission and Switching	transport a call from the U.S.-Mexico border to the international gateway switch and use the international gateway switch	1.5 cents per minute (see footnote 123 for basis)
Local Link	transport call from the international gateway switch to an entry point in the domestic network	.022 cents per minute (see footnote 124 for basis)
Long Distance Link	transport call from the entry point in the domestic network to a local switch	.536 cents per minute (this rate is for the <i>maximum</i> possible distance even though this rate is well above the average rate for long distance links) See footnote 127 below for basis.
Subscriber Line	transport call through the domestic switch in the terminating city and transmission to the receiving telephone (in cities where Telmex has opened to competition)	1.003 cents per minute (see footnote 125 for basis)
<b>TOTAL</b>		<b>3.061 cents per minute</b>

Therefore, Telmex’s costs can be no more than 3 cents per minute (1.5 cents plus .022 cents plus .536 cents<sup>127</sup> plus 1.003 cents) for the network components used to interconnect a call from the

<sup>127</sup> This per minute rate for long distance links is based on Telmex’s published “Ladenlace” rates for private leased circuits (2 Mbp/s). Available at [http://www.cft.gob.mx/frame\\_marc\\_juridico\\_reglamentos.html](http://www.cft.gob.mx/frame_marc_juridico_reglamentos.html) (SECCION No. 8B TARIFAS PARA LADAENLACES Folio 1474 Tarifas ladaenlace de 2 MBPS). Currently, Telmex only offers these medium -capacity links (2 Mb/s) to competitors for long-distance links (although they appear to be of inefficiently low capacity for high-volume routes. As with local links, it is necessary to convert this monthly rate of \$5149 into a per-minute rate of .536 cents. See footnote 124 for the approach used by the United States to make this conversion. Note that the approach used by the U.S. assumes an unrealistically small capacity circuit (2Mbps) and further assumes that the entire circuit is used solely to carry traffic from the United States. In practice, Telmex’s network consists of far higher capacity circuits and carries a mix of both originating and terminating, domestic and

(continued...)



United States border to a Zone 2 city. However, Telmex currently charges a Cofotel-approved rate of 8.5 cents to connect these calls. Thus, Telmex charges U.S. suppliers an interconnection rate approximately 275% of the maximum cost it incurs to terminate a call in Zone 2.

- (c) The maximum cost that Telmex could incur to terminate a call in a Zone 3 city is 9.28 U.S. cents per minute; however Cofotel allows Telmex to charge cross-border suppliers 11.75 cents or 127% of that cost-ceiling.

133. The third and final calling pattern involves calls to cities in Zone 3, or “off-net” cities. Off-net cities are cities that Telmex has not opened to originating competition and where Telmex does not allow competitors to purchase “on-net” termination.<sup>128</sup>

134. To terminate calls in Zone 3 cities, Telmex uses the same network components as it does for Zone 2: (1) international transmission and switching, (2) local links, and (3) subscriber lines. However, unlike the preceding two calling patterns, Telmex’s rate for terminating interconnection is substantially higher than that charged by Telmex for “on-net” interconnection. In Zones 1 and 2, Telmex terminates calls in cities where competitors are allowed to purchase “on-net” termination at rates established by Cofotel and incorporated into commercial agreements between Mexican operators. However, Telmex charges highly inflated rates (known as “*reventa*” or “off-net” rates) to terminate calls in cities where competitors are not allowed to buy “on-net” terminating interconnection.

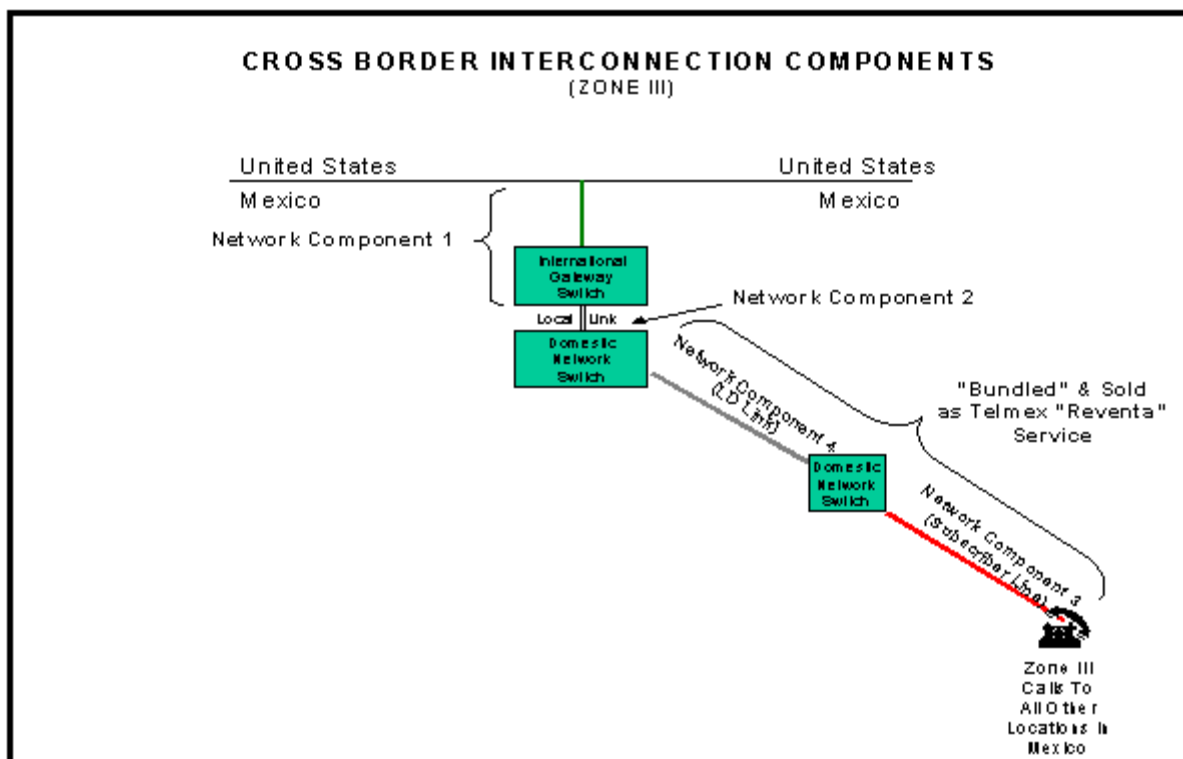
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<sup>127</sup>(...continued)

international traffic.

The rate for such links depends on distance. The greater the distance from the international gateway switch, the greater the charge for the long distance link. These distance sensitive charges in Telmex’s tariff range from 46 and 226 pesos per kilometer per month. However, for purposes of this analysis, the United States will use the link rates for calls that traveled an average of 800 km from a gateway switch to the city of termination. The 800 km average has been calculated by measuring the maximum distance calls are required to travel from each of the international gateway city locations and dividing by 2. This rate is .536 cents per minute. (The United States calculated this rate by using the monthly cost of the 800km line, with the 45 percent discount that Telmex offers to phone companies (\$5149, using a rate of 9.65 Mexican pesos to the U.S. dollar) and then dividing that monthly rate by 960,000 minutes). See footnote 124 for FCC source data.

<sup>128</sup> The Zone 3 cities are listed by their associated three digit Mexican Numbering Plan Area Code (MNPA) in the Telmex WorldCom agreement on file with the FCC. See *WorldCom Petition for Waiver of the International Settlements Policy* filed with the FCC on March 21, 2002, Exhibit US-29.



135. Unbundled pricing information for the network components used to provide *reventa* service – terminating calls in off-net cities – is not readily available. Therefore, to determine Telmex’s maximum costs, the United States utilizes the 7.76 cent *reventa* rate that Telmex charges its competitors to terminate calls to off-net cities.<sup>129</sup> There is no evidence that this

<sup>129</sup> Telmex and its competitors agreed upon this rate by discounting Telmex’s best retail rate (i.e., the 1 peso *Plan Lada* rate discussed above) by 25 percent. Telmex offered this rate to its competitors as an alternative to complying with a lower, regulated rate that Cofetel was prepared to impose in October 2000. In October 2000, Cofetel issued a resolution to resolve pending interconnection disputes between Telmex and Avantel (it also issued the same resolution to resolve the interconnection dispute between Telmex and Alestra). This resolution contained a provision on off-net interconnection and required Telmex to deduct from Telmex’s lowest market rate the cost of those network components that Alestra/Avantel do not require for the provision of their long-distance service. Cofetel, Resolución Número P/EXT/061000/007, CUARTO (“*Para tal efecto, a la tarifa más baja de mercado aplicada por Telmex/Telnor a sus usuarios comerciales del servicio telefónico de larga distancia nacional, dicha empresa deberá restarle el costo de aquellos elementos de red que no son necesarios en la prestación del servicio de larga distancia que preste a Avantel.*”)

Telmex rate is itself *basadas en costos*,<sup>130</sup> but Telmex’s costs for the network components used would certainly be no higher than this wholesale price charged by Telmex.

136. The *maximum* total cost that Telmex incurs to terminate calls to Zone 3 cities is 9.28 (U.S.) cents per minute.

<b>Network Component</b>	<b>Purpose</b>	<b>Cost Ceiling and Basis</b>
International Transmission and Switching	transport a call from the U.S.-Mexico border to the international gateway switch and use the international gateway switch	1.5 cents per minute ( <i>see</i> footnote 122 above for basis)
Local Link	transport call from the international gateway switch to an entry point in the domestic network	.022 cents per minute ( <i>see</i> footnote 123 for basis)
Terminating Interconnection (“Off-Net”)	transport call from the long distance switch to end user (in cities where only Telmex is authorized to terminate calls)	7.76 cents per minute
<b>TOTAL</b>		<b>9.28 cents per minute</b>

Therefore, Telmex’s costs can be no more than 9.28 cents per minute for the network components to interconnect a call from the United States border to a Zone 3 city. However, Telmex currently charges a Cofetel-approved rate of 11.75 cents to connect these calls. Thus, Telmex charges U.S. suppliers an interconnection rate approximately 127% of the maximum cost it incurs to terminate a call in Zone 2.

<sup>130</sup> In reality, this 7.76 cent rate significantly exceeds Telmex’s costs. AT&T’s filing with the FCC on June 20, 2001 contains an estimated cost ceiling for off-net termination of 2.44 cents per minute, based on the prices charged by Telmex for the network components used to provide off-net interconnection. Although Telmex participated in the FCC proceeding, it did not attempt to rebut this estimated cost ceiling. In order to present a conservative estimate of costs, the United States has utilized the *reventa* rate charged by Telmex, rather than the 2.44 cents cost estimate. Exhibit US-33.

2. The rate Telmex charges cross-border suppliers for interconnection vastly exceeds the maximum cost Telmex could incur to provide this interconnection.

137. The 9.2 cents per minute blended average (*see* footnote 106) of the three zone rates that Telmex charges U.S. suppliers for interconnection exceeds Telmex’s published price for the network components used to provide such interconnection, and hence, Telmex’s *maximum* blended average costs, by 77 percent.

<b>Telmex Proposed Rate (blended average)</b>	<b>Blended Cost Ceiling</b>	<b>Percent Telmex’s Proposed Rate Exceeds Cost Ceiling</b>
9.2 (U.S.) cents	5.2 (U.S.) cents	77%

138. Finally, each of the three zone, geographically-based rates that Telmex charges U.S. suppliers for interconnection exceeds Telmex’s published price for the network components used to provide such interconnection, and hence, Telmex’s *maximum* costs by 27 to 183 percent.

<b>Telmex’s Proposed Rate (by region)</b>	<b>Cost Ceiling to Terminate Calls to These Regions</b>	<b>Percent Current Rate Exceeds Telmex’s Costs</b>
5.5 (U.S.) cents (for calls to the Zone 1 gateway cities of Mexico City, Monterey, and Guadalajara)	2.5 cents	<b>120%</b>
8.5 cents (for calls to the Zone 2 or on-net cities)	3.0 cents	<b>183%</b>
11.75 cents (for calls to Zone 3 or “off-net” cities)	9.28 cents	<b>27%</b>

139. In sum, based on prices charged by Telmex and published by Cofetel or Telmex, Telmex’s current interconnection rates exceed the estimated cost of the network components used to provide interconnection to U.S. suppliers. The United States again underscores that the data it is using – including Telmex’s retail rates for private lines and Telmex’s rates for off-net interconnection – yields the *maximum* cost that Telmex could possibly incur to provide interconnection to U.S. suppliers. The real cost that Telmex incurs is likely far lower than the maximum cost ceilings identified in this section, and is likely in line with the 1 to 2 cent per minute rate in effect with carriers in countries with WTO-compliant competitive conditions. Even so, the rates that Telmex charges U.S. suppliers for interconnection far exceed even this inflated cost ceiling.

140. Therefore, by approving the interconnection rates charged by Telmex to U.S. suppliers, Mexico has failed to comply with its obligation under Section 2.2(b) of the Reference Paper to ensure that Telmex provides interconnection at rates that are *basadas en costos*.

- b. The interconnection rates that Telmex charges U.S. cross border suppliers also greatly exceed “grey market” retail rates for calls into Mexico.

141. Another proxy for identifying costs of interconnection are “grey market” rates for transport and termination of international minutes into Mexico, sold in London, Los Angeles and New York. Operators offering such rates use a variety of network arrangements, including leasing cross-border links and terminating calls in Mexico using interconnection arrangements identified in the analysis above (i.e., combinations of switching services and links purchased from Telmex or other operators to reach destination subscribers in Mexico). Such arrangements bypass the uniform settlement rates required by regulations in Mexico and therefore are technically illegal in Mexico. However, these rates provide another estimate of what some operators are currently paying for the network components used to terminate such calls, even given the constraints of Mexico’s regulations. As a result, “grey market” rates also provide insight as to the relevant costs incurred to complete calls into Mexico, given that a grey market for such calls would not exist unless operators were making a profit over the cost of the network components required to complete the calls.<sup>131</sup> In all cases, these “grey market” rates are far lower than the rate charged by Telmex. In addition, these rates are lower than the maximum costs shown in the above U.S. pricing surrogate, and confirm the conservative nature of the assumptions underlying that methodology.

142. For this analysis, the United States relies on publicly available data provided by a major traffic-exchange company that matches buyers of international telecom minutes with sellers.<sup>132</sup> Rates are available for nationwide termination in Mexico (i.e., to any destination) or on a city-by-city basis. These rates provide a convenient basis for comparison with the 5.5-, 8.5- and 11.75-cent Cofotel-approved rates for interconnection in the three geographically differentiated zones discussed above.

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<sup>131</sup> Telmex estimated that in 2001, gray market calls displaced up to 18 percent of international revenue (1.7 billion pesos). Telmex 2001 Annual Report, page 11, Exhibit US-2, also available at <http://www.telmex.com/internos/inversionistas/finanzas/pdf/Annual01.pdf>

<sup>132</sup> The rates used in this brief were available at [www.arbinet.com](http://www.arbinet.com) on September 13, 2002.

<b>City in Mexico</b>	<b>Current Cofetel Approved Rate (U.S. cents per minute)</b>	<b>Grey Market Rate (U.S. cents per minute)</b>	<b>Percent Current Rate Exceeds Grey Market Rate</b>
Mexico City	5.5	1.3	<b>323%</b>
Monterey	5.5	1.6	<b>243%</b>
Guadalajara	5.5	1.6	<b>243%</b>
Chihuahua	8.5	6.3	<b>34%</b>
Ciudad Juarez	8.5	6.3	<b>34%</b>
Durango	8.5	5.22	<b>63%</b>
Mazatlan	8.5	6.35	<b>34%</b>
Nuevo Laredo	8.5	5.25	<b>62%</b>
Puerto Vallarta	8.5	6.36	<b>34%</b>
Reynosa	8.5	5.25	<b>62%</b>
Saltillo	8.5	6.12	<b>39%</b>
Veracruz	8.5	6	<b>142%</b>
Zacatecas	8.5	6.42	<b>32%</b>
Atlixo	11.75	6.9	<b>70%</b>
Oaxaca	11.75	6.64	<b>77%</b>
Papanao	11.75	9.5	<b>24%</b>
Pericos	11.75	9.5	<b>24%</b>
Progreso	11.75	9.5	<b>24%</b>
Rio Grande	11.75	8.29	<b>42%</b>
Romita	11.75	9.6	<b>22%</b>

143. These grey market rates are lower than Telmex rates despite the fact that these rates include costs for network components that are in addition to the network components used by Telmex to terminate U.S. calls into Mexico. For example, the grey market rates include – in addition to termination – the cost of transporting calls from different points abroad (Los Angeles, New York, or London) to the Mexican border. Telmex does not provide, nor incur the cost, of

this network component. U.S. cross border suppliers pay Telmex an interconnection rate for the purpose of terminating calls from the U.S.-Mexico border to their final destinations in Mexico.

144. Second, because such calls are technically illegal in Mexico, they necessarily involve a regulatory risk premium to cover the possibility that these grey market operations can be shut down at any time. Furthermore, to avoid detection, such operators typically do not use efficient, high capacity links for their networks (but instead rely on commercially available low capacity links), thereby incurring network inefficiencies and higher costs.<sup>133</sup> Third, given the price ceiling set by Telmex (i.e., the cross-border interconnection rate) which still governs the overwhelming majority of calls, and the limited capacity of the grey market to meet demand for alternative termination, market pressure to drive grey market rates to cost is limited—such operators can meet demand by offering a limited discount to the Telmex-set price umbrella, which likely results in such grey market rates being well above cost.

145. In sum, these grey market rates – which include costs for network components in addition to those used by Telmex to supply interconnection to U.S. suppliers – are above the maximum cost that Telmex could incur to terminate calls that originate in the United States (otherwise the grey market would not exist). Nevertheless, the current rate that Telmex charges U.S. suppliers exceeds these grey market rates by a range of 27%-197% (depending on the destination of the call). Therefore, these grey market rates are yet another benchmark for demonstrating that Telmex's interconnection rates are substantially above Telmex's cost, and provide yet further support for the U.S. claim that Mexico has failed to comply with its obligations under Section 2.2(b) of the Reference Paper.

- c. The interconnection rates that Telmex charges U.S. cross border suppliers also exceed wholesale rates for the termination of calls into other countries.

146. The market for wholesale transportation and termination of international calls provides additional evidence of the extent to which Telmex's current and proposed termination rates are above-cost. On the table below, the United States sets forth wholesale rates established by a major operator<sup>134</sup> to terminate calls to various countries that, like Mexico, have more than one long-distance provider.

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<sup>133</sup> The unit price of transport capacity declines significantly with the purchase of larger units. For example, Telmex charges 3,465 pesos per month for a 64 kilobit per second circuit of 500 kilometers. However, for a 2 megabit per second circuit of the same distance, with 30 times the capacity, Telmex charges only 71,153 pesos per month – a one third reduction in per unit cost. See [http://www.cft.gob.mx/frame\\_marc\\_juridico\\_reglamentos.html](http://www.cft.gob.mx/frame_marc_juridico_reglamentos.html)

<sup>134</sup> These September 13, 2002 rates were available at [www.arbinet.com](http://www.arbinet.com).

<b>Country</b>	<b>Wholesale termination rates (U.S. cents per minute), as of September 13, 2002</b>	<b>Percent Telmex's Proposed 9.2 Cents Rate (blended average) Exceeds Termination Rate</b>
Argentina	3.4	<b>171%</b>
Australia	1.37	<b>572%</b>
Austria	1.46	<b>531%</b>
Brazil	6.23	<b>48%</b>
Canada	1.46	<b>530%</b>
Chile	1.86	<b>399%</b>
China	2	<b>360%</b>
Czech Republic	3	<b>207%</b>
Dominican Republic	5.79	<b>59%</b>
Estonia	2.18	<b>322%</b>
Finland	1.7	<b>441%</b>
France	1.44	<b>539%</b>
Germany	1.35	<b>581%</b>
Hong Kong	1.2	<b>667%</b>
Hungary	3.59	<b>156%</b>
Indonesia	6.2	<b>48%</b>
Israel	2.14	<b>331%</b>
Italy	1.32	<b>597%</b>
Japan	2.1	<b>338%</b>
Korea (South)	1.86	<b>395%</b>
Malaysia	2.3	<b>300%</b>
New Zealand	1.5	<b>513%</b>



Norway	1.18	<b>680%</b>
Poland	3.47	<b>165%</b>
Singapore	1.2	<b>667%</b>
South Africa	4.37	<b>111%</b>
Spain	1.44	<b>539%</b>
Taiwan	1.68	<b>448%</b>
Zimbabwe	4	<b>130%</b>

147. As discussed above, these rates include transport from points of interconnection in Los Angeles, New York or London and thus include network components and costs in addition to those used and incurred by Telmex in terminating a call from the Mexican border to the final destination in Mexico. In addition, none of these countries match the volume of international traffic and corresponding economies of scale for traffic between the United States and Mexico. Nevertheless, these international rates provide a useful, but highly conservative, benchmark further supporting the U.S. claim that Mexico has failed to ensure that Telmex provides interconnection to cross border suppliers at rates that are *basadas en costos*.

- d. Financial compensation procedures among Mexican operators demonstrate that the interconnection rates charged to U.S. suppliers are not cost-oriented.

148. Finally, an incontrovertible indication that Telmex’s rates are well above cost is the ILD Rules themselves. The ILD Rules require Mexican international operators to allocate incoming international calls among themselves under a “proportionate return” system that reflects each operators’ share of outgoing calls.<sup>135</sup> Because the Mexican international operators do not necessarily receive traffic (and the associated payments by U.S. carriers) in accordance with this proportionate return requirement, the ILD Rules also establish redistribution and compensation procedures to ensure that each operator either receives the correct amount of traffic or receives appropriate financial compensation.

149. Under the traffic redistribution procedures established by ILD Rule 16, the operator receiving the excess traffic at its international port is required to transfer the excess traffic to another operator entitled to receive the traffic under the allocation formula. The initial operator is allowed to deduct from the settlement rate for its own international port services (authorized by Cofetel at 1.5 cents per minute), with the remainder of the settlement rate going to the operator to which the traffic is transferred.

<sup>135</sup> ILD Rules 10, 16, 17. This traffic allocation requirement system prevents Mexican carriers from independently competing to terminate calls of cross-border suppliers and ensures that all Mexican international operators receive an allocated share of the lucrative, above-cost payments from U.S. suppliers for sending calls into Mexico.

150. Alternatively, ILD Rule 17 allows the Mexican international operators to “mutually negotiate financial compensation agreements in consideration of the rights generated for each of them in accordance with the proportionate return system.” This allows operators that are unable to identify and transfer excess traffic in accordance with Rule 16 to terminate that traffic and then negotiate financial compensation agreements (or “true-up” payments) with the operator entitled to receive the traffic under the allocation formula.

151. The mere existence of Rule 17 should be regarded as an admission by Mexico that the interconnection rate charged to cross-border suppliers is not *basadas en costos*. If the settlement rate was *basadas en costos*, no Rule 17 “financial compensation” would be available for any “entitled” operator to receive, because the settlement rate received by the operator actually receiving and terminating the “excess” traffic would merely be sufficient to cover those termination costs. However, Rule 17 allows an operator that has incurred no cost for call termination to receive a share of the interconnection rate for a call terminated on another operator’s network for which the other operator paid all the costs involved.<sup>136</sup> Simply put, Rule 17 allows Mexican operators to receive “money for nothing.”

152. The United States understands that, because of the difficulties involved in the real-time identification of “excess” traffic, most market allocation adjustments among Mexican carriers use Rule 17 financial compensation procedures. The operation of these procedures shows that the rates that Mexican carriers charge each other for settling accounts relating to terminating international calls are far below the interconnection rates that Telmex charges U.S. cross-border suppliers.

153. Under Rule 17 financial compensation procedures, operators terminate excess traffic with their own network arrangements, deduct the “cost” incurred in such termination from the settlement payments received for that traffic, and distribute the residual amount to the operator entitled to additional traffic under the ILD Rules. Implementing this financial transfer, however, requires operators to agree on the cost of terminating a call – since what they transfer between themselves is only the “premium” on such calls, or the amount in excess of the costs incurred for terminating such calls.

154. Rule 17 requires these negotiated financial compensation agreements to be notified to Cofotel. While these agreements are not public, they are believed to be based on the relevant domestic interconnection rates and to allow for the deduction of average costs in the range of 6 to 7 cents per minute for years up to and including 2000, the most recent year covered by these agreements. However, since 2000 Cofotel approved domestic interconnection rates have declined by over 2 cents a minute (from 3.46 cents to 1.003 cents). Therefore, it is reasonable to

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<sup>136</sup> In the event that multiple Mexican operators’ networks are used to terminate the call, those operators are compensated under domestic interconnection rates. For example, when a new entrant Mexican operator terminates a U.S. originated call on Telmex’s local network, Telmex is compensated, not through the international settlements process, but through domestic interconnection rates, as approved by Cofotel.

assume that present interconnection costs for these purposes would be no more than 4-5 cents a minute.

155. Therefore, Rule 17 payments are required solely because cross-border interconnection rates are not *basadas en costos*, as required by Mexico’s Reference Paper obligations. They further demonstrate that Mexico is in violation of obligations under Section 2.2 of the Reference Paper to ensure that Telmex provides interconnection rates that are *basadas en costos* to cross-border suppliers of scheduled services.

156. In conclusion, for all the above reasons, Mexico has failed to meet its obligations under the Reference Paper to ensure that Telmex provides interconnection to cross-border suppliers of scheduled basic telecommunications services at rates that are *basadas en costos*.

- b. Mexico has failed to ensure that Telmex provides interconnection at *tarifas basadas en costos que sean razonables*.

157. The Reference Paper imposes an *additional* requirement on interconnection. Not only must the rates be *basadas en costos*, but the terms and conditions must be *razonables*: *La interconexión con un proveedor principal se llevará a cabo . . . en términos, condiciones . . . y tarifas basadas en costos que sean transparentes, razonables . . .*<sup>137</sup>

- i. Terms and Conditions are “reasonable” if they do not restrict the supply of scheduled services.

158. The Reference Paper does not define “*razonable*” or “reasonable.”<sup>138</sup> As a result, the term should be interpreted according to the customary rules of treaty interpretation reflected in Article 31(1) of the Vienna Convention.

159. Such an analysis considers the ordinary meaning of “reasonable” (a word that has a very broad meaning<sup>139</sup>) in its context and in light of the object and purpose of the agreement.<sup>140</sup> Under this analysis, terms and conditions on interconnection are “reasonable” if they do not restrict the supply of scheduled services.

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<sup>137</sup> Mexico’s Schedule, Reference Paper, Sec. 2.2, GATS/SC/56/Suppl.2, (emphasis supplied) (“Interconnection with a major supplier . . . is provided . . . on terms, conditions . . . and cost-oriented rates that are transparent, *reasonable* . . .”).

<sup>138</sup> *The Oxford Spanish Dictionary* defines “*razonable*” as “reasonable.” (2001), p. 624

<sup>139</sup> *The New Shorter Oxford English Dictionary* defines “reasonable” as “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.” Lesley Brown (ed), (vol. 2) (1993), p. 2496.

<sup>140</sup> Vienna Convention, Article 31(1) (a “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”).

160. As discussed above, Section 2.2 of the Reference Paper is an additional commitment to the GATS, the preamble of which establishes as part of the treaty’s overall object and purpose the promotion of the expansion and liberalization of trade in services:

*Recognizing* the growing importance of trade in services for the growth and development of the world economy.

*Wishing* to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries . . . .

161. The Reference Paper is also a direct outgrowth of the negotiations on basic telecommunications. Trade Ministers defined the mission of these negotiations to be – along the lines of the GATS preamble – for the purpose of expanding trade in telecommunications services.

*Ministers* decide as follows:

1. Negotiations shall be entered into on a voluntary basis with a view to progressive liberalization of trade in telecommunications transport networks and services (hereinafter referred to as “basic telecommunications”) within the framework of the General Agreement on Trade in Services . . .

6. Any commitments resulting from the negotiations, including the date of their entry into force, shall be inscribed in the Schedules annexed to the General Agreement on Trade in Services and shall be subject to all the provisions of the Agreement. . . .<sup>141</sup>

The commitments that resulted from the negotiations on basic telecommunications should therefore be interpreted in light of both that particular object and purpose of the agreement as a whole and of those negotiations in particular: the liberalization of trade in basic telecom services.

162. The Reference Paper is an integral part of these basic telecom commitments. These additional commitments recognize that major suppliers of basic telecommunications services have the potential to use their dominant position to undermine market access and national treatment commitments. In this respect, Section 2 of the Reference Paper establishes disciplines

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<sup>141</sup> Decision on Negotiations on Basic Telecommunications, reprinted in the Note by the Secretariat , Negotiating Group on Basic Telecommunications, TS/NGBT/W/1 (2 May 1994), p. 4. (Emphasis supplied)

to prevent major suppliers from using interconnection to restrict other suppliers from offering a scheduled service.

163. The interconnection obligations of Section 2 are especially important for the cross-border supply of basic telecom services – particularly in markets like Mexico, which legally bar foreign service suppliers from owning facilities and therefore force foreign suppliers to rely on the major supplier to deliver their services to the end user. In such cases, foreign suppliers have *no choice* but to pay a domestic service supplier (such as Telmex) an interconnection rate to terminate their calls.<sup>142</sup> As a result, the major supplier has the power and incentive to price this input at levels which extract as much revenue as possible from cross-border suppliers. Thus, by raising the wholesale price of cross-border interconnection, the major supplier has the power to raise the retail price, reduce demand for the retail service, and thereby restrict the cross-border supply of services into Mexico.

164. Section 2 of the Reference Paper requires Mexico to ensure that interconnection with its major supplier be on reasonable terms and conditions. Under Section 2, it is not enough for a WTO Member like Mexico to ensure that its major supplier's cross border interconnection rate is cost-based. Mexico must also ensure that the terms and conditions are reasonable – providing additional security that a major supplier may not use its bottleneck control of interconnection to restrict a foreign supplier availing itself of scheduled cross-border market access and national treatment commitments. In other words, Section 2 ensures that the major supplier cannot use interconnection to take away with one hand what its government has given to foreign service suppliers with the other hand.

165. Viewed in this context and in light of the object and purpose of the GATS generally and the basic telecom commitments specifically, Section 2.2 of the Reference Paper is designed to ensure that a major supplier cannot restrict the supply of a scheduled basic telecom service through the terms and condition for interconnection. Therefore, interconnection terms and conditions are not “reasonable” if they would permit a major supplier to restrict the supply of a scheduled basic telecom service.

166. As the United States explains below, Mexico has failed to ensure that Telmex provides interconnection at cost-based rates and reasonable terms and conditions for the cross-border supply of scheduled basic telecom services. Instead, by precluding competitive alternatives through the ILD rules, Mexico has given Telmex *carte blanche* to set interconnection rates, which undermine competition, harm consumers, and represent a windfall to Telmex. For this reason, Mexico has not fulfilled its obligations under Section 2.2(b) of the Reference Paper.

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<sup>142</sup> Mexico's ILD Rules only exacerbate this reliance on the major supplier by granting Telmex alone the authority to negotiate the interconnection rate with foreign operators and requiring all Mexican suppliers to incorporate the Telmex rate into the interconnection agreements they conclude with foreign operators. ILD Rules 13 and 23. The United States discusses the anti-competitive aspects of these rules more fully in paras. 189-206.

- ii. Mexico has given Telmex *de jure* monopoly power to set and maintain interconnection rates with foreign operators enabling it to restrict the supply of scheduled services.

167. Mexico's failure to meet its Section 2 obligations is not merely one of omission. Instead, Mexico has *enabled*, through its ILD Rules, its major supplier to affect the supply of scheduled basic telecom services through its exclusive negotiating authority and power to set interconnection rates for all Mexican carriers. On their face, the ILD Rules prevent Telmex from providing interconnection as required by Section 2.2 of the Reference Paper. The rules establish a structure and process that allow Telmex to set inflated interconnection rates and insulate Telmex from any competitive pressures that would otherwise lead to rates that are reasonable. Specifically, Rule 13 grants Telmex alone the exclusive authority to negotiate the interconnection rate with cross-border suppliers, and Rules 3, 6, 10, 22, and 23 prohibit any alternatives to this Telmex-negotiated rate. As a result, these particular ILD Rules prevent Mexico from fulfilling its obligations under Section 2.2 and, for that reason, are inconsistent with that provision.

168. First, Rule 13 empowers Telmex to set inflated and anti-competitive interconnection rates. This rule gives Telmex the exclusive legal authority to negotiate the interconnection rate (the "settlement rate") with foreign service suppliers:

*Regla 13. El concesionario de servicio de larga distancia que tenga el mayor porcentaje del mercado de larga distancia de salida de los últimos seis meses anteriores a la negociación con un país determinado, será quien deba negociar las tarifas de liquidación con los operadores de dicho país. Estas tarifas deberán someterse a la aprobación de la Comisión.*<sup>143</sup>

169. Telmex is always "the long distance concessionaire with the greatest percentage of the outgoing long distance market." Therefore, Telmex is always the sole Mexican service supplier that negotiates the settlement rate with foreign basic telecom providers. To date, there has never been another Mexican basic telecom provider to negotiate the interconnection rate. Since Telmex currently has 62 percent of the outgoing long distance market in Mexico, and the carrier with the next largest share of that market has under 20 percent, it is unlikely for the foreseeable future that any other long-distance concessionaire will qualify under Rule 13 to negotiate the cross-border interconnection rate with foreign operators.<sup>144</sup>

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<sup>143</sup> ILD Rule 13. The English translation for this Rule is: "The long distance service concessionaire with the greatest percentage of the outgoing long distance market in the last six months prior to negotiation with a determined country, shall be the one to negotiate the settlement rate with operators of such country. Such rates shall be submitted for the approval of the Commission."

<sup>144</sup> Telmex controls 97 percent of fixed subscriber lines, and 82 percent of subscribers are pre-subscribed to use Telmex for originating long distance or international calls. See [www.Cft.gob.mx](http://www.Cft.gob.mx) and *Telmex Annual Report*, at p. 8, Exhibit US-2.

170. Rule 13 removes any competitive pressure for Telmex to negotiate cost-based and competitive cross-border interconnection rates. U.S. basic telecom providers have no choice but to negotiate with Telmex alone for this rate and cannot seek to negotiate and use a lower or more competitive rate with any other Mexican operator.

171. The FCC – on several occasions – pointed to this rule as restricting competition on the U.S.-Mexico route and limiting the ability to achieve cost-based interconnection rates. In 1997, the FCC stated that:

We agree . . . that [the ILD Rules] inhibit competition on the U.S.-Mexico route. If all competitors were authorized to negotiate accounting rates independently, it is likely that market forces would drive settlement rates closer to the actual cost of terminating traffic. We find that the inability of carriers other than Telmex to negotiate accounting rates impacts negatively on the development of competition on the U.S.-Mexican route.<sup>145</sup>

Similarly, in a November 1998 order, the FCC raised serious concerns with the anti-competitive implications of Rule 13:

Our concern that Telmex is engaging in anticompetitive behavior in its accounting rate negotiations with U.S. carriers is exacerbated by the fact that, under Rule 13 of the regulations issued by Mexico's Secretariat of Communications and Transport, Telmex negotiates accounting rates for all Mexican carriers. As a result, Telmex has *de jure* monopoly power in its negotiations with U.S. carriers. In the *TSC Order*, the Commission noted that Rule 13 inhibits competition on the U.S.-Mexico route and limits the potential for achieving settlement rates that are closer to the cost of terminating international traffic. We believe that these effects of Rule 13 are demonstrated by Telmex's refusal to negotiate lower interim rates with AT&T and MCI/WorldCom.<sup>146</sup>

172. Rule 13 locks in an anti-competitive structure that allows Telmex to unilaterally set the terms and conditions for cross-border suppliers to obtain interconnection. Therefore, this measure authorizes and requires Mexico's major supplier to act in a manner contrary to Mexico's obligation to ensure that Telmex provides interconnection on reasonable terms and conditions.

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<sup>145</sup> *In the Matter of Telmex/Sprint Communications, L.L.C.; Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier Between the United States and International Points, Including Mexico*, Order (October 29, 1997), 12 FCC Rcd. 17551, 17587, Exhibit US-26.

<sup>146</sup> *In the Matter of Telmex/Sprint Communications, L.L.C.; Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier Between the United States and International Points, Including Mexico*, Order to Show Cause (November 24, 1998), 13 FCC Rcd. 24990, 24995, Exhibit US-34. (Emphasis supplied)

For this reason, Rule 13 is incompatible with Mexico’s obligations under Section 2.2(b) of the Reference Paper.

173. Second, Rules 3, 6, 10, 13, 22, and 23 require all Mexican long distance basic telecom suppliers to charge foreign suppliers only the Telmex-negotiated interconnection rate, even if Telmex is not a party to that agreement. In particular:

- Rule 3 limits interconnection with foreign suppliers to “international port operators;”<sup>147</sup>
- Rule 6 requires Mexican service suppliers to route all international traffic through the “international ports;”<sup>148</sup>
- Rule 10 requires “international port operators” to charge “uniform settlement rates,”<sup>149</sup> which Rule 2 defines as the rate that the international port operator charges a foreign operator for receiving calls from a foreign country (i.e., the cross-border interconnection rate);<sup>150</sup>
- Rule 13 grants Telmex the exclusive authority to negotiate the uniform settlement rate;<sup>151</sup>
- Rule 22 requires Mexican service suppliers to interconnect with foreign suppliers pursuant to interconnection agreements;<sup>152</sup> and
- Rule 23 requires all such agreements to recognize and incorporate the Telmex-negotiated uniform settlement rates.<sup>153</sup>

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<sup>147</sup> ILD Rule 3 (“*Regla 3. Únicamente los operadores de puerto internacional estarán autorizados para interconectarse directamente con las redes públicas de telecomunicaciones de operadores de otros países con el objeto de cursar tráfico internacional.*”)

<sup>148</sup> ILD Rule 6 (“*Regla 6. Los concesionarios de servicio de larga distancia sólo podrán cursar tráfico internacional conmutado por circuitos a través de puertos internacionales, y de conformidad con las presentes Reglas.*”)

<sup>149</sup> ILD Rule 10 (“*Regla 10. Los operadores de puerto internacional deberán cursar el tráfico internacional de entrada y de salida utilizando los sistemas de tarifas de liquidación uniformes y de retorno proporcional.*”) (Emphasis supplied)

<sup>150</sup> ILD Rule 2(XIV) (“*Tarifa de liquidación: aquella que: a) cobra un operador de puerto internacional a un operador extranjero por recibir tráfico proveniente de un país determinado; y b) cobra un operador extranjero a un operador de puerto internacional por recibir tráfico originado dentro de territorio nacional.*”)

<sup>151</sup> ILD Rule 13. For text of the Rule, see para. 168.

<sup>152</sup> ILD Rule 22 (“*Regla 22. De conformidad con el artículo 47 de la Ley, la interconexión de redes públicas de telecomunicaciones con redes extranjeras se llevará a cabo mediante convenios que celebren las partes interesadas.*”)

<sup>153</sup> ILD Rule 23 (“*Regla 23. . . . Los convenios [de interconexión con operadores extranjeros] deberán observar las siguientes condiciones: . . . II. Reconocer los principios de los sistemas de tarifas de liquidación*



174. These rules prevent Mexican and foreign suppliers from agreeing to alternative rates that could exert competitive pressures on the rate exclusively negotiated by Telmex. The ILD Rules not only grant Telmex exclusive authority to negotiate with foreign operators but also prevent other Mexican suppliers from concluding an agreement that contains a competitive rate.

175. Thus, in contrast to the entire pro-competitive object and purpose of the Reference Paper, the ILD Rules protect Mexico’s major supplier from any competition to establish rates for interconnection rates. Telmex has the sole power to negotiate a rate that no other service supplier can challenge or against which no other service supplier can compete. Through these ILD Rules, Mexico has established and maintained an anti-competitive structure that encourages Telmex to establish inflated interconnection rates that stifle competition in the cross-border supply of telecommunications services. These rules provide Telmex with every incentive to establish rates that further its overwhelming market dominance at the expense of competitors and consumers alike.

176. In sum, far from ensuring that Telmex provides interconnection on reasonable terms and conditions, Mexico maintains measures – namely, the ILD Rules – that give Telmex the unfettered opportunity to restrict the supply of scheduled services. Mexico has granted Telmex the exclusive right to set this rate and prohibits any competitive alternatives to this rate. In a regime like Mexico’s that permits alternative public networks to exist and has no scheduled restriction on their right to compete, a requirement that the interconnection rate be exclusively negotiated by the major supplier with no legal alternatives is unreasonable. For this reason alone, the panel should find that Mexico has failed to honor its commitments under Section 2.2(b) of the Reference Paper.

- iii. Mexico has failed to honor its commitments under Section 2.2(b) by rejecting proposals from U.S. and Mexican suppliers to approve alternative interconnection agreements that would exert competitive pressure on the Telmex-negotiated rate.

177. Mexico has also prevented Telmex from providing interconnection on reasonable terms and conditions by rejecting or ignoring requests of both Mexican and U.S. operators to provide cross-border interconnection at alternative rates. Alternative rates would have the positive benefit of exerting competitive pressure on Telmex to offer competitive, market-driven terms for cross-border interconnection. As the FCC stated in 1999, if Mexico permitted competitive alternatives, consumers in both Mexico and the United States would benefit “. . . by fostering

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<sup>153</sup>(...continued)

*uniformes y de retorno proporcional establecidos en el presente ordenamiento . . . VIII. Incorporar tarifas de liquidación aprobadas por la Comisión . . .*) (emphasis supplied).

innovation, increasing competition, and lowering prices on the U.S.-Mexico route.”<sup>154</sup> However, Mexico has chosen to protect Telmex, reject competitive alternatives, and thereby breach its obligation to ensure that Telmex provides interconnection on reasonable conditions.

178. Since 1998, U.S. and Mexican suppliers have tried to convince Mexican authorities to permit competitive alternatives to the Telmex-negotiated cross-border interconnection rates. However, Mexican authorities either rejected or ignored each request. For example:

- In July 1998, AT&T requested from both Telmex and Cofetel the ability to conclude agreements incorporating cost-based interconnection rates, rather than the above-cost “uniform settlement rate” negotiated and charged by Telmex.<sup>155</sup> Telmex refused AT&T’s request,<sup>156</sup> and Cofetel has not yet responded.
- In November 1998, a coalition of competitive Mexican long distance suppliers petitioned Cofetel to authorize them to conclude alternative interconnection arrangements with foreign operators that did not incorporate the Telmex-negotiated settlement rate. In the view of Telmex’s competitors, alternative arrangements were necessary to expand service and promote the competitive supply of cheaper telecommunications services:

*Por medio de la presente, los concesionarios con puerto internacional autorizado que suscribimos venimos a manifestar a esa H. Comisión nuestra intención de iniciar el ofrecimiento de servicios transfronterizos de telecomunicaciones con operadores extranjeros, específicamente el servicio de originación y terminación de tráfico conmutado internacional a través de líneas privadas fuera de los sistemas de tarifas uniformes de liquidación y retorno proporcional.*

*Este nuevo servicio representa una alternativa al actual sistema de tarifas uniformes y retorno proporcional que de hecho ha servido para subsidiar al operado dominante, incrementar artificialmente los precios al público y provocar así una disminución en la demanda de llamadas de larga distancia internacional.*

*Nuestra alternativa nos permite ofrecer de forma inmediata y significativa una mejora en el servicio a los consumidores mexicanos, estimulando el tráfico desde y hacia México. En la medida en que los servicios están*

<sup>154</sup> FCC, *In re Petition of AT&T Corp. and MCI WorldCom, Inc. for Declaratory Ruling Regarding Alternative Accounting Rate Arrangements for Service between the United States and Mexico*, 13 April 1999, Exhibit US-35.

<sup>155</sup> Letters from George Foyo (AT&T) to Jaime Chico Pardo (Telmex) and Javier Lozano Alcarón, 31 July 1998, Exhibit US-8.

<sup>156</sup> Letter from Jaime Chico Pardo (Telmex) to George Foyo (AT&T), 31 August 1998, Exhibit US-9.

*orientados a costos, los beneficios serán para la economía nacional y el consumidor mexicano.*<sup>157</sup>

Cofotel did not authorize these alternative arrangements; rather, it responded to this petition by reiterating the requirements of the ILD Rules but promising to review these rules “in the coming year” in order to determine the usefulness of modifying the “uniform settlement rate system.”<sup>158</sup> Nearly four years later, the United States continues to await such modifications.

- In July 1999, AT&T and Alestra concluded an agreement to provide interconnection at rates far less than the then-Telmex-negotiated rate of 31 (U.S.) cents per minute. These operators submitted their agreement to the FCC and Cofotel for approval. The FCC approved this alternative arrangement (despite vigorous opposition from Telmex and Cofotel<sup>159</sup>), concluding that it would increase competition and lower prices on the U.S.-

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<sup>157</sup> Letter to Cofotel by six Mexican basic telecom service suppliers, 19 November 1998, Exhibit US-10. (Emphasis supplied). In English, this passage states that:

We, the undersigned concessionaires with authorized international gateways, hereby inform the Commission of our intention to offer cross-border telecommunications services with foreign operators, specifically the international switched traffic origination and termination service through private lines, outside the uniform settlement rate and proportionate return systems.

This new service represents an alternative to the current system of uniform rates and proportionate return that has served as a *de facto* subsidy for the dominant operator and artificially increased prices paid by the public, thereby cutting demand for international long distance calling.

Our alternative enables us to offer an immediate and significant improvement in service to Mexican consumers and to boost traffic to and from Mexico. Because our services are cost-driven, the Mexican economy and consumer will benefit. . . .

<sup>158</sup> Letter from the then-President of Cofotel, Javier Lozano Alarcon, 27 November 1998, Exhibit US-36.

<sup>159</sup> See, e.g., Consolidated Opposition of Telefonos de Mexico, S.A. de C.V., *In the Matter of AT&T Corp. and MCI WorldCom, Inc. Petitions for Declaratory Ruling Regarding Proposed Flexible Arrangements for the Origination and Termination of International Switched Traffic between the United States and Mexico*. Exhibit US-37. One filing included a letter from Cofotel, which affirmed that operators could not agree to rates other than the Telmex-negotiated settlement rate: “no operator of an international gateway will be able to agree to rates other than those approved by this Commission, nor may they carry international traffic outside of the systems of proportional return and uniform rates . . .” Letter from Cofotel Commissioner Jorge Lara Guerrero, 18 March 1999. (Emphasis supplied) Telmex appended this letter to its March 24 filing with the FCC opposing the alternative arrangements concluded by both AT&T and MCI WorldCom with Alestra and Avantel respectively. Exhibit US-38.

Mexico route.<sup>160</sup> However, Cofetel summarily rejected the agreement in spite of the benefits to competition and Mexican consumers.<sup>161</sup>

- In October 2000, AT&T’s affiliate, Concert, requested SCT to ensure that Telmex provides foreign operators cross-border interconnection at cost-oriented rates and to remove Mexico’s regulations protecting Telmex from competition on establishing this cross-border rate (i.e., the ILD Rules). Concert underscored how the current Mexican regime stifles competition, maintains artificially high rates, and harms consumers:

Because Mexican regulations have restricted competition for cross-border interconnection and allowed Telmex to maintain above cost rates for those services, Concert believes that the Government of Mexico has an obligation to correct the problem that is costing consumers over \$480 million annually. Concert believes that, but for the current regulations in Mexico restriction competition, cross-border interconnection rates below 4 cents would have already been commercially negotiated with Mexican carriers. Commercially negotiated interconnection rates for cross-border traffic between the United States and Canada are currently within that range. In other, more distant countries with multiple carriers, competitive market forces has similarly provided financial incentives for carriers to negotiate cost-oriented rates.<sup>162</sup>

Mexican authorities have yet to respond to this letter or remove the anti-competitive ILD Rules. Instead, Mexican authorities continue to authorize Telmex to provide interconnection to cross-border suppliers at above-cost rates and on unreasonable terms and conditions that restrict Telmex’s competitors from implementing any alternatives that might lead to lower rates.

- In May 2002, Cofetel rejected efforts by the border towns of Laredo, Texas (United States) and Nuevo Laredo, Tamaulipas (Mexico) to reduce telecom costs between the two border cities. Laredo and Nuevo Laredo – located directly across the U.S.-Mexico border from each other – share close social and economic ties. These cities have attempted to create a local, cross-border calling area to reduce the high price that U.S. and Mexican

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<sup>160</sup> FCC, *In re Petition of AT&T Corp. and MCI WorldCom, Inc. for Declaratory Ruling Regarding Alternative Accounting Rate Arrangements for Service between the United States and Mexico*, 13 April 1999, Exhibit US-35. *See also*, Chairman Kennard Statement on Alternative Settlement Arrangements with Mexico, April 14, 1999, Exhibit US-39 (alternative arrangements “provide significant benefits to those making calls between the U.S. and Mexico by allowing U.S. carriers to carry traffic between the United States and Mexico outside of the transitional settlement arrangement that is a legacy of the monopoly era.” )

<sup>161</sup> Letter from Salme Jalife Villalon (Cofetel) to Rolando Zubiran (Alestra), 1 July 1999, Exhibit US-12. Cofetel rejected the AT&T/Alestra agreement on the basis that it did not comply with the relevant ILD Rules, including Rules 2, 10, 13, 22, and 23 (i.e., those that require suppliers to incorporate the Telmex-negotiated “uniform settlement rate” in all international interconnection agreements).

<sup>162</sup> Letter from Eloisa Regalado of Concert to Carlos Ruiz Sacristan, former Secretary of the SCT, 27 October 2000, Exhibit US-13.

consumers pay for calls to each other and to avoid the social costs produced by artificially high telecommunications prices.<sup>163</sup> Interested parties have recognized the way these border towns could reduce consumer prices is to allow U.S. and Mexican telecom companies to freely negotiate interconnection rates that are lower than the Telmex-imposed settlement rate. The U.S. FCC applauded the efforts of the two cities but recognized that lower cross-border prices could not be a reality without the cooperation of Cofotel.<sup>164</sup> Unfortunately, despite the tremendous benefits that Mexican and U.S. consumers would gain from reduced cross-border rates, Cofotel on May 20, 2002, rejected the efforts of Nuevo Laredo and Laredo and stated that they were contrary to Mexican law, in particular the ILD Rules.<sup>165</sup>

179. These examples reinforce the conclusion that Mexico has taken affirmative steps to prevent any competition to the Telmex-negotiated interconnection rate. Time and again, Mexican authorities have rejected or ignored pleas by competitive U.S. and Mexican service suppliers for the opportunity to compete against Telmex to set interconnection rates. They have asked Mexican authorities to reform the anti-competitive ILD Rules, permit competitive alternatives to the Telmex rate, and help encourage Telmex to establish cost-oriented interconnection rates. However, despite the benefits that competition would bring and the lower prices that consumers would enjoy, Mexican authorities have steadfastly refused to remove Telmex's *de jure* monopoly power and to require Telmex to provide interconnection to cross-border suppliers at reasonable rates.

180. Mexico has not merely failed to ensure that Telmex provides interconnection according to the requirements of Section 2.2 of the Reference Paper. Instead, by maintaining the ILD Rules and repeatedly refusing to permit alternatives to the Telmex rate, the Government of Mexico has willingly compelled and empowered Telmex to act inconsistently with this provision.

181. For these reasons, the United States considers that Mexico has failed to honor its commitments under Section 2.2 of the Reference Paper.

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<sup>163</sup> The FCC found that inflated telecom prices stifle cross-border social and economic ties and contribute to public safety concerns (associated with the growth in use of illegal wireless transmitters that interfere with emergency and safety communications) and that reduced telecom prices between the two cities would facilitate trade and would benefit business and residential customers. Federal Communications Commission, *In the Matter of Proposal by City of Laredo, Texas, and Nuevo Laredo, Mexico, to Create a Cross-Border Local Calling Area*, Declaratory Ruling, FCC 02-14, para. 10 (Feb. 4, 2002), Exhibit US-40. *See also* Comments of the Public Utility Commission of Texas before the Office of the United States Trade Representative, *In the Matter of Mexico - Telecommunications Service*, p. 2, note 1. Exhibit US-41.

<sup>164</sup> FCC, *In the Matter of Proposal by City of Laredo, Texas, and Nuevo Laredo, Mexico, to Create a Cross-Border Local Calling Area*, Declaratory Ruling, FCC 02-14 (February 4, 2002), para. 12, Exhibit US-40.

<sup>165</sup> Letter from Cofotel President Jorge Arredondo Martinez to Jose Manuel Suarez Lopez, Cofotel Document Number CFT/DO1/P/146/02, May 20, 2002, Exhibit US-15.

- iv. The result of Mexico’s failure to ensure interconnection on reasonable terms and conditions is that Telmex has restricted the supply of scheduled services.

182. Mexico’s failure to ensure interconnection on reasonable terms and conditions has had an effect wholly contrary to the underlying purpose of Section 2 of the Reference Paper – it has enabled Telmex to maintain rates that restrict the supply of scheduled services. In particular, this rate has eviscerated competition among Mexican suppliers, reduced demand for the cross-border supply of services, and given Telmex windfall profits to use to further restrict competition.

183. First, the Telmex-negotiated rate restricts competition among Mexican suppliers, including U.S. service suppliers with a commercial presence in Mexico.<sup>166</sup> As discussed above, the ILD Rules require these suppliers to incorporate only the Telmex-negotiated settlement rate into interconnection agreements concluded with U.S. and other foreign operators. Mexican suppliers cannot compete with Telmex and among themselves for the business of terminating calls that originate in the United States. They can neither offer lower rates than Telmex nor conclude competitive cross-border arrangements with their U.S. partners. Instead, they are bound by the rates, terms, and conditions negotiated by the dominant supplier. Therefore, the interconnection rate charged by Telmex – which Telmex alone negotiates and all other suppliers must use – entirely prevents competition among Mexican suppliers, including those U.S. suppliers with a commercial presence in Mexico.

184. No other country in the world that has undertaken WTO basic telecommunications commitments as broad as Mexico’s similarly restricts its service suppliers from negotiating their own rates with competitive foreign carriers. This is not surprising given the anti-competitive nature of such restrictions.<sup>167</sup> As the EU’s recent Access Directive states, “in an open and competitive market, there should be no restriction that prevent undertakings from negotiating access and interconnection arrangements between themselves, in particular on cross-border arrangements subject to the competition rules of the Treaty.”<sup>168</sup>

185. Second, Telmex’s high wholesale rate reduces demand for the cross-border supply of services. High wholesale rates hurt consumers, which bear the brunt of Telmex’s artificially high prices. Typical retail rates for calls into Mexico from the United States equal approximately 34 cents per minute. In contrast, it costs 6 cents per minute to call Canada from the United States

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<sup>166</sup> Mexico has also undertaken mode 3 commitments for facilities-based services supplied by a foreign service supplier through “commercial presence” in the territory of Mexico. See GATS, Article I:2(c) (definition of mode 3 supply). Mexico scheduled a 49 percent foreign investment limitation to this commitment. Mexico’s Schedule, GATS/SC/56/Suppl.2. Therefore, U.S. service suppliers in Mexico have a commercial presence in Mexico through a minority investment in a Mexican operator. For instance, AT&T and WorldCom have a commercial presence in Mexico through their investments in Alestra and Avantel, respectively.

<sup>167</sup> For a detailed discussion of this argument, see paras. 189-206.

<sup>168</sup> Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities, *Official Journal of the European Communities* L 108, 24 April 2002, pp. 7-8.

and 9 cents per minute to call the United Kingdom. This compares to the typical retail rate of \$1 per minute to call the United States from Mexico.<sup>169</sup>

186. Third, Telmex’s inflated cross-border interconnection rate constitutes a subsidy that U.S. consumers pay to Mexican carriers and from which Telmex derives principal benefit. In an Order assessing settlement rates on the U.S.-Mexico route, the FCC stated that “above cost settlement rates are contrary to the public interest because (a) they contribute to artificially high international calling prices and (b) they represent a subsidy from U.S. consumers to foreign carriers.”<sup>170</sup> Based on cost proxies explained in this submission, the United States estimates that approximately 75 percent of U.S. payments to Mexican carriers represents an above-cost subsidy that forces consumers on both sides of the U.S.-Mexican border to pay “irrationally high rates.”<sup>171</sup>

187. Telmex derives disproportionate benefit from the rate it negotiates because it receives the lion’s share of the subsidy that it forces U.S. consumers to pay to Mexican carriers.<sup>172</sup> In other words, Telmex pockets the lion’s share of the subsidy that Telmex’s cross-border interconnection rate forces U.S. consumers pay to Mexican carriers. It is entirely unreasonable for Mexico to allow its major supplier to reap such a huge windfall from U.S. consumers – a windfall that Telmex could use to further its dominant position in Mexico and further stifle the supply of scheduled basic telecom services.

188. In sum, Mexico allows Telmex to flout the Reference Paper commitments. Rather than ensuring that Telmex provides interconnection to cross-border suppliers at rates that “*basadas en costos*”, Mexico has given Telmex the authority to set and maintain a rate that undermines competition, harms consumers, stifles demand, and bolsters Telmex’s dominant position. As a result, Mexico has limited the opportunity of U.S. (and other foreign) service suppliers to supply basic telecom services into Mexico in a manner responsive to market pressures. Mexico’s regime runs counter to the very purpose of the Reference Paper, which is to provide safeguards that a major supplier like Telmex is unable to use the terms and conditions of interconnection to thwart competition and undermine the competitive supply of scheduled basic telecom services. For that reason, Mexico has failed to ensure that Telmex provides interconnection on reasonable terms and conditions and therefore has not honored its commitments under Section 2.2(b) of the Reference Paper.

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<sup>169</sup> Retail rates available at [www.swbell.com](http://www.swbell.com)

<sup>170</sup> *In the Matter of Sprint Communication Company, L.P.: Request for Modification of International Settlements Policy to Change the Accounting Rate for Switched Voice Services with Mexico*, ISP-97-M-708, Memorandum Opinion and Order (November 24, 1998), para. 5. [footnote omitted]. See Exhibit US-34, footnote 19.

<sup>171</sup> Comments of the Public Utility Commission of Texas before the Office of the United States Trade Representative, *In the Matter of Mexico - Telecommunications Service*, p. 3, Exhibit US-41.

<sup>172</sup> FCC, *In the Matter of Telmex/Sprint Communications, L.L.C.; Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier Between the United States and International Points, Including Mexico*, File No. ITC-97-127, October 29, 1997, para. 3, Exhibit US-26.

## **B. Mexico Has Not Complied with Section 1 of the Reference Paper**

189. Section 1 of the Reference Paper requires Mexico to maintain appropriate measures to prevent Telmex from engaging in or continuing anti-competitive practices. The United States considers that Mexico has not fulfilled this commitment. Specifically, as previously explained, Mexico's ILD Rules give Telmex the exclusive authority to negotiate the interconnection rate that foreign basic telecom suppliers must pay to Mexican telecom carriers. By law, all Mexican basic telecom suppliers must incorporate that rate in their interconnection contracts with foreign cross-border basic telecom suppliers. Also, as explained previously, the proportional allocation Rule ensures that Telmex receives the greatest share of the revenue generated from this charge, regardless of how many calls it terminates from abroad.

190. Far from preventing Telmex from engaging in anti-competitive practices, Mexico's rules empower and require Telmex to operate a cartel dominated by itself to fix rates for international interconnection and mandate that all Mexican carriers must adhere to those rates.

### 1. The Relevant Obligation

191. Section 1 of the Reference Paper, as inscribed in Mexico's Schedule, provides, in pertinent part:

#### 1. *Salvuardas Competitivas*

##### 1.1 *Prevención de prácticas anticompetitivas en telecomunicaciones*

*Se mantendrán las medidas apropiadas, con el propósito de prevenir que, los proveedores que se constituyan, de manera individual o conjunta, como proveedor principal, se involucren en, o continúen con prácticas anticompetitivas.*<sup>173</sup>

192. The purpose of Section 1 of the Reference Paper is to support the parallel goals of de-monopolization and market access by protecting and fostering competition among basic telecom competitors. This first section complements the more specific interconnection rules for "major suppliers" found in Section 2.

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<sup>173</sup> Mexico's Schedule, Reference Paper, Sec. 1, GATS/SC/56/Supp.2, p.7. According to the WTO English language version of the Reference Paper, Section 1 reads, in pertinent part:

#### 1. Competitive Safeguards

##### 1.1. Prevention of anti-competitive practices in telecommunications

Appropriate 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.



193. Apart from three illustrative practices included in Section 1, the Reference Paper does not define the term “anti-competitive practices.” While the outer perimeters of this term are not certain, the United States considers that, in the context here, the term encompasses, at a minimum, what are usually characterized as “abuses of dominant position” and/or “monopolization” offenses as well as “cartelization.” All of these terms are common antitrust concepts<sup>174</sup> and are generally included within the universe of business practices usually found to be anti-competitive under national regulatory schemes<sup>175</sup> and competition laws and policies.<sup>176</sup> Mexico’s own antitrust law also generally prohibits behavior of this sort.<sup>177</sup> “Monopolization” and “abuse of dominance” are terms that, at a minimum, encompass predatory or exclusionary actions by enterprises with market power to maintain or extend that power and restrict supply in the marketplace.<sup>178</sup> The descriptive term “cartelization” generally refers to agreements among direct competitors (“horizontal” agreements) to fix prices, reduce output or allocate customers or sales territories.<sup>179</sup>

194. The 1999 Report of the WTO Working Group on the Interaction Between Trade and Competition Policy describes the nature and consequences of “horizontal” agreements as follows:

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<sup>174</sup> See, e.g., WTO, Working Group on the Interaction between Trade and Competition Policy, “The Fundamental Principles of Competition Policy,” Note by the Secretariat “ (7 June 1999), WT/WGTCP/W/127, Exhibit US-42; and “Overview of Members’ National Competition Legislation,” Note by the Secretariat (Rev. 2, 4 July 2001), WT/WGTCP/W/128/Rev.2), both available at [www.wto.org/english/tratop\\_e/comp\\_e/comp\\_e.htm](http://www.wto.org/english/tratop_e/comp_e/comp_e.htm) under “Working Documents”; ABA Section of Antitrust Law, *Competition Laws Outside the United States I* (2001), Chapter 1, Exhibit US-49.

<sup>175</sup> FCC, *In the Matter of International Settlement Rates*, IB Docket No. 96-261, FCC 97-280, Report and Order, 12 FCC Rcd 19,806 (“Benchmarking Order”), aff’d sub nom. *Cable and Wireless Plc v. FCC*, 166 F.3rd 1224 (D.C.Cir. 1999), recon. granted in part and denied in art, FCC 99-124, Report and Order on Reconsideration and Order Lifting Stay, 14 FCC Rcd 9256 (1999); FCC, *Telmex/Sprint Communications L.L.C. Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier between the United States and International Points, including Mexico*, Order, Authorization and Certificate, ITC-97-127, DA 97-2289, 12 FCC Rcd 17,551 (released October 30, 1997), stay denied, DA 98-1678, 13 FCC Rcd 15,678 (1998), Exhibit US-26; FCC, *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, IB Docket Nos. 97-142 and 95-22, FCC 97-398, Report and Order and Order on Reconsideration, 12 FCC Rcd 23,891, at ¶¶ 72-86 (1997), Order on Reconsideration, FCC 00-339 (released September 19, 2000).

<sup>176</sup> See OECD “Recommendation of the Council Concerning Effective Action against Hard Core Cartels (1998),” [www.oecd.org/pdf/M00018000/M00018135.pdf](http://www.oecd.org/pdf/M00018000/M00018135.pdf); see also ABA Section of Antitrust Law, at 13-14, Exhibit US-49.

<sup>177</sup> Federal Law of Economic Competition, Articles 8 and 9, Exhibit US-18; see also Van Fleet, “Mexico’s Federal Economic Competition Law: the Dawn of a New Antitrust Era,” 64 *Antitrust L.J.* 183 (1995), Exhibit US-50.

<sup>178</sup> OECD, *Glossary of Industrial Organisation Economics and Competition Law* (1993), at 9, 59 (¶¶1, 133, defining “abuse of dominant position” and “monopolization”), [www.oecd.org/pdf/M00007000/M00007651.pdf](http://www.oecd.org/pdf/M00007000/M00007651.pdf). See Exhibit US-51.

<sup>179</sup> OECD Recommendation of the Council Concerning Effective Action against Hard Core Cartels,” *supra* at note 6; WTO, Working Group on the Interaction between Trade and Competition Policy, “The Fundamental Principles of Competition Policy,” *supra* at note 4, Exhibit US-42; Mexican Federal Law of Economic Competition, Article 9, Exhibit US-18.

Horizontal agreements, by their very nature, are more likely than vertical arrangements to have a direct, negative impact on competition (and, potentially, trade), and, therefore, to give rise to the exercise of market power. This is particularly the case in regard to ‘naked’ horizontal agreements (i.e. cartels that fix prices or allocate markets among firms that would otherwise be in direct competition with each other). These arrangements serve no purpose other than to enrich producers at the expense of consumers, and entail significant “deadweight losses” in economic surplus. Accordingly, in some jurisdictions, these arrangements are treated as illegal “per se” (i.e. without the need for a detailed inquiry into their impact in the relevant market(s)). There is a growing degree of international agreement that naked or hard-core cartels should be subject to strict prohibition under antitrust legislation. Reflecting this, in 1998, the OECD adopted a recommendation calling for strict prohibition of such arrangements. The importance of a clear prohibition of horizontal cartel arrangements is also noted in the United Nations Set.

195. As explained below, Mexico’s ILD Rules do not “prevent” anti-competitive practices, but instead they require it. This is 180 degrees at variance with the letter and spirit of Mexico’s Reference Paper obligations.

2. Mexico’s rules authorize and require anti-competitive practices rather than prevent such practices

196. Although Mexico maintains a general competition statute, it also maintains measures, set forth in its ILD Rules, that require its telecommunications carriers to adhere to a Telmex-led horizontal price-fixing cartel, restrict competition for the termination of international switched telecommunications traffic and otherwise restrict the supply of scheduled telecommunications services.

197. Specifically, as previously explained, ILD Rule 13 provides that the carrier with the greatest share of outgoing international calls in the last six months is given the exclusive authority to negotiate the interconnection rates with foreign carriers.<sup>180</sup> To date, Telmex has always been the carrier with the largest share of outgoing international calls and thus holds the exclusive negotiating authority. The ILD Rules also require all Mexican long distance basic telecom suppliers to charge foreign suppliers only the Telmex-negotiated cross-border interconnection rate, even if Telmex is not a party to that agreement.<sup>181</sup>

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<sup>180</sup> ILD Rule 13.

<sup>181</sup> ILD Rule 23.

198. As also explained in the previous section, Mexico has established a “proportional return” system under which Mexican carriers receive a share of the above cost payments associated with inbound international traffic in relation to their outbound international traffic.<sup>182</sup> This system further restricts the ability of Mexican operators to compete to terminate traffic from the United States and guarantees that Telmex can extend its market power from the outbound market, as determined by Cofeco, to the inbound market. U.S. suppliers are, thus, denied any ability to benefit from competition in Mexico.

199. As Mexico itself recently reported to the OECD’s Committee on Law and Policy, Mexico’s ILD Rules “might not be the optimum for competition...”<sup>183</sup> Indeed not. As demonstrated above, Telmex is a “major supplier” for purposes of applying Mexico’s Reference Paper obligations. Telmex is exactly the sort of former official monopoly that the Reference Paper meant to be restrained in order to allow a competitive basic telecom services trade to develop.

200. Telmex’s government-sanctioned control of international interconnection rates, including those of its competitors, effectively mandates a horizontal price fixing cartel. Telmex is given the exclusive authority to negotiate the international interconnection rate and all other Mexican carriers must use that rate. These measures protect and perpetuate Telmex’s dominant positions in both origination and termination of international calls. They stifle market challengers and allow Telmex to maintain artificially high prices.

201. As previously noted, the FCC – on several occasions – has identified Rule 13 as restricting competition on the U.S.-Mexico route and limiting the ability to achieve cost-based cross-border interconnection rates. In 1997, the FCC stated that:

We agree . . . that [the ILD Rules] inhibit competition on the U.S.-Mexico route. If all competitors were authorized to negotiate accounting rates independently, it is likely that market forces would drive settlement rates closer to the actual cost of terminating traffic. We find that the inability of carriers other than Telmex to negotiate accounting rates impacts negatively on the development of competition on the U.S.-Mexican route.<sup>184</sup>

Similarly, in a November 1998 order, the FCC raised serious concerns with the anti-competitive implications of Rule 13:

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<sup>182</sup> ILD Rules 16 and 17.

<sup>183</sup> OECD, CLP, Working Party No.2 on Competition and Regulation, “Competition and Regulation Issues in Telecommunications,” submitted by Mexico (18 May 2001), DAF/CLP/WP2/WD(2001)25, at 3-4, Exhibit US-7.

<sup>184</sup> *In the Matter of Telmex/Sprint Communications, L.L.C.; Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier Between the United States and International Points, Including Mexico*, Order (October 30, 1997), 12 FCC Rcd. 17551, 17587, Exhibit US-26.

Our concern that Telmex is engaging in anticompetitive behavior in its accounting rate negotiations with U.S. carriers is exacerbated by the fact that, under Rule 13 of the regulations issued by Mexico’s Secretariat of Communications and Transport, Telmex negotiates accounting rates for all Mexican carriers. As a result, Telmex has *de jure* monopoly power in its negotiations with U.S. carriers. In the *TSC Order*, the Commission noted that Rule 13 inhibits competition on the U.S.-Mexico route and limits the potential for achieving settlement rates that are closer to the cost of terminating international traffic. We believe that these effects of Rule 13 are demonstrated by Telmex’s refusal to negotiate lower interim rates with AT&T and MCI/WorldCom.<sup>185</sup>

202. These Rules, 13 and 23 in particular, prevent Mexican and foreign suppliers from agreeing to alternative rates that could exert competitive pressures on the rate exclusively negotiated by Telmex. The ILD Rules not only grant Telmex exclusive authority to negotiate with foreign operators but also prevent other Mexican suppliers from concluding an agreement that contains a competitive rate.

203. This situation is made all the worse for competition by the fact that Mexico, despite having undertaken WTO commitments, leaves U.S. suppliers no choice but to pay the Telmex-negotiated interconnection rate if they want to provide scheduled services on a cross-border basis. This is because, despite having undertaken a WTO commitment to do so, Mexico does not allow “resale” which requires the use of private lease circuits for the purposes of providing circuit switched telecommunications traffic.

204. Under ILD Rule 3, only “international port operators” may interconnect with the public networks of foreign operators. The ILD Rules require an international port operator to be a supplier with a *concession* to supply long distance services,<sup>186</sup> and Mexican law permits only Mexican facilities-based operators to hold such a concession.<sup>187</sup> Because neither a U.S. facilities-based nor non-facilities-based service supplier can be a long distance concessionaire,

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<sup>185</sup> *In the Matter of Telmex/Sprint Communications, L.L.C.; Application for Authority under Section 214 of the Communications Act for Global Authority to Operate as an International Switched Resale Carrier Between the United States and International Points, Including Mexico*, Order to Show Cause (November 24, 1998), 13 FCC Rcd. 24990, 24995, Exhibit US-34. (Emphasis supplied)

<sup>186</sup> ILD Rule 3. *See also* ILD Rule 2(VII). *See also*, ILD Rule 7, which allows only long distance *concessionaires* to request authorization to be an international port operator. *See also* ILD Rules 5 and 6.

<sup>187</sup> Mexican law requires holders of a concession to operate public telecommunications services to be of Mexican nationality. *See, e.g.*, (1) Mexico’s Federal Telecommunications Law, art. 12 (“*Las concesiones a que se refiere esta Ley sólo se otorgarán a personas físicas o morales de nacionalidad mexicana.*”); (2) “Agreement of the SCT establishing the procedure to obtain concessions for the installation, operation or exploitation of interstate public telecommunications networks, pursuant to the Federal Telecommunications Law,” published in the *Diario Oficial* on 4 September 1995, art. 2.4.1, *et seq.* (requires all applicants for a concession to be of Mexican nationality); (3) Rules for Long Distance Service, published by the SCT in the *Diario Oficial* on 21 June 1996, Rule 2(V) (defines a long distance concession holder as an individual or corporation having a concession to install, operate or exploit a public telecommunications network authorized to render long distance service).

they *cannot* be an “international port operator” and thereby *cannot* interconnect a private circuit leased in Mexico with the U.S. public telecom network. Thus, U.S. suppliers have no choice but to interconnect with the Mexican public network at the border and pay the Telmex-negotiated rate. Along with the other ILD Rules (such as 6, 10, 13, 22, and 23), Rule 3 prevents competitive alternatives to the Telmex-negotiated settlement rate and buttresses Telmex’s ability to abuse its control over Mexico’s public telecom networks and services to undermine the supply of scheduled services supplied on a cross-border basis.

205. That Mexico’s ILD Rules sanction anti-competitive practices has been recognized by the OECD Secretariat in its lengthy 1999 Report on Regulatory Reform in Mexico.<sup>188</sup> That Report recognized that “[i]mplementation [of the Federal Telecom Law] has permitted the incumbent to enjoy advantages over rivals”<sup>189</sup> and that “Mexico prevents competition in the termination of international traffic.”<sup>190</sup> The Report goes on to say that:

the existing system of uniform settlement rate and proportional return has prevented prices from decreasing for Mexican and foreign consumers calling to and from Mexico, to the benefit of the [Mexican] telecommunications operators.<sup>191</sup>

The OECD Secretariat concluded that “the elimination of this system would lead to immediate price reductions on international calls and benefits to both Mexican and foreign consumers.”<sup>192</sup>

206. In sum, Mexico’s ILD Rules operate to prevent competition in the termination of cross-border switched traffic, hold international interconnection rates artificially high, and allow foreign suppliers no choice but to pay the Telmex-negotiated rate if they want to supply voice telephony, circuit-switched data transmission and facsimile services on a cross-border basis. As such, Mexico’s ILD Rules are the opposite of “appropriate” measures to prevent anti-competitive practices. As a result, Mexico has not fulfilled its commitments under Section 1 of the Reference Paper.

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<sup>188</sup> OECD, Regulatory Reform in Mexico (1999), Exhibit US-43.

<sup>189</sup> *Id.* at p. 68.

<sup>190</sup> *Id.* at p. 85.

<sup>191</sup> *Id.* at p. 292.

<sup>192</sup> *Id.* at p. 85.

**C. 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.**

1. Introduction: The GATS Annex on Telecommunications

207. The arguments in this section relate to the GATS *Annex on Telecommunications* – a watershed document that addresses telecommunications as a means of transporting scheduled services.<sup>193</sup> Unlike the commitments that WTO Members inscribe in their GATS Schedules, the Annex does not obligate Members to provide market access and national treatment. Rather, the Annex requires Members to ensure that users of telecommunications (e.g., service suppliers) have access to or use of telecommunications – free from obstacles – to deliver their services.

208. The Annex grew out of a recognition that telecommunications represents the primary delivery mechanism for services, particularly those offered on a cross-border basis. Without telecommunications, it would be impossible for many service suppliers to deliver their services. For instance, without telecommunications, banks could not transfer financial information from branch to branch, lawyers could not communicate with their clients in faraway locations, suppliers of video conference services could not offer video conferences, travel agents could not access information contained in a central database, and businesses could not conduct intra-corporate communications.

209. However, access to telecommunications as a transport mechanism depends on those entities which control telecommunications networks and offer telecommunications services. Such entities – principally monopolies or former monopoly providers – have represented the principal obstacle to access and use of telecommunications as a transport mechanism.

210. Therefore, like the Reference Paper, the Annex represents an effort to prevent dominant telecom providers from using their control over public telecom networks and services to undermine the supply of a scheduled service. In this respect – again like the Reference Paper – the obligations of the GATS Annex aim to ensure that dominant telecom suppliers cannot nullify the services commitments that their home country undertakes.

211. The Annex accomplishes this goal by requiring each WTO Member to ensure – by whatever means necessary<sup>194</sup> – that foreign service suppliers have reasonable and non-

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<sup>193</sup> Section 1 establishes the objectives of the GATS Annex as “[r]ecognizing the specificities of the telecommunications sector and, in particular, its dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities, the Members have agreed to the following Annex with the objective of elaborating upon the provisions of the Agreement with respect to measures affecting access to and use of public telecommunications transport networks and services.” GATS Annex, Section 1.

<sup>194</sup> GATS Annex, note 14 (“This paragraph is understood to mean that each Member shall ensure that the obligations of this Annex are applied with respect to suppliers of public telecommunications transport networks and

(continued...)

discriminatory access to and use of public telecommunications networks and services to supply a scheduled service. According to Section 5 of the Annex:

(a) Each Member shall ensure that any service supplier of any other Member is accorded access to and use of public telecommunications transport networks and service on reasonable and non-discriminatory terms and conditions for the supply of a service included in its Schedule. This obligation shall be applied, *inter alia*, through paragraphs (b) through (f) [footnote omitted].

(b) 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 . . . (underlines supplied).

In other words, for each service inscribed in its Schedule (including basic telecom services), each WTO Member must ensure that foreign service suppliers may access or use public telecommunications networks and services – whether through interconnection or any other form of access and use – to transport their service.

212. The scope of this obligation is wide and extends to *any* public telecom network and service offered within or across the border of that Member. Moreover, the definition of such networks and services is broad enough to encompass all types of public networks and services that a telecom provider may offer.<sup>195</sup>

213. The Annex focuses on one such network and service – private leased circuits<sup>196</sup> – particularly important to users. These circuits are essentially lines that a user leases from a public telecom operator over which it transports (or supplies) its service. For instance, a bank might lease a line from a public telecom operator over which it sends financial information from its branch in Mexico City to its home office in New York. Likewise, a telecommunications company may lease a line from a public telecom operator over which it sends a phone call from its customer in Los Angeles to the end user in Montreal. In either case, the service supplier (the bank or the phone company) needs access to a line (a public telecom network or service) to provide a scheduled service (a financial service or a basic telecom service).

214. In the sections that follow, the United States demonstrates that Mexico has not ensured that U.S. service suppliers have access to and use of any public telecommunications network and service for the supply of the basic telecom services inscribed in Mexico's Schedule. In

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<sup>194</sup>(...continued)

services by whatever measures are necessary.”)

<sup>195</sup> GATS Annex, Section 3(b) (definition of public telecommunications transport service) and Section 3(c) (definition of public telecommunications transport network)

<sup>196</sup> See, e.g., GATS Annex, Section 5(b)

particular, the United States will show that Mexico has failed to ensure that U.S. service suppliers may access and use public telecom networks and services through

- interconnection at reasonable terms and conditions for the supply of scheduled services by facilities-based operators and commercial agencies (instead, U.S. suppliers may only obtain interconnection at anti-competitive and other unreasonable terms and conditions);
- private leased circuits for the supply of scheduled services by facilities-based operators and commercial agencies (instead, U.S. suppliers have no access to and use of such circuits).

215. For such reasons, the United States considers that Mexico has failed to honor its commitments under the Annex.

2. Mexico has not ensured that U.S. service suppliers may interconnect to access and use public telecom networks and services on reasonable terms and conditions for the cross-border supply of scheduled facilities-based services and commercial agencies.

216. As noted above, pursuant to the Annex, U.S. service suppliers are entitled to access and use of public telecommunications networks and services. As explained more fully below in the next subsection, interconnection is the means by which U.S. service suppliers access and use Mexico's public telecommunications networks and services. U.S. service suppliers must interconnect with the Mexican network in order to ensure they can transport their scheduled service to its final destination in Mexico. Without such access, a U.S. service supplier could never supply a scheduled facilities-based or non-facilities-based basic telecom service.

217. In the following subsection, the United States demonstrates that Mexico has failed to ensure that U.S. service suppliers can interconnect (and therefore access and use public telecom network and services in Mexico) on reasonable terms and conditions. Mexico maintains measures – principally the ILD Rules – that prevent reasonable access to and use of public telecom networks and services. As discussed in the previous sections, Mexico has required Telmex and other Mexican basic telecom suppliers to uniformly impose an above-cost interconnection rate in their agreements with U.S. suppliers. The requirements of the ILD Rules – combined with the actual rate that Mexican service suppliers charge – have prevented Mexico from honoring its commitments under Section 5 of the Annex.



- a. Section 5 of the Annex applies to the terms and conditions of interconnection between a U.S. supplier of scheduled basic telecom services and Mexican suppliers of such service.

218. As discussed above, Section 5 requires Mexico to ensure that (1) for the supply of a service included in its Schedule, (2) any service supplier of any other Member (3) is accorded access to and use of public telecom transport networks and services on (4) reasonable terms and conditions. Before explaining why Mexico's terms and conditions for access to/use of are not reasonable, the United States will first describe how the above four elements apply to the factual issues raised in this argument, namely the need for U.S. suppliers of scheduled services to interconnect in order to access and use Mexican public telecom networks and services for the supply of a service include in Mexico's Schedule.

- i. “. . . for the supply of a service included in its Schedule. . .”  
(Mexico inscribed market access and national treatment commitments for basic telecom services in its Schedule).

219. Mexico's obligations under the Annex trigger only to the extent to which it has undertaken commitments in its Schedule. As discussed in paragraphs 45-68 above, Mexico undertook market access and national treatment commitments for public basic telecom services supplied by facilities-based operators and non-facilities-based operators (“commercial agencies”). Mexico undertook these obligations on a cross-border basis, and with few limitations, and specifically intended these obligations to encompass international services. Therefore, Mexico's obligations under the Annex apply to the supply of cross-border public basic telecom services supplied by facilities-based operators and commercial agencies.

- ii. “. . . any service supplier of any other Member . . .”  
(U.S. service suppliers supply scheduled basic telecom services)

220. Mexico's Annex obligations apply to *any* U.S. service supplier (whether facilities-based or non-facilities-based) wishing to supply the scheduled basic telecom services discussed in the previous subsection. For instance, AT&T, WorldCom, and Sprint are *facilities-based* suppliers of scheduled cross-border basic telecom services between the United States and Mexico. They offer their customers, for example, voice service, data service, and fax service between the two countries. Therefore, Mexico must ensure that these facilities-based suppliers are accorded access to and use of public telecom networks and services.

221. These obligations also apply to the cross-border supply of scheduled basic telecom services supplied by *non-facilities-based* U.S. operators. As discussed above, Mexico inscribed cross-border commitments for such services (commercial agencies), and there are U.S. service suppliers that do not own facilities that would like to provide such services between the United States into Mexico. However, despite its scheduled commitments, Mexico does not permit non-

facilities-based U.S. service suppliers to offer telecom services into Mexico and therefore does not permit such service suppliers to access and use public telecom networks and services to supply these scheduled services.<sup>197</sup>

- iii. “. . . is accorded access to and use of public telecommunications transport networks and services . . .”  
(Interconnection is access and use.)

222. As discussed above, the Annex imposes a broad obligation upon Members to ensure – by whatever measures necessary – that service suppliers have broad access to and use of public telecom networks and services to transport their services.<sup>198</sup> Without such access, a domestic telecom operator would be able to restrict the supply of a scheduled service by limiting a foreign service supplier’s access to and use of essential public telecom networks and services.

223. Interconnection is the principal method that U.S. suppliers obtain access and use of Mexican public telecommunications networks and services for the cross-border supply of scheduled basic telecom services. Without interconnection, suppliers of basic telecom services could not deliver a scheduled service on a cross-border basis between the United States and Mexico.

224. As discussed above, interconnection consists of the linking of the networks of two different suppliers for the purpose of exchanging traffic and using services provided by the other public network.<sup>199</sup> Section 2.1 of the Reference Paper, which defines interconnection, makes clear that suppliers of public telecommunications transport networks or services interconnect with each other in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier.

225. A U.S. supplier of basic telecommunications must access and use Mexican public telecom networks and services in order to transport its service (e.g., a phone call originating in the United States) to its final destination in Mexico. Mexican law prohibits U.S. (or any other foreign) suppliers from owning public telecom networks and services in Mexico.<sup>200</sup> Therefore,

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<sup>197</sup> In paras. 280-296, the United States demonstrates that this prohibition constitutes a violation of Mexico’s obligations under Section 5 of the Annex.

<sup>198</sup> See Annex, Section 2(a), note 14 (“This paragraph is understood to mean that each Member shall ensure that the obligations of this Annex are applied with respect to suppliers of public telecommunications transport networks and services by whatever measures are necessary.”) (emphasis supplied)

<sup>199</sup> See *supra* paragraphs 38-42 for relevant definitions of interconnection. For instance, Cofetel’s definition of interconnection (*supra* footnote 27) explains how interconnection enables a supplier to access and use public telecom network and services.

<sup>200</sup> See, e.g., Mexico’s Federal Telecommunications Law, art. 12 (“the concessions to which this law refers shall only be granted to natural persons or legal entities with Mexican nationality”), Exhibit US-16. Mexico scheduled this foreign investment restriction as a mode 3 limitation to its commitments for facilities-based services.

U.S. suppliers of scheduled basic telecom services cannot originate and terminate services over their own networks. Instead, U.S. suppliers have no choice but to rely on Mexican suppliers of public telecom networks and services – such as Telmex and others<sup>201</sup> – to transport their service to its final destination. In other words, without access to and use of Mexican public telecom networks and services, a U.S. supplier of basic telecom services cannot supply its service.

226. Therefore, U.S. basic telecom suppliers must interconnect with Mexican public telecom networks and services – such as Telmex – in order to supply their scheduled service on a cross-border basis between the United States into Mexico. This interconnection can take two principal forms.

227. First, a U.S. *facilities-based* supplier of scheduled basic telecom services (i.e., a supplier that provides services over its own facilities) can interconnect its public telecom network directly with the Mexican public telecom network. By linking its network with that of a Mexican supplier, a U.S. facilities-based operator accesses and uses Mexican public telecom networks and services for the supply of a scheduled basic telecom service.

228. Second, U.S. suppliers can also interconnect facilities that they lease from another operator with Mexican public networks and services. A U.S. *facilities-based* supplier of basic telecom services may not own facilities in a particular area and therefore may wish to lease circuits from another facilities-based supplier and route its scheduled basic telecom services over these leased circuits. Similarly, a U.S. *non-facilities-based* supplier does not own its own network and therefore must rely on leasing circuits from other operators in order to supply basic telecom services. In both cases, the U.S. facilities-based and non-facilities-based suppliers seek to supply cross-border basic telecom services over capacity (i.e., a private leased circuit) that it leases from another operator. These suppliers must interconnect the leased capacity into Mexican public networks and services in order to provide cross-border basic telecom services between the United States and Mexico.

229. Section 5(b) contemplates these forms of access and use:

Each Member shall ensure that service suppliers of any other Member have access to and use of any public telecommunications transport network and service offered within or across the border of that Member, including private leased circuits, and to this end shall ensure, subject to paragraphs (e) and (f), that such

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<sup>200</sup>(...continued)

Mexico's Schedule, GATS/SC/56/Suppl.2, p. 3, Exhibit US-14.

<sup>201</sup> Telmex, Alestra, and Avantel are examples of suppliers of public telecommunications networks and services. Mexican law requires entities wishing to operate such networks and services to hold "concessions". See, e.g., Federal Telecommunications Law, art. 11. For instance, Telmex's concession requires Telmex to provide local, national, and international public service network services (including voice and data) and public voice telephony. *Modificacion al Titulo de Concesion de Telefonos de Mexico, S.A. de C.V.*, August 10, 1990, pp. 3, 4-7, 20, Exhibit US-17.

suppliers are permitted . . . (ii) to interconnect private leased or owned circuits with public telecommunications transport networks or with circuits leased or owned by another service supplier.

230. This section specifically guarantees that foreign service suppliers may obtain access to and use of Mexican public telecom networks and services through both forms of interconnection. Facilities-based suppliers, which own their own circuits, interconnect their networks with those of Mexican public transport networks and services. Non-facilities-based suppliers, which lease their circuits, also wish to interconnect these circuits with public telecom networks and services.

231. Thus, in either case, U.S. service suppliers must rely on interconnection with a Mexican supplier of public telecom networks and services – such as Telmex – in order to access and use Mexican public telecom networks and services for the supply of a scheduled basic telecom service between the United States and Mexico. Mexico must therefore ensure – under Section 5 of the Annex – that U.S. suppliers of scheduled basic telecom services may interconnect with these Mexican suppliers on reasonable terms and conditions.

iv. “. . . reasonable . . . terms and conditions . . .”

232. Unlike the term “non-discriminatory,” the Annex does not define “reasonable.” Therefore, to determine the scope of “reasonable” terms and conditions, a treaty interpreter should look to the ordinary meaning of “reasonable” in its context and in light of the object and purpose of the Annex and the GATS.<sup>202</sup> Under this reading, the United States considers that the terms and conditions that Mexico has imposed are unreasonable.

233. “Reasonable” appears in the context of an affirmative obligation placed on all WTO Members to ensure that foreign service suppliers have access to and use of public telecom networks and services on *reasonable* terms and conditions. Section 2 of the Annex defines this obligation very broadly, requiring Members must ensure such access by “whatever measures are necessary.”<sup>203</sup> By obligating Members to take whatever measures necessary to ensure that foreign suppliers have access to and use of telecom transport on reasonable terms and conditions, the Annex prevents domestic operators from obstructing the expansion of trade in scheduled services, in accordance with the trade-liberalizing goal of the GATS.<sup>204</sup>

234. Therefore, the Annex establishes disciplines guaranteeing foreign service providers access to and use of public telecom networks and services for the supply of a scheduled service.

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<sup>202</sup> See paras. 158-166.

<sup>203</sup> Annex, sec. 2, note 14.

<sup>204</sup> The preamble to GATS establishes the expansion of trade in services as a priority: “Wishing to establish a multilateral framework of principles and rules for trade in service with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries.” GATS, preamble.

Terms and conditions are *reasonable* if they facilitate this access. Terms and conditions that obstruct such access are *unreasonable*.

- b. Mexico’s measures prevent Mexico from ensuring that U.S. suppliers of scheduled basic telecom services have access to and use of public telecom networks and services (through interconnection) on “reasonable” terms and conditions.

235. In the previous subsection, the United States explained that the Annex obligates Mexico to ensure that U.S. suppliers of scheduled basic telecom services have access to and use of public telecom networks and services on reasonable terms and conditions. In particular, the United States demonstrated that:

- Mexico undertook market access and national treatment commitments for basic telecom services supplied by facilities-based operators and commercial agencies;
- U.S. suppliers of such services (such as AT&T and WorldCom) obtain access to and use of Mexican public telecom networks and services by interconnecting with Mexican suppliers of such networks and services (such as Telmex). Without such interconnection, U.S. suppliers could never access and use in Mexico these networks and services and could therefore never supply a scheduled service on a cross-border basis; and
- Mexico must ensure that U.S. suppliers may interconnect with Mexican suppliers of public telecom networks and services on reasonable terms and conditions.

236. In the following subsection, the United States will show that Mexico has failed to ensure that U.S. suppliers are accorded access to and use of Mexican public telecom networks and services on reasonable terms and conditions for the supply of scheduled basic telecom services. Instead, Mexico maintains a series of restrictions that are the antithesis of that obligation.

- i. Mexico unreasonably conditions foreign suppliers’ access to and use of public telecom networks and services on negotiating exclusively with its dominant supplier of public telecom networks and services.

237. Despite the existence of multiple Mexican suppliers of public telecom networks and services, Mexico requires foreign service suppliers to negotiate access to and use of such networks and services only with Telmex – Mexico’s dominant supplier. As discussed above, ILD Rule 13 grants Telmex the exclusive legal authority to negotiate the “settlement rate” with

foreign basic telecom service suppliers.<sup>205</sup> The settlement rate (i.e., the interconnection rate for cross-border suppliers) is the charge that Mexican suppliers of public telecom networks and services impose upon foreign suppliers of scheduled basic telecom services for access to and use of such Mexican networks and services.

238. Under Rule 13, foreign suppliers of scheduled basic telecom services have no choice but to negotiate with Telmex alone for this rate. Foreign suppliers cannot seek to negotiate alternative arrangements or more competitive terms and conditions from any other Mexican supplier of public telecom networks and services.

239. Mexico also requires all Mexican suppliers of public telecom networks and services to charge foreign suppliers only the rate that Telmex negotiates for access to and use of such networks and services (i.e., the settlement rate or cross-border interconnection rate), even if Telmex is not a party to that agreement. Therefore, U.S. suppliers of such scheduled services cannot negotiate alternative terms and conditions for access to and use of public telecom networks and services with any of the more than twenty other Mexican suppliers of such networks and services.

240. As discussed above, ILD Rules 3, 6, 10, 13, 22, and 23 prohibit Mexican suppliers from concluding an agreement that contains an alternative to Telmex-negotiated settlement rate for the cross-border supply of scheduled basic telecom services.<sup>206</sup> Moreover, Mexican authorities have rejected or ignored petitions from both Mexican and foreign operators to conclude agreements containing alternative terms and conditions.<sup>207</sup>

241. Therefore, through these measures, Mexico has given Telmex the sole power to negotiate the charge for access to and use of public telecom networks and services, prevented other Mexican suppliers from offering competing terms and conditions, and provided foreign basic telecom suppliers no alternatives to this monopoly rate. These anti-competitive measures contravene the very purpose of the Annex, which is to prevent suppliers of public telecom networks and services – whoever they may be and however they may be constituted – from engaging in unfair, restrictive, or anti-competitive conduct. Far from ensuring this goal by whatever measures necessary, these measures - namely Rules 3, 6, 10, 13, 22 and 23 and the rejection by Mexican authorities of alternative terms and conditions - instead concentrate all power and control over access to and use of Mexico's public telecom networks and services in the hands of the dominant supplier of such networks and services.<sup>208</sup> These anti-competitive restrictions impair the ability of U.S. and other foreign suppliers of basic telecom services to

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<sup>205</sup> ILD Rule 13.

<sup>206</sup> *Supra*, paras. 167-176

<sup>207</sup> *Supra*, paras. 177-181.

<sup>208</sup> The FCC highlighted the anti-competitive nature of this rule in two orders. *See supra*, para. 171 (“[the ILD Rules] inhibit competition on the U.S.-Mexico route . . . We find that the inability of carriers other than Telmex to negotiate accounting rates impacts negatively on the development of competition on the U.S.-Mexican route”).

negotiate fair and competitive access to and use of Mexican public networks and services and therefore are *unreasonable*.

- ii. Foreign suppliers must pay unreasonable, above-cost rates for access to and use of public telecom networks and services.

242. Mexico requires all Mexican suppliers of public telecom networks and services to charge foreign basic telecom suppliers the same, Telmex-negotiated rate for access to and use of public telecom networks and services. That blended average rate of 9.2 cents per minute is substantially above the cost that Mexican suppliers incur to provide foreign basic telecom suppliers access to and use of public telecom networks and services, which is no higher than 5.2 cents on average. These above cost rates, which Mexican authorities have approved, require Mexican public networks and services operators to extract unreasonable terms and conditions from U.S. suppliers of basic telecom services as a condition for access to and use of their networks and services.

243. As discussed previously, Mexican law prevents foreign suppliers from owning public telecom networks and services in Mexico. Foreign suppliers therefore have no choice but to rely on Mexican operators to provide the access to and use of the public networks and services they need to deliver scheduled basic telecom services from the United States into Mexico. Because of Telmex's monopoly over the negotiation of settlement rates and the requirement that all other Mexican carriers must charge the rate negotiated by Telmex, all Mexican operators are required to charge rates that exceed cost.

244. The entire purpose of Section 5 of the Annex is to require WTO Members to prevent this very form of behavior. Members drafted the Annex to ensure that their suppliers of public networks and services – whether they are monopolies, major suppliers, or competitive suppliers – do not hold access to and use of their networks and services hostage to monopoly rates, or any other form of unfair or anti-competitive conduct that would undermine the supply of scheduled services.

245. Rather than fulfill this goal, the Government of Mexico has adopted regulations that encourage Telmex to engage in such unfair and anti-competitive conduct and prohibit other Mexican suppliers from offering any different rates. The Government of Mexico and Telmex thus ensure that all suppliers use their control over public telecom networks and services to charge above-cost rates from those suppliers that must use Mexican networks and services to transport scheduled basic switched telecom services from the United States into Mexico.

246. In sum, Mexico has failed to ensure that foreign service suppliers are accorded access to and use of public telecom networks and services on *reasonable* terms and conditions for the cross-border supply of scheduled basic telecom services. The United States explained 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 telecom 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 telecom 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 of the Annex.

3. Mexico has failed to ensure that U.S. service suppliers have access to and use of private leased circuits for the supply of scheduled basic telecom services by facilities-based operators and commercial agencies.

247. Section 5(a) of the Annex requires Mexico to ensure that service suppliers of other Members can access and use public telecom networks and services on reasonable terms and conditions to provide a scheduled service. To this end, Section 5(b) of the Annex requires Mexico to ensure that suppliers can access and use private leased circuits offered within and across Mexico’s border and interconnect those circuits with public networks and services.

248. In this section, the United States will demonstrate that Mexico’s measures – namely the failure to ensure that Mexican basic telecom service suppliers make such circuits available as well as Mexican law and regulation – preclude foreign suppliers from offering scheduled basic telecom services over private leased circuits; and is therefore a violation of the basic obligation to provide access to and use of private leased circuits for the provision of a scheduled service by Mexico.

- a. Mexico must ensure that foreign suppliers have access to and use of private leased circuits to supply scheduled basic telecom services.

249. Section 5(b) of the Annex requires Mexico to:

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 paragraphs (e) and (f) that such suppliers are permitted to . . .



(ii) interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another supplier.

Moreover, because the obligations in Section 5(a) of the Annex apply to paragraph (b),<sup>209</sup> Mexico must ensure that foreign suppliers have access to and use of such private leased circuits on reasonable terms and conditions for the supply of scheduled services. In this case, the analysis need not extend to whether the “terms and conditions” are reasonable and non-discriminatory because Mexico has failed to ensure *any* access to and use of private leased circuits for the supply of scheduled services.<sup>210</sup>

250. The specific elements of Section 5(b) require Mexico to ensure that (1) for the supply of a service included in its Schedule, (2) service suppliers of any other Member (3) have access to and use of private leased circuits offered within or across Mexico’s border (4) and can interconnect private leased or owned circuits with public telecommunications networks and services. The United States will first analyze each of these elements and then show that Mexico has acted inconsistently with its obligations under Sections 5(a) and (b).

i. “. . . for the supply of a service included in its Schedule. . .”

251. Mexico has failed to comply with Section 5 of the Annex with respect to the market access and national treatment commitments it undertook for the (1) cross-border (mode 1) supply of facilities-based basic telecom services and (2) the cross-border (mode 1) and domestic (mode 3) supply of non-facilities-based basic telecom services (“*comercializadoras*” or “commercial agencies”).<sup>211</sup> The United States analyzed these commitments generally *supra* at paras. 45-58. However, this argument requires a more thorough analysis of these scheduled commitments, particularly with respect to the supply of such services using private leased circuits. To avoid any confusion, the U.S. claims related to private leased circuits do not address Mexico’s scheduled commitment to permit service suppliers to *sell* or *lease* private leased circuits which is covered in Mexico’s Schedule as “private leased circuit services,”<sup>212</sup> or to offer *private* basic

<sup>209</sup> Annex, sec. 5(a) (“This obligation shall be applied, inter alia, through paragraphs (b) through (f) [footnote omitted].”)

<sup>210</sup> The United States considers that the terms and conditions of access to and use of private leased circuits are *ipso facto* unreasonable and discriminatory when there is *no* access and use by service suppliers of the other Member for scheduled services, as required by the Annex. Although the Panel need not further analyze whether the terms and conditions are reasonable and nondiscriminatory, the United States would be prepared to present further discussion of these issues, if the Panel deemed it necessary to reach them.

<sup>211</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2, pp. 2-6.

<sup>212</sup> Mexico undertook market access and national treatment commitments for subsector (g), “*servicios de circuitos privados arrendados*” (or “private leased circuit services”). The Chairman’s Note on basic telecom (according to which Mexico scheduled its commitments) defines this service in the following manner: “Subsector (g) – private leased circuit services – involves the ability of service suppliers to sell or lease any type of network capacity for the supply of services listed in any other basic telecom service subsector unless otherwise noted in the sector column. This would include capacity via cable, satellite and wireless network.”). Chairman’s Note,

(continued...)

telecommunications services. Rather, the claims made by the United States address the delivery of scheduled *public* basic telecom service *using* private leased circuits.

- (a) Non-facilities-based suppliers (“commercial agencies”) use leased capacity, i.e., private leased circuits, to supply basic telecom services on a cross-border basis and through a commercial presence.

252. According to Mexico’s Schedule, *comercializadoras* (“commercial agencies”) are “*empresas que, sin ser propietarias o poseedoras de medios de transmisión, proporcionan a terceros servicios de telecomunicaciones mediante el uso de capacidad arrendada de un concesionario de redes públicas de telecomunicaciones.*”<sup>213</sup> These agencies do not supply basic telecom services over their *owned* facilities.<sup>214</sup> Instead, they supply such telecom services to third parties over capacity they lease from a licensed facilities-based telecom operator (a “concessionaire”).<sup>215</sup> The supply of telecommunications services over leased capacity is typically known as “resale,” but Mexico’s Schedule uses the phrase “commercial agencies.”

253. “Leased capacity” is therefore essential to the supply of this scheduled service. Without access to such capacity, a commercial agency cannot, according to Mexico’s definition, supply its service. The most common (if not only) form of “leased capacity” for the supply of basic telecom services are “private leased circuits.”<sup>216</sup> Private leased circuits – not defined in the Annex – are generally understood to mean telephone lines leased from a phone company that are specifically dedicated to a customer’s use.<sup>217</sup>

254. Therefore, Mexico scheduled market access and national commitments to allow non-facilities-based suppliers (“commercial agencies”) to provide basic circuit-switched telecom services to third parties over a private (i.e., dedicated) circuit that it leases from a concessionaire.

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<sup>212</sup>(...continued)

S/GBT/W/2/Rev. 1 (16 January 1997).

<sup>213</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2., note 2.

<sup>214</sup> By definition, these agencies do not own transmission means (“*empresas . . . sin ser propietarias o poseedoras de medios de transmisión*”). Mexico’s Schedule, GATS/SC/56/Suppl.2., note 3.

<sup>215</sup> According to Mexico’s Schedule a “concessionaire” is an operator with a concession to supply service over a facilities-based telecom network. Mexico’s Schedule, GATS/SC/56/Suppl.2, p. 2. Therefore, a commercial agent leases its capacity from an operator with a concession. Telmex is a concessionaire.

<sup>216</sup> “Private leased circuits” are also referred to as “leased lines,” “private lines,” “dedicated lines,” “dedicated circuits.” See Harry Newton, *Newton’s Telecom Dictionary*, 16<sup>th</sup> Edition (2000), p. 490. Because the Annex refers to “private leased circuits,” the United States will use this term to avoid confusion.

<sup>217</sup> *Newton’s Telecom Dictionary* defines “leased circuit” as “same as Leased Line or Private Line” and defines “leased line as “same as LEASED or DEDICATED CIRCUIT, PRIVATE LINE, LEASED CHANNEL. A telephone line rented for the exclusive use of the customer 24-hours a day, seven days a week from a telephone company.” It defines “private line” as “a direct channel specifically dedicated to a customer’s use between specified points.” Harry Newton, *Newton’s Telecom Dictionary*, 16<sup>th</sup> Edition (2000), pp. 490, 675.

255. Mexico undertook these commitments for the cross-border supply of services (mode 1) over leased capacity from the territory of one Member (e.g., the United States) into the territory of any other Member (i.e., Mexico).<sup>218</sup> Mexico limited this mode 1 commitment to ensure that foreign commercial agencies route international traffic through the facilities of a “concessionaire”.<sup>219</sup> In other words, according to Mexico’s Schedule, foreign commercial agencies must supply international basic telecom services through facilities leased from a concessionaire.<sup>220</sup> Therefore, Mexico committed to allow a foreign, non-facilities-based supplier to offer telecom services from the territory of the United States into the territory of Mexico over capacity leased from a public network concessionaire (i.e., private leased circuits). The cross-border supply of a basic telecom service over leased capacity is typically known as International Simple Resale.<sup>221</sup>

256. Mexico also undertook commitments for locally-established (mode 3)<sup>222</sup> commercial agencies, with certain limitations.<sup>223</sup> Because Mexico did not schedule a foreign ownership limitation for such services, a foreign service supplier should be able to own 100% of a locally established commercial agency. Moreover, because Mexico did not indicate otherwise, this mode 3 commitment allows a locally established commercial agency to provide international basic telecom services over leased capacity.<sup>224</sup> Therefore, Mexico committed to allow a foreign service supplier to acquire a 100% interest in a commercial agency in order to offer international

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<sup>218</sup> GATS, Article I:2(a) (“the supply of a service . . . from the territory of one Member into the territory of any other Member.”)

<sup>219</sup> Mexico inscribed the following mode 1 limitation for commercial agencies: “*el tráfico internacional debe ser enrutado a través de las instalaciones de una empresa con una concesión otorgada por la Secretaría de Comunicaciones y Transportes (SCT).*” (The WTO’s English version states that “International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).”) Mexico’s Schedule, GATS/SC/56/Suppl.2., p. 2.

<sup>220</sup> This mode 1 limitation is consistent with the definition of commercial agencies in Mexico’s Schedule, which describes these services as using “*capacidad arrendada de un concesionario de redes públicas de telecomunicaciones*” (i.e., capacity leased from a public network concessionaire).

<sup>221</sup> The ITU defines International Simple Resale in the following manner: “Under International Simple Resale, a country permits the leasing of international lines for the carriage of international voice and data traffic. Thus, flat payments would substitute for the standard per minute charge used under the accounting rate regime.” International Telecommunications Union, Trends in Telecommunications Reform: Interconnection Regulation, 3<sup>rd</sup> Edition (2001), p. 107 note 14.

<sup>222</sup> GATS, Article I:2(c) (“the supply of a service . . . by a service supplier of one Member, through commercial presence in the territory of any other Member.”). GATS Article XXVIII(d) defines “commercial presence” as “any type of business or professional establishment, including through [a juridical person or a branch office] within the territory of a Member for the purpose of providing a service.”

<sup>223</sup> For instance, a commercial agency must obtain a permit, which Mexican authorities will not issue until they issue the relevant regulations. Mexico’s Schedule, GATS/SC/56/Suppl.2., p. 6. Over 4 years after the entry into force of Mexico’s commercial agency commitments, Mexico has still not issued the relevant regulations and therefore does not permit the supply of this service.

<sup>224</sup> Mexico scheduled its commitments in accordance with the Chairman’s Note (S/GBT/W/2 Rev. 1), which states that “[u]nless otherwise noted in the sector column, any basic telecom service listed in the sector column . . . (a) encompasses . . . international services for public and non-public use . . .” Mexico Schedule, GATS/SC/56/Suppl.2., p. 2 (“*Esta lista de compromisos toma en cuenta las notas del presidente del Grupo de Telecomunicaciones Básicas S/GBT/W/2/Rev.1 . . .*”).

(e.g., Mexico to U.S.) telecommunications services over capacity leased from a public network concessionaire (i.e., private leased circuits). This is another example of the supply of international basic telecom service through what is typically known as International Simple Resale.

257. In sum, Mexico undertook mode 1 and mode 3 commitments for services, which – by Mexico’s own definition – require access to and use of private leased circuits for their supply. A U.S. service supplier cannot supply basic telecom services over leased capacity on a cross-border basis if it cannot lease private leased circuits from a Mexican supplier. Nor can a U.S. service supplier establish a commercial presence to supply international basic telecom services over leased capacity if it cannot lease private leased circuits from a Mexican supplier. As the United States will discuss below, Mexico does not permit U.S. basic telecom service suppliers to lease such circuits for these services and therefore precludes the supply of mode 1 and mode 3 commercial agency services.

- (b) Facilities-based operators also use leased capacity, i.e., private leased circuits, to supply public basic telecom services on a cross-border basis.

258. Mexico also undertook cross-border market access and national treatment commitments for specific public basic telecom services supplied by a facilities-based operator (i.e., “*servicios de telefonía*” or “voice telephony”, “*servicios de transmisión de datos con conmutación de circuitos*” or “circuit-switched data transmission services, and “*servicios de facsímil*” or “facsimile services”).<sup>225</sup> Mexico limited this commitment to ensure that foreign service suppliers route international traffic through the facilities of a Mexican concessionaire.<sup>226</sup> Therefore, for the supply of these public facilities-based services from the territory of the United States into the territory of Mexico, Mexico promised to accord market access and national treatment to U.S. suppliers of these services provided that the U.S. service supplier routes international traffic through the facilities of a Mexican concessionaire.

259. Foreign facilities-based service suppliers – which cannot own telecom facilities in Mexico<sup>227</sup> – can provide these services into Mexico in two ways. First, they can interconnect their network with that of a Mexican service supplier, which then delivers the service to its final destination in Mexico. The United States discussed this option in detail above.

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<sup>225</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2., p. 3-4. *See also supra*, at paras. 45-58.

<sup>226</sup> Mexico inscribed the following mode 1 limitation for facilities-based services: “*el tráfico internacional debe ser enrutado a través de las instalaciones de una empresa con una concesión otorgada por la Secretaría de Comunicaciones y Transportes (SCT).*” (The WTO’s English version states that “International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).”) Mexico’s Schedule, GATS/SC/56/Suppl.2., p. 2.

<sup>227</sup> *See, e.g.*, Mexico’s Federal Telecommunications Law, art. 12, Exhibit US-16.

260. Second, foreign facilities-based service suppliers can supply cross-border service using private leased circuits.<sup>228</sup> In the case of the cross-border supply of a service between the United States and Mexico, a U.S. facilities-based supplier (whose network ends at the U.S.-Mexico border) would lease a private leased circuit (from the U.S.-Mexico border into Mexico) from a Mexican supplier. The U.S. supplier would interconnect that private leased circuit with its telecom network at the U.S.-Mexico border and would supply basic telecom services into Mexico over that circuit. To deliver these services to the end user, the U.S. facilities-based operator would interconnect this private leased circuit with a Mexican supplier at the Mexico end of the circuit. As discussed earlier, the cross-border supply of service over leased lines is typically known as International Simple Resale.<sup>229</sup>

261. Thus, to summarize, access to and use of private leased circuits is essential to the supply of the following services inscribed in Mexico's Schedule: (a) facilities-based services (i.e., voice telephone, circuit-switched data, facsimile services by a facilities-based operator from the United States into Mexico) supplied on a cross-border basis, (b) commercial agencies (i.e., basic telecom services by a non-facilities-based operator over leased capacity from the United States into Mexico) supplied on a cross-border basis, and (c) locally established commercial agencies (i.e., basic telecom services by a non-facilities-based operator over leased capacity from Mexico into the United States). As the United States will discuss below, Mexico has failed to ensure that private leased circuits are available for the supply of these scheduled services.

ii. “. . . service suppliers of any other Member . . .”

262. As discussed above, Mexico's Annex obligations apply to any foreign service supplier (whether facilities-based or non-facilities-based) wishing to supply scheduled basic telecom services. For instance, AT&T, WorldCom, and Sprint are *facilities-based* suppliers of scheduled basic telecom services between the United States and Mexico on a cross-border basis. For example, they offer voice telephone, circuit-switched data, and facsimile services between the two countries. Therefore, Mexico must ensure that these suppliers have reasonable access to and use of private leased circuits to supply these services.

263. Having undertaken a commitment for “commercial agencies,” Mexico must also ensure that any foreign *non-facilities-based* supplier has access to and use of private leased circuits to supply telecom services to third persons over leased capacity. However, despite this scheduled commitment, Mexico does not permit foreign non-facilities-based operators to supply this resale service on a cross-border (U.S.-Mexico) basis or through a commercial presence.

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<sup>228</sup> The United States again notes that the facilities-based services at issue are voice telephone, circuit switched data, and facsimile services, *not* private leased circuit services which constitutes the *sale* or *lease* of these circuits but rather the supply of basic telecom service through leased circuits.

<sup>229</sup> *Supra*, footnote 221.

- iii. “. . . have access to and use of any public telecommunications transport network and service offered within or across Mexico’s border, including private leased circuits . . .”

264. Mexican suppliers of public telecom networks and services *offer* private leased circuits to their customers.<sup>230</sup> Therefore, because Mexican suppliers offer such circuits within or across Mexico’s border, Mexico must ensure that foreign suppliers have access to and use of private leased circuits for the supply of any service inscribed in Mexico’s Schedule, such as the facilities-based and non-facilities-based basic telecom services discussed above.

- iv. “. . . shall ensure . . . that such suppliers are permitted . . . to interconnect private leased or owned circuits with public telecommunications transport networks and services . . .”

265. Section 5 further obliges Mexico to ensure that a foreign service supplier can connect a private leased circuit into any public telecom network and service for the supply of services inscribed in Mexico’s Schedule. This interconnection is essential for the supply of scheduled (1) basic telecom services over private leased circuits (i.e., from the United States into Mexico) by a facilities-based operator on a cross-border basis; (2) basic telecom services over private leased circuits (i.e., from the United States into Mexico) by a non-facilities-based operator (“commercial agencies”) on a cross-border basis; or (3) international basic telecom services (i.e., from Mexico into the United States) over private leased circuits by a non-facilities-based operator (“commercial agencies”) locally established in Mexico. In all three cases, a U.S. supplier must interconnect the private circuit that it leases with public telecom networks and services on the U.S.-end and with those on the Mexico-end in order to supply the respective scheduled basic telecom service.

266. In sum, Mexico committed under Sections 5(a) and (b) to ensure that

- foreign facilities-based suppliers,
- foreign commercial agencies (non-facilities-based suppliers), and
- locally established commercial agencies (non-facilities-based suppliers)

have access to and use of private leased circuits to supply scheduled international basic telecom services over such circuits and can interconnect such circuits with public telecom networks and services. Because Mexican suppliers offer private leased circuits to their customers, Mexico

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<sup>230</sup> Telmex private line tariffs are listed on the Cofetel web site at [http://www.cft.gov.mx/html/4\\_tar/telmex/SECC8B.html](http://www.cft.gov.mx/html/4_tar/telmex/SECC8B.html)

must therefore ensure that these circuits are available to all suppliers of scheduled basic telecom services.

267. However, as discussed in the next subsections, foreign suppliers do not have access to and use of private leased circuits to supply scheduled basic telecom services. Mexican suppliers have refused to provide these circuits, Mexican law prevents foreign basic telecom 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 telecom services. Therefore, Mexico has failed to honor its commitments under Sections 5(a) and (b) of the Annex.

- b. Mexico has failed to ensure that U.S. facilities-based service suppliers have access to and use of private leased circuits for the cross-border supply of scheduled basic telecom services and that such suppliers can interconnect such circuits with public networks and services.

268. U.S. facilities-based suppliers have *no* access to private leased circuits for the supply of scheduled basic telecom services between the United States and Mexico. Even if they did, the ILD Rules *prevent* foreign suppliers from interconnecting such circuits with public telecom networks and services. These restrictions – wholly at odds with Section 5 of the Annex – violate the obligation to provide access to and use of private leased circuits in the first place.

- i. Telmex has refused to make private leased circuits available for the cross-border supply of scheduled voice telephone services.

269. Mexican suppliers do not make private leased circuits available to U.S. facilities-based suppliers to provide basic telecom services into Mexico on a cross-border basis, and Mexican authorities have done nothing to require Mexican suppliers to do so. For example, on July 31, 1998, AT&T sent a letter to Telmex requesting the ability to lease private circuits from various points on the U.S.-Mexico border to several destinations in Mexico and to interconnect such circuits into Mexico’s public network. In this letter, AT&T explained that it wanted access to and use of these private leased circuits over which it wished to provide scheduled voice telephone service on a cross-border basis.<sup>231</sup>

270. In other words, AT&T requested the use of the facilities of a concessionaire (i.e., private leased circuits from Telmex) for the cross-border supply of a basic telecom service inscribed in Mexico’s Schedule (“*servicios de telefonía*” or voice telephone service by a facilities-based

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<sup>231</sup> Letter from George Foyo (AT&T) to Jaime Chico Pardo (Telmex), 31 July 1998, Exhibit US-8.

operator).<sup>232</sup> As discussed earlier, the supply of such service is typically known as International Simple Resale.

271. Telmex, which offers private leased circuits to other customers, refused AT&T's request for private leased circuits and the ability to interconnect such circuits into its network. As justification for its refusal, Telmex wrongly opined that Mexico's WTO commitments did not permit the supply of such services over private leased circuits:

Second, with respect to AT&T's request that Telmex allow it to provide "cross-border voice services over resold international private lines," the Mexican Government's WTO offer did not include the provision of international simple resale services. As you know, at this time such services remain unlawful in Mexico: the Mexican Government has determined that immediate adoption of ISR would undermine its carefully-planned transition to competition.

For these reasons, Telmex cannot at this time provide AT&T the arrangements you request.<sup>233</sup>

272. Mexican authorities have done nothing to ensure that Telmex or any other supplier provides these leased circuits to U.S. suppliers for the cross-border supply of scheduled basic telecom services. Nor have Mexican authorities ensured that Telmex or any other supplier allows U.S. suppliers to interconnect private leased circuits into their public networks. On the same date that AT&T requested private leased circuits from Telmex, AT&T sent a letter to the President of Cofetel to inform Mexican authorities that it had requested private leased circuits from Telmex and interconnection of such circuits with public networks and services.<sup>234</sup> Cofetel has neither responded to AT&T's letter nor taken any action to ensure that Telmex provides the private leased circuits – that Telmex offers to other customers – to AT&T for the supply of scheduled services.

273. Telmex's action – and the Government of Mexico's inaction – fails to meet the requirements set out under Sections 5(a) and (b) of the Annex. The blatant refusal to accord a U.S. service supplier access to and use of private leased circuits for the purpose of providing a basic telecom service inscribed in Mexico's Schedule contradicts Section 5(b) on its face. The entire purpose of the Annex is to ensure that Mexican suppliers of public telecom networks and services – particularly the former monopolist – do not use their control over such networks and services frustrate the supply of scheduled services. However, Telmex and Mexican authorities have acted to ensure that U.S. service suppliers *cannot* supply scheduled services over private leased circuits. For these reasons, Mexico has failed to honor its commitments under the Annex.

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<sup>232</sup> Mexico's Schedule, GATS/SC/56/Suppl.2, pp. 2-3.

<sup>233</sup> Letter from Jaime Chico Pardo (Telmex) to George Foyo, 31 August 1998, Exhibit US-9.

<sup>234</sup> Letter from George Foyo (AT&T) to Javier Lozano Alarcón (Cofetel), 31 July 1998, Exhibit US-8.



- ii. Even if U.S. facilities-based suppliers could access and use private leased circuits from Mexican suppliers, the ILD Rules prevent any foreign supplier from interconnecting these leased circuits with foreign public networks and services.

274. Mexico not only has failed to ensure that its suppliers provide private leased circuits to foreign suppliers for the cross-border supply of scheduled basic telecom services but has also maintained measures that preclude foreign suppliers from ever using these circuits to supply such services. Under Mexican law, a foreign supplier cannot interconnect a private circuit leased in Mexico with foreign public networks and services for the provision of scheduled basic telecom services.

275. Mexico’s ILD Rules preclude this connection.

*Regla 3. Unicamente los operadores de puerto internacional estarán autorizados para interconectarse directamente con las redes públicas de telecomunicaciones de operadores de otros países con el objeto de cursar tráfico internacional.*<sup>235</sup>

According to this Rule, only “international port operators” may interconnect with the public telecommunications networks of foreign operators in order to supply basic telecom services.<sup>236</sup> However, under Mexican law, a foreign facilities-based supplier can never be an international port operator and therefore can never interconnect a private leased circuit into a U.S. operator’s public telecom network. The ILD Rules require an international port operator to be a supplier with a *concession* to supply long distance services,<sup>237</sup> and Mexican law prohibits non-Mexican

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<sup>235</sup> ILD Rule 3.

<sup>236</sup> “*Tráfico internacional*” or “*international traffic*” is a generic term for international telecommunications. The *New Shorter Oxford English Dictionary* defines “traffic” as the “messages, signals, etc., transmitted through a communications system; the flow or volume of such business.” Lesley Brown (ed.) *The New Shorter Oxford English Dictionary* (vol. 2) p. 3359. The basic telecom services inscribed in Mexico’s Schedule – such as international public voice telephone services – constitute international traffic and are subject to Mexico’s ILD Rules.

<sup>237</sup> ILD Rule 2(VII) (“*Operador de puerto internacional: concesionario de servicio de larga distancia autorizado por la Comisión para operar una central de conmutación como puerto internacional*”) (“International Port Operator: a long distance services concessionaire authorized by the Commission to operate a switching exchange as an international port.”). See also, ILD Rule 7, which allows only long distance *concessionaires* to request authorization to be an international port operator. See also ILD Rules 5 and 6. Exhibit US-1.

entities from holding such a *concession*<sup>238</sup> (Mexico inscribed this nationality restriction for concessionaires in its Schedule<sup>239</sup>).

276. Because a U.S. facilities-based service supplier *cannot* be a long distance concessionaire, it *cannot* be an “international port operator” and thereby *cannot* interconnect a private circuit leased in Mexico with the U.S. public telecom network. However, the interconnection of this circuit with the network of a U.S. operator is essential to the cross-border provision of public basic telecom services over private leased circuits - a commitment included in Mexico’s Schedule. Without such interconnection, the U.S. facilities-based supplier could supply *no* scheduled public telecom service between the United States and Mexico over that circuit. Instead, such U.S. supplier could do nothing with a circuit it leased other than dangle it at the U.S.-Mexico border. In other words, a private leased circuit is worthless for the cross-border supply of scheduled public basic telecom services if the service supplier cannot interconnect it with public telecom networks and services.

277. The United States demonstrated in this section how Mexico failed to comply with its obligations under Sections 5(a) and (b) of the Annex for the cross-border supply of public telecommunications services by foreign facilities-based operators. Mexican operators have refused to provide U.S. suppliers private leased circuits for such services, and – despite Mexico’s commitments under the Annex – Mexican authorities have done nothing to ensure that, consistent with the Annex, its suppliers provide such circuits. Moreover, even if Mexican suppliers were to lease private circuits to a U.S. facilities-based supplier, ILD Rule 3 prevents foreign suppliers from interconnecting that circuit into their networks and thereby prohibits the cross-border supply of scheduled public basic telecom services over such circuits.

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<sup>238</sup> Mexican law requires holders of a concession to operate public telecommunications services to be of Mexican nationality. *See, e.g.*, (1) Mexico’s Federal Telecommunications Law, art. 12, Exhibit US-16; (2) “Agreement of the SCT establishing the procedure to obtain concessions for the installation, operation or exploitation of interstate public telecommunications networks, pursuant to the Federal Telecommunications Law,” published in the *Diario Oficial* on 4 September 1995, art. 2.4.1, *et seq.* (requires all applicants for a concession to be of Mexican nationality); (3) Rules for Long Distance Service, published by the SCT in the *Diario Oficial* on 21 June 1996, Rule 2(V) (defines a long distance concession holder as an individual or corporation having a concession to install, operate or exploit a public telecommunications network authorized to render long distance service).

<sup>239</sup> Mexico inscribed the following limitations for basic telecom services supplied by a mode 3 facilities-based operator: *Se require concesión [footnote omitted] otorgada por SCT. Sólo empresas constituidas conforme a la ley mexicana pueden obtener tal concesión . . . Se permite la participación de la inversión directa hasta 49 por ciento en una empresa constituida conforme a las leyes mexicanas.* Mexico’s Schedule, GATS/SC/56/Suppl.2, pp. 2-3. (The English language version of Mexico’s Schedule states that “A concession [footnote omitted] from the SCT is required. Only enterprises established in conformity with Mexican law may obtain such a concession . . . Direct foreign investment up to 49 percent is permitted in an enterprise set up in accordance with Mexican law.”)

- c. Mexico has failed to ensure that foreign non-facilities-based service suppliers (“commercial agencies”) have access to and use of private leased circuits for the cross-border supply of scheduled basic telecom services and that such suppliers can interconnect such circuits with public networks and services.

278. As discussed above, Mexico undertook cross-border commitments for *comercializadoras* (“commercial agencies”), which Mexico defined as the supply by non-facilities-based providers of telecommunications services to third parties over capacity leased from a Mexican concessionaire.<sup>240</sup> By Mexico’s definition, the supply of this international “resale” service<sup>241</sup> requires a Mexican concessionaire to provide a foreign service supplier access to and use of private leased circuits. Without such circuits, foreign suppliers cannot provide cross-border telecom services as commercial agencies.

279. Sections 5(a) and (b) of the Annex ensure that foreign commercial agencies have access to and use of these circuits and can interconnect these circuits with public telecom networks and services on reasonable terms and conditions to provide “resale” services on a cross-border basis – services that cannot be supplied without such circuits. However, Mexico has failed to comply with these commitments. Instead, as a matter of policy, Mexico has prohibited foreign service suppliers from offering this “resale” service that it scheduled. Moreover, even if Mexico permitted foreign suppliers to offer this “resale” service, ILD Rule 3 precludes the supply of this service by preventing all commercial agencies (domestic and foreign) from interconnecting private leased circuits with foreign telecom networks. Such restrictions prevent Mexico from honoring its commitments under the Annex.

- i. Mexico’s refusal to permit the supply of scheduled cross-border “commercial agencies” is inconsistent with its obligation to provide access to and use of public telecom networks and services.

280. Mexico inscribed a commitment for cross-border “commercial agencies” that it has not fulfilled. To the knowledge of the United States, Mexico does not permit foreign non-facilities-based suppliers (*empresas que, sin ser propietarias o poseedoras de medios de transmisión*) to

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<sup>240</sup> Mexico’s Schedule, GATS/SC/56/Suppl.2., note 3. The WTO’s English version of Mexico’s Schedule defines “commercial agencies” as “[a]gencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire.” As discussed *supra*, Mexico limited this commitment to ensure that commercial agencies route international traffic through the facilities of a Mexican concessionaire. Mexico’s Schedule, GATS/SC/56/Suppl.2.,p. 2. In other words, according to this limitation, foreign commercial agencies must supply international telecom services using facilities leased from a Mexican concessionaire. The terms of this limitation are therefore consistent with Mexico’s definition of commercial agencies in its schedule (“using capacity leased from a public network concessionaire.”)

<sup>241</sup> As discussed *supra*, the supply of telecommunications services over leased capacity is typically known as “resale,” and the supply of cross-border telecom services over leased capacity is typically known as International Simple Resale (ISR).

supply to third parties (*proporcionan a terceros*) basic telecommunications services (*servicios de telecomunicaciones*) from the territory of the United States into Mexico using capacity leased from a Mexican concessionaire (*mediante el uso de capacidad arrendada de un concesionario de redes públicas de telecomunicaciones*). By refusing to permit the supply of this service, Mexico has failed to ensure that foreign commercial agencies have access to and use of public telecom networks and services (namely, private leased circuits) to supply a scheduled service at reasonable terms and conditions.

281. The policy of the Mexican government – since undertaking commitments for *comercializadoras* – has been to refuse to permit any foreign carrier from supplying international “resale” services (i.e., international telecom services supplied over private leased circuits). Eight months after finalizing its “commercial agencies” commitments, the then-Secretary of Mexico’s Secretariat of Communications and Transportation (SCT) wrote a letter to the then-Chairman of the FCC stating that the policy of his government was to forbid the resale of “long-distance public network capacity in Mexico”:

*Uno de esos argumentos está orientado hacia la imposibilidad de revender capacidad de redes públicas de Larga Distancia en México, lo cual ha sido y seguiría siendo política interna de mi administración. Se trata de promover la rentabilidad de la inversión en la edificación de la infraestructura competitiva que hoy necesita nuestro país y no de obtener beneficios marginales de la operación de revendedores, que sólo aprovechan la infraestructura de terceros para hacer arbitrajes de precios.*<sup>242</sup>

In other words, despite the fact that Mexico had committed to its WTO partners that it would permit commercial agencies to provide all forms of telecommunications services to third parties over resold capacity, Secretary Ruiz Sacristan affirmed that Government of Mexico had no intention to allow telecom operators to do so.

282. Secretary Ruiz Sacristan reaffirmed this position in a May 8, 1998 letter to then-USTR Charlene Barshefsky. Ambassador Barshefsky wrote to both Secretary Ruiz Sacristan and Secretary Herminio Blanco Mendoza (then-Secretary of Commerce and Industrial Development) on April 4, 1998 to express her deep concern over Mexico’s implementation of its GATS basic telecom commitments, including “Mexico’s failure to permit unrestricted domestic and

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<sup>242</sup> Letter from Secretary Carlos Ruiz Sacristan to Chairman Reed Hundt, 22 October 1997. (Emphasis supplied), Exhibit US-46. In English, this passage states: “One of these arguments concerns the impossibility of reselling long-distance public network capacity in Mexico, which has been and will continue to be the internal policy of my government. This is a matter of promoting the profitability of investment in constructing the competitive infrastructure our country needs today, rather than obtaining marginal benefits from the operations of resellers, who only take advantage of the infrastructure of third parties so as to juggle with prices.”

international resale of telecommunications services (including international simple resale).”<sup>243</sup> Secretary Sacristan responded that Mexico’s WTO commitments did not include these services.<sup>244</sup>

283. Therefore, by expressing his government’s refusal to permit the domestic and international resale of telecommunication services, Secretary Sacristan acknowledged Mexico’s failure to honor its scheduled commitment to allow “commercial agencies” to supply cross-border telecommunications services to third parties over leased capacity (i.e., private leased circuits). Foreign commercial agencies *cannot* provide this scheduled resale service between the United States and Mexico.

284. Mexico’s failure to permit this scheduled service – which by definition relies on private leased circuits – means that Mexico has failed to ensure – consistent with Sections 5 (a) and (b) of the Annex – that foreign service suppliers have access to and use of public telecom networks and services (i.e., private leased circuits). For that reason, Mexico has failed to honor its commitments under these provisions.

- ii. ILD Rule 3 prevents Mexico from ensuring that foreign non-facilities-based suppliers can use private leased circuits for the cross-border supply of scheduled “commercial agencies” services.

285. As discussed above, suppliers of telecommunications services over private leased circuits must interconnect those circuits into public telecom networks and services in order to provide that service. Indeed, Section 5(b) of the Annex guarantees this right and requires WTO Members to ensure that foreign suppliers have access to and use of private leased circuits and can “interconnect private leased or owned circuits with public telecom telecommunications transport networks and services . . .”

286. ILD Rule 3 precludes this connection for (1) foreign and (2) non-facilities-based suppliers. First, as discussed above, this rule – in combination with other provisions of Mexican law – prevents any *foreign* supplier (whether facilities-based or non-facilities-based) from interconnecting a private circuit leased in Mexico with foreign public telecom networks and services.

287. Second, Rule 3 prevents any *non-facilities-based* foreign supplier (whether foreign or domestic) from interconnecting a private leased circuit into foreign public telecom networks and services. Under Rule 3, only “*operadores de puerto internacional*” may interconnect with

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<sup>243</sup> Letter from Ambassador Charlene Barshefsky to Secretary Carlos Ruiz Sacristan, 4 April 1998, Exhibit US-47.

<sup>244</sup> Letter from Secretary Carlos Ruiz Sacristan to Ambassador Charlene Barshefsky, 8 May 1998 (emphasis supplied), Exhibit US-48.

foreign public telecom networks to supply international telecom services.<sup>245</sup> However, under the ILD Rules, international port operators must be a facilities-based supplier.<sup>246</sup> Therefore, a non-facilities-based supplier (i.e., a commercial agency) can *never* be an international port operator, and, therefore, under Rule 3, a non-facilities-based supplier can *never* interconnect with a foreign telecom network.

288. Thus, perversely, Rule 3 prevents commercial agencies – which rely on private leased circuits to supply telecom services – from ever providing service from the United States to Mexico (or from Mexico to the United States)<sup>247</sup> over such circuits because they cannot interconnect circuits leased in Mexico with a foreign network. Without such interconnection, foreign non-facilities-based suppliers cannot *use* private leased circuits (even if they could even lease such circuits in the first place) to supply a scheduled service.

289. In sum, Rule 3 cuts off the ability of all foreign and all non-facilities-based service suppliers to use private leased circuits to supply basic circuit-switched telecom service on a cross-border basis and therefore nullifies Mexico’s commercial agencies commitment to allow foreign non-facilities-based suppliers to offer basic circuit-switched telecom services over these lines from the territory of the United States into the territory of Mexico. This restriction is wholly at odds with the obligations contained in Sections 5(a) and (b) of the Annex, and undermines the entire purpose of that agreement.

290. Therefore, by maintaining Rule 3, Mexico has failed to ensure that foreign suppliers of scheduled services have access to and use of private leased circuits and can interconnect such circuits into public telecom networks and services. For these reasons, Mexico has failed to honor its commitments under Section 5 of the Annex.

- d. Mexico has failed to ensure that locally established *comercializadoras* have access to and use of private leased circuits for the cross-border supply of scheduled basic telecom services and

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<sup>245</sup> ILD Rule 3.

<sup>246</sup> See ILD Rule 7(3) (requires an international port operator to have infrastructure in at least three Mexican states) and ILD Rule 2(VII) defines an international port operator as a supplier with a *concession* to supply long distance services. See also ILD Rules 5 and 6. Under Mexican law, *only* facilities-based suppliers – not commercial agencies – may hold a long distance concession. Compare Mexico’s Federal Telecommunications Law, art. 11 (requires a Mexican company to obtain a *concession* to operate a public telecommunications network) with Mexico’s Federal Telecommunications Law, arts. 31, 52 (requires non-facilities-based commercial agencies to obtain a *permit* (rather than a concession) to offer services over the facilities of a concessionaire). Mexico’s Schedule reflects the distinction between concessionaires (which own facilities) and commercial agencies (which do not). For instance, footnote 1 of the Schedule defines *concesión* as “*se refiere al otorgamiento de un título para instalar, operar o explotar una red pública de telecomunicaciones basada en infraestructura*” (According to the English language Schedule: “the granting of title to install, operate or use a facilities-based public telecommunications network”). In contrast, footnote 3 of Mexico’s Schedule defines commercial agencies as those operators that do not own their own facilities, or transmission means. Mexico’s Schedule, GATS/SC/56/Suppl.2., note 1 and note 3.

<sup>247</sup> The United States will address this scenario (i.e., a commercial agency – locally established in Mexico – wishing to supply international telecom services between Mexico and the United States) in the next subsection.

that such suppliers can interconnect such circuits with public networks and services.

291. Mexico undertook mode 3 commitments for *comercializadoras* (“commercial agencies”).<sup>248</sup> Specifically, Mexico promised to permit foreign suppliers to acquire a 100 percent interest in a local non-facilities-based supplier and offer international (e.g., Mexico to U.S.) telecommunications services to third parties over capacity (i.e., private circuits) leased from a Mexican concessionaire. The supply of this international “resale” service requires a Mexican concessionaire to provide a foreign service supplier access to and use of private leased circuits.

292. Sections 5(b) of the Annex obliges Mexico to ensure that these service suppliers have access to and use of the private leased circuits they need to supply this scheduled resale service and can interconnect such circuits with public telecom networks and services. However, Mexico has failed to comply with these provisions. First, Mexico has not permitted non-facilities-based service suppliers (commercial agencies) to establish locally and supply international telecom services from Mexico over private leased circuits. Second, ILD Rule 3 prevents all commercial agencies from interconnecting private leased circuits with foreign telecom networks. These restrictions therefore prevent Mexico from complying with its commitments under the Annex.

- i. Mexico has refused to permit the local establishment of commercial agencies to supply international telecom services using private leased circuits.

293. To the knowledge of the United States, Mexico does not permit foreign non-facilities-based suppliers to establish locally and supply third parties international telecommunications services over private leased circuits. In fact, as discussed *supra*, Mexican government policy has been to refuse to permit international “resale” service.

294. The United States recognizes that Mexico conditioned the mode 3 supply of “commercial agencies” on the issuance of the relevance regulations.<sup>249</sup> However, over five years have elapsed since Mexico finalized this commitment in February 1997 (and four years have elapsed since this commitment entered into force in February 1998), and Mexico still has not issued – and has indicated no intention to issue – the relevant regulations. The refusal to issue such regulations raises questions about whether Mexico ever intends to implement this scheduled mode 3

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<sup>248</sup> Mexico defined this service as the supply by non-facilities-based providers of telecommunications services to third parties over capacity leased from a Mexican concessionaire. Mexico’s Schedule, GATS/SC/56/Suppl.2., note 3.

<sup>249</sup> According to Mexico’s mode 3 limitation for *comercializadoras*, “*El establecimiento y operación de las empresas comercializadoras deberá sujetarse invariablemente a las disposiciones reglamentarias respectivas. SCT no otorgará permiso para el establecimiento de una comercializadora hasta emitir la reglamentación correspondiente.*” (“The 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.”) GATS/SC/56/Suppl.2., p. 5.

commitment for commercial agencies. It also raises the question whether this limitation, if Mexico’s GATS Schedule is read as Mexico interprets it, renders this commitment to inutility.<sup>250</sup>

- ii. Even if Mexico issued the relevant regulations, ILD Rule 3 still prevents Mexico from ensuring that foreign non-facilities-based suppliers can establish locally and use private leased circuits for the supply of international telecom services.

295. As discussed *supra*, ILD Rule 3 – in combination with other provisions of Mexican law – prevents all *foreign* suppliers and all *non-facilities-based* suppliers from interconnecting a private leased circuit into foreign public telecom networks and services. Therefore, because ILD Rule 3 prevents this interconnection, it renders useless any private leased circuit that a foreign, non-facilities-based supplier may wish to use for the supply of scheduled international telecommunications services from a point in Mexico to a foreign destination (i.e., international resale services). In other words, Rule 3 prevents foreign non-facilities-based suppliers from *using* private leased circuits to supply a scheduled service.

296. As a result, by maintaining this Rule, Mexico has failed to ensure that foreign suppliers can access and use private leased circuits and interconnect these circuits into public networks and services. For this reason, Mexico has failed to comply with its commitments under Section 5 of the Annex.

## V. CONCLUSION

297. For the reasons stated above, 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 telecom suppliers on a cross-border basis with cost-oriented, reasonable rates, 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; in particular, that:

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<sup>250</sup> The Appellate Body has condemned interpreting a treaty in a manner that reduces certain provisions to inutility: “[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.” Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R (“Appellate Body Report, *United States - Gasoline*”), p. 22. The Appellate Body has attached great significance to this principle. *See, e.g.*, Appellate Body Report, *Argentina - Footwear*, ¶ 121; Appellate Body Report, *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS 103/AB/R, WT/DS103/AB/R, ¶ 133; Appellate Body Report, *United States - Gasoline*, p. 22. *See also* Panel Report, *Japan - Taxes on Alcoholic Beverages*, adopted on 1 November 1996 WT/DS8/R, WT/DS10/R, WT/DS/11/R, (“Panel Report, *Japan - Alcohol*”), ¶ 6.22.



- (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 *razonables* because:
    - (i) Mexico has allowed Telmex to charge an interconnection rate that exceeds cost, and to restrict the supply of scheduled basic telecommunications services; and
    - (ii) Mexico prohibits the use of any alternative to this rate;
  - (d) Mexico’s ILD Rules (specifically Rule 13 along with Rules 3, 6, 10, 22 and 23) fail to ensure that Telmex provides cross-border interconnection in accordance with Section 2.2 of the Reference Paper.
- 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 telecom suppliers reasonable and non-discriminatory access to, and use of, public telecom 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.

## ATTACHMENT A

1. This attachment provides additional evidence that Telmex has the ability to exercise market power, and so remains a major supplier, in international services generally in Mexico and in the relevant market for termination of voice telephony, facsimile and circuit-switched data transmission services supplied on a cross-border basis from the United States into Mexico.

2. *Telmex's International Retail Prices.* Telmex's prices for its international outbound services from Mexico remain high, compared with the retail prices of U.S. carriers for international traffic to Mexico and even the prices charged by other Mexican carriers. The ability of a firm to price its services consistently and significantly higher than those of its direct competitors, or other firms offering similar services in related markets that can be used as benchmarks, while continuing to retain most of the market share over a period of years provides strong evidence of market power -- indeed, it essentially defines market power. It is very unlikely that these higher prices are attributable solely or even primarily to higher costs of providing service, in light of the evidence discussed below of Telmex's high profits. High retail prices for outbound services also affect what U.S. and other foreign carriers need to pay for termination in Mexico. Because high retail prices naturally tend to suppress demand for originating services, they maintain the considerable imbalance of inbound to outbound minutes in Mexico, which according to Cofetel's own data has historically been on the order of two or three to one,<sup>251</sup> and keep overall settlement costs high.

3. According to the most recent tariffs filed with Cofetel by the Mexican carriers, Telmex's retail prices for basic international voice telephone services to the U.S. are several times the published rates available from the largest U.S. carrier, AT&T, for such services to Mexico, and Telmex's prices for such international services to the U.S. also remain higher than those of the other Mexican international carriers.<sup>252</sup> Telmex has not changed these rates since March 1999, when it actually increased its basic international rates to the U.S. by 14.2%.<sup>253</sup>

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<sup>251</sup> For 1997 and 1998, the ratio of incoming to outgoing international minutes in Mexico was 2.3/1, for 1999 2.6/1, for 2000 3.1/1, and for 2001 2.5/1. Cofetel, "Relación de Minutos de Trafico de Larga Distancia Internacional Entrada/Salida," FR-CFT-DGTE-DIE-PO-03-04.

<sup>252</sup> The most recent international service tariffs published by Telmex, Alestra and Avantel can be found on Cofetel's web site. Tarifas, Libro tarifario de Telmex, Seccion 7, Tarifas para el servicio de Larga Distancia Internacional (Mar. 10, 1999), 1.1, Tarifa Plena Mexico vs. E.U.A., and 3.1, Servicios automaticos LADA Internacional (March 10, 1999), available at [http://www.cofetel.gob.mx/html/4\\_tar/telmex/SECC7.html](http://www.cofetel.gob.mx/html/4_tar/telmex/SECC7.html); Tarifas, Libro tarifario de Alestra, Capitulo 1, Larga Distancia Automatica, 4.2 (June 1, 2001), available at [http://www.cofetel.gob.mx/html/4\\_tar/alestra/alestra00.html](http://www.cofetel.gob.mx/html/4_tar/alestra/alestra00.html); Tarifas, Libro tarifario de Avantel, Avantel Unico Internacional, 2 (June 28, 2002), available at [http://www.cofetel.gob.mx/html/4\\_tar/avantel/avantel13a.html](http://www.cofetel.gob.mx/html/4_tar/avantel/avantel13a.html).

<sup>253</sup> Telefonos de Mexico, S.A. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission June 27, 2002), at 15. Exhibit US-24.

Mexico-U.S. Tariff Zones	Telmex Basic International Rates (Tarifa Plena)	Telmex LADA 09+1 International Rates Peak Times	Telmex LADA 09+1 International Rates Off-Peak Times (33.33% discount)	Alestra Larga Distancia Automatica Rates Peak Times	Alestra Larga Distancia Automatica Rates Off-Peak Times (33.33% discount)	Avantel Tarifa Unico International Rates
Mexico - U.S. Frontier (75 km to border in Mexico, 89 km in U.S.)	3.20 pesos per minute	4.16 pesos per minute	2.77 pesos per minute	3.20 pesos per minute	2.13 pesos per minute	1.82 pesos per minute
Mexico North (within 550 km from border) - U.S.	7.88 pesos per minute	10.24 pesos per minute	6.83 pesos per minute	7.79 pesos per minute	5.19 pesos per minute	4.55 pesos per minute
Mexico South (above 550 km from border) - U.S.	9.48 pesos per minute	12.32 pesos per minute	8.21 pesos per minute	9.30 pesos per minute	6.2 pesos per minute	4.55 pesos per minute

Based on these published tariffs, the lowest prices Telmex offers retail consumers for voice telephony international long distance calls from most locations in Mexico to the U.S. are between \$0.69-0.83 U.S. (based on a current exchange rate of about 9.9 pesos to the dollar), and for some times and locations are in excess of \$1 per minute. Even the lowest available prices to any location, in the frontier zone, are nearly 30 cents per minute. By comparison, AT&T's most recently published international retail rates from the U.S. to Mexico, using the widely available discounted Anyhour International Savings Plan, are at least three to four times lower to most locations, and more than twice as low even in the frontier zone. AT&T charges either \$0.10 or \$0.21 per minute depending on the location "band" indicating the call destination in Mexico (the lower rate applies to bands 1-3, closer to the international border, and the higher one to bands 4-

8, with Mexico City in band 7, one of the higher-rate bands).<sup>254</sup> Similarly, SBC, one of Telmex's owners and a U.S. local exchange carrier now authorized to provide long distance services in several of the states where it operates, charges per minute rates identical to AT&T's under one of its published rate plans, and under other plans with lower fees charges no more than \$0.34 to most locations in Mexico or \$0.15 cents in the frontier zone.<sup>255</sup>

4. Another way to assess comparative prices, taking into account the differences in specific prices due to times of day, classes of customers, discounts and other factors, is to examine average revenue per minute for outgoing international traffic, subtracting revenues from settlements and the share of total minutes represented by incoming minutes.<sup>256</sup> Because international traffic from Mexico to the U.S. represents such a great majority of Mexico's total international traffic, average data on Telmex's outbound international service prices can serve as a reasonable proxy for average prices on the Mexico-U.S. route. Telmex's outgoing international minutes, international revenues excluding settlements for incoming traffic, and average revenue per minute calculated from this data for the years 1999-2001 are as follows:<sup>257</sup>

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<sup>254</sup> AT&T international rates, available at <http://www.consumer.att.com/global>. Rates under this plan are available to customers who pay a monthly service charge of \$2.95, regardless of number of calls. This service charge, applied to a monthly bill involving 100 international minutes, would effectively add less than 3 cents per minute to the call price.

<sup>255</sup> Under SBC's International Saver plan, residential consumers who pay a fee of \$2.95 per month can call locations in the frontier zone in Mexico for \$0.15 cents per minute, and all other locations in Mexico for \$0.34 cents per minute, at any time of day. Under SBC's SuperMexico 60 plan, residential consumers can call any location in Mexico for \$0.30 cents per minute. And under SBC's International SuperSaver plan, residential consumers who pay a fee of \$5.95 per month can call locations in the frontier zone in Mexico for \$0.10 cents per minute, and all other locations in Mexico for \$0.21 cents per minute. Rates available from SBC's web site, <http://www.swbell.com>.

<sup>256</sup> Telmex, for example, offers discounted long distance rates for large corporate customers and some other types of customers, and offers discounted international rates based on time of day. Telefonos de Mexico, S.A. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission June 27, 2002), at 16; Exhibit US-24.

<sup>257</sup> See Telmex, *Annual Report* at 9, 22-23 (2001), Exhibit US-2. Average annual exchange rates are those used by Telmex in its own reports. See Telefonos de Mexico, S.A. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission June 27, 2002), at 3; Exhibit US-24.

Year	1999	2000	2001
Telmex estimated outgoing international minutes (based on proportion of total Mexican international minutes that are outgoing from Cofetel data)	1,165 million minutes (27.8% of Telmex total of 4,192 million minutes)	1,325 million minutes (24% of Telmex total of 5,521 million minutes)	1,259 million minutes (28.6% of Telmex total of 4,404 million minutes)
Telmex estimated international revenues collected from end users for outgoing traffic (total international revenues less settlement revenues)	7,054 million pesos (13,125 million pesos less 6,071 million pesos from settlements)	6,543 million pesos (11,873 million pesos less 5,330 million pesos from settlements)	7,023 million pesos (9,422 million pesos less 2,399 million pesos from settlements)
Telmex average international revenue per minute	6.054 pesos (63.3 U.S. cents at 1999 average rate of 9.54 pesos = \$1)	4.938 pesos (52.1 U.S. cents at 2000 average rate of 9.47 pesos = \$1)	5.578 pesos (59.8 U.S. cents at 2001 average rate of 9.33 pesos = \$1)

By comparison, the average revenue collected from end users by U.S. carriers (*i.e.*, not taking into account the large costs for settlement outpayments that substantially lower net revenue) per outgoing minute on international switched traffic from the U.S. to Mexico for 2000, the most recent year for which such data are available, was 44.7 cents per minute.<sup>258</sup> Telmex's average revenue collected from customers in Mexico per outgoing international minute for the most recent year available, 2001, was thus 33.7% higher than the average 2000 revenue collected from customers by U.S. carriers per outgoing minute on the U.S.-Mexico route, and was 16.5% higher even in 2000, the year in which Telmex's average revenues per outgoing international minute were lowest. U.S. carriers' retail rates must cover not only their costs of transmission and network operation as well as profit in the U.S., but also their substantial outpayments to Mexico, given the large imbalance between the U.S. and Mexico in international traffic flows. In

<sup>258</sup> U.S. carriers collected from customers in the U.S. \$3,041,164,397 for international switched traffic to Mexico in 2000, and sent 6,801,152,199 minutes of switched traffic to Mexico. Federal Communications Commission, *2000 International Telecommunications Data*, Table A1 (December 2001). This average revenue per outgoing minute to Mexico collected by U.S. carriers was slightly higher, in large part due to the substantial settlement rates that U.S. carriers must pay in Mexico, than the U.S. carriers' worldwide average of 43.4 cents collected per outgoing minute for all routes, whether competitive or monopolistic on the non-U.S. end.

contrast, Telmex’s costs of operation in Mexico are partly offset by the substantial payments it receives from U.S. carriers, making it difficult to attribute this large disparity in prices to factors other than exercise of market power by Telmex.

5. *Elasticity of Demand.* Available evidence also indicates that demand for Telmex’s international telecommunications services in Mexico is relatively inelastic, meaning that when prices are changed, the percentage change in quantity demanded alters less than the percentage change in price. Inelasticity, *i.e.*, an elasticity of demand less than 1, is a factor enhancing the ability of a provider with market power to raise or maintain prices above competitive levels without suffering excessive losses in demand. One estimate has indicated that a 20% change in international long distance telephone taxes in Mexico would alter demand by 10.3%, yielding an elasticity of about 0.5.<sup>259</sup> The annual changes in Telmex’s average revenue per outgoing minute in Mexico, which allow aggregate effects of various price adjustments to be assessed, and the changes in volume of outgoing international minutes for the same years, during the periods 1999-2000 and 2000-2001, permit the elasticity of demand faced by Telmex to be calculated as follows:

Period	1999-2000	2000-2001
Increase or decrease in Telmex’s average revenue per outgoing international minute	-19% (decrease from 6.054 to 4.938 pesos per minute)	+13.7% (increase from 4.938 to 5.578 pesos per minute)
Increase or decrease in outgoing international minutes sold by Telmex	+13.7% (increase from 1,165 to 1,325 million minutes)	-4.9% (decrease from 1,325 to 1,259 million minutes)
Estimated elasticity of demand faced by Telmex	0.72	0.36

6. Elasticity of demand is more difficult to estimate for termination of cross-border services, because demand for cross-border services by end users in the U.S. is not directly related to the settlement rates charged by Telmex and other Mexican carriers but rather to the retail prices charged by the U.S. carriers to their customers. Changes in settlement rates do affect demand by U.S. end users indirectly, however, as they are reflected in retail price reductions by competitive U.S. carriers made in response to their lowered costs. In other words, U.S. carriers’ willingness to lower their retail prices and stimulate more demand from end users is affected by changes in the price they must pay to terminate traffic. Available evidence suggests that demand for additional minutes to Mexico from the U.S. in response to settlement reductions has also been somewhat inelastic. For example, between 1998 and 1999, when the settlement rate between the

<sup>259</sup> Vector, Sector Telecomunicaciones, Comentario de Empresa, *Impacto de la propuesta de impuesto telefónico al 20%* (Nov. 30, 2001).

U.S. and Mexico fell from 37 cents to 19 cents per minute, a total change of 18 cents or 48.6%, minutes from the U.S. to Mexico increased in the same period from 3.020 billion to 4.053 billion or 34.2%, resulting in an elasticity of 0.7.<sup>260</sup> During the longer period from 1998 through 2001, when the settlement rate between the U.S. and Mexico fell from 37 cents to 15.5 cents per minute, a decrease of 58.1%, overall incoming minutes received by Mexican carriers increased 71%.<sup>261</sup> Adjusting this volume increase for the increase in volume of minutes that likely would have taken place over this period in any case due to extraneous economic factors, based on evidence of the annual growth in U.S.-Mexico traffic of 8.4% from 1997-1998 when there was no decrease in the settlement rate,<sup>262</sup> the total price-related change in volume over this period can be estimated at 46.5%, yielding an elasticity of 0.8. In any event, even if demand for international services from the U.S. to Mexico were more elastic, Mexican carriers other than Telmex are not permitted to take advantage of this to increase their business by independently agreeing to settlement rate reductions, sustaining Telmex's market power regardless of normal market conditions.

7. *Telmex's Profitability.* High profits, sustained over time, provide direct evidence of a provider's ability to price its products and services in excess of its costs. Telmex has remained quite profitable notwithstanding the considerable decline overall in the telecommunications industry worldwide over the past two years. In 2001, its EBITDA (earnings before taxes, interest, depreciation and amortization) was 54% of sales, higher than even local incumbents in

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<sup>260</sup> FCC, *IMTS Accounting Rates of the United States, 1985-1999* (March 1, 2000), and FCC, *1998 Section 43.61 International Telecommunications Data*, Table A.1 (Jan. 2000), and *1999 International Telecommunications Data*, Table A.1 (Dec. 2000). This data also indicates that U.S. carriers' average revenue per minute collected from end users for traffic from the U.S. to Mexico declined between 1998 and 1999 from about 59.3 cents per minute to 50 cents per minute, following the reduction in settlement rates. By 2000, as indicated above, U.S. carriers' average revenue collected from end users on this route had fallen to 44.7 cents per minute, a 14.6 cents per minute total reduction, so that U.S. carriers had more than passed through the net reduction in settlements (lower outgoing payments offset by lower incoming revenue, based on equal division of settlements and the 4-1 imbalance in U.S.-Mexico traffic and settlement payments) of 14.1 cents per minute. Though traffic from the U.S. to Mexico continued to rise substantially in 2000, by an additional 68% over 1999 based on the FCC data discussed above, a significant part of that increase is likely attributable to changes in demand related to extraneous conditions that did not endure in the following year, making it difficult to determine how much of the additional change reflects price-driven demand. Incoming international minutes received by Telmex and other Mexican carriers, according to Cofetel's data, fell substantially from 2000 to 2001, from 5,896 million to 5,100 million, even though settlement rates between the U.S. and Mexico also declined again in 2001 from 19 to 15.5 cents per minute. Cofetel, "Trafico de Larga Distancia Internacional de Entrada, Millones de minutos y crecimiento anual," FR-CFT-DGTE-DIE-PO-03-04.

<sup>261</sup> Cofetel, "Trafico de Larga Distancia Internacional de Entrada, Millones de minutos y crecimiento anual," FR-CFT-DGTE-DIE-PO-03-04. This aggregate data for minutes received by Mexican carriers from all countries can be used as a reasonable proxy for estimating changes in incoming minutes from the U.S., given that the great majority of Mexican incoming traffic is from the U.S. so that changes in U.S. related minutes are the primary component of any changes in the overall Mexican figure. Mexico-specific data published by the FCC are not yet available for 2001.

<sup>262</sup> Between 1997 and 1998, IMTS minutes from the U.S. to Mexico increased from 2,766 million to 3,020 million, or 8.4%. FCC, *1998 Section 43.61 International Telecommunications Data*, Table A.1 (Jan. 2000), and FCC, *1997 Section 43.61 International Telecommunications Data*, Table A.1 (Dec. 1998).

the U.S. or Europe, and Telmex experienced an increase of 28% in its stock value during a period from early 2001 into 2002, even while the Dow Jones Total Market Telecom Index fell 42%.<sup>263</sup> Telmex's 2001 net income was 21.2% of its total revenues, and its operating income was 38.4% of total revenues, an uncommonly high level of profitability in the telecommunications industry during the past two years.<sup>264</sup> Even in Telmex's most recent financial results for the second quarter of 2002, the company reported EBITDA of 51.6% of revenues, operating income of 34.7% of revenues, and net income of 14.5% of revenues.<sup>265</sup> These profits, of course, reflect income from all of Telmex's lines of business, including the monopolistic fixed local network that is a particularly large source of revenues and profits,<sup>266</sup> but Telmex has never indicated that its international business is unprofitable. To the contrary, the high prices that Telmex charges for originating international services compared with other Mexican carriers, or with U.S. carriers for comparable traffic into Mexico, as well as the settlement rates well in excess of costs charged by Telmex to U.S. carriers, indicate that Telmex's international services remain a substantial source of profit.

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<sup>263</sup> Luhnow, Wall Street J. at 1; Exhibit US-28.

<sup>264</sup> Telmex, *Annual Report* at 22 (2001); Exhibit US-2.

<sup>265</sup> Telmex, *Highlights Second Quarter 2002* at 4.

<sup>266</sup> Telmex's prices for local service are the highest charged by any incumbent telephone operator in an OECD member country, Luhnow, Wall Street J., at 1, and the OECD has found that Mexico's baskets of domestic telephone charges (excluding international and mobile) are among the highest of any OECD member countries (surpassed only by two or three Eastern European states) for residential customers and the highest of any of the OECD's member countries for business customers. OECD, *Communications Outlook (2001)* at Figures 7.4, 7.5, 7.6, 7.7 and Tables 7.8, 7.9, 7.10 and 7.11. The great majority of these charges, of course, are paid to Telmex given its control of virtually all of the fixed local service market and most of the long distance market. Indeed, Telmex has repeatedly raised its prices for local service during the 1999-2001 period, by over 20% in the aggregate. Telefonos de Mexico, S.A. de C.V., *Form 20-F Annual Report* (filed with U.S. Securities and Exchange Commission June 27, 2002), at 15; Exhibit US-24. The consequences of these high prices are reflected in Mexico's level of telephone penetration, which is not only far below most OECD members but also lower than many other Latin American countries. See United Nations, Department of Economic and Social Affairs, Statistics Division, "Telephone lines and cellular subscribers per 100 population," available at <http://unstats.un.org/unsd/mi> (placing Mexico in 2001 at 33.55 telephone lines and cellular subscribers per 100 population, about half of the average for the Americas at 61.22, and below the Central and South American countries of Argentina, Brazil, Chile, French Guiana, Panama, Suriname, Uruguay and Venezuela); International Telecommunications Union, "Main telephone lines per 100 inhabitants" (2002), available at <http://www.itu.int/ITU-D/ict/statistics> (placing Mexico in 2001 at 13.72 main telephone lines per 100 population, about a third of the average for the Americas at 35.21, and below the Central and South American countries of Argentina, Belize, Brazil, Chile, Colombia, Costa Rica, Panama, Suriname, and Uruguay).



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- US-7 Submission by Mexico to the OECD Working Party No. 2 on Competition and Regulation, DAFPE/CLP/WP2/WD(2001)25
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- US-9 Letter from Jaime Chico Pardo (Telmex) to George Foyo (AT&T), 31 August 1998
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- US-11 Letter from Javier Lozano Alarcón (Cofetel) to Alfonso Migoya (Alestra), 27 November 1998
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