

**MEXICO – MEASURES AFFECTING  
TELECOMMUNICATIONS SERVICES**

***Report of the Panel***

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## I. INTRODUCTION

1.1 On 17 August 2000, the United States requested consultations with Mexico pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU") and Article XXIII of the General Agreement on Trade in Services (the "GATS").<sup>1</sup> This request concerned Mexico's GATS commitments and obligations on basic and value-added telecommunications services.

1.2 The consultations took place on 10 October 2000, but the parties failed to reach a mutually satisfactory resolution. On 10 November 2000, the United States requested the Dispute Settlement Body (the "DSB") to establish a panel, in accordance with Articles 4 and 6 of the DSU, in order to examine Mexico's measures with respect to trade in basic and value-added telecommunications services.<sup>2</sup> On the same date, the United States requested additional consultations with Mexico, pursuant to Article 4 of the DSU and Article XXIII of the GATS, regarding Mexico's measures affecting trade in telecommunications services.<sup>3</sup> The additional consultations took place on 16 January 2001, but the parties failed again to reach a mutually satisfactory resolution. On 13 February 2002, the United States again requested the DSB to establish a panel, in accordance with Articles 4 and 6 of the DSU in order to examine Mexico's measures affecting telecommunications services.<sup>4</sup>

1.3 At its meeting on 17 April 2002, the DSB established a Panel in accordance with Article 6 of the DSU.<sup>5</sup> At that meeting, the parties agreed that the Panel should have standard terms of reference as follows:

"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."<sup>6</sup>

1.4 On 16 August 2002, the United States requested the Director-General to determine the composition of the Panel pursuant to Article 8.7 of the DSU, which provides:

"If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request."

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<sup>1</sup> See WT/DS204/1.

<sup>2</sup> See WT/DS204/2.

<sup>3</sup> See WT/DS204/1/Add.1.

<sup>4</sup> See WT/DS204/3.

<sup>5</sup> See WT/DSB/M/123.

<sup>6</sup> See WT/DS204/4.

1.5 On 26 August 2002, the Director-General composed the Panel as follows:<sup>7</sup>

Chairman: Mr Ernst-Ulrich Petersmann

Members: Mr Raymond Tam  
Mr Björn Wellenius

1.6 Australia, Brazil, Canada, Cuba, the European Communities, Guatemala, Honduras, India, Japan and Nicaragua reserved their rights to participate in the Panel proceedings as third parties.

1.7 The Panel met with the parties on 17 and 18 December 2002 and on 12 and 13 March 2003. The Panel met with the third parties on 18 December 2002.

1.8 The Panel submitted its Interim Report to the parties on 21 November 2003. The Panel submitted its final report to the parties on 12 March 2004.

## II. FACTUAL ASPECTS

2.1 This dispute concerns provisions in Mexico's domestic laws and regulations on telecommunications which govern the supply of telecommunication services.

### A. MEXICO'S TELECOMMUNICATION MARKET

2.2 Prior to 1997, long-distance and international telecommunications services in Mexico were supplied on a monopoly basis by Teléfonos de México, S.A. de C.V. ("Telmex"). Since that date, Mexico has authorized multiple Mexican carriers to provide international services over their networks. Under Mexican laws, the largest carrier of outgoing calls to a particular international market, has the exclusive right to negotiate the terms and conditions for the termination of international calls in Mexico that apply to any carrier between Mexico and that international market.<sup>8</sup> Telmex is presently the largest carrier of outgoing calls for all markets. Currently, there are 27 carriers ("concesionarios" or "concessionaires") allowed to provide long distance services, including two United States-affiliated carriers – Avantel (WorldCom) and Alestra (AT/T).<sup>9</sup> Of these 27 long-distance concessionaries 11 are authorized to operate international gateways, allowing them to carry incoming and outgoing international calls.<sup>10</sup> Telmex remains the largest supplier of basic telecommunications services in Mexico, including international outbound traffic.

### B. MEXICO'S TELECOMMUNICATIONS LAWS AND REGULATIONS

#### 1. Federal Telecommunications Law

2.3 The Federal Telecommunications Law (the "FTL") of Mexico provides the legal framework for the regulation of telecommunications activities in Mexico.<sup>11</sup> Its purpose is "to govern the use, utilization and exploitation of the radio-electrical spectrum, of the telecommunications networks, and of satellite communication".<sup>12</sup> More broadly, it is intended to "promote efficient development of

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<sup>7</sup> See WT/DS204/4.

<sup>8</sup> See ILD Rules 2 and 13.

<sup>9</sup> See Mexico's first written submission, paragraph 87. See also Mexico's first oral statement, paragraph 11.

<sup>10</sup> See Mexico's first written submission, paragraph 88.

<sup>11</sup> See Federal Telecommunications Law (FTL), ("*Ley Federal de Telecomunicaciones*"), published in the Federal Gazette ("*Diario oficial de la Federación*") on 7 June 1995, entered into force on 8 June 1995.

<sup>12</sup> See FTL, Article 1.

telecommunications; exercise the authority of the State on these matters to ensure national sovereignty; to promote a healthy competition among the different telecommunications service providers in order to offer better services, diversity and quality for the benefit of the users and to promote an adequate social coverage".<sup>13</sup>

2.4 The FTL establishes a Secretariat of Communications and Transportation ("*Secretaría de Comunicaciones y Transportes*" or "Secretariat"), which is authorized, *inter alia*, to grant concessions required for "installing, operating or exploiting public telecommunications networks".<sup>14</sup> A concession may only be granted to a Mexican individual or company, and any foreign investment therein may not exceed 49 per cent<sup>15</sup>, except for cellular telephone services.<sup>16</sup>

2.5 Special rules apply to "*comercializadoras*" ("commercial agencies").<sup>17</sup> A commercial agency is any entity which, "without being the owner or possessor of any transmission media, provides telecommunication services to third parties using the capacity of a public telecommunications network concessionaire."<sup>18</sup> A concessionaire of a public telecommunications network may not, without permission of the Secretariat, have "any direct or indirect interest in the capital" of a commercial agency.<sup>19</sup> The establishment and operation of commercial agencies is "subject, without exception, to the respective regulatory provisions".<sup>20</sup> The Secretariat has issued regulations for commercial agencies to provide pay public telephone public telephony services (pay phones).<sup>21</sup>

2.6 The "interconnection" of public telecommunications networks with foreign networks is carried out through agreements entered into by the interested parties.<sup>22</sup> Should these require agreement with a foreign government, the concessionaire must request the Secretariat to enter into the appropriate agreement.<sup>23</sup>

2.7 Several fundamental technical terms are defined in the FTL. These are:

2.8 *Telecommunications*: "every broadcast, transmission or reception of signs, signals, written data, images, voice, sound or data of whatever nature carried out through wires, radio-electricity, optic or physical means or any other electromagnetic systems";

2.9 *Telecommunications network*: "systems integrated by means of transmission such as channels or circuits using frequency bands of the radio-electrical spectrum, satellite links, wiring, electric transmission networks or any other transmission means, as well as when applicable, exchanges, switching devices or any other equipment required";

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<sup>13</sup> See FTL, Article 7.

<sup>14</sup> See FTL, Article 11.

<sup>15</sup> See FTL, Article 12. Foreign investment in cellular telephone services may however be greater than 49 per cent, with the permission of the Commission on Foreign Investment.

<sup>16</sup> See FTL, Article 12.

<sup>17</sup> Also referred to in English language translations of the FTL as 'telecommunications service marketing companies'.

<sup>18</sup> See FTL, Article 52.

<sup>19</sup> See FTL, Article 53.

<sup>20</sup> See FTL, Article 54.

<sup>21</sup> See Mexico's answer to question No. 6(d) of the Panel of 19 December 2002 ("*Mexico has inscribed in its schedule that it 'will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued'. Why has Mexico not issued the regulations on the establishment and operation of commercial agencies?*"). See also the Public Telephony Regulations, published in the Federal Gazette on 16 December 1996 (Exhibit MEX-29).

<sup>22</sup> See FTL, Article 47, paragraph 2.

<sup>23</sup> See FTL, Article 47, paragraph 4.

2.10 *Private telecommunications network*: "the telecommunications network used to meet specific requirements for telecommunications services of certain people not implying commercial exploitation of services or capacity of said network";

2.11 *Public telecommunications network*: "the telecommunications network through which telecommunications services are commercially exploited. The network does not include users' terminal telecommunications equipment nor telecommunications networks located beyond the terminal connection point".<sup>24</sup>

## 2. International Long-distance Rules

2.12 The International Long Distance Rules ("ILD Rules") are issued by the Federal Telecommunications Commission ("*Comisión Federal de Telecomunicaciones*" or "Commission"), an agency of the Secretariat of Communications and Transportation.<sup>25</sup> They serve "to regulate the provision of international long-distance service and establish the terms to be included in agreements for the interconnection of public telecommunications networks with foreign networks."<sup>26</sup> International long-distance service is defined as the service whereby all international switched traffic is carried through long-distance exchanges authorized as international gateways.<sup>27</sup>

2.13 Direct interconnection with foreign public telecommunications networks in order to carry international traffic may only be done by "international gateway operators".<sup>28</sup> These are long-distance service licensees authorized by the Commission "to operate a switching exchange as an international gateway"<sup>29</sup>, that is, the exchange is "interconnected to international incoming and outgoing circuits authorised by the Commission to carry international traffic".<sup>30</sup> Traffic is "switched" when it is "carried by means of a temporary connection between two or more circuits between two or more users, allowing the users the full and exclusive use of the connection until it is released."<sup>31</sup>

2.14 Each international gateway operator must apply the same "uniform settlement rate" to every long-distance call to or from a given country, regardless of which operator originates or terminates the call.<sup>32</sup> The uniform settlement rate for each country is established, through negotiations with the operators of that country, by the long-distance service licensee having the greatest percentage of outgoing long-distance market share for that country in the previous six months.<sup>33</sup>

2.15 Each international gateway operator must also apply the principle of "proportionate return". Under this principle, *incoming* calls (or associated revenues) from a foreign country must be distributed among international gateway operators in proportion to each international gateway operator's market share in *outgoing* calls to that country.<sup>34</sup>

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<sup>24</sup> See FTL, Article 3.

<sup>25</sup> See *Rules for the Provision of International Long-Distance Service To Be Applied by the Licensees of Public Telecommunications Networks Authorized to Provide this Service (ILD Rules)* (Reglas para Prestar el Servicio de Larga Distancia Internacional que deberán aplicar los Concesionarios de Redes Públicas de Telecomunicaciones Autorizados para Prestar este Servicio). Issued by the Commission; published in the Federal Gazette on 11 December 1996; entered into force on 12 December 1996.

<sup>26</sup> See ILD Rule 1.

<sup>27</sup> See ILD Rule 2:XI.

<sup>28</sup> See ILD Rules 3 and 6.

<sup>29</sup> See ILD Rule 2:VII.

<sup>30</sup> See ILD Rule 2:VIII.

<sup>31</sup> See ILD Rule 2:XV.

<sup>32</sup> See ILD Rules 2:XII(a) and (b); and 10.

<sup>33</sup> See ILD Rule 13.

<sup>34</sup> See ILD Rules 2:XII, 10, 13, 16, 17 and 19.

2.16 Private cross-border networks must lease capacity from a long-distance licensee (concessionaire).<sup>35</sup> Any cross-border traffic carried through dedicated infrastructure that forms part of a private network must be originated and terminated within the same private network.<sup>36</sup>

## C. THE COMPETITION LAWS OF MEXICO

### 1. Federal Law of Economic Competition<sup>37</sup>

2.17 The Federal Law of Economic Competition ("*Ley Federal de Competencia Económica*" or "FLEC") is intended "to protect the process of competition and free market participation, through the prevention and elimination of monopolies, monopolistic practices and other restrictions that deter the efficient operation of the market for goods and services."<sup>38</sup>

2.18 Under the law, the "relevant market" is determined by considering, *inter alia*, "the possibilities of substituting the goods or services in question, with others of domestic or foreign origin, bearing technological possibilities, and the extent to which substitutes are available to consumers and the time required for such substitution".<sup>39</sup> Whether an economic agent has "substantial power" in the relevant market is determined, *inter alia*, on "the share of such agent in the relevant market and 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".<sup>40</sup>

### 2. Code of Regulations (to Federal Law on Economic Competition)<sup>41</sup>

2.19 The Code of Regulations to the FLEC sets out in detail the rules, *inter alia*, for the analysis of the relevant market and substantial power.

2.20 For the relevant market analysis, the Code states that the Commission shall "identify the goods or services which make up the relevant market, whether produced, marketed or supplied by the economic agents, and those that are or may be substituted for them, whether domestic or foreign, as well as the time required for such substitution to take place." The Commission is also to take into account "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".<sup>42</sup>

2.21 With respect to substantial power, the Code requires the authorities to take into account the "degree of positioning of the goods or services in the relevant market"; the "lack of access to imports or the existence of high importation costs"; and the "existence of high cost differentials which could face consumers on turning to other suppliers."<sup>43</sup>

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<sup>35</sup> See ILD Rule 4.

<sup>36</sup> See ILD Rule 4.

<sup>37</sup> See FLEC. Approved by the Congress on 18 December 1992, promulgated by the President on 22 December 1992, published on 24 December 1992, entered into force 180 days after publication.

<sup>38</sup> See FLEC, Article 2.

<sup>39</sup> See FLEC, Article 12.

<sup>40</sup> See FLEC, Article 13.

<sup>41</sup> See *Code of Regulations to the Federal Law on Economic Competition* ("*Reglamento de la Ley Federal de Competencia Económica*"), published in the Official Gazette on 4 March 1998, entered into force on 5 March 1998 (with the exception of Article 6 which entered into force 6 months from 5 March 1998).

<sup>42</sup> See *Code of Regulations to the Federal Law on Economic Competition*, Article 9.

<sup>43</sup> See *Code of Regulations to the Federal Law on Economic Competition*, Article 12.

D. MEXICO'S COMMITMENTS UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

2.22 Mexico has undertaken specific commitments for telecommunications services under Articles XVI (Market Access), XVII (National Treatment), and Article XVIII (Additional Commitments). Its additional commitments consist of undertakings known as the "reference paper". These commitments are reproduced in Annex B.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1 The United States requests the Panel to find that:<sup>44</sup>

- (a) Mexico's failure to ensure that Telmex provides interconnection to United States basic telecom suppliers on a cross-border basis on 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:
  - (i) Mexico's Reference Paper obligations apply to the terms and conditions of interconnection between Telmex and United States suppliers of basic telecommunications services on a cross-border basis;
  - (ii) Telmex is a "major supplier" of basic telecommunications services in Mexico, as that term is used in Mexico's Reference Paper obligations;
  - (iii) Mexico has failed to ensure that Telmex provides interconnection to United States suppliers at rates that are "*basadas en costos*" and terms and conditions that are *razonables* because:
    - Mexico has allowed Telmex to charge an interconnection rate that substantially exceeds cost,
    - Mexico allows Telmex to restrict the supply of scheduled basic telecommunications services; and
    - Mexico prohibits the use of any alternative to the Telmex negotiated interconnection rate through Mexico's ILD rules, specifically Rule 13 along with Rules 3, 6, 10, 22 and 23.
  - (iv) 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.
- (b) 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;

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<sup>44</sup> See the United States' first written submission, paragraph 297, and the United States' second written submission, paragraph 129. See also the United States' second oral statement, paragraph 88.

- (c) Mexico's failure to ensure United States 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 United States service suppliers may access and use public telecommunications networks and services through:
  - (i) interconnection at reasonable terms and conditions for the supply of scheduled services by facilities-based operators and commercial agencies; and
  - (ii) private leased circuits for the supply of scheduled services by facilities-based operators and commercial agencies.

3.2 The United States also requests that the Panel recommend that Mexico bring its measures into conformity with its obligations under the GATS.

3.3 Mexico requests that the Panel reject all of the claims of the United States, and find that:

- (a) The measures being challenged by the United States are not inconsistent with Sections 2.1 and 2.2 of the Reference Paper, inscribed in Mexico's GATS Schedule of Specific Commitments;
- (b) Mexico has not acted inconsistently with its obligations under Section 1.1 of the Reference Paper, inscribed in Mexico's GATS Schedule of Specific Commitments; and
- (c) The measures being challenged by the United States are not inconsistent with Section 5 of the GATS Annex on Telecommunications.<sup>45</sup>

#### IV. MAIN ARGUMENTS OF THE PARTIES

##### A. SECTION 2 OF THE REFERENCE PAPER

4.1 The **United States** claims that Mexico's ILD Rules fail to ensure that Telmex provides interconnection to United States basic telecom suppliers on a cross-border basis with cost-oriented, reasonable rates, terms and conditions and that this 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.<sup>46</sup> The United States argues that the interconnection obligations in Section 2 of the Reference Paper apply: (i) as legally binding GATS commitments; (ii) because of the specific commitments Mexico has undertaken in its GATS Schedule; and (iii) to the circumstances at issue in this case, namely the interconnection between United States service suppliers and Telmex for the purpose of delivering their basic telecom services from the United States into Mexico.<sup>47</sup>

4.2 **Mexico** argues that the claims of the United States must fail because Mexico's Reference Paper obligations do not apply to the measures at issue in this dispute, namely the accounting rates set by bilateral agreements between the United States and Mexican basic telecommunications carriers.<sup>48</sup>

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<sup>45</sup> See Mexico's first written submission, paragraph 267. See also Mexico's first oral statement, paragraph 58, Mexico's second written submission, paragraph 107 and Mexico's second oral statement, paragraph 124.

<sup>46</sup> See the United States' first written submission, paragraph 297, and the United States' second written submission, paragraph 129. See also the United States' second oral statement, paragraph 88.

<sup>47</sup> See the United States' first written submission, paragraph 44.

<sup>48</sup> See Mexico's first written submission, paragraph 112.

In the alternative, Mexico argues, if Section 2 of the Reference Paper is found to apply to the accounting rate regime as implemented between the United States and Mexico, the United States has nevertheless failed to establish a prima facie case that the accounting rates negotiated between United States and Mexican carriers are not "*basadas en costos*" ("cost-oriented") and "*razonables*" ("reasonable") pursuant to Section 2.2(b) of Mexico's Reference Paper.<sup>49</sup> Moreover, Mexico argues, the United States has failed to establish that the ILD Rules are inconsistent with Section 2.2 of the Reference Paper.<sup>50</sup>

## 1. Scope of application of the Reference Paper

4.3 The **United States** argues that Mexico undertook the interconnection obligations of Section 2 of the Reference Paper as additional binding commitments under Article XVIII of the GATS. According to the United States, Mexico inscribed the entire text of the Reference Paper into its Schedule as an additional commitment.<sup>51</sup> Therefore, the United States argues, pursuant to Article XVIII of the GATS, 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, the United States argues, 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.<sup>52</sup>

4.4 **Mexico** submits that its Reference Paper does not apply to the accounting rates set by bilateral agreements between United States and Mexican basic telecommunications carriers<sup>53</sup> since it governs matters relating to domestic regulation.<sup>54</sup> Mexico argues that the United States fails to recognize that the Reference Paper is a statement of "definitions and principles" that have the objective of guiding domestic regulators in dealing with major telecommunications suppliers.<sup>55</sup> According to Mexico, the Reference Paper was intended to accommodate different political and legal regimes in WTO Members, and is sufficiently flexible to accommodate differences in market structures and regulatory philosophies.<sup>56</sup> In Mexico's view, this means that the principles and definitions in the Reference Paper must be interpreted in the light of the domestic regulatory system of the WTO Member in question.<sup>57</sup> Mexico considers that in this case, because its domestic regulatory regime distinguishes between: (i) the accounting rate regime applicable to traffic exchange between foreign carriers and Mexican concessionaires; and (ii) the regime that is applicable to carriers within Mexico's borders, the United States' challenge under Section 2 of the Reference Paper must fail.<sup>58</sup>

4.5 **Mexico** notes that Section 2 of the Reference Paper contains a number of requirements as to how a major supplier must provide interconnection, with the goal of promoting competition within domestic markets; that is, preventing a major supplier from using its position to prevent new entrant competitors from participating in the domestic market. In contrast, Mexico argues, because carriers from different countries that enter into accounting rate arrangements are not competing with each other, the requirements of the Reference Paper have no meaning for those arrangements.<sup>59</sup>

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<sup>49</sup> See Mexico's first written submission, paragraph 117.

<sup>50</sup> Ibid.

<sup>51</sup> See the United States' first written submission, paragraph 45.

<sup>52</sup> See the United States' first written submission, paragraph 47.

<sup>53</sup> See Mexico's first written submission, paragraph 112.

<sup>54</sup> See Mexico's first written submission, paragraph 152. See also Mexico's first oral statement, paragraph 25.

<sup>55</sup> See Mexico's first oral statement, paragraph 48.

<sup>56</sup> See Mexico's first oral statement, paragraph 49.

<sup>57</sup> Ibid.

<sup>58</sup> See Mexico's first oral statement, paragraph 50.

<sup>59</sup> See Mexico's first written submission, paragraph 154.

4.6 The **United States** contends that there is nothing in the Reference Paper to suggest that its only goal was to promote domestic competition. In its view, there is no textual basis for concluding that the Reference Paper is limited to one mode of supply of the service, i.e. that which is solely within its territory. Instead, the United States notes, Article I of the GATS states that the Agreement covers all measures affecting trade in services, including the cross-border supply of services. While the United States asserts that it is undoubtedly true that the Reference Paper "governs matters relating to domestic regulation", it further submits that this does not mean that foreign service suppliers are "outside the scope of application of" the Reference Paper, or that the Reference Paper governs only matters relating to domestic regulation.<sup>60</sup>

4.7 **Mexico** argues that the mere fact that Article I of the GATS ascribes a broad application of the general obligations of the GATS to all measures by Members affecting trade in services does not mean that Mexico's Reference Paper has a similarly broad application. Mexico submits that it is an "additional commitment" that it inscribed in its Schedule pursuant to Article XVIII of the GATS and, as such, its terms must be interpreted in accordance with the rules of treaty interpretation in Articles 31 and 32 of the *Vienna Convention on the Law of the Treaties of 1969* ("*Vienna Convention*").<sup>61</sup> According to Mexico, the Model Reference Paper, upon which Mexico's Reference Paper is based, develops further the principles and obligations found in Article VI of the GATS on domestic regulation and Article VIII of the GATS on monopolies and exclusive service suppliers, both of which focus on activities within the territory of the Member in question. Thus, Mexico concludes, these Articles deal with matters relating to domestic regulation, and not "the supply of a service from the territory of one Member into the territory of any other Member", which is the focus of the United States' claims in this dispute.<sup>62</sup>

4.8 The **United States** contends that Section 2 applies to this case because United States 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. According to the United States, Telmex and United States basic telecom suppliers are *proveedores de redes públicas de telecomunicaciones de transporte o de servicios* ("suppliers providing public telecommunications transport networks or services") ("PTTNS") because they provide basic telecommunications services, which, pursuant to the *Decision on Negotiations on Basic Telecommunications* by the WTO Trade Negotiations Committee, is synonymous with "telecommunications transport networks and services"; also, it adds, such services are "public" because the Central Product Classification (CPC) codes that Mexico used to describe its commitments refer to "public" services. The United States further argues that supply on a cross-border basis of basic telecom services between the United States and Mexico requires "linking" (*conexión*) between United States suppliers (e.g., AT&T) and Mexican suppliers (e.g., Telmex) in order to allow users of the United States supplier to communicate with users of the Mexican supplier and to access services provided by the Mexican supplier.<sup>63</sup> According to the United States, this is because under Mexican law, United States basic telecom suppliers may not own telecommunications facilities in Mexico and thereby extend their public telecommunications networks from the United States into Mexico. Therefore, the United States argues, when a United States 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

<sup>60</sup> See the United States' first oral statement, paragraph 22. See also the United States' answer to question No. 7 of the Panel of 19 December 2002 ("*Article I of the GATS states that the agreement covers all measures affecting trade in services, including the cross border supply of services. Mexico claims that the Reference Paper applies only to matters relating to domestic regulation within the borders of each WTO Member. Please explain.*").

<sup>61</sup> See Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>62</sup> See Mexico's second written submission, paragraph 25. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>63</sup> See the United States' first written submission, paragraphs 60-64.

end-user in Mexico.<sup>64</sup> This *conexión*, in turn, allows the consumers of the United States basic telecom supplier ("users of one supplier") to communicate with Telmex's consumers in Mexico ("users of another supplier"), as well as the United States 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.<sup>65</sup>

4.9 **Mexico** argues that the apparently broad technical definition of "interconnection" in Section 2.1 of Mexico's Reference Paper<sup>66</sup> is not determinative of the scope of application of Section 2 as a whole. In Mexico's view, this definition must be interpreted in its context, which substantially narrows the scope of application of Section 2. Mexico explains that interconnection occurs between two entities. With respect to one entity, the wording of Section 2.2 restricts the scope of Section 2 to interconnection with a "major supplier". With respect to both entities, the definition in Section 2.1 refers to "suppliers providing public telecommunications transport networks or services". Mexico contends that, although suppliers in Mexico provide PTTNS in Mexico, i.e. Alestra and Avantel, thus enabling both suppliers in an interconnection arrangement to meet this definition, United States-based suppliers such as AT&T and WorldCom do not provide such services in Mexico. Thus, Mexico argues, meaning must be given to the fact that Section 2.1 does not refer to "service suppliers of any other Member", a phrase which is used elsewhere in the GATS and which would have made it clear that Section 2 applies to cross-border (i.e., international) interconnection. Mexico also submits that the phrase *respecto de los cuales se contraigan compromisos específicos* in Section 2.1 of Mexico's Reference Paper further narrows the scope of application of Section 2 to the bounds of the market access inscribed in Mexico's Schedule. Thus, it argues, Section 2 applies only to services supplied in Mexico through mode 3 (commercial presence) by concessionaires with foreign direct ownership up to 49 per cent. In other words, Mexico concludes, it applies only to interconnection within Mexico.<sup>67</sup>

4.10 The **United States** submits that, if Mexico had meant to limit the applicability of Section 2 to interconnection of "some" suppliers with a major supplier, it would have adopted language to that effect. In the absence of any such limitation, the United States contends, Section 2 applies to interconnection of "all" suppliers with a major supplier. For context, the United States refers to the definition in Article XXVIII(g) of the GATS, which states that "'service supplier' means any person that supplies a service." According to the United States, there is no limitation on whether the service supplier is domestic or foreign.<sup>68</sup>

## 2. The scope of "interconnection" within Mexico's Reference Paper

### (a) The concept of interconnection

4.11 The **United States** submits that interconnection consists of the linking of the networks of two different suppliers of telecommunications services for the purpose of exchanging traffic. According to the United States, 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").<sup>69</sup> The United States explains that, because no telecom supplier has a worldwide ubiquitous network, all telecommunications service suppliers 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, it argues, the calling

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<sup>64</sup> See the United States' first written submission, paragraph 65.

<sup>65</sup> See the United States' first written submission, paragraph 67.

<sup>66</sup> As regards the definition of the term "interconnection", see Section IV.A.2(a) of this Report.

<sup>67</sup> See Mexico's second written submission, paragraphs 27-28. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>68</sup> See the United States' second oral statement, paragraphs 27-28.

<sup>69</sup> See the United States' first written submission, paragraph 39.

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 United States submits, 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.<sup>70</sup>

4.12 The **United States** submits that, 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. In support of its view, the United States refers to Section 2.1 of the Reference Paper, which 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". The United States also notes that in its domestic regulation, Mexico defines interconnection similarly as "[p]hysical 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>71</sup>

4.13 The **United States** also refers to the definition of "interconnection" in the European Communities' Interconnection Directive as "the physical and logical linking of telecommunications networks used by the same or a different organization in order to allow the users of one organization to communicate with users of the same or another organization, or to access services provided by another organization."<sup>72</sup> The United States submits that the European Commission has explained that "[t]he most basic interconnection service provided is that of *call termination* (i.e. delivering a call which originates on one network to its destination on another network)."<sup>73</sup>

4.14 In **Mexico's** view, the term "interconnection" is a broad concept that can have different meanings in different contexts. Generally, it explains, interconnection rates are charges for physically and technically linking two domestic networks for purposes of exchanging traffic. In some contexts, it indicates, interconnection is treated as distinct from commercial arrangements – such as settlement, peering, and reciprocal compensation arrangements – that involve charges for use of a network for transport and termination of traffic that originates on another network. Mexico contends that, for example, United States law makes a clear distinction between interconnection and transport and termination services: interconnection is the physical linking of two networks, while transport and termination is when one carrier routes traffic over the network of another carrier. According to Mexico, the regulation of interconnection rates is a significant issue in domestic markets for telephone service where carriers need access to other carriers' networks to provide service in competition with each other. As a result, countries seeking to encourage domestic competition must have strict requirements for incumbent providers with market power. Mexico claims that these rules generally require incumbent carriers to provide all of their competitors interconnection with rates, terms and conditions that are reasonable and non-discriminatory. Mexico argues that interconnection must be permitted at any technically feasible point within the carrier's network and at least equal in quality to that provided by the incumbent provider to itself or to its subsidiaries, affiliates, or any other

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<sup>70</sup> See the United States' first written submission, paragraph 40.

<sup>71</sup> See the United States' first written submission, paragraph 41.

<sup>72</sup> The United States refers to Directive 97/33/EC, Interconnection in Telecommunications, Art. 2(1)(a), available at <http://europa.eu.int/ispo/infosoc/telecompolicy/en/dir97-33en.htm>.

<sup>73</sup> The United States refers to *Commission Recommendation on Interconnection in a Liberalised Market, Part I – Interconnection Pricing*, Explanatory Memorandum (January 8, 1998), Sect. 3.1 (emphasis in original), available at <http://www.europa.eu.int/ISPO/infosoc/telecompolicy/en/r3148-en.htm>.

competitor. Mexico adds that competitors must also have a process to resolve disputes with incumbent carriers that arise during and after the negotiation process.<sup>74</sup>

4.15 The **United States** considers that Mexico's argument that United States law makes a "clear distinction" between interconnection and call termination is irrelevant. It submits that in the United States, as in the European Communities, a key purpose of the regulation of interconnection is to ensure that carriers may terminate calls on other carriers' networks at cost-oriented rates. The United States submits that the FCC (Federal Communications Commission) has made clear that "[t]he interconnection obligation of Section 251(c)(2) ... allows competing carriers to choose the most efficient points at which to exchange traffic with incumbent LECs, *thereby lowering the competing carriers costs of, among other things, transport and termination of traffic.*"<sup>75</sup> The United States explains that United States law defines "transport and termination" separately from interconnection because United States local exchange carriers have *additional* obligations with respect to the transport and termination of calls, including the requirement to establish "reciprocal compensation arrangements" for the termination of calls originated on other local networks.<sup>76 77</sup>

(b) The meaning of interconnection within the Reference Paper

4.16 According to **Mexico**, the term "interconnection" in Section 2 of the Reference Paper is capable of many meanings including: domestic local interconnection, domestic long-distance interconnection and international interconnection.<sup>78</sup> However, Mexico contends, when properly interpreted, "interconnection" in Section 2 of the Reference Paper does not include arrangements under the accounting rate regime.<sup>79</sup> In Mexico's view, the term "interconnection" does not encompass the accounting rate regime.<sup>80</sup> Mexico understands that, in the context of the Reference Paper, "interconnection" must be interpreted to refer to interconnection within a WTO Member's borders, for example, interconnection to a local exchange carrier by a domestic long-distance carrier, or by a competitive local carrier and the incumbent local carrier.<sup>81</sup> Mexico thus submits that the United States incorrectly defines the rates for the transportation and termination of international calls as "interconnection rates".<sup>82</sup>

4.17 **Mexico** further contends that this interpretation does not render the Reference Paper meaningless in the context of international trade in services as implied by the EC in its third party submission. Mexico explains that, for example, where permitted under a WTO Member's Schedule, if a foreign company establishes a commercial presence in that Member's territory, it would have to interconnect with other carriers within the domestic network. Mexico submits that this

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<sup>74</sup> See Mexico's first written submission, paragraphs 36-38.

<sup>75</sup> The United States refers to the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, paragraph 172 (1996) (emphasis added) (Exhibit US-55).

<sup>76</sup> The United States refers to the 47 USC. § 251(b)(5) (Exhibit US-56). Traffic terminated under reciprocal compensation arrangements is subject to the same "forward-looking economic cost-based pricing standard" that governs other interconnection services provided by incumbent local carriers. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, paragraph 1054 (1996) (Exhibit US-55).

<sup>77</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002 ("*What are the main differences and similarities between an accounting rate regime and an interconnection regime from commercial, contractual, technical, and regulatory viewpoints?*").

<sup>78</sup> See Mexico's first written submission, paragraph 150.

<sup>79</sup> See Mexico's first written submission, paragraph 151. See also Mexico's first oral statement, paragraph 26.

<sup>80</sup> See Mexico's first written submission, paragraph 164. See also Mexico's first oral statement, paragraph 25.

<sup>81</sup> See Mexico's first written submission, paragraph 152.

<sup>82</sup> See Mexico's first written submission, paragraph 21.

interconnection would be governed by the provisions of the Reference Paper. Mexico further submits that its ILD Rules fully implement those provisions of the Reference Paper vis-à-vis foreign carriers with a commercial presence in Mexico, among others, AT&T, WorldCom and Verizon.<sup>83</sup>

4.18 The **United States** contends that the plain language of the Reference Paper simply does not support Mexico's argument. According to the United States, the definition of "interconnection" in Section 2.1 is not limited to domestic interconnection, or in other words, interconnection provided to commercially present suppliers. Rather, it argues, it is written broadly to include all means of "linking" for the purpose of enabling users to communicate – whether domestic (mode 3) or international (mode 1).<sup>84</sup> Citing to provisions of Mexico's ILD Rules and Federal Telecommunications Law, the United States also argues that even Mexico, in almost all references in its internal laws and regulations, refers to the linking of foreign service suppliers to its international port operators as "interconnection".<sup>85</sup>

4.19 **Mexico** submits that the United States ignores ILD Rules 2, 10, 13, 16 and 19 which define "settlement rate" and explicitly distinguish between "settlement rates", which are applicable to international traffic, and "interconnection rates, which are paid to the local operator that terminates the call."<sup>86</sup>

4.20 The **United States** submits that the distinction Mexico draws between "interconnection rates" and "charges for use of a network for transport and termination of traffic that originates on another network" is irrelevant.<sup>87</sup> In its view, even though interconnection arrangements cover a wide variety of different commercial, contractual and technical situations, all of these arrangements are "interconnection" under Section 2.1 of the Reference Paper.<sup>88</sup> According to the United States, the requirements of Mexico's Reference Paper apply to all interconnection services, particularly call termination. The United States explains that, because call termination means allowing calls originated on the network of one supplier to be terminated on the network of another supplier, it falls squarely within Mexico's definition of "interconnection" in Section 2.1, which is "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."<sup>89</sup>

(i) *Interpretation of the term "interconnection" in its context*

4.21 **Mexico** argues that the United States' interpretation arises from an improper application of the general rule of interpretation in Article 31 of the *Vienna Convention*<sup>90</sup> since, in its view, the United States simply presents the "ordinary meaning" of the term "interconnection".<sup>91</sup> Mexico submits that, under Article 31 of the *Vienna Convention* it is insufficient to rely solely on the ordinary

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<sup>83</sup> See Mexico's first oral statement, paragraph 29.

<sup>84</sup> See the United States' first oral statement, paragraph 20. See also the United States' second written submission, paragraph 41.

<sup>85</sup> See the United States' first oral statement, paragraph 20. See also the United States' second written submission, paragraphs 41-42.

<sup>86</sup> See Mexico's second oral statement paragraph 11.

<sup>87</sup> The United States refers to Mexico's distinction in paragraph 36 of its first written submission (see paragraph 4.14 of this Report). See the United States' second written submission, paragraph 54.

<sup>88</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>89</sup> See the United States' second written submission, paragraph 54.

<sup>90</sup> See Mexico's second written submission, paragraph 33. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>91</sup> See Mexico's first written submission, paragraph 150. See also Mexico's first oral statement, paragraph 27.

meaning of a term and that the United States has therefore failed to take into account the context of the term and object and purpose of Mexico's Reference Paper.<sup>92</sup>

4.22 As regards the context, **Mexico** submits that, the history of the negotiations on basic telecommunications confirms that "interconnection", "accounting rates" and "termination services" were discussed but that agreement was reached only on interconnection. Accordingly, Mexico contends, accounting rates were clearly outside the scope of what was agreed. Mexico contends that a specific draft text on accounting rates was removed from the negotiating drafts for the Model Reference Paper.<sup>93</sup> For example, Mexico states that the following bracketed text was included in a 6 March 1996 provisional negotiating text:

"[Accounting rate is the rate per traffic unit agreed upon between administrations for a given relation, which is used for the establishment of international accounts, as per International Telecommunication Union Recommendation D. 150 New System for Accounting in International Telephony.]...

[7. Public availability of accounting rates

International accounting rates maintained by any supplier of public telecommunications transport services with foreign correspondents will be open to public review. Upon request of another Member, and [sic] essential facilities supplier will be required to justify why an international accounting rate differs significantly from domestic interconnection rates.]"

But the final version of the Reference Paper did not include any of this text. Furthermore, Mexico submits that accounting rates were consciously excluded from this text is confirmed by the fact that they are "on the table" in the Doha Round of negotiations.<sup>94</sup>

4.23 The **United States** responds that Mexico's citation of an earlier draft of the Reference Paper does not support its argument that accounting rates (or international interconnection rates) were intended to be excluded from the definition of "interconnection." According to the United States, Mexico's argument ignores the rules of treaty interpretation included in the *Vienna Convention*. The United States submits that whatever provisions were considered during the drafting process, the Panel is charged with interpreting the final version of the Reference Paper. Mexico's final version includes, in Section 2.1, a definition of "interconnection" that broadly covers "linking ... to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier."<sup>95</sup>

4.24 The **United States** also argues that the requirement in that earlier draft of the Reference Paper that "a dominant supplier explain the reasons why an international accounting rate differs significantly from domestic interconnection rates" at the request of a Member indicates that the negotiators considered accounting rates and domestic interconnection rates to be charges for two types of interconnection. According to the United States, the former is a charge for international interconnection and the latter is a charge for domestic interconnection and that the deletion of this provision merely demonstrates that Members did not undertake those specific obligations. The United States further argues that it does not affect the remaining Reference Paper obligations,

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<sup>92</sup> See Mexico's first written submission, paragraph 151. See also Mexico's first oral statement, paragraph 27.

<sup>93</sup> See Mexico's first written submission, paragraphs 167-169. See also Mexico's first oral statement, paragraphs 21-22, Mexico's second written submission, paragraph 37 and Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>94</sup> See Mexico's first written submission, paragraphs 167-170.

<sup>95</sup> See the United States' second written submission, paragraph 47.

including the obligation of Mexico to ensure that its major supplier Telmex charges interconnection rates, including rates for international interconnection, that are *basadas en costos*.<sup>96</sup>

4.25 **Mexico** submits that the following factors contradict the position of the United States. First, the fact that the negotiating drafts explicitly distinguished between "accounting rates" and "interconnection/interconnection rates" confirms that the negotiators treated the accounting rate regime separately from interconnection. Second, the fact that there were transparency requirements in draft Sections 2.2(b) and 2.3 negated the need for a transparency requirement in square-bracketed Section 7 if, as the United States' argues, "interconnection" subsumed the accounting rate regime. [This fact, t]hat an explicit transparency requirement was included in Section 7 confirms that the negotiators treated the accounting rate regime separately and distinctly from "interconnection". Third, the United States is one of the few WTO Members that make their accounting rates transparent. If the interconnection transparency provisions in the Reference Papers of WTO Members applied to accounting rates, all WTO Members with such commitments would make their rates transparent. Fourth, the fact that no other provisions in the negotiating drafts, the Model Reference Paper and Mexico's Reference Paper could be interpreted to include an obligation analogous to that contained in draft Section 7, so it could not have been removed from the final version of the Reference Paper because its substance was subsumed by other Sections of it. Rather, its subject matter and substance was unique and the negotiators were unable to agree upon its inclusion.<sup>97</sup>

4.26 **Mexico** further argues that the Understanding on Accounting Rates ("the Understanding"), which was outlined in the February 15, 1997 Report of the Chairman of the Group on Basic Telecommunications<sup>98</sup>, confirms that WTO Members did not intend that accounting rates would be subject to the obligations of the GATS, including the Reference Paper.<sup>99</sup> According to Mexico, the Understanding resulted from a discussion of whether Members should take Article II of the GATS (most-favoured nation) exemptions in respect of the application of differential accounting rates, after several countries did take such exemptions. Article II of the GATS, Mexico explains, applies to "any measure covered by [the GATS]". The main debate was whether accounting rates negotiated between private entities should be considered "measures" within the meaning of Article XXVII of the GATS.<sup>100</sup> Mexico argues that, given this uncertainty, as well as the fact that the accounting rate regime was the subject of ongoing and active study in the ITU, the Members agreed that accounting rates would be treated as a subject for further negotiation, as part of the "built-in" negotiations under the GATS. In the meantime, it explains, the Understanding imposes a moratorium on dispute settlement action relating to accounting rates in the WTO.<sup>101</sup> In addition, Mexico argues, although the Understanding originally arose in the context of Article II exemptions, WTO Members did not contemplate that any other obligation of the Reference Paper or of the Annex on Telecommunications would apply to accounting rates. According to Mexico, it only agreed to inscribe the Reference Paper as an additional commitment in its Schedule because of the Understanding that accounting rates were not covered by it.<sup>102</sup>

4.27 As regards the Understanding, the **United States** submits that it is concerned with Article II of the GATS, concerning most-favoured-nation treatment, rather than the Reference Paper. The United States points out that it did not address the issue of cost-orientation or reasonable terms.<sup>103</sup>

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<sup>96</sup> See the United States' second written submission, paragraph 48.

<sup>97</sup> See Mexico's comments on the United States' answer to question No. 18 of the Panel of 14 March 2003, paragraphs 29-33.

<sup>98</sup> The Panel understands that the document referred to by Mexico is the Report of the Group on Basic Telecommunications (S/GBT/4, February 15, 1997).

<sup>99</sup> See Mexico's first written submission, paragraph 171.

<sup>100</sup> See Mexico's first written submission, paragraph 172.

<sup>101</sup> See Mexico's first written submission, paragraph 173.

<sup>102</sup> See Mexico's first written submission, paragraph 176.

<sup>103</sup> See the United States' answer to question No. 16(a) of the Panel of 19 December 2002 ("*At the close of the negotiations on basic telecommunications, an understanding on accounting rates was reached (S/GBT/4,*

The United States further argues that Mexico's claim based on the Chairman's Note (the Understanding)<sup>104</sup> is unsound for at least two reasons.<sup>105</sup> First, the Chairman's Note is at best a non-binding statement that did not find its way into the GATS, the Reference Paper or Mexico's Schedule itself.<sup>106</sup> In support of this, the United States cites to a report by the Group on Basic Telecommunications<sup>107</sup>, which states that "[t]he Chairman stressed that this was merely an understanding, which could not and was not intended to have binding legal force. It therefore did not take away from Members the rights they have under the Dispute Settlement Understanding . . .".<sup>108</sup> Second, the United States argues that the report itself made clear that the Chairman's Note "was merely intended to give members who had not taken MFN exemptions on accounting rates some degree of reassurance." Even in that limited context, the Note has no application outside of GATS Article II - the MFN article.<sup>109</sup> The United States argues that this is clear from the Note's text: the reference in the Chairman's Note to "such" accounting rates is a reference back to the introductory paragraph of the Note, which speaks to "differential" accounting rates and the MFN exemptions actually taken by the five countries mentioned in the Note. However, it argues, because the United States has not brought a claim under Article II of the GATS, the Note is irrelevant to this dispute.<sup>110</sup> The United States further indicates that the fact that accounting rates are subject to discussions in the ITU has no relevance to whether they are covered by Mexico's WTO commitments; nor is it relevant that WTO Members are considering further commitments on accounting rates in the current services negotiations.<sup>111</sup>

(ii) *Subsequent practice*

4.28 **Mexico** submits that the rule of interpretation in paragraph 3(b) of Article 31 of the *Vienna Convention*, which provides that "[t]here should be taken into account together with the context... any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation", is also relevant to this dispute. According to Mexico, all fifty-five of the WTO Members (including the United States) that inscribed the interconnection commitments in Section 2.2(b) of the Model Reference Paper maintain the traditional joint service accounting rate regime. Thus, Mexico argues, WTO Members, including the United States, did not intend Section 2

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paragraph 7). *If Section 2 of the Reference Paper requiring 'cost-oriented' rates and 'reasonable' terms applies to accounting rates, why would there have been a need for the Group on Basic Telecommunications to arrive at a separate understanding on accounting rates?'").*

<sup>104</sup> The Panel takes note here that, from the context of the United States' submission, the document referred to by the United States should be the Report of the Group on Basic Telecommunications (S/GBT/4, 15 February 1997).

<sup>105</sup> See the United States' first oral statement, paragraph 25. See also the United States' second written submission, paragraph 49.

<sup>106</sup> See the United States' first oral statement, paragraph 26. See also the United States' second written submission, paragraph 50.

<sup>107</sup> The Panel takes note here that, from the context of the United States' submission, the document referred to by the United States should be the Report of Meeting of 15 February 1997 (S/GBT/M/9, 10 March 1997).

<sup>108</sup> See the United States' first oral statement, paragraph 26. See also the United States' second written submission, paragraph 50.

<sup>109</sup> See the United States' first oral statement, paragraph 27. See also the United States' second written submission, paragraph 51.

<sup>110</sup> See the United States' first oral statement, paragraph 27. See also the United States' second written submission, paragraph 51. See also the United States' answer to question No. 16(b) of the Panel of 19 December 2002 ("What is the significance of the statement in the understanding that 'the accounting rate system ... by its nature involves differential rates'?").

<sup>111</sup> See the United States' first oral statement, paragraph 24. See also the United States' answer to question No. 12 of the Panel of 19 December 2002 ("Which ITU instruments, if any, are relevant for the interpretation of Section 2 of the Reference Paper? Why?").

of their Reference Papers to apply to international interconnection under the traditional accounting rate regime.<sup>112</sup>

4.29 **Mexico** further submits that, its interpretation is supported by the practice of the United States and other WTO members. According to Mexico, fifty-five WTO Members included the interconnection commitments of Section 2.2(b) of the Model Reference Paper in their individually inscribed Reference Papers and all of them, including the United States, maintain the traditional joint service accounting rate regime.<sup>113</sup>

4.30 **Mexico** submits that the Benchmarks Order is relevant to this dispute in several respects. United States law, including the Benchmarks Order, is consistent with Mexico's position that WTO Members did not believe that the Fourth Protocol or the Annex on Telecommunications applied to accounting rate arrangements. In this regard, the FCC established and applied the benchmarks for the countries that inscribed the Reference Paper as well as those that did not, and did not purport to set benchmarks for the former at the same level as the domestic interconnection rates in those countries. Also, although there are United States carriers that qualify as "major suppliers" under the definition advocated by the United States, the Benchmarks Order does not require any United States carriers to base settlement rates on their own costs – to the contrary, the United States Benchmarks Order and International Settlements Policy effectively prohibit United States carriers from adopting settlement rates based on their own costs. In the event that the Panel were to conclude that the Section 2.2 of the Reference Paper applies to accounting rate arrangements and that Telmex is a major supplier within the meaning of the Reference Paper in the context of the negotiation of rates for bilateral United States-Mexican traffic exchanges, it would need to establish a methodology to determine whether the rates were "cost-based, reasonable and economically feasible." Initially, the United States seemed to suggest that the requirement for "cost-based" rates required an evaluation of the specific costs of Telmex. However, Mexico introduced evidence that it is accepted practice – both in the international and domestic contexts – to use "benchmarks" to determine whether rates are acceptable. The United States had also now agreed with Mexico that Members "can reasonably rely on competitive market dynamics to yield cost-based settlement rates." This meant that Mexico was not obliged by the Reference Paper to make calculations of the specific costs of Mexican carriers in providing transport and transmission services for incoming international calls. It also meant that the Panel reasonably could refer to the available benchmarks for accounting rates – those of the ITU Working Group 3 and the FCC – to determine whether the rates are "cost-based" and "reasonable." Mexico submits that, under the standards of both the ITU and the FCC, Mexico's settlement rates clearly are cost-based and reasonable.<sup>114</sup>

4.31 The **United States** argues that Mexico errs in suggesting that the FCC's "Benchmarks Order", which requires United States carriers to negotiate lower accounting rates, is inconsistent with the United States claim in this proceeding that Mexico's WTO Reference Paper obligations apply to settlement rates. The United States submits that the FCC recognized in the Benchmarks Order that "[t]he WTO Basic Telecom Agreement reached on 15 February 1997 will have profound effects on the accounting rate system," since 69 countries had agreed to open their markets, and 59 countries had agreed to implement the Reference Paper. The United States points out that the FCC went on to state that "the WTO Basic Telecom Agreement will fundamentally change the nature of relations between international telecommunications carriers," and expected that its benchmarks would be "moot for competitive countries and carriers." However, the FCC emphasized that "[n]onetheless, the benchmarks are necessary because many countries still will not be open to competition." Thus, according to the United States, the FCC was particularly concerned by the failure to achieve

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<sup>112</sup> See Mexico's second written submission, paragraph 32. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>113</sup> See Mexico's second written submission, paragraphs 14 and 32.

<sup>114</sup> See Mexico's comments on the United States' answer to question No. 19(b) of the Panel of 14 March 2003, paragraph 41.

meaningful accounting rate reform through the ITU, the 189-country membership of which includes the large majority of countries for which benchmark rates were established by the Benchmarks Order. The countries opening their markets and accepting the Reference Paper comprised less than 25 per cent of the nearly 250 routes for which the FCC established benchmark accounting rates. According to the United States, the Benchmarks Order was necessary to fill this gap.<sup>115</sup>

4.32 The **United States** also argues that Mexico is incorrect in its argument that its accounting rates are consistent with ITU recommendations on benchmark rates. The United States submits that neither ITU recommendations nor ITU benchmarks are relevant to Mexico's WTO obligations. In addition, according to the United States Recommendation ITU D.140, included by Mexico as Exhibit MEX-11, expressly states, at paragraph E.3.2, that the benchmark levels discussed therein should not be "taken as cost-orientated levels."<sup>116</sup>

4.33 Finally, according to **Mexico**, the United States has argued that its own ILD rules are consistent with Section 1 of the Reference Paper because it only applies the rules to foreign carriers that have market power. As shown above, however, the FCC continues to apply the rules to Mexico notwithstanding that, according to the FCC's own standards, there is "meaningful economic competition" within Mexico. Mexico has also submitted documents from the FCC establishing that it has waived its International Settlements Policy only for 15 countries, and that it deems virtually every major foreign carrier to have market power. According to Mexico, the conduct of the United States in maintaining uniform settlement rate, symmetrical rate and proportionate return requirements is evidence that the United States either does not believe that the Reference Paper applies to accounting rate arrangements or that such market control practices are consistent with Section 1.<sup>117</sup>

(iii) *Supplementary means of interpretation*

4.34 According to **Mexico**, even if the United States' interpretation could be considered a proper application of Article 31 of the *Vienna Convention*, it "leads to a result which is manifestly absurd [and] unreasonable", thus requiring recourse to the negotiating history and to the circumstances surrounding the conclusion of the treaty.<sup>118</sup> Mexico explains that, under Article 32 of the *Vienna Convention*, recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31 or to determine the meaning when the interpretation according to Article 31 leaves the meaning ambiguous.<sup>119</sup>

aa) Negotiating history

4.35 According to **Mexico**, a review of the negotiating history of the Reference Paper upon which Mexico's version is based confirms that the term "interconnection" in the Reference Paper was not intended by the WTO Members to encompass the accounting rate regime.<sup>120</sup> See the parties arguments on this matter in Section IV.A.2(b)(i) above.

bb) The international scope and bilateral nature of the accounting rate regime

4.36 **Mexico** further argues that the United States' expansive interpretation of Section 2 of Mexico's Reference Paper fails to take into account the international scope and bilateral nature of the

<sup>115</sup> See The United States' second written submission, footnote 42 to paragraph 59.

<sup>116</sup> See the United States' second written submission, paragraph 66.

<sup>117</sup> See Mexico's comments on the United States' answer to question No. 19(b) of the Panel of 14 March 2003, paragraph 41.

<sup>118</sup> See Mexico's second written submission, paragraph 33. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>119</sup> See Mexico's first written submission, paragraph 165.

<sup>120</sup> See Mexico's first written submission, paragraph 166.

accounting rate regime. In terms of the international scope, it argues, only fifty-five of the one hundred and forty-four WTO Members inscribed a version of the Reference Paper in their schedules that included the "cost-oriented" requirement in paragraph 2.2(b) of the Model Reference Paper while the remaining eighty-nine WTO Members are under no such obligation. Mexico contends that, under the United States' interpretation of Section 2.2 of Mexico's Reference Paper, those fifty-five WTO Members would be required to implement termination rates on their own national carriers using the strict "cost-oriented" standard posed by the United States, while nothing would oblige carriers from the remaining eighty-nine WTO Members and from non-Members to do the same. In its view, the result would be that the net outflows of payments from countries subject to Section 2.2(b) disciplines to countries not subject to Section 2.2(b) disciplines would rise astronomically, forcing carriers of the former countries to choose between bankruptcy and refusing to pay. It further indicates that the accounting rate regime would collapse completely without a viable replacement, possibly even leading to interruptions in international traffic.<sup>121</sup>

4.37 Also, **Mexico** claims, the bilateral nature of accounting rate regimes could lead to a further absurdity. Mexico explains that the financial pressures caused by one of the parties in a bilateral accounting rate arrangement dropping its settlement rate to a very low level could pressure the other party to reduce its rates in order to sustain the economic viability of the arrangement. In such a situation, the other party would effectively be compelled to bring itself closer into compliance with a WTO standard or requirement that it did not inscribe in its Schedule. Thus, it argues, even if that WTO Member had been careful in its Schedule to ensure that its accounting rate regime was not disciplined, it would be indirectly subject to disciplines inscribed in the schedules of other WTO Members with whom it had accounting rate arrangements in place. In Mexico's view, this circumstance would undermine the overall balance of concessions that formed the basis for the agreement.<sup>122</sup>

4.38 The **United States** submits that neither Mexico nor any other Member violates the Reference Paper by continuing to use "accounting rates", or violates the ITU's International Telecommunications Regulation by subjecting "accounting rates" to the obligations in the Reference Paper. According to the United States, Members that have scheduled the Reference Paper may continue to allow their carriers to charge "accounting rates" to terminate traffic. Those Members must simply ensure that those "accounting rates", when used by major suppliers, are consistent with the requirements of Section 2.2(b).<sup>123</sup>

4.39 The **United States** further submits that Mexico need not worry that Telmex will be faced with "net outflows of payments." In fact, it argues, ISR or other types of interconnection arrangements have, in large part, already superseded the accounting rate regime among most of the 55 countries Mexico lists.<sup>124</sup> Also, the United States argues that price reductions made by private parties in response to competitive pressure are not "compelled".<sup>125</sup> In the view of the United States, Mexico's "doomsday" scenario is an invention. The United States contends that Mexico's assertion that Telmex would be forced into bankruptcy if it is forced to observe the "strict 'cost-oriented' standard posed by the United States" is not accurate. Rather, the United States submits that Telmex's current rates substantially exceed the prices charged for the very same elements of interconnection furnished domestically. Thus, it argues, cutting Telmex's rates for the interconnection of international traffic to the level of prices charged for interconnection furnished domestically would not lead to the "doomsday" scenario posed in Mexico's submissions, since under Mexican law these rates already

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<sup>121</sup> See Mexico's second written submission, paragraph 34. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>122</sup> See Mexico's second written submission, paragraph 35. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>123</sup> See the United States' second oral statement, paragraph 33.

<sup>124</sup> See the United States' second oral statement, paragraph 37.

<sup>125</sup> See the United States' second oral statement, paragraph 38.

cover costs, including a reasonable rate of return.<sup>126</sup> Moreover, the United States notes, approximately 80 per cent of Mexico's international traffic is exchanged with the United States. Thus, it submits, if Telmex were to charge cost-based interconnection rates to terminate this traffic, given the large imbalance in traffic flows between the United States and Mexico, the result will not even approach a situation in which Telmex makes "net outflows of payments".<sup>127</sup>

cc) Circumstances of the conclusion of the treaty: Mexican legislation at the time of negotiations

4.40 As to the circumstances of the conclusion of the treaty, **Mexico** turns to Mexican legislation and regulation in effect at the time of the basic telecommunications negotiations. This includes the ILD Rules. Those rules recognize that the term "interconnection" can be used to describe the technical aspects of interconnection in all contexts. However, they also explicitly distinguish between "settlement rates" for international incoming calls and "interconnection charges" for interconnection within Mexico's borders. Accordingly, Mexico submits that, under these laws, at the time of the conclusion of the negotiations, interconnection disciplines such as those in Section 2.2 of Mexico's Reference Paper applied only to domestic interconnection and points out that this is still the case today.<sup>128</sup> As support, Mexico cites to the Appellate Body Report in *EC – Computer Equipment*<sup>129</sup>, where the Appellate Body found that, *inter alia*, a Member's legislation on customs classification at the time of conclusion of the negotiations was part of the circumstances of the conclusion of the treaty.<sup>130</sup>

4.41 The **United States** argues that, while it is true that in *EC – Computer Equipment*, the Appellate Body found that a Member's legislation at the time of negotiations can be used as a *supplementary* means of interpretation, Mexico considers that its ILD rules should *override* the definition of "interconnection" used in Section 2.1.<sup>131</sup> The United States submits that Mexico ignores the Appellate Body's cautionary note that "[t]he purpose of treaty interpretation is to establish the *common* intention of the parties to the treaty. To establish this intention, the prior practice of only *one* of the parties may be relevant, but it is clearly of more limited value than the practice of all parties." The United States submits that, according to the Appellate Body, if the prior practice of a party is not consistent, it is not relevant at all as a supplementary means of interpretation. The United States further submits that, while Mexico focuses on one particular provision of Mexican law which it contends distinguishes between "interconnection" and "settlement rates", it has demonstrated that elsewhere in Mexican law, the linking of foreign service suppliers to Mexican international port operators is referred to as "interconnection", and that throughout its laws and regulations, Mexico uses the term "interconnection agreement" to describe agreements with foreign operators.<sup>132</sup>

(c) Whether the Reference Paper obligations extend to accounting rate regimes

4.42 The **United States** claims that the interconnection obligations in Section 2 of the Reference Paper apply to the interconnection between United States service suppliers and Telmex for the purpose of delivering their basic telecom services from the United States into Mexico.<sup>133</sup> Because

<sup>126</sup> See the United States' second oral statement, paragraph 35.

<sup>127</sup> See the United States' second oral statement, paragraph 36.

<sup>128</sup> See Mexico's second written submission, paragraph 38. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>129</sup> Mexico refers to paragraphs 92-94 of the Appellate Body Report, *EC – Computer Equipment*.

<sup>130</sup> See Mexico's second written submission, paragraph 38. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>131</sup> See the United States' second oral statement, paragraph 44.

<sup>132</sup> See the United States' second oral statement, paragraph 45.

<sup>133</sup> See the United States' first written submission, paragraph 44.

accounting rates are interconnection rates between carriers located in two different countries, the Reference Paper obligations apply to accounting rate regimes as well.<sup>134</sup>

4.43 **Mexico**, on the contrary, argues that the substantive provisions in Section 2.2 of Mexico's Reference Paper can be given full meaning only in the domestic context and therefore cannot be given full meaning in the context of arrangements under the accounting rate regime.<sup>135</sup>

(i) *Concept of "accounting rate"*

4.44 **Mexico** argues that the "accounting rate regime" refers to bilateral relationships between carriers in two countries whereby they agree to compensate one another for transporting and terminating traffic that originates in the other country.<sup>136</sup> Based on the definition by the ITU, Mexico submits that the "accounting rate" is the price two carriers of different countries negotiate for carrying one minute of international telephone service between their countries. Mexico explains that each carrier's portion of the accounting rate is called the "settlement rate." Settlement payments between carriers result when traffic flowing in one direction exceeds traffic flowing in the opposite direction. To calculate its settlement payment, a carrier multiplies the number of minutes its outbound traffic to a particular foreign carrier exceeds its inbound traffic from that foreign carrier and then multiplies this amount by the settlement rate charged by the other carrier (also known as the "accounting rate division share"). Thus, it concludes, a carrier that originates more traffic than it terminates will make periodic settlement payments to its foreign correspondent carrier.<sup>137</sup>

4.45 The **United States** notes that Mexico provides no citation for the definition of accounting rate regime, and no definition – nor any reference to accounting rates – is included in Mexico's Schedule. Thus, the United States submits, Mexico's definition confirms that accounting rates are interconnection rates between carriers located in two different countries, and fails to show that these terms are mutually exclusive. The United States also points out that Mexico's ILD rules make no reference to accounting rates, and refer throughout to "interconnection" and "international interconnection" agreements.<sup>138</sup>

4.46 The **United States** submits that Mexico's Schedule – including its Reference Paper commitments – must be interpreted on its own terms, according to the rules of interpretation included in the *Vienna Convention*. According to the United States, ITU instruments, developed for a different organization, of different members, for different purposes, are not relevant for the interpretation of the requirements of Section 2 of the Reference Paper. The United States notes that Mexico cites no binding ITU resolutions that would be violated by Mexico's compliance with its WTO obligations as claimed by the United States and indeed there are none. According to the United States, Mexico principally uses ITU documents to support its argument that the accounting rate regime is not included within the scope of the Reference Paper. The United States claims that Mexico neglects to discuss the definition of "interconnection" included in Section 2.1 of its Reference Paper, or to present any justification for its view that the arrangements in question do not meet that unambiguous definition.<sup>139</sup> Furthermore, the United States argues that the definition of "accounting rates" maintained by the ITU is in fact consistent with the definition of interconnection included in Section 2.1 of the Reference Paper. According to the United States, the ITU has recognized that competition has changed the ways that international carriers compensate one another for

<sup>134</sup> See the United States' second written submission, paragraph 45.

<sup>135</sup> See Mexico's second written submission, paragraphs 29-30. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>136</sup> See Mexico's first written submission, paragraph 24.

<sup>137</sup> See Mexico's first written submission, paragraphs 28-29.

<sup>138</sup> See the United States' second written submission, paragraph 45. See also the United States answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>139</sup> See the United States' answer to question No. 12 of the Panel of 19 December 2002. For question No. 12, see footnote 111 of this Report.

interconnection, and that accounting rates are one, and only one, of the alternative charging mechanisms that are available for use between carriers in different countries to interconnect their networks.<sup>140</sup>

4.47 **Mexico** acknowledges that the ITU instruments do not assist in the determination of when "*tarifas basadas en costos*" or "cost oriented rates" are reasonable and economically feasible within the meaning of Section 2.2(b) of Mexico's Reference Paper. However, Mexico argues, they could have some relevance in the interpretation of Section 2.2(b) of Mexico's Reference Paper in the context of interconnection rates within Mexico's borders. In addition, Mexico notes, International Telecommunications Regulation ("ITR") 6.2.1, which requires that accounting rates be established by mutual agreement among administrations or recognized private operating agencies is an important element of the context in which the negotiations on basic telecommunications took place. Mexico submits that ITR 6.2.1 requires that accounting rates be determined in negotiations between carriers. As a result, accounting rates that a carrier negotiates for carrying traffic to different countries typically vary widely. Mexico further submits that other recommendations of ITU working committees, such as E.110, also help to illustrate the context in which certain terms are used within the telecommunications sector, which in turn may assist the Panel in determining the "ordinary meaning" of terms in the Reference Paper.<sup>141</sup>

4.48 **Mexico** also notes that the ITRs are supplemented by a series of D-series Recommendations produced by ITU-T Study Group 3. Recommendation D.140 states that "accounting rates for international telephone services should be cost-orientated and should take into account relevant cost trends." At the same time, this same Recommendation recognizes that "the costs incurred in providing telecommunication services, although based on the same components, may have a different impact depending on the country's development status."<sup>142</sup> Thus, Mexico contends, as a whole, the Recommendation encouraged a transition to lower accounting rates, but did not mandate a particular methodology for calculating costs nor contemplate that countries would be able to immediately establish cost-oriented rates.<sup>143</sup>

(ii) *Domestic interconnection v. accounting rates*

4.49 Comparing the two, **Mexico** argues that domestic interconnection is more complicated than accounting rate regimes.<sup>144</sup> Mexico explains that, for example: international interconnection cannot occur at "any technically feasible point"; by their nature accounting rates are per se discriminatory and cannot comply with the non-discrimination requirement; and domestic regulatory bodies do not have legal authority to resolve disputes and impose solutions over carriers that are outside of their territorial jurisdiction. Mexico also points to a Note by the Secretariat on Additional Commitments under Article XVIII of the GATS, which states that the primary purpose of the interconnection provisions of the Model Reference Paper (Section 2) is to safeguard competitive situations where a dominant supplier can exert control *over its competitors*. Thus, Mexico argues, even assuming *arguendo* that Telmex is a dominant supplier, it does not "exert control over its competitors" with respect to the supply of a service from the territory of one Member (i.e., the United States) into the territory of any other Member (i.e., Mexico) because Telmex simply does not compete with United States suppliers for the supply of such services.<sup>145</sup>

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<sup>140</sup> See the United States' second written submission, paragraph 58.

<sup>141</sup> See Mexico's first written submission, paragraphs 30-31. See also Mexico's answer to question No. 12 of the Panel of 19 December 2002. For question No. 12, see footnote 111 of this Report.

<sup>142</sup> See Mexico's first written submission, paragraph 32.

<sup>143</sup> Ibid.

<sup>144</sup> See Mexico's first written submission, paragraph 39.

<sup>145</sup> See Mexico's second written submission, paragraphs 29-30. See also Mexico's answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

4.50 The **United States** argues that, under the definition included in Section 2.1 of Mexico's Reference Paper, the "linking" accomplished via the accounting rate regime is just one form of "interconnection." As a result, there is no element of an "accounting rate regime" that cannot also be an element of an "interconnection regime." Any commercial, contractual, technical or regulatory differences between various types of interconnection arrangements, including accounting rate arrangements, fall under the broad definition included in Section 2.1.<sup>146</sup>

4.51 In response to a question by the Panel, the parties commented on the possible differences between domestic interconnection and accounting rate regimes from a commercial, contractual, technical and regulatory point of view.<sup>147</sup>

aa) Differences from a commercial point of view

4.52 **Mexico** argues that domestic interconnection and accounting rate regimes are different from a commercial viewpoint. According to Mexico, a national carrier entering into an accounting rate arrangement with a national carrier of another nation is not in competition with that carrier, because the two carriers cannot compete for each other's customers. Moreover, it argues, under the accounting rate regime, carriers from different countries must come to a mutual agreement on their relationship; there is no supra-national authority that can dictate terms or rates to both parties simultaneously. On the other hand, Mexico indicates, the commercial context of domestic interconnection regimes is quite different. In the sphere of domestic interconnection, the main focus is on how new entrant ("competitive") carriers gain access to the established networks of incumbent carriers, so as to compete with the incumbents for their customers. Mexico explains that, for example, a new entrant providing a local telephone service generally will not start out with a network that reaches all of the potential customers in the region; it therefore must interconnect with the incumbent carrier to ensure its customers can be connected with all of the incumbent's customers. There is little economic incentive for the incumbent carrier to allow its competitors to interconnect, since the competitor will be trying to sell the same services to those customers as the incumbent. But if the new entrant cannot interconnect, Mexico submits, it will be unable to provide a fully competitive service.<sup>148</sup>

4.53 **Mexico** submits that domestic interconnection arrangements vary depending upon the location as well as type of interconnection, and also involve technical and operational issues.<sup>149</sup> In addition, unlike with the accounting regime whereby a relationship with only one carrier in the destination country enables termination throughout that country, domestic interconnection requires relationships with potentially numerous different carriers.<sup>150</sup> Mexico explains that this is because to ensure a local carrier's customers can reach all customers in the market, a carrier must interconnect with all other local carriers in the market. Similarly, it argues, a domestic long-distance carrier (or inter-city or interexchange carrier) must interconnect with local carriers throughout a country in order to be able to reach all end-user customers. Because a long-distance carrier depends exclusively upon local carriers for access to customers, whereas the local carrier has no similar need for access to the long-distance carrier, the local carrier has the incentive and ability to set interconnection rates as high

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<sup>146</sup> See the United States' answer to question No. 17 of the Panel of 14 March 2003 ("*In considering the commercial, contractual, technical, and regulatory differences between an accounting rate regime and an interconnection regime, which you described in your responses to our questions following the First Panel Meeting, could you please identify those elements in each regime that can never be elements of the other regime?*").

<sup>147</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>148</sup> Ibid.

<sup>149</sup> See Mexico's first written submission, paragraph 39.

<sup>150</sup> See Mexico's first written submission, paragraph 40. See also Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

as possible.<sup>151</sup> Thus, Mexico concludes, regulators again play an important role in setting the terms, conditions, and rates for interconnection between domestic long-distance and local carriers.<sup>152</sup> In conclusion, Mexico submits, the accounting rate regime by its nature must be cooperative, whereas domestic interconnection involves fierce competition that must be regulated.<sup>153</sup>

4.54 The **United States** considers that, from a commercial viewpoint, interconnection is a key wholesale input in supplying a basic telecommunications service because it allows suppliers to complete phone calls where the person placing the call uses a different network from the person receiving the call. Because no telecommunications supplier has a worldwide, ubiquitous network, all telecommunications suppliers must interconnect with other telecommunications suppliers to complete phone calls to receiving parties that use different networks. Similarly, it argues, telecommunications suppliers without their own local networks also must interconnect with other telecommunications suppliers to originate calls. The United States submits that all interconnection, including accounting rate arrangements between carriers in different countries, performs this key commercial function of allowing the completion of calls between the networks of different suppliers. The definition of interconnection set forth in Section 2.1 of the Reference Paper includes all such "linking" between the networks of different suppliers.<sup>154</sup>

4.55 The **United States** further submits that Mexico wrongly seeks to imply that the regulation of interconnection rates is necessary only where interconnecting suppliers compete with each other. Mexico goes on to acknowledge that interconnection is also an important concern in domestic markets where the interconnecting carriers do *not* compete with each other, such as where "a domestic long-distance carrier (or inter-city or interexchange carrier) must interconnect with local carriers throughout a country in order to be able to reach all end-user customers." In these circumstances, it argues, the domestic long-distance carrier must interconnect with local carriers for both call termination *and* call origination. The United States submits that Mexico further acknowledges that the regulation of interconnection rates is necessary in such circumstances, not because the interconnecting carriers are targeting the same customers, but because "the local carrier has the incentive and ability to set interconnection rates as high as possible." For the same reasons, it submits, the regulation of interconnection rates is necessary for the cross-border supply of international basic telecommunications services, which are also dependent on interconnection arrangements for call termination with suppliers that have "the incentive and ability to set interconnection rates as high as possible."<sup>155</sup>

bb) Differences from a contractual point of view

4.56 In response to a question by the Panel, **Mexico** lists the major provisions of the standard domestic interconnection agreement in comparison with accounting rate agreements. According to Mexico, most of the provisions of one agreement are either not applicable or can never be a provision in the other agreement.<sup>156</sup> For example, Mexico pointed to an accounting rate agreement that provided for dispute settlement through international commercial arbitration, while a US domestic interconnection agreement provided for dispute settlement in the courts, before a state public utility commission, or before the Federal Communications Commission. Mexico also highlighted that the

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<sup>151</sup> See Mexico's first written submission, paragraph 41. See also Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>152</sup> See Mexico's first written submission, paragraph 41.

<sup>153</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>154</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>155</sup> Ibid.

<sup>156</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report; see also Mexico's answer to question No. 17 of the Panel of 14 March 2003. For question No. 17, see footnote 146 of this Report.

domestic interconnection agreement contained many provisions not included in accounting rate agreements, such as with respect to audits, indemnification, insurance, discontinuation of service, intellectual property, directory and operator assistance, access to unbundled network elements, access to poles, ducts, conduits, and rights-of-way, access to databases needed to provide 911 emergency call service, and a provision that each party reserves the right to institute an appropriate proceeding with the appropriate federal or state governmental body of appropriate jurisdiction regarding the prices charges for services by the incumbent carrier.<sup>157</sup>

4.57 The **United States** points out that, from a contractual viewpoint, interconnection arrangements between suppliers in the same or different countries, including accounting rate arrangements between suppliers in different countries, may include a wide variety of rates, terms and conditions concerning such matters as specific services covered by the agreement, the rates applicable to specific services, payment schedules, procedures for dispute resolution, time duration of the agreement, restrictions on assignments of rights, and various network technical considerations. The United States explains that interconnection arrangements may provide for one-way or two-way traffic flows, with the same or different rates applying in each direction, and two-way traffic flow. Interconnection arrangements may also provide for "net" payment arrangements under which the two carriers set off their interconnect payments with one carrier remitting the balance to the other carrier.

4.58 The **United States** indicates that, under a traditional accounting rate regime, an agreed accounting rate is divided in half and applied to traffic flows in both directions. However, it argues, Mexico's ILD rules governing "interconnection agreements with foreign operators" (Rule 23) do not restrict the compensation methods that may be negotiated by the "concession holder who holds the largest outgoing long-distance market share" (Rule 13). Notably, the rates that Telmex currently charges United States suppliers differ significantly from the "accounting rate revenue division procedure" described by the informal note submitted by the ITU to the Council on Trade in Services ("a net settlement payment is made on the basis of excess traffic minutes, multiplied by half the accounting rate"). The United States explains that United States suppliers are currently charged different rates for each of three rate zones in Mexico. Additionally, under that arrangement, another rate applies to Mexico-United States traffic. Furthermore, the United States submits, negotiated interconnection rates, including accounting rates between suppliers in different countries, are normally established by the interconnecting suppliers. Mexico's ILD Rule 13 requirement that only the concession holder with the largest market share may negotiate with foreign operators rates that are then binding on its competitors does not reflect any traditional accounting rate regime and, to the knowledge of the United States, is not required by any Member other than Mexico.<sup>158</sup>

cc) Differences from a technical point of view

4.59 **Mexico** argues that domestic interconnection and accounting rate regimes are different from a technical viewpoint. Mexico submits that Section 2.2 of the Reference Paper requires that interconnection be ensured at "any technically feasible point" in the major supplier's network. In contrast, under the accounting rate regime international carriers connect at a border or some international mid-way point that is decided privately between the carriers, who have a mutual interest in cooperating with each other to complete international calls. In Mexico's opinion, unless a country permits foreign carriers to establish their own facilities within its territory – which Mexico has not,

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<sup>157</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8 see footnote 77; see also Mexico's answer to question No. 17 of the Panel of 14 March 2003. For question No. 17 see footnote 146 of this Report.

<sup>158</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

and for which it has a limitation in its Schedule – foreign carriers must always connect at the border, not at any technically feasible point.<sup>159</sup>

4.60 According to **Mexico**, each specific international relationship has its individual technical complexities. Nations that use ANSI standards and interconnect with those that use CEPT standards must carry out conversions of speeds and protocols for coding of voice channels or of signalling of channels, among other things. These conversions require an agreement between the parties on the installation of standard translator equipment, which can be in the country of origin, the country of destination, or even in an intermediate country. No authority regulates the required translations, and neither company has any obligation to comply with the other's requirements in any manner. Furthermore, conditions can vary from interconnection to interconnection. National interconnection arrangements, in contrast, are generally homogeneous, and the technical aspects of all agreements entered into with one local company are virtually identical. Mexico also notes that domestic interconnections are carried out between two carriers, and if they in a particular case require a third party for interconnection, in general terms it is transparent; the company that interconnects is always responsible for the whole network, whether it is owned or leased, up to the point of interconnection with the local operator. In contrast, in international relationships, the infrastructure is shared up to an intermediate point, and the concept known as HMIU, or "half-miu," applies, a term not commonly used in the domestic interconnection lexicon. In the case of border interconnections, the HMIU is limited to a virtual point or to a very short fiber optic segment; nevertheless, a point of mutual responsibility between the parties continues to exist. Mexico further submits that the special complexities of international interconnection are reflected in ITU-T Recommendation E.110, and the recommendation to concentrate international traffic in "a few international exchanges" highlights that the concept of interconnection "at any technically feasible point" is not applicable to international interconnection.<sup>160</sup>

4.61 The **United States** considers that, from a *technical* viewpoint, interconnection, by definition, involves the "linking" of networks of different suppliers, and the technical characteristics of the networks of different suppliers vary. Consequently, it argues, there may be technical differences between interconnection arrangements depending on the technologies used by the interconnecting supplier networks, or on whether the interconnection arrangement is between two fixed line carriers; between a fixed line and a wireless carrier; between local and long-distance carriers; or between two local carriers. The United States submits that, for all interconnection arrangements, including interconnection arrangements involving cross-border suppliers, technical issues are generally resolved through the use of protocols and standards and through joint coordination and planning. Also, to the extent that interconnection at a particular point in the network of the major supplier is not "technically feasible", Section 2.2 of the Reference Paper does not apply.<sup>161</sup>

4.62 The **United States** considers that since United States carriers interconnect their networks with the network of Telmex at the border, the border is clearly a "technically feasible point" of interconnection under Section 2.2. In its view, that Mexico prohibits interconnection at other technically feasible points does not change the nature of the activity encompassed by interconnection.<sup>162</sup> The United States also observes that the international interconnection arrangements are plainly interconnection under Section 2.1 of the Reference Paper, and also are similar to the "meet-point interconnection arrangements" that incumbent local exchange carriers in the

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<sup>159</sup> See Mexico's first written submission, paragraph 155.

<sup>160</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, *see* footnote 77 of this Report.

<sup>161</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, *see* footnote 77 of this Report.

<sup>162</sup> See the United States' first oral statement, paragraph 29.

United States are required to provide to new entrants. Thus, Mexico can not exclude the accounting rate regime from interconnection on this ground.<sup>163</sup>

4.63 The **United States** contends that Mexico's attempt to exclude the accounting rate regime from interconnection on the grounds that "international carriers connect at a border or some international mid-way point" is unfounded. In its view, such "linking" of networks is plainly interconnection under Section 2.1 of the Reference Paper, and also is similar to the "meet-point interconnection arrangements" that incumbent local exchange carriers in the United States are required to provide to new entrants. The United States considers that meet-point arrangements are arrangements by which each telecommunications carrier builds and maintains its network to a meet point. The FCC found in 1996 that meet-point arrangements for interconnection between carrier facilities, also known as "mid-span meets", were commonly used between neighbouring LECs (local exchange carriers) for the mutual exchange of traffic.<sup>164</sup>

dd) Differences from a regulatory point of view

4.64 **Mexico** argues that domestic interconnection and accounting rate regimes are different from a regulatory viewpoint. According to Mexico, in the domestic interconnection context, countries seeking to encourage domestic competition must have strict requirements for incumbent providers with market power. These rules generally require incumbent carriers to provide all of their competitors interconnection with rates, terms and conditions that are reasonable and non-discriminatory.<sup>165</sup> In this regard, Section 2.2(a) provides that interconnection must be provided under "non-discriminatory terms, conditions, and rates." In contrast, there is no expectation that a carrier offer the same accounting rate agreement to foreign carriers from different countries; indeed, there was specifically no agreement in the GATS negotiations to require that accounting rates be non-discriminatory.<sup>166</sup> Interconnection must be permitted at any technically feasible point within the carrier's network and at least equal in quality to that provided by the incumbent provider to itself or to its subsidiaries, affiliates, or any other competitor.<sup>167</sup> Mexico notes that Section 2.2(a) also provides that a major supplier must provide interconnection "of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates." In its view, issues of comparable quality arise only when there is concern that an incumbent carrier could provide inferior quality facilities to carriers competing with it. This issue does not arise in the context of the accounting rate regime, where the traffic is handed off at the border to a national long-distance carrier that has no interest in impeding calls or providing low quality service, but rather is responsible for all of the facilities within its country used to complete the call.<sup>168</sup>

4.65 **Mexico** submits that Section 2.2(b) of the Reference Paper provides that interconnection must be provided in a "timely fashion". In its view, this issue does not arise in the context of the accounting rate regime, where national carriers have no incentive to block access; to the contrary, international calls can be completed only if the carriers from the two countries act in cooperation, and the carriers are compensated for completing the call.<sup>169</sup> Mexico further submits that Section 2.2(b) also provides that interconnection tariffs must be "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." In

<sup>163</sup> See the United States' second written submission, paragraph 44.

<sup>164</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>165</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>166</sup> See Mexico's first written submission, paragraph 156.

<sup>167</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>168</sup> See Mexico's first written submission, paragraph 157.

<sup>169</sup> See Mexico's first written submission, paragraph 158.

contrast, it argues, unbundling does not arise in the context of the accounting rate regime because once a carrier hands traffic off at a border, the terminating carrier is completely responsible for ensuring that the call reaches its final destination.<sup>170</sup>

4.66 **Mexico** notes that Section 2.2(c) of the Reference Paper provides that a major supplier shall provide interconnection upon request "at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities."<sup>171</sup> Mexico points out that, under the accounting rate regime in effect between Mexico and the United States, however, the decision of whether to construct new gateways for connecting with international carriers is left solely to the discretion of the carriers, and each carrier bears its own costs because neither has facilities within the other country.<sup>172</sup> Mexico argues that Section 2.3 provides that procedures applicable for interconnection negotiations must be made publicly available. Because negotiation of accounting rate agreements is done privately, this requirement has no application to the accounting rate regime.<sup>173</sup> Mexico also contends that Section 2.4 provides that a major supplier must make publicly available its interconnection agreements or a reference interconnection offer. There is, however, no expectation that accounting rates be made public.<sup>174</sup>

4.67 **Mexico** recalls that Section 2.5 requires that countries have an independent domestic regulatory body to resolve disputes regarding appropriate terms, conditions and rates for interconnection.<sup>175</sup> Mexico points out that competitors must have a process to resolve disputes with incumbent carriers that arise during and after the negotiation process. Because both parties to the interconnection agreement are established under the laws of one country, dispute settlement mechanisms can be established giving a governmental regulator the authority to impose terms, conditions and rates on both parties. In the context of accounting rate agreements, in contrast, governments have different regulatory goals and more limited power.<sup>176</sup> For example, a domestic regulatory body can have the authority to resolve disputes and impose solutions only over two carriers that are within its rate-setting jurisdiction. Mexico submits that a domestic regulatory agency cannot require a foreign carrier to accept its determination of an appropriate accounting rate; and, in any case, the foreign carrier would always be free to ignore the determination.<sup>177</sup> As reflected in requirements such as those for uniform settlement rates (adopted by both the United States and Mexico), proportionate return (adopted by both the United States and Mexico), and symmetrical rates (adopted by the United States but not Mexico), governments generally seek to: (i) avoid allowing accounting rate arrangements to undermine domestic competition; and (ii) bolster the negotiating position of their national carriers vis-à-vis foreign carriers. At the same time, Mexico argues, because a government of one country lacks jurisdiction over foreign carriers, neither rates nor other terms and conditions can be enforced by that government. A government can require that its national carriers seek approval of accounting rate arrangements and in that manner try to impose various conditions, but its authority is circumscribed.<sup>178</sup>

4.68 The **United States** submits that, from a regulatory viewpoint, interconnection arrangements, including accounting rate arrangements, may be subject to different regulatory requirements to address different commercial, contractual and technical situations. The United States submits that any such regulatory differences, however, do not alter the status of all of these arrangements as

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<sup>170</sup> See Mexico's first written submission, paragraph 159.

<sup>171</sup> See Mexico's first written submission, paragraph 160.

<sup>172</sup> Ibid.

<sup>173</sup> See Mexico's first written submission, paragraph 161.

<sup>174</sup> See Mexico's first written submission, paragraph 162.

<sup>175</sup> See Mexico's first written submission, paragraph 163.

<sup>176</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, *see* footnote 77 of this Report.

<sup>177</sup> See Mexico's first written submission, paragraph 163.

<sup>178</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, *see* footnote 77 of this Report.

"interconnection" under Section 2.1 of the Reference Paper.<sup>179</sup> The fact that some of the requirements of Section 2 may not apply to interconnection provided to cross-border suppliers does not mean that other requirements of Section 2 are equally inapplicable.<sup>180</sup> As stated by the European Communities, "from a regulatory point of view, accounting rates are just one form of interconnection."<sup>181</sup> The United States further submits that Mexico is wrong in implying that the regulation of interconnection rates is necessary only where interconnecting suppliers compete with each other. The United States points out that Mexico also acknowledges that interconnection is an important concern in domestic markets where the interconnecting carriers do not compete with each other, such as where "a domestic long-distance carrier (or inter-city or interexchange carrier) must interconnect with local carriers throughout a country in order to be able to reach all end-user customers". The United States further notes that Mexico also acknowledges that the regulation of interconnection rates is necessary in such circumstances, not because the interconnecting carriers are targeting the same customers, but because "the local carrier has the incentive and ability to set interconnection rates as high as possible." The United States argues that, for the same reasons, the regulation of interconnection rates is necessary for the cross-border supply of international basic telecommunications services, which are also dependent on interconnection arrangements for call termination with suppliers that have "the incentive and ability to set interconnection rates as high as possible."<sup>182</sup>

4.69 The **United States** further submits that Mexico is also wrong to contend that a major supplier "has no interest in impeding calls or providing inferior quality service" to cross-border suppliers because these suppliers are not competitors. In fact, major suppliers are direct competitors with cross-border suppliers that originate services in-country through home-country direct and similar call reversal services. Moreover, a major supplier has an incentive to impose a competitive disadvantage on a foreign cross-border supplier if an affiliate of the major supplier competes with the cross-border supplier – as many such affiliates were expected to do following a successful outcome of the basic telecommunications negotiations.<sup>183</sup> The United States also notes that the requirements of non-discrimination and unbundling are equally relevant to the interconnection of international traffic as they are to the interconnection of domestic traffic.<sup>184</sup>

### 3. Specific Commitments of Mexico

4.70 The **United States** claims that Section 2.1 of Mexico's Reference Paper defines the scope of Mexico's interconnection obligations. Section 2.1 states that "[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". In this regard, the United States claims that, Mexico's obligations under Section 2 of the Reference Paper apply to the interconnection between Telmex and United States suppliers of basic telecom services on a cross-border basis because such interconnection: (i) involves the specific market access; and national treatment commitments that Mexico undertook in its Schedule for basic telecommunications services; and (ii) links suppliers of public telecom networks and services (a United States supplier of basic

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<sup>179</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>180</sup> See the United States' first oral statement, paragraph 29. See also the United States' second written submission, paragraph 57. See also the United States' answer to question No. 7 of the Panel of 19 December 2002. For question No. 7, see footnote 60 of this Report.

<sup>181</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report.

<sup>182</sup> See the United States' second written submission, paragraph 52.

<sup>183</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report. See also the United States' first oral statement, paragraph 30. See also the United States' second written submission, paragraph 53.

<sup>184</sup> See the United States' first oral statement, paragraph 29. See also the United States' second written submission, paragraph 57.

telecom services and Telmex) to enable users of the United States supplier to communicate with users of Telmex and to access Telmex's services.<sup>185</sup>

4.71 **Mexico** submits that a proper interpretation of the provisions of Mexico's Reference Paper and Schedule demonstrates that Section 2 of Mexico's Reference Paper does *not* apply to the terms and conditions of interconnection between United States suppliers of basic telecommunications services and Telmex, that is, to "international" interconnection.<sup>186</sup>

(a) Definition of the service and mode of supply

(i) *Definition of services*

4.72 **Mexico** submits that the services at issue are basic telecommunication services and not "telephone calls" or any other customer-supplied information or data (e.g., voice or facsimile). Mexico argues that, the services at issue are the services related to the transportation or transmission of such data. In Mexico's view, it is the "public telecommunications infrastructure" that permits the supply of such services. In support of its argument, Mexico cites to the CPC definitions of "voice telephony" (found in CPC codes 75211 and 75212), and "circuit-switched data transmission services" (CPC 7523).<sup>187</sup>

4.73 **Mexico** deems it significant that "communications" are listed in Section 7 along with "transport" and "storage" services. Mexico contends that its view is substantiated by the fact that no Member imposes restrictions on the number of incoming or outgoing calls, whereas many of them impose restrictions on services relating to the calls. Mexico also notes the specific wording used to describe the modes for trade in services highlights this difference. Mode 1 covers cross-border "supply" of a service. Thus, Mexico argues, it cannot reasonably be established that United States carriers "supply" telephone calls; what they supply is the service that transports their customers' telephone calls.<sup>188</sup>

4.74 The **United States** argues that Mexico's argument should be rejected because Mexico ignores the text of the CPC codes it inscribed. According to the United States, the CPC codes states that the services subject to Mexico's market access commitments are not simply the "transmission or transport of customer-supplied information". Contrary to Mexico's argument, the United States submits, the nature of the service and its cross-border character is not affected by the fact that the Mexican concessionaire assumes responsibility for the traffic at the border. This "hand off" is expressly contemplated in CPC 75212, which provides that the customer has access to both "the suppliers' and

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<sup>185</sup> See the United States' first written submission, paragraph 48.

<sup>186</sup> See Mexico's second written submission, paragraph 22.

<sup>187</sup> See Mexico's second written submission, paragraphs 64-65. See also Mexico's answer to question No. 3(a) of the Panel of 19 December 2002 ("*The cross-border supply of telecommunications services is defined as the supply of a service 'from the territory of one Member into the territory of any other Member.'*" Mexico states that a foreign supplier of facilities-based telecommunications services can only supply these services cross-border, if that supplier is also permitted to supply facilities-based services in Mexico (para 234). (a) Does Mexico consider that cross-border supply of basic telecommunications by a foreign supplier can take place only if that supplier terminates its cross-border services on the facilities of the concessionaire owned or controlled by that same supplier? Does Mexico therefore consider that an international telecommunications service terminated on facilities of any other concessionaire cannot be considered a service supplied through mode 1?").

<sup>188</sup> See Mexico's answer to question No. 1 of the Panel of 14 March 2003 ("*Why do you consider that the service being scheduled is the transport of the calls instead of the calls themselves? Please relate to the standard definitions in the Central Product Classification (CPC)*").

connecting carriers' entire telephone network". Thus, it concludes, the CPC code specifically contemplates the "joint provision" of voice services.<sup>189</sup>

4.75 According to the **United States**, the CPC codes make clear that the services covered by Mexico's market access commitments include, under CPC 75212, "switching and transmission services necessary to establish and maintain communications between local calling areas." Establishing and maintaining communications requires active coordination between a supplier on each side of the border, and is not two discrete services provided by different companies. For example, the United States explains, in order to complete a call, AT&T's switch must communicate with Telmex's switch, which is located within Mexico, not on the border. Similarly, CPC 75212 states that the scheduled service "provides the customers with access to the suppliers' and connecting carrier's entire telephone network." According to the United States, what a "customer" purchases from a United States supplier is a "communication" – a telephone call – from its point of origin in the United States to its point of termination in Mexico. In other words, the United States submits, the service includes the entirety of a telephone call. Moreover, CPC 75212 covers "services necessary to establish and maintain communications between local calling areas." This includes communications between a local calling area in the United States and a local calling area in Mexico.<sup>190</sup>

4.76 **Mexico** concludes that, the relevant trade in services, or the "supply of a service", at issue in this dispute, is the production, marketing, or sale of *transmission or transport* services of customer-supplied information or data. Mexico notes that cross-border supply occurs when a service supplier is not present within the territory of the Member where the service is delivered or consumed, but it supplies the relevant services across the border. Therefore, Mexico argues, cross-border supply under mode 1 in the GATS requires that the *service* at issue cross a border.<sup>191</sup>

4.77 Accordingly, **Mexico** argues, in order to determine whether the market access commitments inscribed in Mexico's Schedule allow the cross-border supply of public telecommunications transport services, the Panel must determine whether Mexico's commitments permit public transmission or transport services provided by United States suppliers to cross the border into Mexico.<sup>192</sup>

4.78 **Mexico** submits that what the United States fails to mention is that the joint provision of telephone services typically involves more than one "switching and transmission" service supplier. In Mexico's view, this is confirmed by the "hand-off" occurring at the border, as clearly evidenced by the accounting rate transaction, which has major implications in terms of the modes of supply under the GATS. Indeed, where a Member's Schedule requires services to be provided jointly by a foreign supplier and a locally established supplier, there can be no cross-border trade within the meaning of GATS Article I:2(a).<sup>193</sup>

4.79 According to **Mexico**, this legal reasoning likewise applies to cross-border transport of other items. Mexico submits that, where a "hand-off" occurs at the border to a service supplier established in the destination country, there can be no cross-border trade in the transport of the services involved into the destination country. In the case of water, Mexico explains, if – at the border – a different supplier provides the pipeline transport service into the destination country, then the transport service supplier in the originating country cannot be said to provide cross-border service "from the territory"

<sup>189</sup> See the United States' second oral statement, paragraph 17. See also the United States' comments on Mexico's answer to question No. 21 of the Panel of 14 March 2003, paragraphs 1 and 5.

<sup>190</sup> See the United States' second oral statement, paragraphs 18-20.

<sup>191</sup> See Mexico's second written submission, paragraphs 65-67. See also the Mexico's answer to question No. 3(a) of the Panel of 19 December 2002. For question No. 3(a), see footnote 187 of this Report. See also Mexico's second oral statement, paragraph 27.

<sup>192</sup> See Mexico's second written submission, paragraph 68. See also Mexico's second oral statement, paragraph 27.

<sup>193</sup> See Mexico's answer to question No. 1 of the Panel of 14 March 2003. For question No. 1, see footnote 188 of this Report.

of the originating country "into the territory" of the destination country. Mexico further submits that the above interpretation is not only legally but also "logically" sound. According to Mexico, one of the important elements in the ability to supply cross-border services is that the foreign service supplier does not have to involve suppliers in the destination country in order to provide the services in question. This is impossible in the case of hand-off at the border and the joint provision of services.<sup>194</sup>

4.80 The **United States** argues that, second, the cross-border supply of a service does not require that the service supplier operate on both sides of the border. The United States submits that Article I:2(a) of GATS defines the cross-border supply of a service as the supply of a service from the territory of one Member into the territory of any other Member. The United States argues that it is the service that crosses the border, not the supplier. According to the United States, accepting Mexico's argument would mean that the provision of basic telecommunications services on a cross-border basis would only be possible if a service supplier also operated on a commercial presence basis. The United States submits that the result would be to render meaningless Mexico's mode 1 commitments in the basic telecommunications sector. Since United States and Mexican basic telecommunications suppliers currently interconnect at the border, accepting Mexico's argument would also mean that the supply of basic telecommunications services does not fit into any of the modes of supply under GATS. The United States submits that such an interpretation would be contrary to the nature of basic telecommunications services. That basic telecommunications services can be, and indeed are, supplied on a cross-border basis is confirmed by the undisputed fact that billions of calls (i.e., signals) are actually transmitted between the United States and Mexico annually.<sup>195</sup>

4.81 **Mexico** submits that at the core of the United States' argument that United States suppliers actually provide basic telecommunications services on a cross-border basis is the erroneous proposition that the "telephone calls" are the services of United States suppliers that move across the border. According to Mexico, the flaw in the United States' reasoning becomes obvious when it is applied to other transport services. For example, Mexico explains, in the case of mail, the service consists of the pick-up, transport and delivery of letters. Mexico submits that the fact that millions of letters cross the border between two countries does not necessarily mean that postal services providers in country A supply their services from its territory into the territory of country B. In order for cross-border trade in services to occur, it is the transport and delivery services of a supplier established in country A, not merely the letters, that must cross the border. There will not be any cross-border supply to the extent that the supplier established in country A provides its transport services only in its home country's territory, and delivers the letter at a border point, where it is picked-up by another supplier, which operates in country B, and arrange for the transport of the letter to its final destination. This is an example of the joint provision of a service by two suppliers. In no sense can this joint provision of a service by two suppliers on either side of the border be described as the cross-border supply of transport services by the supplier established in country A into the territory of country B. Similarly, the fact that billions of minutes of calls (i.e., signals) are transmitted between the United States and Mexico annually does not demonstrate that United States basic telecommunications service suppliers provide their transport and transmission services on a cross-border basis into Mexico. The relevant question is whether United States suppliers can transport and transmit signals from the United States into Mexico. The cross-border supply of basic telecommunications services will be possible only to the extent that calls originating in a foreign country are transported and transmitted by the foreign supplier across Mexico's border to the recipient. In the case of basic telecommunications, this requires a transport and transmission network that transcends national borders.<sup>196</sup>

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<sup>194</sup> See Mexico's answer to question No. 1 of the Panel of 14 March 2003. For question No. 1, *see* footnote 188 of this Report.

<sup>195</sup> See the United States' second written submission, paragraph 29.

<sup>196</sup> See Mexico's second oral statement, paragraphs 27-30.

4.82 According to **Mexico**, the United States has not established that such cross-border supply of basic telecommunications services is at issue in this dispute. As a matter of law, it cannot make this demonstration because the transport and transmission services supplied by United States suppliers are not provided across the border, but merely to the border. At that point, traffic is handed off to a Mexican concessionaire, which receives and carries the calls to the recipient, that is, supplies telecommunications transport services into and within Mexico. Therefore, Mexico argues, the United States is mistaken when it states that "the way in which United States suppliers complete calls into Mexico is by routing through the facilities of an enterprise that has a concession". The fact is that United States suppliers do not "complete calls" and, hence, do not supply transport and transmission services across the border into and within Mexico.<sup>197</sup>

4.83 **Mexico** also notes that, under the United States' interpretation, its suppliers are providing telecommunications services on a cross-border basis when the calls are routed through the facilities of another supplier. This is not tenable. "Routing" (i.e., transmitting) traffic is the service being provided by basic telecommunications suppliers. When the calls are "routed" through the facilities of a Mexican supplier, it is that supplier, not the United States supplier, that provides the transport and transmission services at issue in this dispute.<sup>198</sup> Mexico further claims that, accepting the United States' argument that the fact that signals are transmitted across the border demonstrates that basic telecommunications services are provided on a cross-border basis would mean that market access under mode 1 would be granted as soon as a WTO Member allows calls originating in other countries to be transmitted across its borders, regardless of who is supplying that service. This is also untenable.<sup>199</sup> There is not a single WTO Member that prohibits incoming calls to its citizens from the territories of other WTO Members. This does not mean that all WTO Members have granted market access under mode 1.<sup>200</sup> Mexico submits that, cross-border supply does not occur under the half-circuit regime established between Mexico and the United States, as laid down in Mexico's Schedule. According to Mexico, cross-border supply unquestionably cannot occur where a commercial presence limitation is scheduled under mode 1, because the incumbent provider in the United States must either become established in Mexico or rely on another provider established in Mexico in order to transport and terminate calls into and within Mexico. In practice, the half-circuit regime requires telecommunications traffic to be handed over at the border to another provider operating inside Mexican territory, and it is the latter that carries the traffic over the Mexican half of the circuit. Under Mexico's Schedule, therefore, the incumbent provider in the United States cannot supply telecommunications transport services over the Mexican half circuit and so will never be able to provide services "from the territory" of the United States "into the territory" of Mexico.<sup>201</sup>

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<sup>197</sup> See Mexico's second oral statement, paragraphs 31-32.

<sup>198</sup> See Mexico's second oral statement, paragraph 33. See also Mexico's answer to question No. 4(b) of the Panel of 14 March 2003 ("In paragraph 52 of its replies to the questions by the Panel, Mexico asserts that a supplier must be present in the territory of Mexico to supply telecommunications services cross-border. In paragraph 38 of Mexico's second oral statement, Mexico states that the supplier must use or operate transport and transmission facilities. However, Mexico maintains in the same paragraph that a foreign supplier who has established a commercial presence in Mexico automatically supplies services through mode 3. (b) Why does Mexico consider that a supplier routing through facilities of a concessionaire does not 'use transport or transmission facilities'?" ).

<sup>199</sup> See Mexico's second oral statement, paragraph 34.

<sup>200</sup> See Mexico's second oral statement, paragraph 35.

<sup>201</sup> See Mexico's answer to question No. 3(c) of the Panel of 14 March 2003 ("If so, does the supplier have to supply through its network(s) the entire service, or is it sufficient that it supplies through its network for a portion of the transmission service? Please elaborate by using evidence from relevant regulations, and consider the following scenarios: the cross-border service is supplied over a facilities-based network (i) on all segments of the transmission service, and on both sides of the border; or (ii) on any segment of the transmission service, and on either side of the border; or (iii) on the originating side of the border only; or (iv) on the terminating side of the border only?").

aa) Half-circuit v. full-circuit regimes

4.84 In response to a question by the Panel, **Mexico** describes the difference between the half-circuit and full-circuit regimes. Mexico first submits that, the "half-circuit" regime does not allow foreign suppliers to supply their services on the opposite side of the circuit. Because of the inherent "hand off", all services in the destination country are supplied by incumbent suppliers in that country and, therefore, the supply is provided under mode 3.<sup>202</sup> In contrast, Mexico claims, under the full-circuit regime:

"Foreign operators can, if they wish, carry their international calls into the interior of the destination country and terminate them there via interconnect arrangements similar to, or even identical to, those used for domestic traffic. They are no longer compelled to hand off their traffic to a correspondent operator before it reaches the destination country".<sup>203</sup>

4.85 According to **Mexico**, the clearest example of a full-circuit regime is when a foreign supplier expands its network to the territory of the destination country by its own transmission links and network nodes (i.e. "points of presence"). As to mode 1, in order for a United States-based supplier to supply services from United States territory to Mexican territory (in other words, cross-border supply) it must supply telecom transport services over the whole of the full circuit without having a commercial presence in Mexico within the meaning of GATS Article XXVIII(d). According to Mexico, this definition of "commercial presence" relates to the establishment of a particular type of legal entity, as clarified in the GATS Guidelines for Scheduling. A full-circuit regime does not require the establishment of such legal entities. This is confirmed in the ITU Document included as Exhibit MEX-59, which establishes that "international operators can avoid the half-circuit regime by establishing a switch in a foreign territory, then providing end-to-end service to that switch." Indeed, it is not even necessary to establish a commercial presence in the foreign country. Where it is possible to establish a full-circuit regime without the need for such presence, the foreign country supplier can provide services to the destination country under mode 1. For the purposes of this dispute, it is not necessary for the Panel to define all the circumstances in which a single circuit regime may be set up so as to allow telecom transport services to be supplied under mode 1. The crucial point is that Mexico's Schedule maintains the half-circuit regime and requires all telecommunications to be handed over at the border so that the transport and transmission services supplied on the Mexican side of the border are supplied by Mexican-based concessionaires. In other words, Mexico does not permit the supply of telecom transport services under mode 1.<sup>204</sup>

4.86 Moreover, the **United States** argues that the one example Mexico gives of cross-border supply from the United States into Mexico is where a United States supplier "has a full circuit" and

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<sup>202</sup> See Mexico's answer to question No. 4(d) of the Panel of 14 March 2003 ("In paragraph 52 of its replies to the questions by the Panel, Mexico asserts that a supplier must be present in the territory of Mexico to supply telecommunications services cross-border. In paragraph 38 of Mexico's second oral statement, Mexico states that the supplier must use or operate transport and transmission facilities. However, Mexico maintains in the same paragraph that a foreign supplier who has established a commercial presence in Mexico automatically supplies services through mode 3. (d) How do you relate the notions of 'full circuit' and 'half circuit' to supply under mode 1 and mode 3?").

<sup>203</sup> See Mexico's answer to question No. 4(d) of the Panel of 14 March 2003 (quoting M. Tyler and C. Joy, 1.1.98. *Telecommunications in the New Era: Competing in the Single Market*, p.51). For question No. 4(d), see footnote 202 of this Report.

<sup>204</sup> See Mexico's answer to question No. 4(d) of the Panel of 14 March 2003. For question No. 4(d), see footnote 202 of this Report.

"establish[es] a switch" or a "point of presence" in Mexico.<sup>205</sup> Mexico states that the United States supplier does not have a commercial presence on the Mexican side of the border in this example. According to the United States, however, whether or not "establishing a switch" or a "point of presence" on the Mexican side of the border is a "commercial presence," "establishing a switch" or a "point of presence" certainly involves operating in some fashion on the Mexican side of the border. This interpretation therefore adds an element that is not present in Article I:2(a) of GATS, which defines the cross-border supply of a service as the supply of a service from the territory of one Member into the territory of any other Member because Mexico's interpretation requires that to provide basic telecommunications services in the cross-border mode, a service supplier must operate on both sides of the border.<sup>206</sup>

4.87 **Mexico** submits that, under the full-circuit regime, a foreign supplier carries traffic to the "interior" of the destination country. It then interconnects with the local network in the same way as does a national operator. This means that, under the full-circuit regime what is relevant for the foreign operator is the interconnection "within" the destination country.<sup>207</sup> The United States is not contesting the interconnection regime with Mexico as it applies to operators established within the territory of Mexico. Mexico further claims this is based on Mexico's position that Section 2 of its Reference Paper applies solely to "interconnection" within its borders.<sup>208</sup>

4.88 **Mexico** also submits that, the use of a satellite or any other kind of wireless technology instead of a landline does not in or of itself determine whether cross-border supply exists, since countries regulate the use of the radio frequency spectrum in their territory. Even in the case of a satellite system with a global footprint, like the one that the Iridium system uses (the only one of its type), the use of the Mexican spectrum to carry calls is subject to restrictions similar to those for landlines and other wireless services that the operator provides. Accordingly, Iridium has a Mexican affiliate with a concession to supply public telecom transport services inside Mexico and through which switched calls to Mexico must be routed in order to complete transmission to the end-user's handset when the user is in Mexico.<sup>209</sup>

4.89 Therefore, **Mexico** argues, carrying calls by satellite direct to the user's telephone could potentially involve a cross-border service, for example, if there is only one supplier involved and there are no joint services with a supplier who is commercially established in the destination country. Whether a Member has made a commitment or not, and the way in which the commitment has been made to authorize such cross-border supply, can be determined only by examining the specific scope of the Member's inscription.<sup>210</sup>

4.90 The **United States** argues that Mexico's explanation regarding satellite services is, again, based upon acceptance of the notion that a telephone call or signal is a separate service from the transportation of that signal. The United States reiterates that this notion ignores the CPC codes, which specifically contemplate "hand off" of the signal and the joint provision of voice services, and

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<sup>205</sup> The United States refers to Mexico's answers to questions of the Panel of 14 March 2003, paragraphs 51, 58 and 76.

<sup>206</sup> See the United States' comments on Mexico's answer to question No. 4(a) of the Panel of 14 March 2003, paragraphs 15 and 16.

<sup>207</sup> See Mexico's answer to question No. 4(d) of the Panel of 14 March 2003. For question No. 4(d), see footnote 202 of this Report.

<sup>208</sup> Ibid.

<sup>209</sup> See Mexico's answer to question No. 5 of the Panel of 14 March 2003 ("*Does the provision of a telephone service from one Member, transmitted by satellite direct to an end-user's handset in another Member, constitute cross-border supply in terms of Article I:2(a) of the GATS? Why or why not?*").

<sup>210</sup> See Mexico's answer to question No. 5 of the Panel of 14 March 2003. For question No. 5, see footnote 209 of this Report.

the purchase by a "customer" of a "communication" over the entirety of a telephone call, from its point of origin to its point of termination.<sup>211</sup>

(b) Mexico's commitment on cross-border supply

4.91 According to the **United States**, Mexico undertook market access and national treatment commitments in its schedule for basic telecom services supplied by "facilities-based" operators on a cross-border (mode 1) basis. The United States also notes that 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>212</sup>

4.92 The **United States** further submits that Mexico scheduled cross-border commitments for non-facilities-based telecom services ("commercial agencies") as well. Based on Mexico's Schedule, the United States argues that Mexico committed to accord market access and national treatment to United States suppliers, which do not themselves own facilities, but instead provide telecommunications services over capacity (such as a line) that they lease from a concessionaire.<sup>213</sup>

4.93 **Mexico** argues that it did not schedule cross-border commitments for basic telecommunications services supplied by facilities-based and non-facilities-based operators.<sup>214</sup> Mexico submits that the phrase "*respecto de los cuales se contraigan compromisos específicos*" in Section 2.1 of its Reference Paper limits the application of Section 2 to the precise market access allowed in Mexico's specific commitments inscribed in its Schedule. The phrase translates as "on the basis of specific commitments undertaken" or "in respect of which specific commitments are undertaken". It qualifies the entire provision and, thereby, links Section 2 of the Reference Paper to the specific commitments in Mexico's Schedule. It means that Section 2 applies only within the bounds of Mexico's inscribed market access for the supply of services.<sup>215</sup>

4.94 **Mexico** submits that, in order to understand its scheduled commitments in basic telecommunications services, the first thing to consider is the circumstances in which those commitments were negotiated. Mexico started to liberalize its basic telecommunications market with the privatization of Telmex in 1990 and with the implementation of the FTL in 1995. One of the principal objectives of the FTL was to liberalize the Mexican market for basic telecommunications by granting concessions to new entrants, which could include up to 49 per cent foreign ownership. As a result of these reforms, Mexico introduced competition into the international long-distance service market. However, under Mexican law, only those carriers able to meet the conditions necessary to obtain a concession are allowed to enter the market. As to foreign enterprises, they were neither allowed to provide international services, nor to install, operate or use facilities in Mexico.<sup>216</sup>

4.95 **Mexico** argues that it was within this context that Mexico agreed to the market access commitments with accompanying limitations relating to basic telecommunication services in its Schedule, which means that Mexico bound itself to the regulatory *status quo* as it existed in 1997 at the end of the WTO negotiations on basic telecommunications. That *status quo* did not permit

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<sup>211</sup> See the United States' comments on Mexico's answer to question No. 5 of the Panel of 14 March 2003, paragraph 22.

<sup>212</sup> See the United States' first written submission, paragraph 54. See also the United States' answer to question No. 2(a) of the Panel of 14 March 2003 ("*What is a 'facilities based public telecommunications network'? Please elaborate by referring to relevant regulations. Are there public telecommunications networks that are not 'facilities based'?*").

<sup>213</sup> See the United States' first written submission, paragraphs 55-57.

<sup>214</sup> See Mexico's first written submission, paragraph 134. See also Mexico's second written submission, paragraph 76.

<sup>215</sup> See Mexico's second written submission, paragraph 41.

<sup>216</sup> See Mexico's first written submission, paragraphs 120-122.

United States suppliers to supply public telecommunications transport networks and services (PTTNS) from the territory of the United States into the territory of Mexico. Thus, Mexico did not, by inscribing this commitment, permit market access for the supply of basic telecommunications services through mode 1. However, it did permit market access for facilities-based suppliers through commercial presence in Mexico in the form of up to 49 per cent direct foreign ownership of a concessionaire.<sup>217</sup>

4.96 **Mexico** also points out that, according to paragraph 1 of Article XVI of the GATS, the obligation is to accord treatment no less favourable than that provided under the terms, limitations and conditions on market access specified in a Member's Schedule.<sup>218</sup> Thus, Mexico argues, the mere inscription of a service sector in the "sector or subsector" column of a Schedule of Specific Commitments does not imply that a Member has bound itself to grant unconditional market access for any of the modes of supply; rather, any commitment made must be read in light of the "terms, limitations and conditions" specifically inscribed under the relevant column of the Schedule.<sup>219</sup> According to Mexico, the relevant terms, limitations and conditions on market access inscribed in Mexico's Schedule clarify that Mexico did not undertake any commitments to permit basic telecommunications service suppliers of other Members to provide "facilities-based" or "non-facilities" based basic telecommunications services on a "cross-border" basis.<sup>220</sup>

4.97 In response to a question by the Panel, the **United States** contends that, once any level of commitment is undertaken, Section 2 applies fully within the modes of supply in which commitments have been taken, unless the limitation scheduled specifically limits the applicability of the Reference Paper.<sup>221</sup>

4.98 **Mexico** submits that Section 2 of Mexico's Reference Paper does not apply *fully* to a service sector or subsector once *any* level of commitment is made in any mode of supply because of the following reasons:

- (i) First, the specific language of Mexico's Reference Paper — i.e., the phrase "*respecto de los cuales se contraigan compromisos específicos*" — plainly restricts the application of the Reference Paper to the precise scope of Mexico's commitments for market access for the supply of basic telecommunication services. In order to give meaning to this restriction, it is necessary to interpret Mexico's specific commitments in totality, including the inscribed limitations.
- (ii) Second, those commitments must be interpreted in the light of the relevant mode of supply and any associated limitations, because it is the positive inscriptions and the limitations read together that define Mexico's specific commitments with respect to the supply of particular services.

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<sup>217</sup> See Mexico's first written submission, paragraph 123. See also Mexico's answer to question No. 1(a) of the Panel of 19 December 2002 ("*Section 2.1 of the Reference Paper as scheduled by Mexico states that interconnection applies 'respecto de los cuales se contraigan compromisos específicos' [on the basis of specific commitments undertaken]. (a) Are there specific commitments undertaken by Mexico in modes 1 and 3 of its schedule with respect to the supply of basic telecommunications?*").

<sup>218</sup> See Mexico's first written submission, paragraphs 124-125.

<sup>219</sup> See Mexico's first written submission, paragraph 125. See also Mexico's first oral statement, paragraph 37.

<sup>220</sup> See Mexico's first written submission, paragraph 127.

<sup>221</sup> See the United States' answer to question No. 1(c) of the Panel of 19 December 2002 ("*Section 2.1 of the Reference Paper as scheduled by Mexico states that interconnection applies 'respecto de los cuales se contraigan compromisos específicos' [on the basis of specific commitments undertaken]. (c) Does Section 2 of the Reference Paper apply fully to a service sector or subsector once any level of commitment in market access or national treatment is made in any of the modes of supply?*").

- (iii) Third, the United States is wrong to interpret the phrase "where specific commitments are undertaken" to simply mean that where any commitments are undertaken by a WTO Member the Reference Paper applies fully. The inscription of the Reference Paper in the fourth column of a Member's Schedule is, itself, a commitment that would invoke the application of Section 2 of the Reference Paper under the United States' interpretation. Such an interpretation means that the phrase "respecto de los cuales se contraigan compromisos específicos" in Section 2.1 of the Reference Paper is unnecessary. This renders the phrase meaningless and, therefore, is an impermissible interpretation under Article 31 of the Vienna Convention.<sup>222</sup>

4.99 **Mexico** further argues that its interpretation that its Reference Paper applies only within the bounds of its specific commitments and limitations on market access is consistent with the object and purpose of Section 2. According to Mexico, the primary objective of the interconnection provisions of the Reference Paper is to safeguard competitive conditions in situations where a dominant carrier can exert control over its competitors within its market. Thus, in order to benefit from the terms and conditions of interconnection provided for in Section 2, foreign suppliers must first be granted market access under the commitments inscribed in a Member's Schedule. Accordingly, suppliers that are not allowed to compete in a given market because they have not been granted access cannot benefit from the terms and conditions provided for in Section 2.<sup>223</sup>

4.100 **Mexico** also argues that, independently of the meaning of the phrase "*respecto de los cuales se contraigan compromisos específicos*", Article 31 of the *Vienna Convention* requires that Mexico's Reference Paper be interpreted in a manner that gives meaning to its content and to the specific commitments and limitations inscribed in Mexico's Schedule.<sup>224</sup> Mexico also urges the Panel to bear in mind the principle of effectiveness in the interpretation of treaties (*ut res magis valeat quam pereat*) which, according to the Appellate Body, requires that a treaty interpreter:

"... must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."<sup>225</sup>

4.101 According to **Mexico**, the United States' interpretation entails reading the sector/subsector column of Mexico's Schedule in isolation from the rest of its Schedule. Among other things, the United States' interpretation ignores the fact that a Member may inscribe "unbound" in either columns 2 (market access) or 3 (national treatment). In such circumstances, there is no specific market access commitment for the service sector or subsector and mode involved. Similarly, where the term "unbound" is not used, but limitations are inscribed under specific modes, it is only through a detailed examination of the text of those limitations that it can be determined whether or not suppliers of other WTO Members have, in fact, been granted market access under each of the modes.<sup>226</sup>

4.102 **Mexico** argues that the United States interpretation of Mexico's Reference Paper would effectively grant market access to United States suppliers of basic telecommunications services that is not inscribed in Mexico's Schedule. Furthermore, it would render meaningless the limitations on

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<sup>222</sup> See Mexico's second written submission, paragraph 43. See also Mexico's answer to question No. 1(c) of the Panel of 19 December 2002. For question No. 1(c), see footnote 221 of this Report.

<sup>223</sup> See Mexico's second written submission, paragraph 44.

<sup>224</sup> See Mexico's second written submission, paragraph 46.

<sup>225</sup> See Mexico's second written submission, paragraph 46. See also Mexico's answer to question No. 2(a) of the Panel of 19 December 2002 ("*The explanatory note containing Guidelines for the Scheduling of Commitments (MTN.GNS/W/164) requires in paragraph 25 that in scheduling limitations 'the entry should describe each measure concisely, indicating the elements which make it inconsistent with Articles XVI or XVII'. (a) What are the elements of inconsistency with Article XVI contained in the Mexican law referred to in relation to the establishment of enterprises eligible for a concession?*").

<sup>226</sup> See Mexico's second written submission, paragraphs 47-48.

market access that are specified in Mexico's Schedule. Such an interpretation is inconsistent with the principle of effective interpretation in Article 31 of the *Vienna Convention* and, therefore, is impermissible.<sup>227</sup>

(c) Meaning of the limitations inscribed

4.103 **Mexico** also submits that the inscription in its Schedule cannot be equated with providing market access for cross-border trade. Mexico explains that, under Article XVI of the GATS, the mere fact that a Member has inscribed a commitment for a particular mode of supply in a particular sector or subsector cannot be *ipso facto* equated with an undertaking to grant market access to suppliers of other Members for the supply of services through that mode of supply. Rather, whether and to what extent market access has been granted to foreign suppliers depends on careful interpretation of the precise meaning of the limitations inscribed in the Member's Schedule for the relevant mode. This requires detailed analyses of *all* entries in a Member's Schedule in accordance with the general principles of treaty interpretation set forth in the *Vienna Convention*.<sup>228</sup>

4.104 According to **Mexico**, the phrase "none, except the following" is an accepted drafting convention to introduce a limitation. Using its right to inscribe limitations, a WTO Member can effectively disallow market access to foreign suppliers for trade in one mode of supply, even though there is a "standstill" binding for that mode of supply. When specific commitments are undertaken under GATS Article XVI, a Member binds certain measures and commits not to accord to foreign suppliers treatment less favourable than that stipulated in these measures. It is those "terms, limitations and conditions" specified in a Schedule that determine the level of market access, if any, for each mode of supply that is bound by a Member. Thus, Mexico argues, the fact that a Member has inscribed a commitment for a particular mode of supply in a particular service sector does not necessarily mean that market access has been granted to foreign suppliers for the supply of the relevant services in that particular mode.<sup>229</sup>

4.105 **Mexico** notes that, in inscribing their limitations, WTO Members can bind themselves to the *status quo* for the supply of a service through one of the modes of supply. It may very well be that, under the *status quo* as inscribed in the limitations in their Schedule, no market access is actually provided to foreign suppliers for the supply of the relevant service through that mode of supply. In such cases, the limitation has the effect of prohibiting market access for these suppliers even though the Member did not inscribe "unbound" in the relevant column. For example, certain limitations on the number of service suppliers can effectively create a "zero quota", which prohibits market access for foreign suppliers.<sup>230</sup> In support of its argument, Mexico cites two WTO Secretariat Notes.<sup>231,232</sup> According to Mexico, the inscription of a commercial presence requirement in such a manner has the effect of prohibiting market access for the cross-border supply of such services even though the

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<sup>227</sup> See Mexico's second written submission, paragraph 49.

<sup>228</sup> See Mexico's second written submission, paragraph 55.

<sup>229</sup> See Mexico's second written submission, paragraphs 56-57. See also Mexico's answer to question No. 2(a) of the Panel of 19 December 2002. For question No. 2(a), see footnote 225 of this Report. See also Mexico's second oral statement, paragraph 44.

<sup>230</sup> See Mexico's second written submission, paragraph 59.

<sup>231</sup> Explanatory Note in *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164/Add.1, 30 Nov. 1993 and *Draft Revision of the Guidelines for the Scheduling of Specific Commitments*, Committee on Specific Commitments, Note by the Secretariat, S/CSC/W/30, 23 March 2001.

<sup>232</sup> See Mexico's first written submission, footnote 89 to paragraph 129. See also Mexico's first oral statement, paragraph 42. See also Mexico's second written submission, paragraph 59. See also Mexico's answer to question No. 1(b) of the Panel of 19 December 2002 ("*Section 2.1 of the Reference Paper as scheduled by Mexico states that interconnection applies 'respecto de los cuales se contraigan compromisos específicos' [on the basis of specific commitments undertaken]. (b) If Mexico is arguing that it does not have such commitments (paragraphs 134 and 146 of its submission), why did it not schedule these sectors and modes as 'unbound'?*").

Member did not inscribe "unbound" in the relevant column and this is exactly what Mexico has done.<sup>233</sup>

4.106 The **United States** argues that Mexico's reliance on the Scheduling Note is misplaced. The United States points out that the part of the Note that Mexico relies on only applies to "a residence requirement, nationality condition or commercial presence requirement." Thus, it is not applicable to the limitation in Mexico's Schedule, which is a routing requirement.<sup>234</sup>

4.107 The **United States** argues that Mexico's commitment is clear and straightforward: there are no limitations on the mode 1 commitment, with the exception of a routing requirement. The United States submits that Mexico's argument that "None" should be interpreted as "Unbound" is thoroughly untenable. The requirement to route international traffic through the facilities of a Mexican concessionaire does not completely eviscerate Mexico's market access commitment for mode 1 – indeed, there would be no need for this or any other limitation if Mexico had left mode 1 unbound. The way in which United States suppliers complete calls into Mexico is by "rout[ing] through the facilities of an enterprise that has a concession" – an option specifically provided in Mexico's Schedule.<sup>235</sup>

4.108 The **United States** argues that Mexico ignores this aspect of its commitment in asserting that it has made no commitment for the supply of telecommunications services on a cross-border basis. The United States submits that, even if this limitation had any effects, it would still be a limitation on a commitment that Mexico undertook and would therefore still trigger the obligations in Section 2 of the Reference Paper and Section 5 of the Annex.<sup>236</sup>

4.109 The **United States** also considers that, as a legal matter, Mexico's routing requirement is not a market access limitation at all. The United States agrees with the European Communities that the limitation scheduled by Mexico is superfluous and without legal effect because a routing requirement is not one of the limitations listed in Article XVI:2 of GATS. According to the United States, a note by the Secretariat supports this position, confirming that "a Member grants full market access in a given sector and mode of supply when it does not maintain in that sector and mode any of the types of measures listed in Article XVI."<sup>237</sup> In the United States' view, Mexico did not need to schedule the requirement that cross-border suppliers route traffic through the facilities of a concessionaire to maintain that limitation for Article XVI purposes.<sup>238</sup>

4.110 **Mexico** submits that the United States' characterization of Mexico's mode 1 limitation is erroneous. As a legal matter, the concession requirement stipulated in Mexico's mode 1 limitation must be given meaning. Mexico argues that the correct interpretation is that the limitation that "international traffic must be routed to the facilities of an enterprise that has a concession" imposes commercial presence and nationality requirements for the supply of scheduled services. Thus, this limitation ensures that suppliers established in the United States cannot transport and transmit signals across Mexico's borders. Instead, they have to rely on Mexican concessionaires, which have the exclusive right to supply telecommunications transport and transmission services in Mexico.<sup>239</sup>

4.111 For international "facilities-based" services, **Mexico** argues that its schedule sets forth a limitation by requiring that international traffic must be routed through the facilities of an enterprise

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<sup>233</sup> See Mexico's second written submission, paragraph 61.

<sup>234</sup> See the United States' second written submission, paragraph 22. See also the United States' answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), see footnote 232 of this Report.

<sup>235</sup> See the United States' second written submission, paragraph 15.

<sup>236</sup> Ibid.

<sup>237</sup> See document MTN.GNS/W/163, of 3 September 1993, paragraph 4.

<sup>238</sup> See the United States' second written submission, paragraph 16.

<sup>239</sup> See Mexico's second oral statement, paragraph 48.

that has a concession granted by the Ministry of Communication and Transport (SCT).<sup>240</sup> Under Mexican law, only Mexican individuals or companies may obtain such a concession.<sup>241</sup> Thus, the limitation in the market access column of Mexico's Schedule creates a nationality and commercial presence requirement for suppliers of scheduled services.<sup>242</sup> Therefore, Mexico effectively froze the level of market access to that prevailing at the time of the negotiations and reserved its right to limit those enterprises authorized to supply basic telecommunications services within Mexico to service suppliers that have commercial presence in Mexico (i.e., concessionaires).<sup>243</sup> Since United States suppliers (e.g. AT&T and WorldCom) of basic telecommunications services cannot obtain concessions, they are not allowed to supply basic telecommunications services from the territory of the United States into the territory of Mexico, that is, on a cross-border basis.<sup>244</sup> Mexico also claims that it reserved its right to prevent foreign service suppliers from owning facilities in Mexico through the inscription of broad limitations on market access through commercial presence (mode 3) in its Schedule.<sup>245</sup> In order to install, operate or use a facilities-based public telecommunications network in Mexico, Mexico's Schedule stipulates that a concession from the SCT is required and that direct foreign investment is limited to 49 per cent in an enterprise set up in accordance with Mexican law.<sup>246</sup>

4.112 The **United States** replies that whether or not Mexico was "freezing" the level of market access prevailing at the time of the negotiations is irrelevant; the ordinary meaning of Mexico's Schedule speaks for itself and should control. In support of its argument, the United States points to the same Secretariat's Explanatory Note on Scheduling relied upon by Mexico, which emphasizes that, if a Member wished to bind the status quo, as Mexico now asserts was its intention, these so-called "standstill" commitments were to be scheduled no differently than any other market access commitments. Thus, the Panel still has to interpret the meaning of the routing requirement in Mexico's Schedule as it is written, regardless of Mexico's intention.<sup>247</sup>

4.113 The **United States** counters that the requirement to route international traffic through the facilities of a Mexican concessionaire does not completely eviscerate Mexico's market access commitment for mode 1. According to the United States, Mexico's argument is untenable for two reasons. First, even if this limitation had any effect, it would still be a limitation on a commitment that Mexico undertook and would therefore still trigger the obligations in Section 2 of the Reference Paper.<sup>248</sup> Second, the United States argues that Mexico's routing requirement is not a market access limitation at all since a routing restriction is not the type of limitation found in Article XVI:2 of the GATS.<sup>249</sup> The United States points to a note by the Secretariat, which states that "a Member grants full market access in a given sector and mode of supply when it does not maintain in that sector and

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<sup>240</sup> See Mexico's first written submission, paragraph 128. See also Mexico's first oral statement, paragraph 40. See also Mexico's answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), see footnote 232 of this Report.

<sup>241</sup> See Mexico's first written submission, paragraph 129. See also Mexico's second written submission, paragraph 70.

<sup>242</sup> See Mexico's first written submission, paragraph 129. See also Mexico's first oral statement, paragraph 41. See also Mexico's second written submission, paragraph 71. See also Mexico's answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), see footnote 232 of this Report.

<sup>243</sup> See Mexico's first written submission, paragraphs 129-130.

<sup>244</sup> See Mexico's first written submission, paragraph 130. See also Mexico's second written submission, paragraph 72.

<sup>245</sup> See Mexico's first written submission, paragraph 131.

<sup>246</sup> See Mexico's first written submission, paragraph 131. See also Mexico's second written submission, paragraph 72.

<sup>247</sup> See the United States' second written submission, paragraph 20.

<sup>248</sup> See the United States' first oral statement, paragraph 13. See also the United States' second written submission, paragraph 15-16.

<sup>249</sup> See the United States' first oral statement, paragraph 13. See also the United States' second written submission, paragraph 16. See also the United States' answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), see footnote 232 of this Report.

mode any of the types of measures listed in Article XVI."<sup>250</sup> Thus, the United States argues that the routing requirement is superfluous and without legal effect because it is not one of the limitations listed in Article XVI:2 of GATS.<sup>251</sup>

4.114 **Mexico** submits that the United States' interpretation is wrong. Instead, Mexico argues, the correct interpretation is that, in fact, the transport and transmission services provided by United States suppliers do not enter the territory of Mexico when United States suppliers hand over traffic to Mexican suppliers at a border point.<sup>252</sup>

4.115 **Mexico** argues that the United States' interpretation is based on its mistaken belief that United States suppliers are providing basic telecommunications transport services into Mexico when they rely on other service suppliers (i.e., Mexican concessionaires) to transport and transmit signals in Mexico. To the contrary, the transport and transmission services supplied by United States carriers end at the border. There is no cross-border supply simply because United States suppliers do not supply end-to-end services. Accepting the United States argument would mean that suppliers established in United States territory have to be deemed to supply services into another Member's territory when they hand off traffic to other suppliers which then transport and transmit the signals.<sup>253</sup>

4.116 **Mexico** submits that the United States' interpretation fails to give meaning to the word "concession", which is at the heart of Mexico's limitation. The terms of Mexico's Schedule make it clear that a "concession" is a title to "install, operate or use a facilities-based public telecommunications network". A concession is available only to enterprises established in accordance with Mexican law, which includes a limitation on direct foreign investment of up to 49 per cent. The concession requirement, therefore, imposes a commercial presence limitation on Mexico's mode 1 commitment to supply public telecommunications transport and transmission services in Mexico. In other words, only enterprises established in Mexico are entitled by law to transport and transmit international traffic, which is the service at issue in this dispute. This requirement prohibits the cross-border supply of telecommunications transport services by United States suppliers into Mexico and denies cross-border market access for United States suppliers, such as AT&T.<sup>254</sup>

4.117 In response to a question from the Panel, **Mexico** also asserts that the "concession requirement", the "routing requirement," and the commercial agency "permit requirement" fall within the limitations listed in GATS Article XVI:2(a) and (e).<sup>255</sup>

(i) *Concession requirement*

4.118 **Mexico** argues that the concession requirement creates commercial presence and nationality requirements to supply basic telecommunications services in Mexico. According to Mexico, these requirements fall within GATS Article XVI:2(a) which refers to "limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test". More specifically, with respect to mode 1 (cross-border) supply, by requiring a commercial presence, the "number of service suppliers" that can supply

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<sup>250</sup> MTN.GNS/W/164 (September 3, 1993), paragraph 4, cited in the United States' first oral statement, paragraph 13. *See also* the United States' second written submission, paragraph 16. *See also* the United States' answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), *see* footnote 232 of this Report.

<sup>251</sup> *See* the United States' first oral statement, paragraph 13. *See also* the United States' second written submission, paragraph 16. *See also* the United States' answer to question No. 1(b) of the Panel of 19 December 2002. For question No. 1(b), *see* footnote 232 of this Report.

<sup>252</sup> *See* Mexico's second oral statement, paragraph 50.

<sup>253</sup> *See* Mexico's second oral statement, paragraph 51.

<sup>254</sup> *See* Mexico's second oral statement, paragraph 52.

<sup>255</sup> *See* Mexico's answer to question No. 2(a) of the Panel of 19 December 2002. For question No. 2(a), *see* footnote 225 of this Report.

services through mode 1 is zero. The concession requirement creates commercial presence and nationality requirements because concessions can be granted only to Mexican individuals or companies. With respect to mode 3 (commercial presence), the 49 per cent maximum foreign ownership and nationality requirements similarly create a zero quota. This is confirmed by a WTO Secretariat Note, which states that "nationality requirements for suppliers of services" are "limitations on the number of service suppliers" because they are "equivalent to zero quota".<sup>256</sup> Accordingly, the concession requirement prevents nationals and juridical persons of other Members from installing, operating or using a facilities-based public telecommunications network in Mexico. Mexico also submits that the "concession" requirement means that suppliers must assume a specific legal form. Thus, it also falls within Article XVI:2(e) which refers to "measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service". A "concessionaire" is a specific type of legal entity under Mexican law.<sup>257</sup>

4.119 The **United States** argues that, because Mexico's mode 1 limitation does not use the term "commercial presence", the limitation does not impose a commercial presence requirement.<sup>258</sup>

4.120 In addition, the **United States** responds that, first, Mexico's argument that a limitation scheduled under one mode of supply can be "read together" or "in combination with" another limitation listed under a different mode is without any legal support. According to the United States, to interpret Mexico's Schedule in this manner would amount to the Panel inserting a limitation on Mexico's mode 1 commitment that Mexico itself did not schedule. The United States argues that this would impermissibly diminish the rights of the United States in violation of Article 19.2 of the DSU.<sup>259</sup>

4.121 The **United States** argues that Mexico's argument is also contrary to a Secretariat Scheduling Note, MTN.GNS/W/164 (3 September 1993), paragraph 19(a). That Note explains that "international transport, the supply of a service through telecommunications or mail, and services embodied in exported goods (e.g. a computer diskette, or drawings) are all examples of cross-border supply, since the service supplier is not present within the territory of the Member where the service is delivered."<sup>260</sup>

4.122 Finally, the **United States** argues that Mexico's own Schedule does not support its argument. Mexico's Schedule specifically permits market access in mode 1 as long as traffic is routed through the facilities of "an enterprise that has a concession ... ". Mexico's Schedule does not limit market access in mode 1 to only those foreign service supplier itself owns or controls. Thus, Mexico's own Schedule anticipates that a "service," within the meaning of the GATS, can be supplied on a cross-border basis as long as traffic is routed through the facilities of any Mexican concessionaire.<sup>261</sup>

4.123 **Mexico** replies that this interpretation is incorrect.<sup>262</sup> According to Mexico, a commercial presence requirement can be inscribed without the need expressly to use the words "commercial presence requirement".<sup>263</sup> What matters is the effect of the measure inscribed in the Schedule. Mexico did not refer to "commercial presence" in the generic sense but instead used the more specific phrase "enterprise that has a concession". This entails a specific legal form of commercial presence –

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<sup>256</sup> See the *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164, 3 September 1993.

<sup>257</sup> See Mexico's answer to question No. 2(a) of the Panel of 19 December 2002. For question No. 2(a), see footnote 225 of this Report.

<sup>258</sup> See the United States second oral statement, paragraph 11.

<sup>259</sup> See the United States' second written submission, paragraph 28.

<sup>260</sup> See the United States' second written submission, paragraph 30.

<sup>261</sup> See the United States' second written submission, paragraph 31.

<sup>262</sup> See Mexico's answer to question No. 3(c) of the Panel of 14 March 2003. For question No. 3(c), see footnote 201 of this Report.

<sup>263</sup> Ibid.

i.e. a "concessionaire" – as well as nationality and other requirements. The use of a more specific phrase is consistent with the GATS Guidelines for the Scheduling of Commitments, which establish that "[i]f in the context of such a commitment, a measure is maintained which is contrary to Article XVI or XVII, it must be entered as a limitation in the appropriate column (either market access or national treatment) for the relevant sector and modes of supply; the entry should describe the measure concisely, indicating the elements which make it inconsistent with Article XVI or XVII".<sup>264</sup>

4.124 According to **Mexico**, the requirement that "international traffic must be routed through the facilities of an enterprise that has a concession" creates an inconsistency with Article XVI of the GATS, because it reserves the supply of services to entities commercially present in Mexico – thereby establishing a zero quota on cross-border trade which implies that no such trade can occur. More specifically, because the limitations require a commercial presence for the supply of routing services, the number of suppliers that may supply such services through mode 1 is zero. Consequently, the measure inscribed in Mexico's Schedule is a limitation on the number of service suppliers within the meaning of GATS Article XVI:2. It also compels suppliers of routing services to acquire a specific legal status under the terms of this provision.<sup>265</sup>

4.125 **Mexico** submits that, under the scenarios outlined above, a United States supplier would have to "supply" telecommunications transport and transmission services "on both sides of the border" (that is, both sides of the half circuit), without any "commercial presence" in Mexico within the meaning of GATS Article XXVIII(d), in order for cross-border supply to be able to occur. This is not the case where traffic is handed over at the border to another carrier. As explained below, this can occur only under a "full-circuit" regime.<sup>266</sup>

4.126 The **United States** responds that Mexico's assertion that a "half circuit regime" is "incorporated in Mexico's Schedule," requires commercial presence and therefore prevents cross-border supply is based on a misstatement of what Mexico's Schedule actually says. Mexico apparently derives this argument, and the distinction between "half circuit" and "full circuit" service, from the requirement in its Schedule that international traffic "be routed through the facilities of an enterprise that has a concession." The United States argues that this phrase, however, does not require that a foreign supplier own a concession to send international traffic into Mexico. Rather, it only requires that foreign suppliers operating in the cross-border mode route that traffic through the facilities of an entity that has a concession. According to the United States, Mexico clearly knew how to schedule a concession requirement when it meant to do so – to enjoy market access in mode 3, Mexico's Schedule states that "[a] concession from the SCT is required." The United States submits that the contrast between Mexico's mode 1 and mode 3 "limitations" demonstrates that there is no concession requirement with respect to the cross-border supply of basic telecommunications services.<sup>267</sup>

(ii) *Routing requirement*

4.127 **Mexico** further argues that the routing requirement establishes a "zero quota" on mode 1 access for international simple resale (ISR).<sup>268</sup> According to Mexico, the requirement that international traffic be routed "through the facilities" of a concessionaire excludes ISR traffic. Specifically, the "facilities of a concessionaire" means more than its ordinary meaning – i.e. the

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<sup>264</sup> See Mexico's answer to question No. 3(c) of the Panel of 14 March 2003. For question No. 3(c), see footnote 201 of this Report.

<sup>265</sup> Ibid.

<sup>266</sup> Ibid.

<sup>267</sup> See the United States' comments on Mexico's answer to question No. 3(c) of the Panel of 14 March 2003, paragraph 13.

<sup>268</sup> See Mexico's answer to question No. 2(a) of the Panel of 19 December 2002. For question No. 2(a), see footnote 225 of this Report.

equipment of a concessionaire. Either by virtue of Article 31(4) or Article 32 of the *Vienna Convention*, this term must be interpreted in the light of its special meaning under Mexican law. Mexico notes that FTL Article 47 limits installation of telecommunications equipment for cross-border traffic to concessionaires and those otherwise specifically authorized by the SCT. ILD Rule 3 specifies that international long-distance traffic can be carried only by international gateway operators. ILD Rule 6 specifies that long-distance concessionaries may carry international long-distance traffic only through international gateways. This means that the term "through the facilities of" means through an international gateway. This excludes ISR traffic because such traffic, by its character, passes through private lines and not through an international gateway. It effectively imposes a "zero quota" on ISR traffic and, as such, is a limitation that falls within GATS Article XVI:2(a).<sup>269</sup>

4.128 The **United States** further submits that Mexico's position fails to recognize that "facilities" is in fact a much broader term than "ports," and embraces a variety of means that might be used to terminate cross-border traffic, including private leased circuits. The United States argues that Mexico's own laws and regulations recognize that the term "facilities" is broader than just "international ports." Article 47 of Mexico's Federal Law on Telecommunications requires a concession to install "telecommunications equipment and transmission means," a category of facilities obviously broader than merely international ports.<sup>270</sup> Likewise, Mexico's ILD Rule 4 clarifies that the facilities of an international concessionaire include the international port and "telecommunications equipment and means of transmission that cross the country's borders."<sup>271 272</sup>

4.129 The **United States** submits that these definitions are also consistent with the WTO's Telecommunications Services Glossary of Terms, which defines "networks or facilities" to include "the ensemble of equipment, sites, switches, lines, circuits, software, and other transmission apparatus used to provide telecommunications services." International switched ports are only one of the many types of telecommunications facilities embraced by this definition. According to the United States, Mexico's scheduled facilities routing requirement must therefore be interpreted to permit routing through any facilities. Nothing in Mexico's Schedule, with respect to services provided under mode 1, allows Mexico to preclude the termination of cross-border traffic using private leased circuits obtained from a Mexican concessionaire. This is the essence of International Simple Resale ("ISR").<sup>273</sup>

4.130 The **United States** notes that, even if the term "facilities" is construed to mean just "international ports," this conclusion would only affect Mexico's right to prohibit the interconnection of private leased circuits at network points other than the international port, which is relevant to the United States' claim under the Annex on Telecommunications. Mexico would still be required to allow private lines to be interconnected at the international port. According to the United States, even if Mexico's Schedule were interpreted to allow Mexico to require international traffic to route through a switched port operated by a Mexican concessionaire, United States carriers would still be providing telecommunications services on a cross-border (mode 1) basis. Thus, the obligations of Section 2 of the Reference Paper would still apply.<sup>274</sup>

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<sup>269</sup> See Mexico's answer to question No. 6(b) of the Panel of 19 December 2002 ("*Mexico has inscribed in its schedule that it 'will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued'. (b) Mexico asserts that international simple resale is prohibited. Please explain how this follows from its scheduled commitments.*").

<sup>270</sup> See Mexico's Federal Telecommunications Law attached as Exhibit US-16 to the first written submission of the United States.

<sup>271</sup> See Mexico's ILD rules attached as Exhibit US-1 to the first written submission of the United States.

<sup>272</sup> See the United States' second written submission, paragraph 24.

<sup>273</sup> See the United States' second written submission, paragraph 25.

<sup>274</sup> See the United States' second written submission, paragraph 26.

4.131 **Mexico** argues that the term "bypass" in the United States' submission refers to means that carriers can use to avoid paying settlement rates for having their traffic terminated in a foreign country. According to Mexico, the most commonly used method is international simple resale (ISR). Mexico argues that the Reference Paper does not override Mexico's limitation on international simple resale (ISR). Unlike a traditional accounting rate arrangement whereby carriers hand off traffic at the border or another mid-point between countries, ISR entails the use of private leased lines that cross the border. The private lines are connected directly to the domestic public switched telephone network in the destination country, thus enabling direct access to end-users in that country. Private lines are normally used for closed, intracorporate networking capabilities and are usually charged on a flat-rate basis. By leasing capacity on a private line, a carrier seeking to terminate traffic in a foreign country can bypass the accounting rate regime and avoid paying per-minute settlement rates. Many nations, including the United States on certain routes, prohibit the use of ISR for carrying international traffic for the specific reason that they wish to preserve use of the accounting rate regime. According to Mexico, ISR is also prohibited in Mexico.<sup>275</sup>

4.132 According to **Mexico**, the "private" character of a circuit does not stem from its technical features but from the manner in which the circuit is used. To the extent that the circuit is used for an end-to-end private service, it constitutes a private-line circuit; if it is used to carry public traffic, the circuit is public. The issue whether a supplier can do so in conformity with Mexico's Schedule, however, depends on the market access inscriptions and limitations regarding the services in question and the supply of those services. In Mexico, once a private line (end-to-end) is used to carry public traffic, it is considered to be part of the public network and consequently loses its "private" character. It is then regulated as part of the public network and may not be used, or leased, for an end-to-end service. In other words, a "private circuit" may not carry public traffic. Mexico has undertaken commitments with respect to the transport of public traffic using the public network and the transport of end-to-end private traffic using public network facilities (*infraestructura de la red pública*). However, nowhere in Mexico's Schedule has a market access commitment been undertaken for the transport of public traffic through private lines.<sup>276</sup>

4.133 **Mexico** points out that, it is important to have a clear understanding of the nature of private-line service. The main characteristic of private-line service is that it constitutes "end-to-end" service – i.e. the consumer determines beforehand the specific location where the service will be used. Conversely, public traffic is not limited to specific points; it has access to the entire public network. ISR involves sending the traffic by means of a private-line service and then connecting such traffic to the switched public network in the foreign country. The originating carrier thus gains access to an end-to-end private-line service in the foreign country and has to rely on an entity (which has leased a domestic private line, presumably for its own use) within that foreign country in order to arrange for the traffic to be connected to the public network. In other words, the originating carrier itself is not involved in the connection to the public network in the foreign country. However, in Section 2.C(g) of its Schedule, Mexico has made clear that once the operator of a private network "resells" that network in order to connect public traffic to the public network, the private network no longer constitutes a "private" end-to-end connection. The operator becomes subject to all the rules and limitations governing public networks and no longer qualifies as a private-line carrier – which by definition precludes it from being used for ISR.<sup>277</sup>

4.134 Therefore, **Mexico** argues, the United States in fact claims that Mexico should allow Mexican users of end-to-end private-line services to interconnect with the switched public network, so that

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<sup>275</sup> See Mexico's first written submission, paragraphs 33-34.

<sup>276</sup> See Mexico's answer to question No. 3(d) of the Panel of 14 March 2003 ("*Does a supplier who owns facilities but leases private circuits for part of the transmission still supply services through a 'facilities based public telecommunications network'?* Please elaborate by using evidence from relevant regulations.").

<sup>277</sup> See Mexico's answer to question No. 3(d) of the Panel of 14 March 2003. For question No. 3(d), see footnote 276 of this Report.

United States carriers can arrange for their traffic to evade (i.e. bypass) authorized Mexican carriers.<sup>278</sup>

4.135 **Mexico** submits that it has therefore made clear that once the operator of a private network "resells" that network in order to connect public traffic to the public network, the private network no longer constitutes a "private" end-to-end connection. The operator becomes subject to all the rules and limitations governing public networks and no longer qualifies as a private-line carrier – which by definition precludes it from being used for ISR.<sup>279</sup>

4.136 The **United States** notes that, while Mexico continues to argue that a private circuit cannot carry public traffic, it has failed to respond to the United States observation that Telmex in fact offers such private lines to other public network operators, not just private businesses. The United States argues that this demonstrates that the inscription on "private leased circuit services" in Mexico's Schedule does not mean what Mexico now contends. The inclusion in Mexico's Schedule of "private leased circuit services" relates only to the obligation of private "network operators" in Mexico who want to exploit their networks commercially to obtain a concession, not to the ability of firms operating on a resale rather than a facilities basis in Mexico to send traffic through leased private lines obtained from a network operator that has a concession. The separate provision for "commercial agencies" under mode 3 operating on a permit, not a concession, reinforces this interpretation. Though an owner of network facilities in Mexico would need a concession in order to lease its lines to others to carry public traffic on a resale basis (i.e., become the "lessor"), the firms leasing such lines (the "lessee") would not themselves need the concession. The United States contends that ISR does not "evade" the authorized Mexican carriers' networks. Rather, commercial agencies under mode 1 would use the networks of the Mexican carriers as required by the routing restriction, but are simply not bound to send their traffic through the international switched ports subject to the cartel pricing provision of ILD Rule 13.<sup>280</sup>

(iii) *Commercial agency permit requirement*

4.137 **Mexico** submits that the permit requirement establishes a "zero quota" on mode 3 access for commercial agencies which is a limitation under GATS Article XVI:2(a).<sup>281</sup> According to Mexico, the permit requirement is qualified by the paragraph "[t]he 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". This paragraph means that, at the time the limitation was inscribed, permits were not being issued by the SCT. Like the limitations on market access for facilities-based suppliers, this is equivalent to a zero quota. Accordingly, the requirement falls within the category of "limitations on the number of service suppliers" in paragraph (a) of GATS Article XVI:2.<sup>282</sup>

4.138 The **United States** disagrees with this classification.<sup>283</sup> However, the United States argues that the Panel does not need to deal with this issue, for one very simple reason – the mode 1 market access column of Mexico's Schedule does not include such a "concession requirement." Mexico's

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<sup>278</sup> See Mexico's answer to question No. 3(d) of the Panel of 14 March 2003. For question No. 3(d), see footnote 276 of this Report.

<sup>279</sup> Ibid.

<sup>280</sup> See the United States' comments on Mexico's answer to question No. 3(d) of the Panel of 14 March 2003, paragraph 14.

<sup>281</sup> See Mexico's answer to question No. 2(a) of the Panel of 19 December 2002. For question No. 2(a), see footnote 225 of this Report.

<sup>282</sup> See Mexico's answer to question No. 6(a) of the Panel of 19 December 2002 ("*Mexico has inscribed in its schedule that it 'will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued'.* What is the scope of Mexico's commitment under Mode 1 and Mode 3 for commercial agencies?").

<sup>283</sup> See the United States' second written submission, paragraph 17.

Schedule simply does not require foreign suppliers sending international traffic into Mexico to themselves have a concession. Rather, it only requires that they route that traffic through the facilities of an entity that has a concession. The United States further submits that this interpretation of Mexico's routing requirement is reinforced by the contrast between Mexico's mode 1 and mode 3 market access limitations. To enjoy market access as a facilities-based operator in mode 3, Mexico's Schedule states that "[a] concession from the SCT is required." This wording shows that Mexico knew how to describe a concession requirement, where it so intended.<sup>284</sup>

4.139 **Mexico** replies that it is not arguing that its limitation requires the United States-established supplier "itself" to maintain a commercial presence but that, given the nature of the half-circuit regime, routing services over the Mexican half circuit must be supplied by a concessionaire established in Mexico.<sup>285</sup>

4.140 The **United States** does not agree that the routing requirement falls within the limitations listed in GATS Article XVI:2(a) and (e). According to the United States, however, even accepting Mexico's point solely for the sake of argument, classifying the routing requirement under subparagraphs (a) or (e) would not reduce Mexico's cross-border commitment to "unbound", and thus Section 2 of the Reference Paper and Section 5 of the Annex would still apply.<sup>286</sup>

4.141 In response to a question by the Panel, the **United States** further claims that Mexico's argument that the cross-border supply of basic telecommunications services by a foreign supplier can take place only if that supplier terminates its cross border services on the facilities of a concessionaire owned or controlled by that same supplier is untenable for the following reasons:<sup>287</sup>

- (i) Mexico's own Schedule does not limit market access in mode 1 to only those foreign service suppliers that route traffic through the facilities of a Mexican concessionaire that the foreign service supplier itself owns or controls.<sup>288</sup>
- (ii) Second, accepting Mexico's argument would mean that the provision of basic telecommunications services on a cross-border basis would only be possible if a service supplier also operated on a commercial presence basis. The result would be to make mode 1 redundant, and to render meaningless Members' mode 1 commitments in the basic telecommunications sector – a result that is contrary to the rules of interpretation to be applied by the Panel.<sup>289</sup> Such an interpretation would be contrary to the meaning of mode 1, which is defined in GATS as the supply of a service "from the territory of one Member into the territory of any other Member." The ordinary meaning of these terms is that the service moves from the territory of one Member into the territory of the other Member, not the service supplier. This reading is also supported by an explanatory scheduling note, which states that "international transport, the

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<sup>284</sup> See the United States' second oral statement, paragraphs 8-9.

<sup>285</sup> See Mexico's answer to question No. 3(c) of the Panel of 14 March 2003 ("*If so, does the supplier have to supply through its network(s) the entire service, or is it sufficient that it supplies through its network for a portion of the transmission service? Please elaborate by using evidence from relevant regulations, and consider the following scenarios: the cross-border service is supplied over a facilities-based network: (i) on all segments of the transmission service, and on both sides of the border; or (ii) on any segment of the transmission service, and on either side of the border; or (iii) on the originating side of the border only; or (iv) on the terminating side of the border only?*"). See also the United States' comments on Mexico's answer to question No. 3(c) of the Panel of 14 March 2003, paragraph 13.

<sup>286</sup> See the United States' second written submission, paragraph 17.

<sup>287</sup> See the United States' answer to question No. 3(a) of the Panel of 19 December 2002. For question No. 3(a), see footnote 187 of this Report.

<sup>288</sup> Ibid.

<sup>289</sup> Ibid.

supply of a service through telecommunications or mail, and services embodied in exported goods (e.g. a computer diskette, or drawings) are all examples of cross-border supply, since the service supplier is not present within the territory of the Member where the service is delivered".<sup>290</sup>

4.142 **Mexico** acknowledges that a concessionaire which is controlled by a foreign minority partner is a service supplier of another Member under the definitions in Article XXVIII of the GATS. Mexico notes, however, that the United States has not established that any of the concessionaires authorized to supply public telecommunications services in the territory of Mexico are "controlled" by persons of another Member. Thus, the evidence on the record does not demonstrate that these concessionaires are service suppliers of another Member.<sup>291</sup>

4.143 **Mexico** further argues that, even if the United States were to demonstrate that a concessionaire is a service supplier of the United States under the definitions in Article XXVIII of the GATS, this would merely establish that United States suppliers are supplying public telecommunications transport services through commercial presence in the territory of Mexico. Thus, those market entrants would not be supplying services through mode 1 (cross-border supply).<sup>292</sup>

4.144 Moreover, **Mexico** submits, other United States suppliers that "interconnect" with those concessionaires would not be supplying public telecommunications transport services on a cross-border basis from the United States into Mexico because, in that event, the transport and delivery of a telephone call to the receiving party in Mexico would still require the joint provision of services by two service suppliers and the United States supplier that originates the call would still have to hand off its traffic at the border to a supplier commercially established in Mexico. The latter supplier is a different and separate "juridical person" that supplies services under the GATS. Cross-border supply only occurs when a telecommunications service supplier established and operating in the territory of a given WTO Member transports and delivers the data supplied by its customers across a border into the territory of another WTO Member.<sup>293</sup>

4.145 **Mexico** also submits that, even if the United States suppliers that "interconnect" with these concessionaires were supplying PTTNS on a "cross-border" basis from the United States into Mexico, the disciplines in Section 2 of Mexico's Reference Paper would not apply. By virtue of the chapeau to Section 2.2, the disciplines in that section apply only to interconnection with a "major supplier". These concessionaires are not "major suppliers".<sup>294</sup>

4.146 As to non-facilities-based international services, **Mexico** argues that, because an identical limitation relating to mode 1 cross-border supply is inscribed under subparagraph (o) (i.e., Other – Commercial agencies) in Mexico's Schedule, United States non-facilities-based suppliers of basic telecommunications services are prevented from supplying their services on a cross-border basis as well. Also, Mexico claims that, by requiring international calls to be routed through a facilities-based licensed carrier, Mexico has not undertaken any commitment to authorize International Simple Resale (ISR).<sup>295</sup> The effect of this limitation requires all suppliers established in the United States, including

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<sup>290</sup> See the United States' answer to question No. 3(a) of the Panel of 19 December 2002. For question No. 3(a), see footnote 187 of this Report.

<sup>291</sup> See Mexico's answer to question No. 5(c) of the Panel of 19 December 2002 ("*Mexico argues that the limitation set out under Mode 1 read together with the limitation set out under Mode 3 of Mexico's Schedule must be interpreted to mean that Mexico has not committed to the cross-border supply of basic telecommunications. (c) If so, can a concessionaire which is controlled by a foreign minority partner be a service supplier of another Member under the definitions in Article XXVIII of the GATS?*").

<sup>292</sup> See Mexico's answer to question No. 5(c) of the Panel of 19 December 2002. For question No. 5(c), see footnote 291 of this Report.

<sup>293</sup> Ibid.

<sup>294</sup> Ibid.

<sup>295</sup> See Mexico's first written submission, paragraphs 132-133.

United States "resellers" or "commercial agencies", to hand of their traffic at the border for transport services on the Mexican side of the half circuit to be supplied by Mexican concessionaires established in Mexico.<sup>296</sup>

4.147 The **United States** argues that this asserted prohibition does not follow from Mexico's scheduled commitments. According to the United States, Mexico's commitments for commercial agencies specifically include both the supply by a foreign supplier of scheduled basic telecommunications services from the United States into Mexico over capacity leased from a Mexican concessionaire (mode 1), and the acquisition by a foreign service supplier of a locally-established commercial agency for the purpose of supplying scheduled international basic telecommunications services from Mexico to the United States over capacity leased from a Mexican concessionaire (mode 3). Both of these situations are examples of what is typically known as international simple resale. The United States also notes that Mexico's routing requirement does not equate to a prohibition on the use of private leased circuits because a foreign service supplier that leases capacity from a concessionaire is still in compliance with the Mexican requirement to route traffic through the facilities of a concessionaire.<sup>297</sup>

4.148 **Mexico** argues that Article XVIII of the GATS establishes a distinction between measures that affect market access and national treatment, which are subject to scheduling under GATS Article XVI and XVII, and other measures that affect the supply of a service within a Member's territory. Only the latter category of measures can be covered by additional commitments under Article XVIII of the GATS. This means that the terms and conditions governing market access for foreign service suppliers are determined by the commitments made under Article XVI of the GATS, and not by the commitments made pursuant to Article XVIII. Since the Reference Paper was included in Mexico's Schedule pursuant to Article XVIII, it does not relate to Mexico's Scheduled market access commitments.<sup>298</sup>

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

4.149 The **United States** submits that 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". According to the United States, this definition 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. The United States further notes that, because "control over essential facilities" and "use of its position in the market" are in the disjunctive, either is sufficient to meet the definition.<sup>299</sup>

4.150 **Mexico** notes first that the burden is on the United States to demonstrate that the interconnection at issue concerns a "major supplier". According to Mexico, the analysis of the United

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<sup>296</sup> See Mexico's answer to question No. 6 of the Panel of 14 March 2003 (*What in your view, would be the legal significance of the routing restriction, in the absence of any mode 3 limitations in Mexico's Schedule? Under this hypothesis, which subparagraph of Article XVI:2 of the GATS would the routing restriction fit under?*). See also Mexico's answer to question No. 8 of the Panel of 14 March 2003 (*Mexico's commitments relating to commercial agencies – under "(o) other" – appear to be subordinate to the chapeau of its entry on telecommunications services. Please explain this relationship.*).

<sup>297</sup> See the United States' answer to question No. 6(b) of the Panel of 19 December 2002. For question No. 6(b), see footnote 269 of this Report.

<sup>298</sup> See Mexico's first written submission, paragraphs 137-138.

<sup>299</sup> See the United States' first written submission, paragraphs 68-69.

States is flawed. Mexico also claims that the United States has not presented a prima facie case that Telmex is a "major supplier" within the meaning of the Reference Paper.<sup>300</sup>

(a) The relevant market

4.151 The **United States** submits that, according to well-accepted principles of market analysis deriving from competition law, which are similar in both United States antitrust and Mexican competition law, markets are defined in terms of substitution, looking at the alternatives available and acceptable to consumers. According to the United States, 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. In support of its argument, the United States cited to decisions by the Mexican competition authority, the *Comisión Federal de Competencia* ("CFC"), which stated 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 toll services.<sup>301</sup>

4.152 The **United States** further submits that, within the broad category of international services, it is necessary to distinguish the markets for originating traffic and for terminating traffic. According to the United States' substitution analysis, because a United States 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 United States and other foreign carriers to complete their international telecommunications traffic into Mexico. Therefore, argues the United States, 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.<sup>302</sup>

4.153 The **United States** also argues that, because 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, United States 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. According to the United States, 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.<sup>303</sup>

4.154 Thus, the **United States** argues, 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.<sup>304</sup>

4.155 **Mexico** replies that, the United States fails to clearly define the services at issue and how they are supplied in its analysis.<sup>305</sup>

4.156 **Mexico** further argues, assuming that the services at issue are the transportation and transmission of telecommunications signals and that the mode of supply at issue is mode 1 (cross-border), the United States fails to explain how the "relevant market" it defines is relevant to the cross-border supply of such services. The United States defines the "relevant market" as "the termination of

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<sup>300</sup> See Mexico's second oral statement, paragraphs 68, 69, and 74.

<sup>301</sup> See the United States' first written submission, paragraphs 73 and 75.

<sup>302</sup> See the United States' first written submission, paragraph 76.

<sup>303</sup> See the United States' first written submission, paragraph 77.

<sup>304</sup> See the United States' first written submission, paragraph 78.

<sup>305</sup> See Mexico's second oral statement, paragraph 70.

voice telephony, facsimile and circuit-switched data transmission services". According to Mexico, "termination services", to the extent that they are provided by a carrier in a WTO Member, are provided on a mode 3 (commercial presence) basis and not on a cross-border basis. Mexico claims that the United States' analysis confuses two distinct modes of supply – cross-border and commercial presence. Moreover, Mexico submits, the United States relies on a relevant market resolution by the Mexican competition authority that is under review by Mexican courts<sup>306</sup> precisely because it was based on data from 1996, that is, when the telecommunications market was not yet fully open.<sup>307</sup>

4.157 In addition, **Mexico** submits, even assuming that defining the relevant market as "termination services" is relevant, it is unclear whether a carrier in Mexico, such as Telmex, is providing "termination services". According to Mexico, a technical distinction can be made between the traditional accounting rate procedure, which involves jointly provided services and a division of revenues for the provision of these jointly provided services, and a *termination* regime under which telecommunications services are treated as a tradable commodity rather than as jointly provided services. Mexico submits that this distinction has been recognized by the ITU. Mexico maintains a traditional accounting rate regime under which services are provided jointly and revenue is divided. It does not maintain a termination regime. In this sense, it cannot be said that any carrier operating in Mexico provides "termination services". In fact, the rates are determined by bilateral negotiations between private parties – carriers of Mexico and the United States – for traffic going in both directions. Accordingly, the "relevant market" for those negotiations must encompass that two-way traffic. Mexico also notes that, at the time of the negotiation of the current accounting rates, WorldCom had the same market share of southbound traffic that Telmex did of northbound traffic.<sup>308</sup>

4.158 **Mexico** also submits that, even if a carrier in Mexico does provide "termination services" for foreign carriers wishing to terminate calls within Mexico, these services and how to schedule them were a specific topic of discussion during the negotiations on basic telecommunications. There was no agreement on these services and, even if there was, Mexico has not inscribed in its Schedule any specific commitments with respect to these services.<sup>309</sup>

(b) Whether Telmex has market power

4.159 The **United States** argues that, 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 United States 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.<sup>310</sup>

4.160 The **United States** submits that, Telmex's market power 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." Rule 10 also provides that this rate shall be the uniform rate charged by all Mexican carriers. Thus, the United States contends, 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

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<sup>306</sup> See Mexico's second oral statement, paragraph 71.

<sup>307</sup> See Mexico's first written submission, paragraphs 102-108.

<sup>308</sup> See Mexico's second oral statement, paragraph 72.

<sup>309</sup> See Mexico's second oral statement, paragraph 73.

<sup>310</sup> See the United States' first written submission, paragraph 81.

telecommunications carriers that have their own networks, they are prohibited from competing on the price of terminating cross-border traffic into Mexico by operation of Mexican law.<sup>311</sup>

4.161 **Mexico** argues that the requirements in Rules 10 and 13 help protect and promote investment in domestic infrastructure in several ways: (i) they ensure that an incumbent carrier will not be able to use its market position to negotiate better deals than the new entrants; (ii) they prevent large carriers in the two countries from conspiring to exclude smaller carriers; and (iii) they prevent new entrants that focus on high volume, low cost end-users from triggering a "price war" that could drive the rates of all carriers too low to support infrastructure build-out. Mexico points out that, since the United States already has very substantial investments in telecommunications infrastructure, promotion of investments in facilities has not been a high priority. However, for countries such as Mexico, with low teledensity and unserved rural areas, it is vital. Mexico further notes that it implemented the ILD Rules for accounting rate agreements to mirror the pre-existing rules of the United States, which for United States-Mexico traffic require that United States carriers reflect in their accounting rate agreements the requirements of proportional return and uniform settlement rates. The United States further requires that international settlement rates be symmetrical – that is, that United States carriers charge foreign carriers the exact same rate that they pay the foreign carriers. The stated purpose of the United States policy is to prevent its carriers from being "whipsawed" by foreign carriers; that is, to prevent foreign carriers from being able to obtain unduly favourable terms and conditions from United States carriers by setting them against one another. Thus, Mexico argues, in the absence of the ILD Rules, Mexican carriers would be vulnerable to "whipsawing" by United States carriers.<sup>312</sup>

4.162 The **United States** also claims that the extent of Telmex's market power has also been substantiated by Mexico's own competition authority, the *Comisión Federal de Competencia* ("CFC").<sup>313</sup> According to the United States, in 2001, the CFC reaffirmed its earlier conclusion that Telmex had "*poder sustancial*" (substantial power) in international services 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>314</sup> The United States further submits that, 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. The United States explains that, 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. 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.<sup>315</sup>

4.163 The **United States** also submits that, like the CFC, the United States Federal Communications Commission has also found that both Telmex and its United States 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.<sup>316</sup>

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<sup>311</sup> See the United States' first written submission, paragraph 82.

<sup>312</sup> See Mexico's first written submission, paragraphs 79-81.

<sup>313</sup> See the United States' first written submission, paragraph 84.

<sup>314</sup> See the United States' first written submission, paragraphs 84-90.

<sup>315</sup> See the United States' first written submission, paragraph 91.

<sup>316</sup> See the United States' first written submission, paragraph 92.

4.164 **Mexico** argues that it has taken a number of steps to establish a comprehensive regulatory framework for the incumbent (former monopoly) carrier, Telmex, which are designed to introduce competition while protecting and promoting the nation's telecommunications infrastructure.<sup>317</sup> According to Mexico, Telmex's concession title was substantially modified when it was privatized.<sup>318</sup> As a result, Telmex's concession title itself contains provisions intended to prevent anti-competitive activities.<sup>319</sup> Mexico also points out that, under Article 63 of the Federal Economic Competition Law (FTL), a finding by the Federal Competition Commission ("COFECO") that a concessionaire possesses substantial market power does not imply that the concessionaire has abused its market power (that is, behaved in an anticompetitive manner).<sup>320</sup> Rather, it merely allows COFETEL to impose prophylactic measures to prevent abuses of market power.<sup>321</sup>

4.165 The **United States** submits that, current market evidence indicates that Telmex has exercised and continues to exercise, 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. The United States begins by noting that Telmex's share in the international long-distance market has long been well over 50%. The United States notes that, 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>322</sup> Furthermore, the United States submits that Telmex's significant market power is indicated by the absence of significant new suppliers of international telecommunications services in Mexico during the past few years.<sup>323</sup> Also, the United States argues, Telmex's market power is 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.<sup>324</sup>

4.166 **Mexico** submits that currently there are 27 concessionaires allowed to provide long-distance services, including three United States-affiliated carriers, Avantel (WorldCom), Alestra (AT/T) and Iusatel (Verizon).<sup>325</sup> Also, as of September 2002, 11 out of the 27 long-distance concessionaires in Mexico were authorized to operate international ports and, thus, to carry outgoing and incoming international calls.<sup>326</sup> According to Mexico, new entrants in the Mexican domestic and international long-distance market have gained significant market share when compared with other countries that opened the sector to competition under similar conditions.<sup>327</sup> Mexico points out that, with respect to the domestic long-distance market, using data from the year 2000, it took the new entrants only four years to capture a 29% share of the Mexican market (measured in terms of access lines served per carrier).<sup>328</sup> In the European Union, new entrants in the domestic long-distance market had on average 20 per cent market share in 2000 after three years of competition.<sup>329</sup> By comparison, it took new entrants in the United States more than 11 years after competition was allowed to reach a comparable

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<sup>317</sup> See Mexico's first written submission, paragraph 96.

<sup>318</sup> See Mexico's first written submission, paragraph 97.

<sup>319</sup> See Mexico's first written submission, paragraph 98.

<sup>320</sup> See Mexico's first written submission, paragraph 103.

<sup>321</sup> Ibid.

<sup>322</sup> See the United States' first written submission, paragraph 93.

<sup>323</sup> See the United States' first written submission, paragraph 95.

<sup>324</sup> See the United States' first written submission, paragraph 97.

<sup>325</sup> See Mexico's first written submission, paragraph 87. See also Mexico's first oral statement, paragraph 11.

<sup>326</sup> See Mexico's first written submission, paragraph 88.

<sup>327</sup> See Mexico's first written submission, paragraph 89.

<sup>328</sup> See Mexico's first written submission, paragraph 90. See also Mexico's first oral statement, paragraph 13.

<sup>329</sup> Ibid.

market share.<sup>330</sup> Mexico also notes that, in the case of the market for international long-distance traffic, new entrants in Mexico have performed even better in capturing market share.<sup>331</sup> This is reflected in the market share of Telmex, which at the end of 2000 was at a 61%, whereas in European Union member countries the incumbents had an average market share of 80% in terms of minutes.<sup>332</sup> Again, in the United States, after eleven years of competition, the incumbent (AT&T) had a market share of 59% – similar to that of Telmex today.<sup>333</sup> Mexico further submits that that new entrant carriers have been gaining significant market share on many important routes.<sup>334</sup> For example, from January to June of 2002, Alestra (the affiliate of AT&T) had 39% of the outgoing traffic to the United Kingdom while Telmex had 49%.<sup>335</sup>

## 5. Whether Telmex' interconnection rates are "basadas en costos"

4.167 The **United States** argues that Section 2.2 of Mexico's Reference Paper requires Mexico to ensure that Telmex provides interconnection at rates that are "based in cost" (*basadas en costos*) and "reasonable". However, according to the United States, Mexico has failed to meet this obligation because the rates that Telmex charges United States suppliers to interconnect are not based in cost or reasonable.<sup>336</sup>

4.168 **Mexico** argues that, because Mexico did not make any specific commitments relating to the accounting rate regime, Section 2 of the Reference Paper does not apply to the facts of this dispute. Mexico further submits that, even if Mexico's Reference Paper could be considered to apply to the accounting rate regime, the United States has failed to present a prima facie case that the accounting rates negotiated by Mexican and United States carriers do not comply with the obligations of the Reference Paper.<sup>337</sup>

(a) Whether Telmex interconnection rates are "based in cost"

(i) *The meaning of "based in cost"*

4.169 The **United States** submits that the term "based in cost" is not defined in the reference paper. The United States notes first that the ordinary meaning of "based in cost" suggests that the "cost" at issue must be related to the cost incurred in providing the good or service.<sup>338</sup> Next the United States argues that, because the terms "cost-oriented" and *basadas en costos* are used in the telecommunications laws and regulations of WTO Members, this usage could be termed a "special meaning," which Article 31(4) of the *Vienna Convention* provides "shall be given to a term if it is established that the parties so intended."<sup>339</sup> After surveying the laws of many WTO Members, including Mexico, the United States argues that, there appears to be consensus among many WTO Members – including Mexico – to give the term "cost-oriented" and *basadas en costos* the "special meaning" that interconnection rates should be based on the cost of providing interconnection.<sup>340</sup> The United States also submits that this "special meaning" is in line with the meaning derived from

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<sup>330</sup> See Mexico's first written submission, paragraph 90. See also Mexico's first oral statement, paragraph 13.

<sup>331</sup> See Mexico's first written submission, paragraph 91. See also Mexico's first oral statement, paragraph 14.

<sup>332</sup> Ibid.

<sup>333</sup> Ibid.

<sup>334</sup> See Mexico's first written submission, paragraph 73. See also Mexico's first oral statement, paragraph 14.

<sup>335</sup> Ibid.

<sup>336</sup> See the United States' first written submission, paragraphs 100-101.

<sup>337</sup> See Mexico's first written submission, paragraphs 147, 148, and 177.

<sup>338</sup> See the United States' first written submission, paragraph 107.

<sup>339</sup> See the United States' first written submission, paragraph 108.

<sup>340</sup> See the United States' first written submission, paragraphs 109-113.

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>341</sup> According to the United States, the interconnection obligations in Section 2 are one part of the set of pro-competitive regulatory commitments embodied in the Reference Paper, which mandates major suppliers to charge interconnection rates based on the cost that the major supplier incurs in providing interconnection.<sup>342</sup>

4.170 **Mexico** claims that the United States interprets the term "*basadas en costos*" narrowly to mean that the rate in question must equal the bare cost of providing the service and this narrow interpretation must be rejected.<sup>343</sup> According to Mexico, *basadas en costos* allows for more distance between the rate and the cost than is argued by the United States.<sup>344</sup> In support of its argument, Mexico first notes that if the negotiators of the Model Reference Paper and Mexico's Reference Paper had intended this narrow interpretation, they would have referred to "rates that equal cost" or "rates that at most recover cost".<sup>345</sup> Instead, they used a much more flexible term.<sup>346</sup> Further, interpreting "cost oriented" to mean "equal to cost" would lead to an absurdity, in that the carrier supplying the service would be prohibited from making any profit at all in transactions with other carriers.<sup>347</sup>

4.171 According to **Mexico**, cost-oriented rates should allow an adequate rate of return, even without the modifiers "reasonable" and "economically feasible" being taken into consideration. Determining an adequate rate of return is an extremely complex matter and one which is not necessarily restricted to the charges for carrying international calls; rather, it could quite legitimately involve overall carrier costs. Specifically, a multi-product firm (one offering a range of services) incurs different kinds of costs in providing its services, some of which can be directly allocated to specific services, given that it is provision of these particular services which gives rise to the cost incurred. However, in addition to direct costs, a multi-product firm incurs costs that are shared between groups of services and costs which are common to all services. Both common and shared costs can only be avoided if the group of services is terminated (in the case of shared costs) or if the whole firm closes down (in the case of common costs). In spite of the fact that common and shared costs cannot be directly allocated to the various services offered by a multi-product firm, they are nevertheless real economic costs which must be recovered if the firm hopes to earn a competitive return on the capital used and to continue to attract investment funds for the business. Most firms in competitive industries are multi-product and the margins referred to are necessary, as are cost increases. Such increases provide the expected revenue and recoup both common costs and any historic costs permitted by the market. The extent of the margins depends on market conditions. In short, Mexico argues, fixing a carrier's interconnection rate at direct cost level would be incorrect from an economic point of view. At the same time, an "economically correct" increase in common and shared costs is mainly a question of market conditions.<sup>348</sup>

4.172 **Mexico** also submits that it does not, in any case, consider that the Reference Paper provides a basis for determining the level of rate of return appropriate for any particular circumstance. Rather, it would be more advisable to focus on whether the rate is in itself reasonable in the light of all the

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<sup>341</sup> See the United States' first written submission, paragraph 114.

<sup>342</sup> See the United States' first written submission, paragraphs 115-117.

<sup>343</sup> See Mexico's second written submission, paragraph 81. See also Mexico's answer to question No. 10(a) of the Panel of 19 December 2002 ("*Does Mexico consider that the rates that Mexican companies currently charge for terminating incoming traffic from the United States are cost-oriented?*").

<sup>344</sup> See Mexico's second written submission, paragraph 82. See also Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

<sup>345</sup> See Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

<sup>346</sup> Ibid.

<sup>347</sup> Ibid.

<sup>348</sup> See Mexico's answer to question No. 12 of the Panel of 14 March 2003. For question No. 12, see footnote 111 of this Report.

circumstances, for example, by way of a comparison with target rates and the rates of other countries.<sup>349</sup>

4.173 The **United States** submits that Mexico's assertion is not correct. According to the United States, under Mexican law, interconnection rates for commercially-present suppliers must recover at least the total cost of all network elements. The term used for "total cost" in Mexican law is "long run average incremental cost." The United States argues that the term "long run" refers to a period long enough so that all costs become variable. As a result, when Mexican law requires that carriers recover "at least the long run average incremental cost," it already builds in the cost of capital, which includes a reasonable rate of return, or in other words a profit.<sup>350</sup>

4.174 **Mexico** also submits that Mexico's Schedule is part of the GATS which, itself, is part of the WTO Agreement. As a consequence, other agreements within the WTO Agreement form part of the context of the GATS and, thereby, part of the context of Mexico's Schedule. Mexico points out that, according to Article 2.2 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (Anti-Dumping Agreement), where a precise relationship between a price and a cost was intended, this relationship was specified explicitly. However, no such relationship is specified in the Model Reference Paper or in Mexico's Reference Paper. Mexico also submits that, even assuming that the reference papers inscribed in the Members' schedules could apply to the accounting rate regime, the practice of the WTO Members subsequent to the conclusion of the negotiations on basic telecommunications confirms that the Members do not share the United States' narrow interpretation of "cost-oriented". Of the 55 WTO Members that inscribed a version of the reference paper in their schedules that included the "cost-oriented" requirement in paragraph 2.2(b), Mexico is not aware of any that have adopted an explicit requirement that settlement rates negotiated under accounting rates arrangements be based on the costs of their own carriers, let alone equal to cost or no greater than their carriers' rates for domestic interconnection. There is good reason for this state of affairs. If the narrow interpretation posed by the United States is applied to accounting rates, it would create the absurdity identified in Mexico's response to question 7 of the Panel.<sup>351</sup>

4.175 The **United States** replies that it is aware of no Member, other than Mexico, that has accepted commitments under Section 2.2(b) of the Reference Paper and that has simultaneously imposed an explicit prohibition on competition between suppliers providing interconnection to cross-border suppliers, the effect of which is to prevent competition from reducing rates. Even if other WTO Members do not have explicit requirements for settlement rates to be cost-based, they also do not have restrictions, such as those maintained by Mexico, on competition between suppliers. Those other Members therefore can reasonably rely on competitive market dynamics to yield cost-based settlement rates. The United States notes that, for numerous countries where competitive conditions are allowed to govern international interconnection rate negotiations, United States carriers have negotiated rates for traffic termination in the range of 1.5 to 4 cents per minute.<sup>352</sup>

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<sup>349</sup> See Mexico's answer to question No. 12 of the Panel of 14 March 2003 ("*Is there a margin for an adequate rate of return that can be interpreted into the terms 'cost-oriented rates that are ... reasonable.' If so, what would be an adequate margin of return. Please provide examples.*").

<sup>350</sup> See the United States' second oral statement, paragraph 50. See also the United States' comments on Mexico's answer to question No. 12 of the Panel of 14 March 2003, paragraph 36.

<sup>351</sup> See Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

<sup>352</sup> See the United States' answer to question No. 19(a) of the Panel of 14 March 2003 ("*Mexico states in paragraph 146 of its Responses to questions that it 'is not aware that the United States or any other country among the 55 has explicitly attempted to subject accounting rate arrangements to the obligations of Section 2.2(b).' (a) Does the United States share Mexico's belief that most or all of the Members that have accepted Section 2.2(b) Reference Paper commitments also tolerate, or require, non-cost-based 'accounting rate arrangements' with carriers in other countries?*").

4.176 The **United States** also points to evidence showing one major operator's wholesale rates to terminate calls to various countries, including six EC member States and eighteen other WTO Members that included the interconnection commitments under Section 2.2(b) of the Reference Paper. All of those rates are lower than the current average rate Telmex charges United States suppliers, and many are below 2 cents per minute. Mexico has challenged none of this evidence. Thus, the United States argues, to the extent that any WTO Member does not fulfil its obligations under Section 2.2(b) of the Reference Paper, other WTO Members have the right to challenge that failure in dispute settlement.<sup>353</sup>

4.177 **Mexico** argues that, under a "cost-based" or "cost-oriented" standard, a rate is not limited to simply recovering cost but can also recover amounts that reflect social policy and other concerns. Therefore, the narrow benchmark established in the United States' first written and oral submissions is without legal basis. By implication, the evidence used to argue that Mexico does not comply with the narrow benchmark is irrelevant and does not establish a *prima facie* case of a violation of Section 2.2(b) of Mexico's Reference Paper.<sup>354</sup>

4.178 **Mexico** notes that the United States' accounting rate arrangements with a number of other countries provide for much higher settlement rates than the current United States — Mexico arrangement. Noting that accounting rate arrangements exist side-by-side with ISR even in countries where ISR is legal, Mexico argues that the United States continues to ignore those accounting rate arrangements and insists on comparing the United States-Mexico accounting rate arrangement to ISR charges purportedly available to United States' carriers to send traffic to other countries. Mexico submits that the United States refuses to acknowledge a comparison of the United States — Mexico accounting rate arrangement to United States accounting rate arrangements with other countries. Mexico further argues that the United States implicitly admits that other WTO Members "do not have explicit requirements for settlement rates to be cost-based."<sup>355</sup>

4.179 **Mexico** argues that, because accounting rate arrangements provide for access to an entire country's public network, the phrase in Section 2.2(b) does not mean that the charges associated with the interconnection cannot include an amount to offset the cost of rolling out telecommunications infrastructure.<sup>356</sup> Clearly, such charges can be allocated to any and all network components. Under the United States' argument, a WTO Member inscribing commitments analogous to Section 2.2(b) of Mexico's Reference Paper could not include any amount to offset infrastructure roll-out. Such an interpretation is absurd and is contrary to Article IV and paragraph five of the Preamble to the GATS.<sup>357</sup>

4.180 **Mexico** argues further that the United States neglects to acknowledge that paragraph 2.2(b) states that interconnection is provided "on terms, conditions ... and cost-oriented rates ... that are ... reasonable, *having regard to economic feasibility*."<sup>358</sup> According to Mexico, the ordinary meaning of "economically" is "as regards the efficient use of income and wealth: economically feasible proposals"; the ordinary meaning of "feasible" includes "capable of being done, effected or

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<sup>353</sup> See the United States' answer to question No. 19(a) of the Panel of 14 March 2003. For question No. 19(a), see footnote 352 of this Report.

<sup>354</sup> See Mexico's second written submission, paragraphs 83-84.

<sup>355</sup> See Mexico's comments on the United States answer to question No. 19(a) of the Panel of 14 March 2003, paragraphs 36-37.

<sup>356</sup> See the United States' comments on Mexico's answer to question No. 4(a) of the Panel of 14 March 2003, paragraph 16.

<sup>357</sup> See Mexico's second oral statement, paragraph 83.

<sup>358</sup> See Mexico's first written submission, paragraph 181. See also Mexico's second written submission, paragraph 87.

accomplished" and "suitable".<sup>359</sup> In the context of interconnection rates, the term means that the obligation to ensure that rates are cost-oriented is not absolute, but rather tempered by factors arising from economic feasibility, which can include considerations of a nation's overall policy goals for expanding its telecommunications infrastructure.<sup>360</sup> Thus countries – especially developing countries such as Mexico – have wide latitude to allow rates that would permit the continued development of needed infrastructure and the achievement of universal service.<sup>361</sup>

4.181 **Mexico** submits that the United States' claim must fail because the United States did not interpret "based in cost" in light of the entire qualifying phrase.<sup>362</sup> Mexico argues that, in applying the "economically feasible standard," account must be taken of Mexico's clear policy goal of promoting universal access to basic telecommunications service for its population. Accounting rate revenues remain an important potential source of funds for infrastructure development. However, Mexico's net revenue from settlement rates (from all countries) has already been declining. Thus, in light of the important need of Mexico for investment in the telecommunications sector, further and immediate drastic cuts in settlement revenue are not economically feasible.<sup>363</sup>

4.182 **Mexico** cites to a statement of a United States representative in the context of discussions that led to the Annex on Telecommunications.<sup>364</sup> According to Mexico, this statement highlights that the term "cost-based" was not intended to require that the "price of a specific service on a specific route to be identified and charged on a cost-based basis"; rather, the term as used in the telecommunications sector implies considerable flexibility for regulators to take into account social policy goals, the need to balance out varying cost structures across different regions and as between local and long-distance service. Mexico also cites to two reports by the Mexican Government, which shows that Mexico has had an established policy to promote the construction of telecommunications infrastructure with a view toward broadening the availability of telephone and related services. Neither the Reference Paper, nor the GATS more generally, should be interpreted in such a way as to prevent Mexico from carrying out this policy.<sup>365</sup>

4.183 The **United States** argues that the terms "*basadas en costos*" and "cost-oriented" require a relationship between interconnection rates and the cost incurred in providing interconnection, rather than costs incurred in connection with infrastructure development or other social policy goals. The WTO website defines "cost-based pricing" as "the general principle of charging for services in relation to the cost of providing these services." Furthermore, Section 2.2(b) of Mexico's Reference Paper requires that a supplier purchasing interconnection "need not pay for network components or facilities that it does not require for the [interconnection] service to be provided." This language provides relevant context for the interpretation of "*basadas en costos*", and makes clear that the scope of all interconnection charges is limited to the specific network components and facilities required for the interconnection service provided, and not other unrelated costs. By claiming that "accounting rate revenues remain an important source of potential revenue for infrastructure development," the

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<sup>359</sup> See Mexico's second written submission, paragraph 93. See also Mexico's answer to question No. 14(a) of the Panel of 19 December 2002 ("What is the meaning of '... having regard to economic feasibility ...' in paragraph 2.2 of the Reference Paper?")

<sup>360</sup> See Mexico's first written submission, paragraph 181. See also Mexico's second written submission, paragraph 93. See also Mexico's answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

<sup>361</sup> See Mexico's answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

<sup>362</sup> See Mexico's first written submission, paragraph 181. See also Mexico's second written submission, paragraph 88.

<sup>363</sup> See Mexico's second written submission, paragraph 95. See also Mexico's answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

<sup>364</sup> See Mexico's second written submission, paragraph 82.

<sup>365</sup> See Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

United States argues, Mexico effectively concedes that its international interconnection rates recover more than the cost of the "network components or facilities . . . require[d] for service to be provided" to United States suppliers.<sup>366</sup>

4.184 The **United States** submits that nothing in this definition supports consideration of the public policy factors cited by Mexico. According to the United States, Mexico's definition of "economically feasible" as requiring consideration of the "efficient" use of income and wealth in fact prohibits consideration of the non-cost-oriented factors Mexico seeks to include through this language. The efficient use of resources requires cost-oriented pricing and not subsidization. Citing an ITU statement, the United States argues that the efficient use of income and wealth must preclude the open-ended subsidization of "policy goals" such as infrastructure development and universal service. The terms "*basadas en costos*" and "cost-oriented" require a relationship between interconnection rates and the costs incurred in providing interconnection.<sup>367</sup>

4.185 The **United States** also submits that cost-oriented pricing, as that term is used in Section 2 of the Reference Paper, does not permit Mexico so-called "flexibility" to implement the national goals that Mexico identified in its submission. According to the United States, the provisions on interconnection serve to achieve the requirement to which all Members that subscribed to the Reference Paper committed, namely to ensure that the scope of all interconnection charges is limited to the specific network components and facilities required for the interconnection service provided, and not other unrelated costs.<sup>368</sup> Furthermore, the United States disagrees with Mexico's interpretation of its statement during the 1990 negotiations. According to the United States, it is clear from this statement, that the United States was drawing a distinction between a cost-based rate and a price that includes a universal service component. As Mexico notes, this statement was made in the context of the Annex negotiations, which did not lead to the adoption of any "cost-based" or "cost-orientation" rate requirement. In contrast, the Reference Paper separates the disciplines on interconnection rates in Section 2 from the disciplines on universal service in Section 3.<sup>369</sup>

4.186 The **United States** argues that the phrase "having regard to economic feasibility" does not "temper" a Member's obligation to provide interconnection at cost-oriented rates, in light of its "overall policy goals for expanding its telecommunications infrastructure." According to the United States, Section 2.2(b) of the Reference Paper requires a relationship between interconnection rates and the cost incurred in providing interconnection, rather than costs incurred in connection with telecommunications infrastructure roll-out. Additionally, Section 3 of the Reference Paper imposes separate and particular requirements for Members wishing to impose universal service obligations to fund the requirements of Members seeking to rollout their national telecommunications infrastructure. Thus, the United States argues that Mexico seeks to avoid the requirements of Section 3 (and to read Section 3 out of the Reference Paper) by justifying its rollout costs pursuant to the phrase "having regard to economic feasibility."<sup>370</sup>

4.187 The **United States** argues that taking the phrase "economically feasible" into account does not change the fact that Telmex's rates are substantially above cost and that, as a result, Mexico is not in compliance with Section 2 of the Reference Paper. The United States explains that, first this phrase must be read in the context of subparagraph 2.2(b) of the Reference Paper in its entirety. According

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<sup>366</sup> See the United States' answer to question No. 13 of the Panel of 14 March 2003 ("*Does cost-oriented pricing allow for flexibility in implementing national goals, as Mexico appears to argue in paragraphs 188-192 of Mexico's Responses to questions?*"). See also the United States' second oral statement, paragraph 60.

<sup>367</sup> See the United States' second oral statement, paragraphs 59 and 60.

<sup>368</sup> See the United States' answer to question No. 13 of the Panel of 14 March 2003. For question No. 13, see footnote 366 of this Report.

<sup>369</sup> See the United States' second oral statement, paragraph 62.

<sup>370</sup> See the United States' second written submission, paragraph 71. See also the United States' answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

to such reading, this phrase immediately follows the requirement for "reasonable" terms and conditions for interconnection, which prohibits the use of such terms and conditions to restrict the supply of a scheduled basic telecommunications service. Second, under the ordinary meaning of the phrase "having regard to economic feasibility," a term or condition for interconnection will not be "*razonables*" if it restricts the supply of a scheduled telecommunications service where such interconnection is economically practical or possible – that is, where the resulting revenues are sufficient to cover the expenses of its operation or use.<sup>371</sup>

4.188 The **United States** further explains that this means that the obligation to provide interconnection is limited only where there is insufficient demand from interconnecting suppliers to generate sufficient revenue to cover the expenses of operation or use, or where a major supplier requires an additional period of time to install necessary switching capabilities or other required network components or facilities where more rapid installation would entail very high costs that could not be recovered from interconnecting suppliers. However, because the United States-Mexico route carries the world's largest one-way volume of international calls, there is no question of insufficient demand for interconnection; also, because United States suppliers are already interconnected with Telmex, such interconnection does not require additional switching capabilities or other network components or facilities. Thus, neither is the case in Mexico. Third, to the extent that the phrase "having regard to economic feasibility" limits the obligation to provide interconnection at rates that are "*basadas en costos*", interconnection rates should be sufficient to cover the expenses of the operation and use of interconnection, which requires no more than that interconnection rates should cover both direct costs and common costs, and should permit a reasonable return on an operator's investment. According to the United States, all of these costs are already included in the rates set out by the United States as benchmarks for the determination whether Mexico's interconnection rates are "*basadas en costos*".<sup>372</sup>

4.189 The **United States** also notes that, Mexico may meet its other national goals, unrelated to interconnection, in a variety of ways. For example, Mexico could put in place a universal service obligation, under Section 3 of the Reference Paper. However, the recovery of universal service subsidies through inflated interconnection charges paid to the major supplier would be contrary to the Section 3 requirement that universal service obligations be "administered in a transparent, non-discriminatory and competitively-neutral manner . . .". Such recovery would not be transparent, because universal service obligations would be hidden in interconnection rates paid to the major supplier. Nor would it adhere to the requirements for non-discrimination and competitive neutrality, because it would burden only those suppliers purchasing interconnection with the funding of universal service obligations.<sup>373</sup> Moreover, the United States claims that Mexico's argument is also refuted by Section 3 of the Reference Paper, which provides for separate universal service obligations to finance universal service and infrastructure development. The recovery of universal service subsidies hidden in interconnection charges would be contrary to the Section 3 requirement for transparent administration of universal service obligations.<sup>374</sup>

4.190 **Mexico** argues that Section 3 of Mexico's Reference Paper merely imposes obligations for universal service, that is, requirements imposed on domestic carriers to supply universal service. It

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<sup>371</sup> See the United States' second written submission, paragraphs 67-70. See also the United States' answers to question No. 14(a) (for question No. 14(a), see footnote 359 of this Report) and question No. 14(b) ("*How might this phrase modify in practice the determination of cost-oriented interconnection prices?*") of the Panel of 19 December 2002.

<sup>372</sup> See the United States' second written submission, paragraphs 67-70. See also the United States' answers to question 14(a) (for question 14(a), see footnote 359 of this Report) and question 14(b) (for question No. 14(b), see footnote 371) of the Panel of 19 December 2002.

<sup>373</sup> See the United States' answer to question No. 13 of the Panel of 14 March 2003. For question No. 13, see footnote 366 of this Report.

<sup>374</sup> See the United States' second oral statement, paragraph 60. See also the United States' comments on Mexico's answer to question No. 14 of the Panel of 14 March 2003, paragraphs 37-38.

does not in any way discipline the rates charged for interconnection.<sup>375</sup> Furthermore, Mexico has not imposed, nor can it impose, any universal service obligations on United States carriers. According to Mexico, universal service obligations involve costs for domestic carriers, which must then be able to recover them, together with a reasonable return. This is only possible by means of the rates, including the interconnection rates, which they charge. Section 2.2(b) of Mexico's Reference Paper must therefore permit rates which, *inter alia*, allow for the cost of rolling out infrastructure, plus a reasonable return. Mexico submits that this is particularly significant for developing country Members, such as Mexico, which require substantial investment in their telecommunications infrastructure. The objective of achieving universal access is expressly provided for in Mexican legislation. The legitimacy of such investment by developing country Members is explicitly recognized in GATS Article IV. Hence, Mexico concludes, there is no connection between Sections 2 and 3 in the context of accounting rate arrangements.<sup>376</sup>

4.191 Citing to provisions concerning rural telephone companies in the Communications Act of the United States, **Mexico** also argues that an analogous concept can be found in the United States' domestic telecommunications law. Based on these provisions, Mexico claims that under United States law the concept of "economic feasibility" is a complete exception to the requirement to offer cost-based interconnection rates.<sup>377</sup>

4.192 The **United States** argues that, this requirement of United States law is fully consistent with the United States' Reference Paper obligations. The United States expressly limited Section 2.2 of its Reference Paper to permit this exemption for rural carriers. Mexico made no such limitation on its Reference Paper, with respect to rural or any other carriers.<sup>378</sup>

4.193 **Mexico** also argues that the term "cost-based" does not imply that governmental authorities need to set all rates. To the contrary, during the telecommunications negotiations the view was expressed that, where domestic competition in telecommunications services has been established, the market itself will ensure that rates are sufficiently "cost-based". According to Mexico, this view is also endorsed by the United States. Nonetheless, Mexico also notes that, empirical evidence indicates that there is also a high correlation between the introduction of domestic competition and decreases in international accounting rates. Mexico claims that, in a market where there is competition, market dynamics will ensure that the rates are cost-oriented. Recalling its rapid success in introducing competition in its domestic market, Mexico argues that, if the requirements of Section 2.2(b) were applied to accounting rates, Mexico's success in introducing and maintaining competition in the domestic market for long-distance services has satisfied its obligations to ensure that settlement rates are cost-based within the meaning of the Reference Paper. According to **Mexico**, this is supported by the fact that Mexico's settlement rates for calls from the United States have dropped since 1997 – by 85%, 78% and 69%, depending on the destination of the call.<sup>379</sup>

4.194 The **United States** replies that Mexico's argument that competition in a *different* market, for the supply of long-distance service in Mexico, ensures cost-oriented rates in the separate market for the provision of interconnection to United States suppliers operating in the cross-border mode, is not logical. According to the United States, while competitive market dynamics could reasonably be expected to ensure cost-oriented rates in most countries, the market dynamics that would normally

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<sup>375</sup> See Mexico's answer to question No. 14 of the Panel of 14 March 2003 ("*How do Mexico's considerations on elements to be included in the establishment of cost-oriented rates relate to its obligations under Section 3 of its Reference Paper?*").

<sup>376</sup> See Mexico's answer to question No. 14 of the Panel of 14 March 2003. For question No. 14, see footnote 375 of this Report.

<sup>377</sup> See Mexico's answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

<sup>378</sup> See the United States' second oral statement, paragraph 62.

<sup>379</sup> See Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

lead to cost-oriented rates are not allowed in Mexico. The United States points out that, Mexico imposes a naked prohibition on competition on all international routes between firms that would otherwise be competitors, Mexico's ILD rules require a horizontal price-fixing cartel among Mexican suppliers. Those rules prevent all price competition between Mexican suppliers providing interconnection to United States cross-border suppliers. Even if other WTO Members do not have explicit requirements for settlement rates to be cost-based, they also do not have restrictions on competition like Mexico, and therefore can reasonably rely on competitive market dynamics to yield cost-based rates.<sup>380</sup>

4.195 **Mexico** further argues that, with respect to the unilateral reduction of settlement rates for incoming calls to domestic interconnection rate levels, Mexico would have to require that Mexican carriers unilaterally reduce their charges to foreign carriers from all GATS Members for transporting and terminating incoming international telephone traffic, but Mexico would have no assurance that the other Members would implement the same radical change in their regulatory systems, because only Mexico is the subject of the current complaint. This would expose Mexican carriers to huge financial liabilities to foreign carriers, including those of the United States. Thus, Mexico argues, the accounting rate regime cannot be changed or abandoned without a multilateral agreement on a system to replace it.<sup>381</sup>

(ii) *Whether Telmex interconnection rates are "based in cost"*

4.196 The **United States** submits that, in August 2002, Cofetel approved a Telmex proposal to charge United States suppliers' settlement rates based on three zones within Mexico. The "settlement rate" is the interconnection rate that Telmex (and other Mexican suppliers) charge United States cross border suppliers to connect their calls to their final destination in Mexico. 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>382</sup> The United States argues that these rates are not based in cost.

4.197 The **United States** submits that, because Mexico declined to make Telmex's interconnection cost data available to the United States, it uses other relevant public data as proxies for measuring the cost of interconnection provided to United States cross-border suppliers. According to the United States, 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.<sup>383</sup>

4.198 **Mexico** notes that the European Commission allows the regulatory authorities of member states to use target rates for domestic interconnection rates to determine whether rates charged by their carriers could be deemed cost-oriented. Mexico argues that, if the use of target rates is satisfactory to comply with the obligations of Section 2.2 for domestic interconnection rates, the use of target rates is also acceptable for settlement rates. In this regard, Mexico's international settlement rates with the United States are consistent with the target rate recommended by ITU Study Group 3 for Mexico. Mexico also submits that the current accounting rate arrangement between Mexican and United States carriers even complies with the benchmark rate for Mexico unilaterally set by the FCC of the

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<sup>380</sup> See the United States' second oral statement, paragraphs 55-58.

<sup>381</sup> See Mexico's second written submission, paragraph 96. See also Mexico's answer to question No. 14(a) of the Panel of 19 December 2002. For question No. 14(a), see footnote 359 of this Report.

<sup>382</sup> See the United States' first written submission, paragraph 118.

<sup>383</sup> See the United States' first written submission, paragraph 120.

United States. Thus, Mexico argues, its rates are consistent with the cost-based obligation even if the term "cost-based" is viewed in isolation.<sup>384</sup>

4.199 The **United States** questions Mexico's attempts to justify the use of this ITU target rate by citing the European Commission's use of "current best practices" domestic interconnection rates. For 2000, the EC established best practice rates of 1.5 to 1.8 Euro-cents (about 1.4 to 1.65 United States cents) for double transit (or nationwide termination) at peak (time of day) rates. Adding the Cofetel approved rate of 1.5 cents (used in the pricing methodology by the United States as an estimated charge for the additional network components (international transmission and gateway switching) required to terminate an international call) to the EC best practices rates for nationwide termination yields an international "best practices" target of only about 3 cents per minute. The current 5.5, 8.5 and 11.75 cents per minute international rates charged by Telmex exceed this target by 83%, 183% and 292%.<sup>385</sup>

4.200 The **United States** replies that neither the ITU or FCC benchmark is appropriate, because both the ITU and the FCC state that their benchmarks are not cost-oriented.<sup>386</sup>

4.201 The **United States** points out first that Mexico's obligation under Section 2 of its Reference Paper is to ensure that Telmex's interconnection rates are cost-oriented, not to observe that Telmex's interconnection rates are consistent with a transitional target rate that makes no claim to be "basadas en costos". The United States notes that ITU Recommendation D.140 states that its target rates are "to be used . . . during the transition to cost-orientation," and should not be "taken as cost-oriented levels." After ITU members have attained these target rates they "should continue to take positive steps to reduce their accounting rates to cost-oriented levels."<sup>387</sup>

4.202 The **United States** also submits that Mexico incorrectly claims that it is subject to these ITU target rates. ITU Recommendation D.140 states that the target rates "are not applicable between competitive markets." Therefore, the ITU targets do not apply to the termination of United States traffic in Mexico, which has made binding commitments to open its basic telecommunications markets to competition.<sup>388</sup>

4.203 The **United States** also notes that the benchmark rates established by the FCC in 1997 were not cost-oriented when issued, and are even less so in 2003. In adopting those rates, the FCC stated that its benchmarks ". . . still exceed foreign carriers' costs to terminate international traffic because they are based primarily on foreign carriers tariffed rates" in effect in 1996, and "include costs associated with providing retail communications services to consumers which would not be included in cost-based settlement rates." The FCC therefore emphasized that its benchmarks "continue to exceed, usually substantially, any reasonable estimate of the level of foreign carriers' relevant costs of providing international termination services."<sup>389</sup>

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<sup>384</sup> See Mexico's answer to question No. 10(a) of the Panel of 19 December 2002. For question No. 10(a), see footnote 343 of this Report.

<sup>385</sup> See the United States' answer to question No. 21 of the Panel of 14 March 2003 ("*Mexico states that its international settlement rates are consistent with the target rate recommended by ITU Study Group 3 for Mexico, in its Responses to questions, paragraph 195. Please comment.*").

<sup>386</sup> See the United States' second oral statement, paragraph 51.

<sup>387</sup> See the United States' second oral statement, paragraph 52. See also the United States' answer to question No. 21 of the Panel of 14 March 2003. For question No. 21, see footnote 385 of this Report.

<sup>388</sup> See the United States' answer to question No. 21 of the Panel of 14 March 2003. For question No. 21, see footnote 385 of this Report.

<sup>389</sup> See the United States' second oral statement, paragraph 53. See also the United States' answer to question No. 19(b) of the Panel of 14 March 2003 ("*Mexico states in paragraph 146 of its Responses to questions that it 'is not aware that the United States or any other country among the 55 has explicitly attempted to subject accounting rate arrangements to the obligations of Section 2.2(b).'*" (b) What, for example, is the

4.204 **Mexico** submits that the United States' assertion that the FCC's "benchmarks" are not cost-oriented, ignores Mexico's point that the current United States-Mexican accounting rate is not at the level of the United States benchmark for Mexico, but well below it. The FCC's benchmark for Mexico's settlement rate is \$.19, while the current rates are \$.055, \$.085 and \$.115. Thus, the rate for calls to the three largest Mexican cities is about 71 per cent lower than the United States benchmark, and the rate for calls to rural areas is about 40 per cent lower than the benchmark. Mexico also identifies portions of the FCC's 1999 *ISP Reform Order* in which it established its policy that the United States international settlements policy (that is, the requirements for uniform and symmetrical settlement rates and proportionate return) could be waived for a country where the settlement rate was at least 25 per cent below the benchmark for that country, on the basis that rates at this level "are sufficiently below the benchmark level to indicate that a dominant carrier is facing competitive pressures to lower rates" and "an indication that competitive market forces exist to constrain the ability of a foreign carrier to exercise market power." Mexico argues that according to this standard of United States law, the current settlement rates for United States-Mexico traffic indicate that there is "meaningful economic competition" within Mexico.<sup>390</sup>

aa) Costs based on maximum rates charged for network components

4.205 The **United States** submits that, 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 United States 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. According to the United States, 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 the United States' analysis, the maximum average cost that Telmex incurs to provide interconnection to United States suppliers is 5.2 (United States) cents per minute. The blended average rate of approximately 9.2 cents per minute that Telmex charges exceed this maximum average cost by more than 75 per cent.<sup>391</sup> The United States further argues that, because it bases these estimates of cost on prices charged by Telmex, costs incurred by Telmex, especially for the very large volumes of traffic generated by United States carriers, would be substantially lower.<sup>392</sup>

4.206 The **United States** identifies four network components Telmex uses to provide interconnection and terminate in Mexico calls that originate in the United States:

- "(i) International transmission and switching: this network component includes transport from the United States-Mexico border to and through the Telmex/Telnor international gateway switch.
- (ii) 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.
- (iii) Subscriber line: this network component includes switching in the terminating city and transmission over facilities (such as a local loop) to the receiving telephone.

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*situation in the United States in this respect? In particular, what is the relevance of the Benchmarks Order referred to in paragraph 196 of Mexico's Responses to questions?").*

<sup>390</sup> See Mexico's comments on the United States' answer to question No. 19(b) of the Panel of 14 March 2003, paragraphs 38-40.

<sup>391</sup> See the United States' first written submission, paragraph 121.

<sup>392</sup> Ibid.

- (iv) 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."<sup>393</sup>

4.207 According to the **United States**, these network components reflect the guidelines promulgated by the ITU for identifying the costs incurred in terminating international calls. According to the ITU, the network components used to provide international telephone services are international transmission and switching facilities (component 1 above) and national extension (which incorporates components 2 through 4 above).<sup>394</sup> As a basis for its calculation, the United States uses the published Telmex prices, which are approved by Cofetel, for these network components. The United States further argues that, because Mexican law requires these Cofetel-approved rates to recover at least the total cost of these network components, they therefore include at least the true costs of these network components, including direct and indirect costs.<sup>395</sup> For certain network components, the United States relies on either Telmex's retail prices or on certain non-cost-oriented wholesale rates that Telmex charges. The United States argues that Telmex prices, as such, set an upward limit (cost ceiling) of cost; rates above this cost ceiling cannot be "*basadas en costos*".<sup>396</sup>

4.208 The **United States** then discusses the specific prices of these network components, depending on the destination of a call into Mexico. According to the United States, cross-border suppliers of basic telecom services interconnect with Telmex in order to terminate calls to three "zones" in Mexico. 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. The United States notes that 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).<sup>397</sup>

4.209 For calls to Zone 1 cities, the **United States** submits that Telmex's costs can be no more than 2.5 cents per minute (1.5 cents for international transmission and switching plus 0.022 cents for local link plus 1.003 cents for subscriber line) for the network components to interconnect a call from the United States border.<sup>398</sup> However, Telmex currently charges a Cofetel-approved rate of 5.5 cents to connect these calls. Thus, the United States asserts that Telmex charges United States suppliers an interconnection rate that is approximately 220 per cent of the maximum cost it incurs to terminate a call in Zone 1.<sup>399</sup>

4.210 According to the **United States**, calls to Zone 2 cities require one additional network component, i.e., a "long-distance link" used for transport within Mexico between the international gateway switch and the switch in the destination city. For these calls, Telmex allows its competitors to purchase "on-net" interconnection. The United States submits that Telmex's costs can be no more than 3 cents per minute (1.5 cents for international transmission and switching plus 0.022 cents for local link plus 0.536 cents for long-distance link plus 1.003 cents for subscriber line) for the network components used to interconnect a call from the United States border to a Zone 2 city. However, Telmex currently charges a Cofetel-approved rate of 8.5 cents to connect these calls. Thus, the

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<sup>393</sup> See the United States' first written submission, paragraph 122.

<sup>394</sup> See the United States' first written submission, paragraph 123; see also International Telecommunication Union, Recommendation D.140 (Accounting Rate Principles for the International Telephone Service) ("D.140"), October 2000.

<sup>395</sup> See the United States' first written submission, paragraph 124.

<sup>396</sup> See the United States' first written submission, paragraph 126.

<sup>397</sup> See the United States' first written submission, paragraph 127.

<sup>398</sup> See the United States' first written submission, paragraph 130.

<sup>399</sup> Ibid.

United States argues that Telmex charges United States suppliers an interconnection rate approximately 275 per cent of the maximum cost it incurs to terminate a call in Zone 2.<sup>400</sup>

4.211 The **United States** further notes that, calls to Zone 3 cities are classified as "off-net", which means that Telmex has not opened to originating competition and does not allow competitors to purchase "on-net" termination. According to the United States, Telmex uses the same network components as it does for Zone 2 to terminate calls in Zone 3 cities. 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 Cofetel 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. Because unbundled pricing information for the network components used to provide *reventa* service is not readily available, the United States utilizes the 7.76 cent *reventa* rate that Telmex charges its competitors to terminate calls to off-net cities. Based on this, the United States submits that Telmex's costs can be no more than 9.28 cents per minute (1.5 cents for international transmission and switching plus 0.022 cents for local link plus 7.76 cents for terminating interconnection) for the network components used 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, the United States argues that Telmex charges United States suppliers an interconnection rate approximately 127 per cent of the maximum cost it incurs to terminate a call in Zone 3.<sup>401</sup>

4.212 In conclusion, the **United States** argues that the 9.2 cents per minute blended average of the three zone rates that Telmex charges United States 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 per cent. As to each of the three zones, the United States argues that the rates that Telmex charges United States 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 per cent. The United States also emphasizes 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 United States suppliers. According to the United States, 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 United States argues, the rates that Telmex charges United States suppliers for interconnection far exceed even this inflated cost ceiling.<sup>402</sup>

4.213 **Mexico** submits that the proposed United States methodology for determining whether rates are cost-oriented is not found in the agreement. According to Mexico, even though the United States agrees that the Reference Paper does not define the terms "cost based" or "cost oriented", it still attempts to imply that there is universal agreement on the meaning of those terms, as well as universal agreement that the costs of providing national access through accounting rate agreements must be determined in the same manner as the costs of domestic interconnection.<sup>403</sup> Mexico argues that under the United States' methodology, accounting rates negotiated between Mexican and United States carriers must be set no greater than domestic interconnection rates.<sup>404</sup> Citing to publications by the ITU, Mexico claims that there is no common understanding of what the terms "cost-based" and "cost-oriented" mean, either in the domestic or international contexts, and there is no consensus that it

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<sup>400</sup> See the United States' first written submission, paragraphs 131-132.

<sup>401</sup> See the United States' first written submission, paragraphs 133-136.

<sup>402</sup> See the United States' first written submission, paragraphs 137-139.

<sup>403</sup> See Mexico's first written submission, paragraph 186.

<sup>404</sup> See Mexico's first written submission, paragraph 179.

means that the costs of transporting and terminating international calls should be deemed the same as the costs of domestic interconnection.<sup>405</sup>

4.214 The **United States** replies that it is not arguing that the costs of mode 1 interconnection must be equal to the costs for domestic interconnection for commercially-present suppliers. Instead the United States submits that the point of its estimated cost model is to show that the rates currently charged by Telmex substantially exceed the prices charged for the same elements domestically. Since Mexican law requires that interconnection rates for commercially-present suppliers must recover at least the total cost of all network elements, interconnection rates for cross-border suppliers that exceed rates for commercially-present suppliers are by definition not based in cost. The United States further clarifies that it is **not** asking that the Panel determine a rate that would be considered *basadas en costos*; instead it is only asking that the Panel determine that the rates currently charged by Telmex for interconnection provided to cross-border suppliers are not based in cost. According to the United States, Mexico has not contested that rates for international interconnection exceed rates for domestic interconnection by 127 to 283 per cent (using the exact same network elements) and that rates for domestic interconnection are required by Mexican law to be based in cost. Thus, whatever the definition of "*basadas en costos*," under these circumstances Mexico's international interconnection rates cannot be considered cost-based.<sup>406</sup>

4.215 **Mexico** further argues that the United States is wrong in arguing that the type of cost analysis used for domestic interconnection can be applied to settlement rates for international calls. Mexico's GATS commitments preserved the current system under which termination of international long-distance traffic in Mexico is conducted under a joint provision regime (half circuit regime), not under a whole provision regime (full circuit regime). The accounting rate system is widely, if not universally, used for settlements under the half circuit regime. The cost analysis demanded by the United States is used only for interconnection under a whole circuit regime, in particular domestic interconnection. According to Mexico, proposals have been made (such as by Australia) to replace the accounting rate systems with a cost-oriented "termination rate" regime, which could be implemented using half circuit or full circuit criteria. However, there is not yet an agreed methodology on how to determine costs under a termination rate regime, either at the bilateral or multilateral levels. Thus, the issue remains unresolved.<sup>407</sup>

4.216 The **United States** replies that the various methodologies proposed by the United States should not be regarded as estimates of the cost of terminating incoming international calls in Mexico. Rather, the United States argues that, the methodologies presented show a maximum cost or a ceiling on the costs incurred and, as such, exceed the actual cost.<sup>408</sup>

bb) "Grey market" rates for calls between the United States and Mexico

4.217 Another proxy the **United States** uses 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. The United States recognizes that such arrangements bypass the uniform settlement rates required by regulations in Mexico and therefore are technically illegal in Mexico. However, the United States argues that these rates provide another estimate of what some operators are currently

<sup>405</sup> See Mexico's first written submission, paragraphs 187-190.

<sup>406</sup> See the United States' first oral statement, paragraph 33. See also the United States' second written submission, paragraphs 61-62.

<sup>407</sup> See Mexico's answer to question No. 11(b) of the Panel of 19 December 2002 ("If [Mexico does not consider that the estimates of the cost of terminating incoming international calls in Mexico given in the United States submission are roughly correct], please give reasons and outline how more satisfactory figures might be obtained.").

<sup>408</sup> See the United States' answer to question No. 11(a) of the Panel of 19 December 2002 ("Does Mexico consider that the estimates of the cost of terminating incoming international calls in Mexico given in the United States submission are roughly correct?").

paying for the network components used to terminate such calls, even given the constraints of Mexico's regulations. According to the United States, these 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. Based on its comparison of the rates, the United States submits that the grey market rates are far lower than the rates charged by Telmex and even the maximum costs shown in the above United States pricing surrogate, and thus confirm the conservative nature of the assumptions underlying that methodology.<sup>409</sup>

4.218 The **United States** also notes several factors which suggest that the grey market rates include costs in addition to the costs of the network components used by Telmex to terminate United States calls into Mexico. First, the United States argues that 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. Second, the United States asserts, 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. Third, according to the United States, 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.<sup>410</sup>

4.219 In conclusion, the **United States** argues that, even though these grey market rates themselves are above Telmex's maximum costs, the Telmex interconnection rates still exceed these grey market rates.<sup>411</sup> Thus, Telmex's interconnection rates are substantially above Telmex's costs.

4.220 **Mexico** argues that, by asserting that rates for illegal bypass traffic into Mexico should be used as the benchmark for determining whether the accounting rates negotiated between United States and Mexican carriers comply with the Reference Paper, the United States is tantamount to stating that international access must be priced as though Mexico had authorized the United States' carriers to provide service into Mexico through ISR, so that the United States' carriers could interconnect with the domestic network within Mexico without routing their traffic through an authorized facilities based carrier. But Mexico does not allow ISR, and scheduled a reservation to the GATS allowing it to maintain that prohibition. Accordingly, Mexico argues, the United States reliance on the rates charged for illegal ISR traffic into Mexico as a benchmark is completely inappropriate, just as illegally downloaded music can not be used as a measure of the true cost of producing the music.<sup>412</sup>

4.221 The **United States** counters that Mexico's analogy is flawed. According to the United States, in the case of illegally downloaded music, no one pays for the use of the downloaded music; on the other hand, in the case of illegal bypass, the users of bypass are paying for the use of those network elements. Mexico does not assert that bypass rates do not cover the costs of the various components involved in providing bypass service. Nor does it identify any cost that is not recovered by bypass rates.<sup>413</sup>

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<sup>409</sup> See the United States' first written submission, paragraph 141.

<sup>410</sup> See the United States' first written submission, paragraphs 143-144.

<sup>411</sup> See the United States' first written submission, paragraph 145. See also the United States' second written submission, paragraph 63.

<sup>412</sup> See Mexico's first written submission, paragraph 180.

<sup>413</sup> See the United States' second written submission, paragraph 65.

4.222 **Mexico** also submits that the United States makes "apples to oranges" comparisons. According to Mexico, the United States compares ISR rates from the United States to various countries with the United States-Mexico accounting rates, rather than comparing the United States accounting rates with those countries to the United States-Mexico accounting rates. Mexico also points out that, in the same submissions in which it complains about the unavailability of ISR into Mexico, the United States presents detailed information about the rates United States carriers are currently paying for ISR into Mexico. This contradiction serves to highlight that the United States has not presented the complete factual picture.<sup>414</sup>

cc) International proxies

4.223 The **United States** also shows that Telmex termination rates exceed wholesale rates established by a major operator to terminate calls to various countries that, like Mexico, have more than one long-distance provider. The United States notes that 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. The United States also points out that none of these countries match the volume of international traffic and corresponding economies of scale for traffic between the United States and Mexico. Nevertheless, the United States argues, these international rates provide a useful, but highly conservative, benchmark further supporting the United States claim that Mexico has failed to ensure that Telmex provides interconnection to cross border suppliers at rates that are *basadas en costos*.<sup>415</sup>

dd) Financial compensation among Mexican operators relating to international calls

4.224 The **United States** also argues that financial compensation procedures among Mexican operators demonstrate that the interconnection rates charged to United States suppliers are not cost-oriented.<sup>416</sup> According to the United States, 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. Because the Mexican international operators do not necessarily receive traffic (and the associated payments by United States 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.<sup>417</sup>

4.225 The **United States** explains that the "proportionate return" system works in two ways: first, 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>418</sup> Alternatively, the United States argues, 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

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<sup>414</sup> See Mexico's second oral statement, paragraph 78.

<sup>415</sup> See the United States' first written submission, paragraphs 146-147. See also the United States' second written submission, paragraph 63.

<sup>416</sup> See the United States' second written submission, paragraph 64.

<sup>417</sup> See the United States' first written submission, paragraph 148.

<sup>418</sup> See the United States' first written submission, paragraph 149.

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.<sup>419</sup>

4.226 The **United States** argues that, 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*.<sup>420</sup> The United States claims that, 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.<sup>421</sup> The United States further explains that, 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. According to the United States, 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.<sup>422</sup> Thus, the United States argues that Rule 17 payments are required solely because cross-border interconnection rates are not *basadas en costos*.<sup>423</sup>

4.227 **Mexico** argues that the requirement for proportionate return allows new entrants in the domestic market to preserve and gain market share by allowing them to terminate incoming traffic in the same proportion as their share of outgoing traffic. According to Mexico, a carrier that has gained more customers in the domestic market, and thereby carries these customers' outgoing traffic to a particular country, is ensured that it will be able to terminate a proportionate share of the country's incoming traffic, which otherwise might be carried by larger carriers.<sup>424</sup>

(b) Whether Telmex interconnection rates are "reasonable"

(i) *The meaning of "reasonable"*

4.228 The **United States** submits that the Reference Paper does not define "*razonable*" or "reasonable." Thus, the United States argues, the term should be interpreted according to the customary rules of treaty interpretation reflected in Article 31(1) of the *Vienna Convention*. According to the United States, such an analysis considers the ordinary meaning of "reasonable" (a word that has a very broad meaning) in its context and in light of the object and purpose of the agreement.<sup>425</sup>

4.229 The **United States** argues that, the commitments that resulted from the negotiations on basic telecommunications should 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. The United States asserts that 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. Thus, the United States claims, Section 2 of the

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<sup>419</sup> See the United States' first written submission, paragraph 150.

<sup>420</sup> See the United States' first written submission, paragraph 151. See also the United States' second written submission, paragraph 64.

<sup>421</sup> See the United States' first written submission, paragraph 151.

<sup>422</sup> See the United States' first written submission, paragraph 153.

<sup>423</sup> See the United States' first written submission, paragraph 155.

<sup>424</sup> See Mexico's first written submission, paragraph 78.

<sup>425</sup> See the United States' first written submission, paragraphs 158-159.

Reference Paper establishes disciplines to prevent major suppliers from using interconnection to restrict other suppliers from offering a scheduled service.<sup>426</sup>

4.230 In terms of the context, the **United States** argues that 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. 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. The United States further claims that, 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.<sup>427</sup>

4.231 The **United States** concludes that, 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.<sup>428</sup>

4.232 **Mexico** submits that the United States' interpretation of "reasonable" is based on its assumption that Mexico has allowed United States suppliers to provide their services on a cross-border basis. However, Mexico argues, its commitments do not permit United States suppliers of basic telecommunications services to provide their transmission or transport services across the border into Mexico. It is not the rates negotiated by Telmex that restrict the supply of telecommunications transmission and transport services, but rather, the limitations inscribed in Mexico's Schedule. Pursuant to Article XVI of the GATS, Mexico is entitled to restrict the rights of service suppliers of other Members to supply basic telecommunications services into and within its territory.<sup>429</sup>

4.233 According to **Mexico**, the United States' argument on this issue also results from its apparent misunderstanding of the meaning of cross-border supply in the context of telecommunications transport services. Specifically, the United States consistently confuses the "telephone call" or other data that is transported by the service suppliers with the actual transport and transmission services that are at issue in this dispute.<sup>430</sup>

4.234 **Mexico** argues that the United States' interpretation of the word "reasonable" is overly and blatantly simplistic.<sup>431</sup> According to Mexico, the ordinary meaning of "reasonable" is "in accordance with reason; not absurd; within the limits of reason; not greatly more or less than might be expected". Mexico argues that the reasonableness of "*tarifas basadas en costos*" or cost-oriented rates can be judged only within the context of all relevant facts and circumstances because it is those facts and circumstances that provide a basis for reason and expectation.<sup>432</sup> In this light, Mexico argues, it

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<sup>426</sup> See the United States' first written submission, paragraphs 160-162.

<sup>427</sup> See the United States' first written submission, paragraphs 163-164.

<sup>428</sup> See the United States' first written submission, paragraph 165.

<sup>429</sup> See Mexico's second written submission, paragraph 108.

<sup>430</sup> See Mexico's second written submission, paragraph 110.

<sup>431</sup> See Mexico's first written submission, paragraph 182.

<sup>432</sup> See Mexico's second written submission, paragraphs 89 and 115. See also Mexico's answer to question No. 15 of the Panel of 19 December 2002 ("*The United States suggests that interconnection terms and*

cannot be said, categorically, that an action or a measure that restricts the supply of a scheduled service is "unreasonable". In the broad sense, all forms of government regulation related to the terms and conditions of supply of a service have some impact on the level of supply of that service. However, merely because they have that effect, it cannot be said that they are "unreasonable" under any interpretation of the term "reasonable".<sup>433</sup>

4.235 **Mexico** further argues that the fact that other major telecommunications markets, especially the United States, maintain virtually identical rules to preserve the negotiating position of their carriers *vis-à-vis* Mexican carriers must be taken into account in determining whether Mexico's ILD rules are "reasonable," and whether it would be "economically feasible" for Mexico to eliminate them unilaterally.<sup>434</sup>

4.236 **Mexico** argues that the United States' interpretation of "reasonable" does not allow for rates that simply recover bare costs, let alone rates that are "economically feasible" to Mexico. The fact that the same settlement rate applies to other Mexican carriers is irrelevant to the application of the "reasonableness" requirement in Section 2.2(b) because that requirement applies only to interconnection with major suppliers. Accordingly, the interpretation presented by the United States is manifestly absurd and should be rejected by this Panel.<sup>435</sup>

4.237 According to **Mexico**, a multitude of facts and circumstances are relevant to the determination of whether "*tarifas basadas en costos*" are reasonable. These include the state of a WTO Member's telecommunications industry, the coverage and quality of its telecommunications network, the return on investment, and the nature of the rates at issue.<sup>436</sup>

4.238 **Mexico** argues that, in determining the reasonableness of Mexico's accounting rates, the bilateral nature of accounting rates must be taken into account. Bilateral accounting rate arrangements continue to be prevalent and many of the countries with which Mexico has such arrangements are under no obligation to reduce the rates they negotiate. Thus, Mexico submits, it would not be reasonable to expect Mexico to unilaterally reduce its accounting rates to domestic interconnection levels and yet face high accounting rates for outgoing calls.<sup>437</sup>

4.239 **Mexico** also deems it pertinent to compare Mexico's settlement rates with the United States with those of other countries with the United States. According to Mexico, because the current accounting rate arrangement between United States and Mexican carriers provides for lower settlement rates than the accounting rate arrangements of United States carriers with a number of other countries, Mexico's rates must be deemed reasonable.<sup>438</sup>

4.240 **Mexico** also submits that reasonableness must be judged in the light of all relevant circumstances which could include the technology used. Mexico notes that technology reduces costs,

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*conditions are not 'reasonable' under Section 2.2 if they permit a major supplier to 'restrict the supply of a scheduled basic telecom service.' (United States' submission, paragraph 165). Please comment.").*

<sup>433</sup> See Mexico's second written submission, paragraph 115. See also Mexico's answer to question No. 15 of the Panel of 19 December 2002. For question No. 15, see footnote 432 of this Report.

<sup>434</sup> See Mexico's second written submission, paragraph 117.

<sup>435</sup> See Mexico's second written submission, paragraph 118. See also Mexico's answer to question No. 15 of the Panel of 19 December 2002. For question No. 15, see footnote 432 of this Report.

<sup>436</sup> See Mexico's second written submission, paragraph 90. See also Mexico's answer to question No. 13(a) of the Panel of 19 December 2002 ("*Elements to be included in determining whether rates are reasonable (a) What elements should be included in determining whether cost-oriented interconnection prices are 'reasonable'?*").

<sup>437</sup> See Mexico's second written submission, paragraph 91. See also Mexico's answer to question No. 13(a) of the Panel of 19 December 2002. For question No. 13(a), see footnote 436 of this Report.

<sup>438</sup> See Mexico's second written submission, paragraph 92. See also Mexico's answer to question No. 13(a) of the Panel of 19 December 2002. For question No. 13(a), see footnote 436 of this Report.

especially in the long run. However, in the telecommunications sector technological change has been very rapid, so much so that fixed asset obsolescence has led to high depreciation rates and, consequently, higher costs. Currently there is an excess of transmission capacity that must be depreciated very quickly, but with a very low capacity utilization and profitability. Mexico submits that it is not an exception to this global problem.<sup>439</sup>

4.241 According to **Mexico**, another consideration to be taken into account is that technological change does not take place instantly and obsolete equipment cannot be immediately discarded. This factor results in cost reductions that are less dramatic than desired.<sup>440</sup>

4.242 **Mexico** also points out that developing countries are usually technology consumers, not producers, and thus have to pay a higher price for technology than developed countries. Relative to developed countries, this drives costs for developing countries up, not down. In addition, a technology consumer country must spend extra monies to adapt and make compatible different vendors' technologies.<sup>441</sup>

4.243 **Mexico** further submits that, contrary to recent inflated expectations, the bulk of telecommunications revenues (around 80%) still come from voice (or voice-related) services, where new technology does not yet represent a perfect substitute for the traditional (circuit-based) one.<sup>442</sup>

4.244 Thus, **Mexico** concludes, technology, in the present circumstances, for a developing country such as Mexico, does not reduce but rather increases costs, especially with respect to its counterparts.<sup>443</sup>

4.245 **Mexico** claims that the United States has ignored the following statements in the preamble of the GATS:

"Desiring the early achievement of progressively higher levels of liberalization in trade in services ... while giving due respect to national policy objectives; Recognizing the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right; Desiring to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including, inter alia, through the strengthening of their domestic services capacity and its efficiency and competitiveness ..."<sup>444</sup>

4.246 In **Mexico's** view, from the statements above, along with the Schedules themselves, it is obvious that the overall goal of liberalization does not provide a justification for the United States interpretation. Neither the GATS in general nor the Fourth Protocol in particular were intended to eliminate immediately all restrictions and charges on trade in services.<sup>445</sup>

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<sup>439</sup> See Mexico's answer to question No. 13(b) of the Panel of 19 December 2002 ("*Elements to be included in determining whether rates are reasonable. (b) Does the answer depend on the technology used?*").

<sup>440</sup> See Mexico's answer to question No. 13(b) of the Panel of 19 December 2002. For question No. 13(b), see footnote 439 of this Report.

<sup>441</sup> Ibid.

<sup>442</sup> Ibid.

<sup>443</sup> Ibid.

<sup>444</sup> See Mexico's first written submission, paragraph 183.

<sup>445</sup> Ibid.

4.247 **Mexico** further asserts that the United States interpretation leads to an absurd result. If carried to its logical conclusion, the United States argument implies that any charge for access is unreasonable, because any fee higher than zero conceivably "restricts" supply.<sup>446</sup>

4.248 The **United States** replies that it is not arguing that any charge for interconnection or that any term or condition imposed upon interconnection is unreasonable. Rather, the determination of reasonableness must be made on a case-by-case basis. In this case, the facts clearly show that Mexico has failed to ensure that the terms and conditions for interconnection with Telmex are reasonable - that is, Mexico has failed to ensure that those terms and conditions reign in Telmex's ability to abuse its market power and restrict the supply of basic telecommunications services. The result of Mexico's failure to ensure interconnection on reasonable terms and conditions is that Telmex has indeed restricted the supply of scheduled services.<sup>447</sup>

4.249 **Mexico** replies that the United States' qualification highlights a fundamental flaw in the United States' claim. According to Mexico, what the United States is now arguing is that whether or not the rate is reasonable depends on how much it restricts the supply rather than the fact that it restricts supply in the first place. Under this new legal test posited by the United States, a multitude of facts could have a bearing on "how much is too much". Accordingly, the fact that a measure "restricts the supply of a scheduled service" is no longer determinative of "reasonableness" and the entire basis for this claim is eviscerated.<sup>448</sup>

(ii) *Whether Telmex interconnection rates are "reasonable"*

4.250 The **United States** argues that, because 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, it has failed to ensure that Telmex provides interconnection at reasonable rates. According to the United States, 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. The United States alleges that, on their face, the ILD Rules prevent Telmex from providing interconnection as required by Section 2.2 of the Reference Paper. Instead, 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. The United States explains that Rule 13 grants Telmex alone the exclusive authority to negotiate the interconnection rate with cross-border suppliers, while Rules 3, 6, 10, 22, and 23 prohibit any alternatives to this Telmex-negotiated rate. As a result, the United States argues, these particular ILD Rules prevent Mexico from fulfilling its obligations under Section 2.2 and, for that reason, are inconsistent with that provision.<sup>449</sup>

4.251 The **United States** further contends that Mexico has failed to honour its commitments under Section 2.2(b) by rejecting proposals from United States and Mexican suppliers to approve alternative interconnection agreements that would exert competitive pressure on the Telmex-negotiated rate. According to the United States, since 1998, United States 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. The United States alleges that, these examples reinforce the conclusion that Mexico has taken affirmative steps to prevent any competition to the Telmex-negotiated interconnection rate.<sup>450</sup>

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<sup>446</sup> See Mexico's first written submission, paragraph 184.

<sup>447</sup> See the United States' second written submission, paragraphs 74-75.

<sup>448</sup> See Mexico's second oral statement, paragraph 87.

<sup>449</sup> See the United States' first written submission, paragraphs 167-175.

<sup>450</sup> See the United States' first written submission, paragraphs 178-179.

4.252 The **United States** argues that Mexico has failed to ensure that Telmex provides interconnection on reasonable terms and conditions and therefore has not honoured its commitments under Section 2.2(b) of the Reference Paper.<sup>451</sup>

**B. SECTION 1.1 OF THE REFERENCE PAPER: PREVENTION OF ANTI-COMPETITIVE PRACTICES IN TELECOMMUNICATIONS**

4.253 The **United States** claims that 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 Telmex-negotiated rate if they want to supply services on a cross-border basis. According to the United States, Mexico's ILD 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.<sup>452</sup> The United States therefore claims that Mexico has failed to honour its commitments under Section 1.1 of the Reference Paper<sup>453</sup>, which provides that "[a]ppropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices."<sup>454</sup>

4.254 **Mexico** replies that its ILD Rules are not subject to the obligations of the Reference Paper, and therefore, cannot be inconsistent with its Section 1.1.<sup>455 456</sup> Mexico further points out that, even if its ILD Rules were subject to the obligations of the Reference Paper, the United States, in order to succeed in its claim, must present a prima facie case that Mexico has not maintained "appropriate measures... for the purpose of preventing suppliers who... are major supplier from engaging in or continuing anti-competitive practices". According to Mexico, the United States has not done so.<sup>457</sup> Mexico also submits that the United States has misinterpreted the obligations of Section 1.1.<sup>458</sup> Mexico also points out that, although its ILD Rules are not subject to the obligations of the Reference Paper, it has maintained appropriate measures for the purpose of preventing Telmex from engaging in anti-competitive practices.<sup>459</sup> According to Mexico its measures meet the standards of Section 1.1 of the Reference Paper and the Mexican regulatory framework contains the requisite of "Competitive Safeguards".<sup>460</sup>

**1. Panel's standard of review**

4.255 **Mexico** submits that the fact that the United States may have different goals centered on promoting the interest of its own carriers should not influence the manner in which the Panel interprets Section 1 in the light of the objectives of the GATS, which include:

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<sup>451</sup> See the United States' first written submission, paragraph 188.

<sup>452</sup> See the United States' first written submission, paragraph 206.

<sup>453</sup> See the United States' first written submission, paragraph 31.

<sup>454</sup> See Mexico's Reference Paper, page 8, GATS/SC/56/Suppl.2.

<sup>455</sup> See Mexico's first written submission, paragraph 197.

<sup>456</sup> The United States maintains that Mexico's Reference Paper obligations apply to the terms and conditions of cross-border interconnection between Telmex and suppliers from the United States. Mexico disagrees and contends that the settlement rates that carriers from the United States have agreed to pay to Telmex under the accounting rate regime are not subject to Mexico's commitment under Section 2.1 and 2.2 of the Reference Paper. Moreover, Mexico argues that it did not agree to grant cross-border access in its Schedule of specific commitments and that the Reference Paper has no application in this context. For more information regarding the discussion on the scope of application of the Reference Paper, see Section IV.A.1 of this Report.

<sup>457</sup> See Mexico's second written submission, paragraph 122.

<sup>458</sup> See Mexico's first written submission, paragraph 199.

<sup>459</sup> See Mexico's first written submission, paragraph 204.

<sup>460</sup> See Mexico's first written submission, paragraph 205.

*"Desiring the early achievement of progressively higher levels of liberalization in trade in services ... while giving due respect to national policy objectives;*

*Recognizing the right of Members to regulate ... the supply of services within their territories in order to meet national policy objectives and, given wide asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right;*

*Desiring to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including, inter alia, through the strengthening of their domestic services capacity and its efficiency and competitiveness ...*"<sup>461</sup>

4.256 **Mexico** also submits that Section 1.1 does not require a Panel to act as a domestic anti-trust authority, as, Mexico indicates, the United States implicitly argues. In Mexico's view, Section 1.1 sets out "principles and definitions" for regulatory authorities and does not mean that a single and common regulatory system should be imposed in the territory of all WTO Members.<sup>462</sup>

## 2. Section 1.1 of Mexico's Reference Paper

### (a) Purpose of Section 1.1

4.257 According to the **United States**, Section 1.1 of Mexico's Reference Paper provides for the maintenance of appropriate measures to prevent major suppliers from engaging in or continuing anti-competitive practices.<sup>463</sup> The United States recalls that those appropriate measures are intended to prevent anti-competitive conduct by suppliers who "alone or together" are a major supplier. The United States submits that the "or together" language in Section 1.1 indicates that the negotiators attached relevance to horizontal coordination between suppliers. The United States also points out that, although this phrase has direct relevance to the definition of "major supplier," it also lends context to the interpretation of the term "anti-competitive practices," which the United States contends includes, at the very least, horizontal price-fixing agreements.<sup>464</sup>

4.258 According to **Mexico**, the obligation in Section 1.1 is to maintain "suitable or proper" measures with the object or the intention of preventing Telmex from engaging in anti-competitive practices.<sup>465</sup> Mexico claims that Section 1.1 is drafted in such manner that it allows Mexico a large measure of discretion in deciding what measures would be suitable or proper to accomplish the intended objectives and cannot be interpreted to mean that Mexico is required to prevent all suppliers from even engaging in or continuing anti-competitive practices, as suggested by the United States.<sup>466</sup> Mexico further submits that, Section 1.1 creates an obligation of means, not an obligation of result.<sup>467</sup>

### (b) Extent of the requirement under Section 1.1

4.259 **Mexico** maintains that Section 1 of the Reference Paper does not require markets to be opened to competition. According to Mexico, the opening of markets is a market access issue that is

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<sup>461</sup> Mexico refers to the preamble of the GATS. See Mexico's answer to question 17(a) of the Panel of 19 December 2002, paragraph 273 ("*Are Mexican rules that impede price competition among Mexican companies terminating incoming international calls consistent with the GATS and the Reference Paper?*").

<sup>462</sup> See Mexico's first written submission, paragraph 204.

<sup>463</sup> The United States refers to Section 1.1 of Mexico's Schedule, Reference Paper, Sec 1, GATS/SC/56/Supp.2, p.7, Spanish Version. See the United States' first written submission, paragraph 191.

<sup>464</sup> See the United States' second written submission, paragraph 80.

<sup>465</sup> See Mexico's first written submission, paragraph 201.

<sup>466</sup> See Mexico's first written submission, paragraph 202.

<sup>467</sup> See Mexico's first written submission, paragraph 203.

dealt with in Mexico's Schedule of Specific Commitments. Mexico submits that Section 1 requires only that appropriate measures be maintained for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices.<sup>468</sup>

4.260 The **United States** submits that it is not arguing that Section 1 requires a guaranteed result and agrees that it is the maintenance of appropriate measures that is required.<sup>469</sup> According to the United States, what matters is that a Party maintain measures of some sort to prevent, not stimulate or condone, anti-competitive marketplace conduct.<sup>470</sup> The United States further submits that it does not claim that Section 1 of the Reference Paper contains language requiring a market to be opened to competition or that the requirement of the Reference Paper can only be met by opening a market to competition. According to the United States, Mexico's obligation to open various markets derives from the broad range of market access commitments on basic telecommunications contained in its Schedule.<sup>471</sup>

(i) *"Appropriate measures"*

aa) Whether the ILD Rules are "appropriate measures" under Section 1.1

4.261 The **United States** asserts that the FCC has identified Rule 13 as restricting competition, limiting the ability to achieve cost-based cross-border interconnection rates.<sup>472</sup> According to the United States, Rules 13 and 23 prevent Mexican and foreign suppliers from agreeing to alternative rates that could exert competitive pressures on the rate exclusively negotiated by Telmex.<sup>473</sup> The United States submits that Mexico's ILD Rules are the opposite of "appropriate" measures to prevent anti-competitive practices, as required by Section 1.1 of the Reference Paper.<sup>474</sup>

4.262 **Mexico** contends that Section 1.1 does not require Mexico to ensure that Telmex does not act in an anti-competitive manner. Mexico submits that it is obliged to put in place "appropriate measures" aimed at preventing anti-competitive practices<sup>475</sup> and that it has maintained appropriate measures for the purpose of preventing Telmex from engaging in anti-competitive practices.<sup>476</sup> According to Mexico, it must be recognized that the ILD Rules pursue legitimate policy development objectives, and, in fact, constitute appropriate measures to encourage and ensure competition among domestic long-distance carriers.<sup>477</sup> In Mexico's view, the United States' claim under Section 1 fails, even under its incorrect interpretation of the obligation in Section 1.1, since the ILD rules do not require anti-competitive practices.<sup>478</sup>

4.263 **Mexico** submits that Rule 13 grants to the largest carrier of outgoing international traffic to a particular country the right to negotiate the rate for terminating incoming international calls from that country. Mexico indicates that the uniform settlement rate policy ensures that all Mexican international service providers that terminate international calls are paid the same negotiated rate. Mexico further points out that the proportional return policy, ensures that each Mexican provider

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<sup>468</sup> See Mexico's answer to question 17(b) of the Panel of 19 December 2002 ("*Does Section 1 of the Reference Paper require that markets be opened to competition?*").

<sup>469</sup> See the United States' first oral statement, paragraph 36.

<sup>470</sup> See the United States' second written submission, paragraph 83.

<sup>471</sup> See the United States' answer to question 17(b) of the Panel meeting of 19 December 2002. For question No. 17(b), see footnote 468 of this Report.

<sup>472</sup> See the United States' first written submission, paragraph 201.

<sup>473</sup> See the United States' first written submission, paragraph 202.

<sup>474</sup> See the United States' first written submission, paragraph 206.

<sup>475</sup> See Mexico's first oral statement, paragraph 54.

<sup>476</sup> See Mexico's first written submission, paragraph 213.

<sup>477</sup> See Mexico's first oral statement, paragraph 54. See Mexico's first oral statement, paragraph 8.

<sup>478</sup> See Mexico's first written submission, paragraph 213.

receives fees proportionate to the number of calls it actually handles.<sup>479</sup> According to Mexico, the combination of these policies prevents a large carrier taking advantage of that authority by retaining an unfair share of the revenue from incoming international traffic, or otherwise undercutting new entrants.<sup>480</sup>

4.264 According to the **United States**, preventing price competition by new entrants to protect a major supplier's high price cannot possibly be understood as promoting competition.<sup>481</sup> The United States submits that Mexico has offered no evidence that the new entrant carriers at issue need to be protected from a competitive market or from Telmex. In its view, their best prospects of building market share and challenging Telmex's dominance in fact lie in the freedom to compete with Telmex. The United States argues that Mexico's general competition law and its competition authority, the CFC, can address any attempts by Telmex, alone or in collusion with others, to engage in exclusionary or predatory conduct, once the constraints of the ILD rules are lifted.<sup>482</sup> The United States argues that although Mexico maintains a general competition statute, it also maintains measures 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.<sup>483</sup> The United States claims that these measures stifle market challengers and allow Telmex to maintain artificially high prices.<sup>484</sup>

4.265 The **United States** recalls Mexico's report to the OECD's Committee on Competition Law and Policy in which Mexico stated that its own ILD Rules may not be the most favourable for competition.<sup>485</sup> The United States claims 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.<sup>486</sup> The United States also claims that the OECD's Report on Regulatory Reform in Mexico has recognized that Mexico's ILD Rules prevent competition in the termination of international traffic and prevents prices from decreasing for consumers, to the benefit of the Mexican telecommunications operators. The United States further points out that the OECD Secretariat concluded that an immediate price reduction on international calls would follow the elimination of the Mexican system.<sup>487</sup>

4.266 **Mexico** submits that its ILD Rules are not per se anti-competitive, they just form part of Mexico's regulatory framework, which is aimed at increasing competition in its domestic telecommunications market.<sup>488</sup> Mexico claims that Rule 13 of the ILD in combination with its uniform settlement policy and the requirements of proportional return, serves to preserve competition

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<sup>479</sup> See Mexico's first written submission, paragraph 208.

<sup>480</sup> See Mexico's first written submission, paragraph 209.

<sup>481</sup> See the United States' first oral statement, paragraph 38.

<sup>482</sup> See the United States' answer to question No. 25 of the Panel of 14 March 2003, paragraph 62 (*"Please explain whether the effect of Rule 13 of the ILD Rules is pro-competitive or anti-competitive, and support your argument with the appropriate illustrative figures and examples"*).

<sup>483</sup> The United States refers to Mexico's ILD Rules. See the United States' first written submission, paragraph 196. See the United States' answer to question 17(a) of the Panel of 19 December 2002, paragraph 86. For question No. 17(a), see footnote 461 of this Report.

<sup>484</sup> See the United States' first written submission, paragraph 200.

<sup>485</sup> The United States refers to 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. See the United States' first written submission, paragraph 199.

<sup>486</sup> See the United States' first written submission, paragraph 199.

<sup>487</sup> The United States refers to the OECD, Regulatory Reform in Mexico (1999). See the United States' first written submission, paragraph 205.

<sup>488</sup> See Mexico's first written submission, paragraph 206.

among domestic carriers and to promote investment in the domestic telecommunications infrastructure, and cannot be evaluated in isolation.<sup>489</sup>

4.267 The **United States** considers that Mexican ILD Rules, which contain an explicit restriction on price competition together with the division of supply among market participants, have the classic features of a cartel. The United States says that Mexico admits that the effect of its ILD Rules is to prevent smaller carriers from undercutting Telmex on price.<sup>490</sup> The United States submits that ILD Rule 13, in combination with other provisions of the ILD rules, affirmatively requires and promotes per se anti-competitive conduct. According to the United States, the effect of Mexico's rules is to maintain rates for international interconnection that are well in excess of cost, eliminating any competitive incentive to lower international interconnection rates. The United States further points out that the reduction of international interconnection rates, as have occurred, cannot be attributed to this anti-competitive scheme.<sup>491</sup>

4.268 According to the **United States**, the impact of ILD Rule 13 is to prevent new entrant international carriers in Mexico, some of which are affiliated with United States or other foreign providers, from undercutting the above-cost prices charged by Telmex, thereby attracting more traffic for themselves. The United States claims that Mexico has acknowledged its concern about new entrant carriers engaging in a "price war" with Telmex.<sup>492</sup> The United States submits that Mexico's maintenance of ILD Rule 13, in other words, is not directed at preventing harm to competition but rather is directed at preventing the natural results of competition. The United States further points out that Mexico prohibits price competition in the market for interconnection provided to United States suppliers operating on a cross-border basis, and justifies this prohibition as necessary to prevent such competition from reducing rates. In the United States' view, this can only be regarded as anti-competitive.<sup>493</sup>

4.269 **Mexico** alleges that its ILD rules governing settlement rates and proportionate return are not only appropriate, but necessary to prevent a major supplier from engaging in anti-competitive practices in the Mexican domestic market for long-distance services, and to promote the development of the nation's telecommunications infrastructure to meet fundamental goals such as broader consumer access to service.<sup>494</sup> According to Mexico, the requirements for uniform settlement rates and proportionate return in ILD Rule 13 are crucial: (i) to preserve competition in Mexico's domestic market for long-distance services; and (ii) to promote infrastructure development by ensuring that carriers' shares of the settlement rate revenue from incoming calls are proportionate to their success in

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<sup>489</sup> See Mexico's first written submission, paragraph 207. See Mexico's first oral statement, paragraph 53. See Mexico's answer to question No. 18 of the Panel of 19 December 2002, paragraph 284 ("*Do you agree with Mexico's claim that ILD Rule 13 promotes competition? If so, please explain how, giving illustrative examples of desired and undesired outcomes*"); and Mexico's answer to question No. 25 of the Panel of 14 March 2003, paragraph 132. For question No. 25, see footnote 482 of this Report.

<sup>490</sup> The United States refers Mexico's first written submission, paragraph 79. See the United States' first oral statement, paragraph 38.

<sup>491</sup> See the United States' answer to question No. 18 of the Panel of 19 December 2002, paragraph 89. For question No. 18, see footnote 489 of this Report.

<sup>492</sup> The United States refers to Mexico first written submission, paragraph 79. See the United States' answer to question No. 24 of the Panel of 14 March 2003 ("*Are there examples of WTO Members other than Mexico who maintain measures similar to ILD Rule 13 – granting one supplier the right to negotiate with foreign suppliers a settlement rate that is applicable to all other domestic suppliers?*").

<sup>493</sup> See the United States' answer to question No. 24 of the Panel of 14 March 2003, paragraph 48. For question No. 24, see footnote 492 of this Report.

<sup>494</sup> Mexico refers to the preamble of the GATS. See Mexico's answer to question No. 17(a) of the Panel of 19 December 2002, paragraph 273. For question No. 17(a), see footnote 461 of this Report.

penetrating the domestic market for outgoing international calls. This is why, in Mexico's view, the ILD rules must be evaluated in their totality.<sup>495</sup>

4.270 The **United States** submits that its concern that Telmex is engaging in anti-competitive behaviour in its accounting rate negotiations with United States 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.<sup>496</sup> As a result, the United States contends, Telmex has *de jure* monopoly power in its negotiations with United States carriers. The United States submits that its suppliers have no choice but to interconnect with the Mexican public network at the border, since under Mexico's ILD Rule 3, only "international port operators" may interconnect with the public networks of foreign operators. The United States recalls that Mexican law permits only Mexican facilities-based operators to hold a concession to supply long-distance services.<sup>497</sup> The United States further points out that Mexico leaves no choice but to pay the Telmex-negotiated interconnection rates, to suppliers from the United States willing to provide scheduled services on a cross-border basis. The United States claims that Mexico does not allow "resale" which requires the use of private lease circuits for the purpose of providing circuit switched telecommunication traffic.<sup>498</sup>

4.271 **Mexico** argues that the United States' arguments are an attempt to force Mexico to permit ISR.<sup>499</sup> According to Mexico, its commitments were limited to allow international traffic only "through the facilities of an enterprise that has a concession granted by the Secretaría de Comunicaciones y Transportes". Mexico argues that Section 1.1 cannot be construed to indirectly grant carriers, from the United States, access to ISR when Mexico has an express limitation that allows it to prohibit ISR.<sup>500</sup> According to Mexico, the end result of the United States approach would be to affect competitive long-distance carriers in Mexico and thereby cut down domestic market competition with the argument of reducing costs for AT&T and Worldcom. It further argues that the United States, incidentally, has not offered any information whatsoever on how elimination of the ILD Rules would promote competition in the United States, where WorldCom and AT&T together control more than 90 per cent of United States traffic to Mexico. In its view, even with Rule 13, the negotiating power of the duopsony (exclusive market power of two buyers on a market) on the United States side has been so dominant, and the volume of traffic southwards so great, that historically the settlement rate has been drastically reduced.<sup>501</sup>

4.272 In response to a question by the Panel, **Mexico** indicated that it is not aware of any other WTO Member that has a *de jure* Rule 13. However, it argues, most Members, including the United States, have a *de facto* Rule 13, since the carrier with the highest market share is the one that negotiates the corresponding accounting rates (and therefore the settlement rates) with its counterpart, which also has the highest corresponding market share, and the remaining carriers on both sides follow their leaders. Mexico explains that, in the United States, for example, the ISP establishes uniform settlement rates and proportional return rules that result in a *de facto* Rule 13 for all United States carriers. However, if one of the economic effects of Rule 13 could be said to prove "anti-competitive", most, if not all, WTO Members have regulatory measures producing that effect. As is the case with ILD Rule 13, there are legitimate grounds for such measures and the measures should

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<sup>495</sup> See Mexico's answer to question No. 18 of the Panel of 19 December 2002. For question No. 18, see footnote 489 of this Report.

<sup>496</sup> See the United States' first written submission, paragraph 201.

<sup>497</sup> The United States refers to Mexican law. See the United States' first written submission, paragraph 204.

<sup>498</sup> See the United States' first written submission, paragraph 203.

<sup>499</sup> Mexico refers to the United States first written submission, paragraphs 203-204. See Mexico's first written submission, paragraph 211.

<sup>500</sup> See Mexico's first written submission, paragraph 212.

<sup>501</sup> See Mexico's answer to question No. 25 of the Panel of 14 March 2003. For question No. 25, see footnote 482 of this Report.

not be prohibited simply because one of the effects might be "anti-competitive" according to a particular criterion or measure.<sup>502</sup>

4.273 The **United States** submits that Mexico finally admits that no other WTO Member maintains a measure similar to Rule 13, and fails to identify any WTO Members, other than purportedly the United States, which it claims "have a de facto Rule 13." The United States submits that Mexico then repeats its false charges that United States rules and policies are similar to those of Mexico, and again makes no attempt to rebut the evidence put forward by the United States showing that the United States International Settlements Policy requires nondiscriminatory rather than uniform rates, that ISP non-discrimination and proportionate requirements apply only to arrangements with dominant carriers that maintain high rates, and that all United States carriers negotiate rates independently.<sup>503</sup>

bb) Whether a proportionate return system could be an anti-competitive measure

4.274 **Mexico** claims that Rule 13 prevents international anti-competitive activities. According to Mexico, the United States fails to mention that the two other major Mexican long distance carriers are affiliates of carriers from the United States and also fails to explain how allowing those carriers to dictate rates to their Mexican affiliates would serve any anti-competitive purpose. Mexico submits that its ILD Rules were adopted to mirror those of the United States, which otherwise would give carriers from the United States an unbalanced negotiating advantage over Mexican carriers.<sup>504</sup> Mexico contends that its rules have prevented large foreign carriers from pressuring their own affiliated Mexican companies to agree to predatory, uneconomic prices that would serve only the interest of companies from the United States to the detriment of the Mexican market, undermining the opportunity to expand access to basic telecommunications services to those who now lack such services, and who comprise two-thirds of Mexican households.<sup>505</sup>

4.275 The **United States** replies that its international regulatory scheme upon which Mexico's ILD Rules were allegedly based is qualitatively different from Mexico's rules. According to the United States, its rules are designed to prevent monopolistic abuses where the potential for them still exists, not to authorize and mandate such abuses like Mexico's ILD Rules. According to the United States its uniform or nondiscriminatory settlement rate and proportionate return requirements only apply to foreign carriers with market power, whereas Mexico's rules apply to all foreign carriers regardless of their market power. The United States claims that its rules encourage all its carriers to negotiate cost-oriented rates. The United States further points out that Mexico's rules prohibit all carriers, except Telmex, from negotiating rates and thus encourage artificially high rates, the exact opposite of cost-based.<sup>506</sup> The United States submits that it has not at any time given one carrier the exclusive authority to negotiate international interconnection rates for itself and other competitive carriers.<sup>507</sup>

4.276 Mexico contends that, despite the United States claim that it applies its International Settlements Policy in a narrowly targeted fashion, it has waived the policy only for 15 countries, and

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<sup>502</sup> See Mexico's answer to question No. 24 of the Panel of 14 March 2003, paragraphs 128-129. For question No. 24, see footnote 492 of this Report.

<sup>503</sup> See the United States' comments on Mexico's answer to question No. 24 of the Panel of 14 March 2003, paragraph 67.

<sup>504</sup> See Mexico's first written submission, paragraph 210. See Mexico's answer to question No. 17(a) of the Panel of 19 December 2002, paragraph 256. For question No. 17(a), see footnote 461 of this Report.

<sup>505</sup> See Mexico's answer to question No. 17(a) of the Panel of 19 December 2002, paragraph 256. For question No. 17(a), see footnote 461 of this Report.

<sup>506</sup> See the United States' first oral statement, paragraph 40.

<sup>507</sup> See the United States' first oral statement, paragraph 41.

it deems virtually every major foreign carrier to have market power, including all local exchange carriers in the countries to which the Policy applies.<sup>508</sup>

4.277 In the **United States'** view, the use of a proportionate return system is not an anti-competitive practice where it is used solely to prevent the abuse of market power. The United States claims that it applies proportionate return requirements only to cross border suppliers that both (1) possess market power at the foreign end of the international route, and (2) maintain high settlement rates.<sup>509</sup> According to the United States, proportionate return is applied to dominant suppliers with high rates in order to prevent those dominant suppliers from using their control of return traffic to obtain additional concessions from competing suppliers in the United States. The United States claims that, except for dominant suppliers with high rates, cross-border suppliers into the United States are not subject to proportionate return. The United States refers that all suppliers, from all countries, that do not possess market power at the foreign end of the relevant international route, including all Mexican suppliers except Telmex, are not subject to proportionate return, and may terminate unlimited amounts of bound traffic in the United States with any supplier.<sup>510</sup>

4.278 The **United States** claims that it is pro-competitive rather than anti-competitive to apply a proportionate return system narrowly in order to prevent dominant suppliers with high settlement rates from using their market power to receive increased above-cost subsidies. The United States points out that 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>511</sup> In the United States' view, Mexico does not apply proportionate return to prevent the abuse of market power, but just requires all suppliers to comply with proportionate return, irrespective of whether they possess market power. The United States submits that Mexico's proportionate return requirement operates "in combination with" the Telmex monopoly on rate negotiations and the requirement for uniform rates to prevent one Mexican supplier "undercutting" any other Mexican supplier, or otherwise competing to increase its share of traffic received from cross-border suppliers from the United States.<sup>512</sup> The United States contends that Mexico applies proportionate return broadly to all suppliers with the purpose of maintaining payment of above-cost subsidies resulting from the abuse of market power by Telmex.<sup>513</sup>

4.279 The **United States** submits that Mexico has failed to explain why a Mexican carrier, even if minority owned (but not controlled) by a United States carrier, would ignore its responsibility to its majority shareholders and agree to predatory, uneconomic prices for international interconnection. In its view, the impact of ILD Rule 13 is to prevent new entrant international carriers in Mexico, some of which are affiliated with United States or other foreign providers, from undercutting the above-cost prices charged by Telmex, thereby attracting more traffic for themselves. Mexico has acknowledged its concern about new entrant carriers engaging in a "price war" with Telmex. Mexico's maintenance

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<sup>508</sup> See Mexico's comments on the United States' answer to question No. 19(b) of the Panel of 14 March 2003, paragraph 41.

<sup>509</sup> The United States refers to the *International Settlement Policy Reform*, IB Docket No. 02-234, Notice of Proposed Rulemaking. See the United States' answer to question No. 19(d) of the Panel of 19 December 2002, paragraph 96 ("*Does a proportional return system necessarily constitute an anti-competitive practice?*").

<sup>510</sup> See the United States' answer to question No. 19(d) of the Panel of 19 December 2002, paragraph 96. For question No. 19(d), see footnote 509 of this Report. See the United States' second written submission, paragraph 95.

<sup>511</sup> The United States refers to Mexico's ILD Rules 16 and 17. See the United States' first written submission, paragraph 198.

<sup>512</sup> The United States refers to paragraph 207-209 of Mexico's first written submission. See the United States' answer to question No. 19(d) of the Panel of 19 December 2002, paragraph 97. For question No. 19(d), see footnote 509 of this Report.

<sup>513</sup> See the United States' answer to question No. 19(d) of the Panel of 19 December 2002, paragraph 97. For question No. 19(d), see footnote 509 of this Report.

of ILD Rule 13, in other words, is not directed at preventing harm to competition but rather is directed at preventing the natural results of competition. Mexico prohibits price competition in the market for interconnection provided to United States suppliers operating on a cross-border basis, and justifies this prohibition as necessary to prevent such competition from reducing rates. This can only be regarded as anti-competitive.<sup>514</sup>

4.280 In **Mexico's** view, the proportional return system is a pro-competitive practice, directed at Mexico's legitimate policy objectives.<sup>515</sup> According to Mexico, its ILD Rules promote competition in the Mexican domestic market, while protecting Mexican carriers from being played off each other by foreign carriers. Mexico submits that among other pro-competitive features, ILD Rules prevent negotiation by one supplier of a settlement rate that could undercut other suppliers because it would be unprofitable for them (i.e., a predatory settlement rate). Mexico points out that the United States tries to dismiss the pro-competitive goals of the ILD rules as irrelevant, persisting in its claim that Mexico's Reference Paper requires competition in the negotiation of accounting rates regardless of the negative impact on competition that this would bring to the domestic market, including the impact on international calling services to consumers.<sup>516</sup>

(ii) *"Major supplier"*

4.281 The **United States** explains that Mexico's 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. The United States points out that Telmex has always been the carrier with the largest outgoing international calls, holding the exclusive negotiating authority. The United States further points out that ILD Rules 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>517</sup> The United States therefore contends that 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.<sup>518</sup>

4.282 The **United States** submits that Section 1.2 of 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"<sup>519</sup> for basic telecommunications services as a result of: (a) control over essential facilities; or (b) use of its position in the market."<sup>520</sup> According to the United States, Telmex satisfies this definition of "major supplier" because it has the ability, in the Mexican market, to use its position to materially affect the prices charged and the supply of services.<sup>521</sup> The United States further submits that 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", existence and power of ... competitors", and possibility of access ... for sources of inputs.<sup>522</sup>

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<sup>514</sup> See the United States' answer to question No. 25 of the Panel of 14 March 2003, paragraphs 63-64. For question No. 25, see footnote 482 of this Report.

<sup>515</sup> See Mexico's answer to question No. 19(d) of the Panel meeting of 19 December 2002. For question No. 19(d), see footnote 509 of this Report.

<sup>516</sup> See Mexico's second oral statement, paragraph 92.

<sup>517</sup> The United States refers to Mexico's ILD Rules 13 and 23. See the United States' first written submission, paragraph 197.

<sup>518</sup> See the United States' first written submission, paragraph 190.

<sup>519</sup> As regards the parties' argumentation on the "relevant market", see also Section IV.A.4(a).

<sup>520</sup> See the United States' first written submission, paragraph 68.

<sup>521</sup> See the United States' first written submission, paragraph 71.

<sup>522</sup> The United States refers to the unofficial translation of the Mexican Federal Law of Economic Competition, Chapter II, Article 13 (issued December 24, 1992). Exhibit US-18. See the United States' first written submission, paragraph 80.

The United States defines 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, which, in its view, is demonstrated by well-accepted principles of market analysis which derive from competition law.<sup>523</sup> The United States recalls that 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>524</sup>

4.283 **Mexico** argues that the United States has not demonstrated that the interconnection at issue concerns a "major supplier"<sup>525</sup> and has not presented a *prima facie* case that Telmex is a "major supplier" within the meaning of the Reference Paper.<sup>526</sup> In Mexico's view, the United States' analysis<sup>527</sup> in which it sets out its argument that Telmex is a "major supplier" is flawed.<sup>528</sup> In this regard, Mexico submits that the United States has failed to clearly define the services at issue and how they are supplied.<sup>529</sup> It further contends that, even if assuming that the services at issue are the transportation and transmission of telecommunications signals and that the mode of supply at issue is mode 1 (cross-border), the United States has failed to explain how the "relevant market" it defines is relevant to the cross-border supply of such services.

4.284 As regards the United States' definition of "relevant market" as "the termination of voice telephony, facsimile and circuit-switched data transmission services", **Mexico** submits that "termination services", to the extent that they are provided by a carrier in a WTO Member, are provided on a mode 3 (commercial presence) basis and not on a cross-border basis. Mexico claims that the United States' analysis confuses two distinct modes of supply, cross-border and commercial presence. Mexico further claims that the United States relies on a relevant market resolution by the Mexican competition authority that is under review by Mexican courts precisely because the data it was based upon.<sup>530</sup> Mexico also argues that, assuming that defining the relevant market as "termination services" is relevant, it is unclear whether a carrier in Mexico, such as Telmex, is providing "termination services" in the light of the technical distinction between the traditional accounting rate procedure and a termination regime. It further argues that, even if a carrier in Mexico does provide termination services for foreign carriers wishing to terminate calls within Mexico, "termination services" and how to schedule those services was a specific topic of discussion during the negotiations on basic telecommunications. There was no agreement on these services and, even if there was, Mexico has not inscribed in its Schedule any specific commitments with respect to these services, for example, by using the approach proposed by Australia during the negotiations.<sup>531</sup>

4.285 The **United States** responds that Mexico's assertion that termination services are not interconnection is refuted by the plain language in Section 2.1 of Mexico's Reference Paper definition of "interconnection". Additionally, the United States submits that the European Commission has described call termination as "the most basic interconnection service provided" and that in its

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<sup>523</sup> See the United States' first written submission, paragraph 73.

<sup>524</sup> The United States refers to the unofficial translation of the Mexican Federal Law of Economic Competition, Chapter II, Article 13 (issued December 24, 1992). Exhibit US-18. See the United States' first written submission, paragraph 74.

<sup>525</sup> See Mexico's second oral statement, paragraph 68.

<sup>526</sup> See Mexico's second oral statement, paragraph 74.

<sup>527</sup> Mexico refers to paragraphs 68-99 of the United States' first written submission.

<sup>528</sup> See Mexico's second oral statement, paragraph 69.

<sup>529</sup> See Mexico's second oral statement, paragraph 70.

<sup>530</sup> See Mexico's second oral statement, paragraph 71.

<sup>531</sup> See Mexico's second oral statement, paragraphs 72-73.

submissions during the negotiations, Australia stated that termination of international traffic is interconnection, and there is no indication that any other Member objected to this characterization.<sup>532</sup>

4.286 **Mexico** submits that, basically, Mexico and the United States differ on what constitutes the relevant market in which competition must be promoted and protected. Mexican policy, as shown by the ILD Rules, is that domestic carriers should share in and split agreements for incoming calls in terms of their success in securing a share on the domestic market and generating outbound calls. The United States sees it differently (apparently, solely for the purposes of its argument in this case), i.e. the only "market" worth protecting is the one for terminating United States traffic to Mexico. Mexico contends that the United States is acting as if new operators should compete to carry incoming international traffic calls instead of competing for end-customers in Mexico. According to the criterion set by the United States, it argues, an operator who has made a minimal investment in Mexican infrastructure should be allowed to do so on an unlimited basis, taking all the revenue for international calls from the operators who have made such investments and have obtained successful results in acquiring a share of the market.<sup>533</sup>

4.287 The **United States** claims that Mexico is attempting to justify its anti-competitive ILD rules by alleging that the United States "is acting as if new operators should compete in order to carry incoming international traffic calls instead of competing for end-customers in Mexico." The United States submits that Mexico misstates the United States position. In the view of the United States, Mexico's WTO obligations require it to allow new carriers to compete *both* to carry inbound international calls *and* for customers in Mexico. Likewise, it argues, Mexico implies that it is wrong for the United States to assert that carriers that have made "minimal" investments in Mexican infrastructure should be allowed to engage in "unlimited" competition. The United States maintains that a carrier's ability to compete, either for inbound international calls, Mexican customers or in any other area, is limited only by the limitations, if any, in Mexico's Schedule. Mexico cites no requirement in its Schedule that links a supplier's ability to compete for inbound international calls to that supplier's level of investment in Mexican facilities. Additionally, Mexico does not restrict competition for inbound international traffic merely for those suppliers with an undefined level of "minimal investment." Instead, Mexico's ILD rules restrict competition for inbound international traffic for all commercially present suppliers, irrespective of their level of investment in Mexican facilities.<sup>534</sup>

(iii) *"Anti-competitive practices"*

aa) Definition of anti-competitive practices

4.288 The **United States** explains that apart from three illustrative practices included in Section 1, the Reference Paper does not define the term "anti-competitive practices". The United States considers that this term encompasses, at a minimum, what are usually characterized as "abuses of dominant position" and/or "monopolization" offences as well as "cartelization", which, according to the United States, are common antitrust concepts generally included within the universe of business practices usually found to be anti-competitive under national regulatory schemes and competition laws and policies. The United States claims that Mexico's antitrust law generally prohibits behaviour of this sort.<sup>535</sup> The United States further indicates that the 1999 Report of the WTO Working Group

<sup>532</sup> See the United States' comments on Mexico's answer to question No. 17 of the Panel of 14 March 2003, paragraph 59.

<sup>533</sup> See Mexico's answer to question No. 25 of the Panel of 14 March 2003, paragraph 132. For question No. 25, see footnote 482 of this Report.

<sup>534</sup> See the United States' comments on Mexico's answer to question No. 25 of the Panel of 14 March 2003, paragraphs 68 and 69.

<sup>535</sup> The United States refers to the *WTO, Working Group on the Interaction between Trade and Competition "The Fundamental Principles of Competition Policy" (7 June 1999), Exhibit US-42; "Overview of Members' National Competition Legislation" (Rev. 2, 4 July 2001); ABA Section of Antitrust Law, Competition*

on the Interaction Between Trade and Competition Policy describes the nature and consequences of "horizontal" agreements which are likely to have a direct, negative impact on competition and to give rise to the exercise of market power.<sup>536</sup>

4.289 **Mexico** indicates that a definition of "anti-competitive practices" is provided in Section 1.2, which states that:

"The anti-competitive practices referred to in the above paragraph shall include in particular:

- (a) Engaging in anti-competitive cross-subsidization;
- (b) using information obtained from competitors with anti-competitive results; and
- (c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide service." (emphasis added)<sup>537</sup>

4.290 **Mexico** argues that the term "shall include" indicates that the list is non-exhaustive and that the addition of the words "in particular" demonstrate a focus on certain types of activities – namely, actions taken by private companies to gain an advantage over their competitors. Mexico claims that carriers from the United States are not competing with Mexican carriers when they enter into bilateral accounting rate arrangements since they do not offer service to Mexican customers. Mexico submits that, even if the legal requirement that all Mexican carriers charge the same settlement rate somehow could be construed as a "horizontal price fixing agreement" by private companies, such an agreement would not be encompassed by Section 1 because all Mexican carriers would be participating in the conspiracy and none would be harmed by it.<sup>538</sup>

bb) Government intervention

4.291 According to the **United States**, the fact that anti-competitive conduct is compelled by the government does not change the underlying nature of the conduct as anti-competitive.<sup>539</sup> In its view, even if an activity engaged in by Mexico's major supplier, Telmex, is immunised from domestic enforcement action under Mexican law, or is in some sense the act of the Mexican State itself, that does not alter the anti-competitive character of the activity at issue. The United States notes that it is Mexico's failure to observe the obligations of Section 1 that is at issue in this dispute, not Telmex's failure to observe those obligations. According to the United States, if a WTO Member were able to immunize itself from the obligation incumbent upon it under Section 1 to take measures to prevent anti-competitive conduct by major suppliers by simply requiring anti-competitive conduct by major suppliers, the entire purpose of Section 1 would be undermined. The United States says that such an

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*Laws Outside the United States I (2001) Chapter 1, Exhibit US-49; OECD "Recommendation of the Council Concerning Effective Action against Hard Core Cartels (1998)"; Mexican Federal Law of Economic Competition, Arts. 8 and 9, Exhibit US-18. See the United States' first written submission, paragraph 193. See the United States' first oral statement, paragraph 34. See the United States' answer to question No. 17(a) of the Panel of 19 December 2002, paragraph 86. "Are Mexican rules that impede price competition among Mexican companies terminating incoming international calls consistent with the GATS and the Reference Paper?". See the United States' second written submission, paragraph 79.*

<sup>536</sup> See the United States' first written submission, paragraph 194.

<sup>537</sup> See Mexico's answer to question No. 19(a) of the Panel of 19 December 2002, paragraph 287 ("How do you define "anti-competitive practices" in the sense of Section 1.1 of the Reference Paper?").

<sup>538</sup> See Mexico's answer to question No. 19(a) of the Panel of 19 December 2002, paragraph 288. For question No. 19(a), see footnote 537 of this Report.

<sup>539</sup> See the United States' first oral statement, paragraph 42.

interpretation of Section 1 would encourage Members affirmatively to maintain measures requiring anti-competitive conduct, rather than put in place measures to prevent anti-competitive conduct.<sup>540</sup>

4.292 **Mexico** submits that the United States has failed to establish that Section 1 disciplines regulatory "measures" of a WTO Member that have an anti-competitive effect.<sup>541</sup> In Mexico's view, "anti-competitive practices" refer to the practices of a major supplier and not to governmental measures that may have an anti-competitive effect.<sup>542</sup> Mexico recognizes that all regulation of economic activity, by definition, interferes with the operation of a freely competitive marketplace, including rate-setting by governmental authorities, but claims that such government regulation itself is not typically understood to be capable of violating competition rules.<sup>543</sup> According to Mexico, if the United States' interpretation is to be accepted, all government regulatory measures in the telecommunications sector that restrain the actions of a major supplier in a manner that interferes with the operation of a freely competitive marketplace would be prohibited. Mexico claims that this is not what was intended by Section 1 of its Reference Paper. Mexico submits that there is no basis in the text of Section 1 to judge the legitimacy of a WTO Member's internal regulatory policies in circumstances where no multilaterally agreed-upon benchmarks exist. Mexico further contends that in order to justify its own anti-competitive measures, the United States essentially distinguishes between anti-competitive measures that, in its view, have legitimate policy objectives and those that, in its view, do not. In Mexico's view, if the drafters of Section 1 meant to include government regulatory measures, surely they would have included text to take into account such important distinctions and to provide objective benchmarks for assessing the legitimacy of such measures.<sup>544</sup>

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<sup>540</sup> See the United States' answer to question No. 17(c) of the Panel of 19 December 2002 ("*Can the fixing of a uniform price be anti-competitive practice in violation of the obligation under the Reference Paper if uniform prices are required by law?*"). See the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 31. For question No. 23(a), see footnote 545 of this Report.

<sup>541</sup> See Mexico's second oral statement, paragraph 10.

<sup>542</sup> See Mexico's answer to question No. 19(a) of the Panel of 19 December 2002, paragraph 287. For question No. 19(a), see footnote 537 of this Report.

<sup>543</sup> See Mexico's second written submission, paragraph 128.

<sup>544</sup> See Mexico's second oral statement, paragraph 10.

cc) Price fixing as an anti-competitive practice

4.293 Answering a Panel's question<sup>545</sup>, the **United States** submits that, if price-fixing is anti-competitive, then it is anti-competitive even if required by law. According to the United States, even if an activity engaged in by Mexico's major supplier, Telmex, is immunized from domestic enforcement action under Mexican law, or is in some sense the act of the Mexican state itself, that does not alter the anti-competitive character of the activity at issue.<sup>546</sup> The United States further submits that Telmex's ability to negotiate uniform settlement rates is per se anti-competitive. In its view, this is, by definition, a horizontal price-fixing cartel that fits within virtually any definition of anti-competitive practice. The United States notes that horizontal price fixing is condemned both as a per se violation of its own law under Section 1 of the Sherman Act and as an absolute monopolistic practice under Article 9 of Mexico's FLEC.<sup>547</sup> The United States affirms that it is the setting of the rate by a monopolist (since Telmex is given the exclusive authority, it is acting as a monopolist in this context) and the use of this rate by all other suppliers (horizontal price-fixing) that comprise the anti-competitive practices that form the basis for the United States' claim under Section 1 of the Reference Paper. It submits that the fact that the government requires the anti-competitive practice does not change the nature of the practice as anti-competitive.<sup>548</sup>

4.294 Also in answer to a Panel's question, **Mexico** submits that the fixing of a uniform price cannot be an anti-competitive practice in violation of the obligations under the Reference Paper if uniform prices are required by law.<sup>549</sup> Mexico further submits that Telmex's ability to negotiate uniform settlement rates is not per se anti-competitive since Mexican law does not give Telmex the authority to negotiate the rate. According to Mexico, Rule 13 provides the carrier having the greatest share of outgoing traffic to a particular country is authorized to negotiate the rate. Mexico claims that new entrant carriers have been gaining important shares of outgoing traffic on certain routes, and therefore may soon have the right to negotiate the rates for those routes.<sup>550</sup>

4.295 **Mexico** further submits that, in the economic sense, monopolies may be "anti-competitive". However, it cannot be said that a domestic regulatory regime that establishes and permits a monopoly or small number of exclusive service suppliers to exist is equivalent to requiring an "anti-competitive practice" within the meaning of Section 1 of Mexico's Reference Paper. GATS Article VIII explicitly contemplates that WTO Members can maintain monopolies and exclusive service suppliers. Moreover, many WTO Members who have inscribed a Reference Paper maintain monopolies or exclusive service suppliers under their domestic law. Section 1 of Mexico's Reference Paper and the

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<sup>545</sup> Namely, question No. 17(c) of the Panel of 19 December 2002. For question No. 17(c), see footnote 540 of this Report, and question No. 23(a) of the Panel of 14 March 2003 ("*Explain why the Mexican legal requirement that all Mexican suppliers must apply the settlement rate negotiated by the major supplier, amounts to requiring an 'anti-competitive practice' in violation of Section 1.1 even if Mexican suppliers do not collude and do not distort competition voluntarily.*").

<sup>546</sup> See the United States' answer to question No. 17(c) of the Panel of 19 December 2002, paragraph 88. For question No. 17(c), see footnote 540 of this Report. See the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 31. For question No. 23(a), see footnote 545 of this Report.

<sup>547</sup> See the United States' answer to question No. 19(c) of the Panel of 19 December 2002, paragraph 95 ("*Do you consider that Telmex's ability to negotiate uniform settlement rates is per se anti-competitive?*").

<sup>548</sup> See the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 31. For question No. 23(a), see footnote 545 of this Report.

<sup>549</sup> See Mexico's answer to question No. 17(c) of the Panel of 19 December 2002, paragraph 283. For question No. 17(c), see footnote 540 of this Report. See also Mexico's comments on the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraphs 48-51.

<sup>550</sup> See Mexico's answer to question No. 19(c) of the Panel of 19 December 2002, paragraph 292. For question No. 19(c), see footnote 547 of this Report. See also Mexico's comments on the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 52.

equivalent provisions in the Reference Papers of other WTO Members cannot be interpreted to nullify a right that exists under GATS Article VIII. Mexico submits that the obligations in the Reference Paper were negotiated specifically to prevent major carriers in regulated markets from abusing their market positions by engaging in anti-competitive "private" actions. With respect to "the use of the [Telmex] rate by all other suppliers", such action is not the result of anti-competitive practices of a major supplier – the focus of Section 1 of Mexico's Reference Paper – rather, it is the result of a legitimate government regulatory scheme.<sup>551</sup>

4.296 The United States responds that there is no basis for Mexico's assertion that GATS Article VIII contemplates Mexico's restrictions on competition through the ILD rules, and therefore somehow precludes any challenge to such measures under Article 1 of the Reference Paper.<sup>552</sup> Article VIII only applies to monopolists and "exclusive service suppliers, where a Member, formally or in effect, (a) authorizes or establishes a small number of suppliers and (b) substantially prevents competition among those suppliers in its territory." Mexico has placed no limitation on the number of concessionaires, either formally or in effect, and Article VIII therefore does not apply. Mexico's Schedule contains no Article XVI:2(a) limitation on the number of service suppliers, and as of September 2002 Mexico had granted no fewer than 27 concessions for domestic long-distance service, 11 of which are authorized to operate international ports.<sup>553</sup>

(c) Relationship between Section 1.1 and Section 2.2(b) of the Reference Paper

4.297 The **United States** submits that a Member that scheduled the Reference Paper as an additional commitment is required by Section 1 of the Reference Paper to maintain appropriate measures to prevent its major supplier from engaging in or continuing anti-competitive practices, and is also obliged under Section 2.2(b) to ensure interconnection with that major suppliers on reasonable terms, conditions and rates. The United States considers that depending on the facts at issue, a conduct could be both anti-competitive and restrict the supply of basic telecommunication services, leading to a violation of both Sections 1 and 2.2(b).<sup>554</sup> The United States also submits that 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, and that it complements the more specific interconnection rules for major suppliers found in Section 2.<sup>555</sup>

4.298 **Mexico** submits that Sections 1 and 2 of Mexico's Reference paper do not cover the same subject matter. In Mexico's view, independent meaning must be given to each provision and overlapping interpretations must be avoided.<sup>556</sup> According to Mexico, what is "not reasonable" under Section 2.2 and what is "anti-competitive" under Section 1.1 are measured against different standards, there being no relationship between the two.<sup>557</sup>

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<sup>551</sup> See Mexico's comments on the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraphs 50-51.

<sup>552</sup> See Mexico's second oral statement, paragraphs 100-01.

<sup>553</sup> See the United States' comments on Mexico's answer to question No. 25 of the Panel of 14 March 2003, footnote 82 to paragraph 70.

<sup>554</sup> See the United States' answer to question No. 19(b) of the Panel of 19 December 2002, paragraph 94, "How do you view the relationship between an 'anti-competitive practice' in the sense of Section 1.1 and a practice that is not 'reasonable' in the sense of Section 2.2(b)?"

<sup>555</sup> See the United States' first written submission, paragraph 192.

<sup>556</sup> See Mexico's answer to question No. 19(b) of the Panel of 19 December 2002, paragraph 290. For question No. 19(b), see footnote 554 of this Report.

<sup>557</sup> See Mexico's answer to question No. 19(b) of the Panel of 19 December 2002, paragraph 291. For question No. 19(b), see footnote 554 of this Report.

## (d) Relationship between Sections 1.1 and 3 of Mexico's Reference Paper

4.299 In response to question No. 23(b) of the Panel meeting of 13 March 2003<sup>558</sup>, **Mexico** explains that there is no legal relationship between Sections 1.1 and 3 of its Reference Paper. According to Mexico, those Sections relate to different subjects and lay down different obligations. Mexico submits that Section 3 has not been the subject of this dispute. In Mexico's view, Section 1.1 does not regulate measures by a Member with a side-effect that may prove anti-competitive from a particular standpoint. Mexico contends that Section 3 relates to the maintenance of a type of specific governmental measure for the universal service obligation, which includes laying down obligations on domestic carriers to provide universal service coverage over a Member's territory and that such measure be, *inter alia*, administered in a "transparent, non-discriminatory and competitively neutral" manner.

4.300 **Mexico** submits that, for the purposes of this dispute, it is notable that when a governmental measure must be regulated in accordance with Mexico's Reference Paper, it is done explicitly as in Section 3, so that it identifies the exact governmental measure in question (i.e. a "universal service" measure and not a general governmental regulatory measure, which would be the outcome of the United States interpretation of Section 1.1 of Mexico's Reference Paper) and the specific disciplines that apply (i.e., "competitively neutral", contrary to "anti-competitive practices", which are more subjective and general). According to Mexico, this confirms its position that Section 1.1 of its Reference Paper does not regulate a Member's measures, but the "practices" of a "major supplier".<sup>559</sup>

4.301 The **United States** replies noting that Mexico's ILD Rules are not "legislative requirement[s]," but regulatory requirements imposed by Cofetel. According to the United States, Mexico's ILD Rules 13 and 23 implement per se anti-competitive practices under Section 1.1 of the Reference Paper, which are not mitigated by any application of Section 3.<sup>560</sup>

4.302 The **United States** submits that Section 3 allows a Member to "define the kind of universal service obligation it wishes to maintain". The United States claims it is aware of no universal service obligation implemented or defined by the Mexican authorities, and no such obligation is defined by the ILD rules. The United States further submits that Mexico has not even identified or defined a universal service obligation that would, were it identified or defined, "not be regarded as anti-competitive per se," pursuant to Section 3. In the United States view, since Mexico has not identified or defined a universal service obligation, it is not entitled to the presumption against per-se anti-competitiveness included in Section 3.<sup>561</sup>

4.303 The **United States** further submits that even if Mexico had defined a universal service obligation and Section 3 were to apply, Mexico would not be entitled to this presumption, since its ILD rules also breach the additional requirements that the defined obligation be "administered in a transparent, non-discriminatory and competitively neutral manner and ... not [be] more burdensome

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<sup>558</sup> See Mexico's answer to question No. 23(b) of the Panel of 14 March 2003, paragraphs 124-126. "Please also elaborate on the relationship between Section 1.1 and Section 3 of the Reference Paper, i.e. under what conditions can a legislative requirement that all domestic suppliers must apply the settlement rate negotiated by the major domestic supplier be considered as a 'non-discriminatory and competitively neutral' universal service obligation that is not 'regarded as anti-competitive per se' in the sense of Section 3 of the Reference Paper."

<sup>559</sup> See Mexico's answer to question No. 23(b) of the Panel of 14 March 2003, paragraph 127. For question No. 23(b), see footnote 558 of this Report.

<sup>560</sup> See the United States' answer to question No. 23(b) of the Panel of 14 March 2003, paragraphs 49 and 50. For question No. 23(b), see footnote 558 of this Report.

<sup>561</sup> See the United States' answer to question No. 23(b) of the Panel of 14 March 2003, paragraph 51. For question No. 23(b), see footnote 558 of this Report.

than necessary for the kind of universal service defined by the Member.<sup>562</sup> Specifically, the United States argues that, at present, any alleged universal service obligations levied against foreign suppliers are apparently hidden in interconnection rates paid to Telmex. There is no transparency when universal service obligations are hidden in interconnection rates paid to the major supplier. The United States submits that a transparent process must, at a minimum, identify the level of charges associated with the universal service obligation. The ILD rules also fail to provide the "non-discriminatory and competitively neutral" administration of the defined universal service obligation that is required by Section 3. Because the ILD rules only address interconnection rates paid by cross-border suppliers, they ensure that the entire burden of any universal service obligation implemented in this way falls upon cross-border suppliers. Finally, the United States notes that the ILD rules fail to identify the monetary level of the obligation and ensure that the charges are commensurate with that obligation. Because Mexico has not defined a universal service obligation, it cannot determine what level of charges would be "necessary" to meet that obligation. Similarly, levying charges allegedly associated with that obligation are by definition more burdensome than necessary.<sup>563</sup>

### C. SECTION 5 OF THE GATS ANNEX ON TELECOMMUNICATIONS

4.304 The **United States** claims that Mexico has failed to honour its commitments under the GATS Annex on Telecommunications. According to the United States, the Annex requires Mexico to ensure that service suppliers of other Members can access and use public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions to provide a scheduled service.<sup>564</sup> In the United States' view, Mexico has not fulfilled its obligations under either Section 5(a) or 5(b) of the Annex for the provision of the scheduled services.<sup>565</sup>

4.305 **Mexico** submits that the scheduled services - i.e. the market-access commitments - that the United States alleges that Mexico has made and which are the basis for the claim under the Annex do not exist. In Mexico's view, the United States is incorrectly arguing that the Annex confers rights to supply basic telecommunications services when the Annex applies only to access to and use of those services. Therefore, Mexico submits that the provisions of the Annex cited by the United States<sup>566</sup> do not apply to the facts of this dispute. Mexico further submits that even if Sections 5(a) and 5(b) applied, the United States has failed to present a prima facie case that these provisions have been violated. According to Mexico, the measures the United States is challenging are consistent with paragraphs 5(e), 5(f) and 5(g) of the Annex.<sup>567</sup>

#### 1. Application of the Annex

4.306 The **United States** submits that the GATS Annex on Telecommunications addresses telecommunications as a means of transporting scheduled services. In its view, 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.<sup>568</sup> It further submits that the Annex grew out of a recognition that telecommunications represent the primary delivery mechanism for many services, particularly those offered on a cross-border basis. Without telecommunications, it

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<sup>562</sup> See the United States' answer to question No. 23(b) of the Panel of 14 March 2003, paragraph 52. For question No. 23(b), see footnote 558 of this Report. See also the United States' comments on Mexico's answer to question No. 23(b) of the Panel of 14 March 2003, paragraphs 62-66.

<sup>563</sup> See the United States' answer to question No. 23(b) of the Panel of 14 March 2003, paragraphs 53-55. For question No. 23(b), see footnote 558 of this Report.

<sup>564</sup> See the United States' first written submission, paragraph 32.

<sup>565</sup> See the United States' first written submission, paragraph 33.

<sup>566</sup> Mexico refers to Sections 5(a) and (b) of the Annex on Telecommunications. See Mexico's first written submission, paragraph 220.

<sup>567</sup> See Mexico's first written submission, paragraph 220.

<sup>568</sup> See the United States' first written submission, paragraph 207.

would be impossible for many service suppliers to deliver their services.<sup>569</sup> The United States claims that 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.<sup>570</sup> 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 and to ensure that dominant telecom suppliers cannot nullify the services commitments that their home country undertakes.<sup>571</sup>

4.307 **Mexico** contends that enhanced services and suppliers of services in sectors other than the telecommunications sector rely on "access to and use of" the existing public telecommunication network. According to Mexico, the Annex establishes general obligations to ensure that such services have access to and use of the public network on non-discriminatory and reasonable terms and conditions. Mexico claims that the Annex does not confer any right to supply telecommunications transport networks and services (i.e. basic telecommunications services) other than as provided in a Member's Schedule. It further submits that market access rights for the supply of basic telecommunication services were the subject of the later negotiations that led to the Fourth Protocol.<sup>572</sup>

4.308 The **United States** maintains that the Annex requires each WTO Member to ensure that foreign service suppliers have reasonable and non-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."<sup>573</sup>

4.309 The **United States** submits that 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.<sup>574</sup> According to the United States 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. 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>575</sup>

4.310 **Mexico** submits that the focus of the Annex on Telecommunications services is as a transport means for other economic activities, and not the supply of basic telecommunications services.<sup>576</sup> The term "access to and use of" is not defined in the Annex, but paragraphs (b) and (c) of Section 3 of the

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<sup>569</sup> See the United States' first written submission, paragraph 208.

<sup>570</sup> See the United States' first written submission, paragraph 209.

<sup>571</sup> See the United States' first written submission, paragraph 210.

<sup>572</sup> See Mexico's first written submission, paragraph 216.

<sup>573</sup> See the United States' first written submission, paragraph 211.

<sup>574</sup> Ibid.

<sup>575</sup> See the United States' first written submission, paragraph 212.

<sup>576</sup> See Mexico's first written submission, paragraph 221.

Annex define the terms "public telecommunications transport service"<sup>577</sup> and public telecommunications transport networks"<sup>578</sup>. In Mexico's view, the Annex applies to access to and use of a Member's available basic telecommunications services. The services for which "access to and use of" is provided are something other than basic telecommunication services.<sup>579</sup> Mexico contends that the United States' claims under the Annex must be assessed within the context of these definitions. Mexico points out that the United States is arguing that the Annex grants to its suppliers of basic telecommunications services the right to "supply" basic telecommunications services cross-border into Mexico by interconnecting with the public network or by interconnecting with private leased or owned circuits in Mexico. It further points out that the United States is also arguing that the Annex grants foreign companies the right to own 100 per cent of operators established in Mexico who will be entitled to supply such services cross-border into the United States.<sup>580</sup>

4.311 The **United States** claims that Mexican law prevents foreign suppliers from owning public telecom networks and services in Mexico, leaving them 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 abroad 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.<sup>581</sup> According to the United States, the entire purpose of Section 5 of the Annex is to require WTO Members to prevent this very form of behavior. The United States claims that 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.<sup>582</sup>

4.312 In **Mexico's** view, the purpose of the Annex is not to allow facilities-based and non-facilities-based basic telecommunications suppliers to supply their services cross-border, but to provide supplementary or additional obligations to allow "access to" and "use of" Mexico's existing public telecommunications transport network and services<sup>583</sup>. It submits that the terms "access to" and "use of" have different meanings from the term "supply", which is frequently used in the text of the GATS. The term "supply" is defined as meaning "provide or furnish a thing needed". Mexico claims that the Annex applies only to measures which affect "access to or use of public telecommunications transport networks or services, and it does not apply to measures that affect "supply" of telecommunications transport services cross-border.<sup>584</sup> According to Mexico, the United States is confusing "market access" with "access to and use of" existing public telecommunications transport networks operated by domestic concessionaires. Mexico contends that "market access" is dealt with in the market-access commitments made under Article XVI of the GATS inscribed in Mexico's Schedule, whereas "access to and use of" public telecommunications networks is dealt with in the Annex.<sup>585</sup>

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<sup>577</sup> "Public telecommunications transport service" means 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. See Mexico's first written submission, paragraph 223.

<sup>578</sup> "Public telecommunication transport network" means the public telecommunications infrastructure which permits telecommunications between and among defined network termination points. See Mexico's first written submission, paragraph 220.

<sup>579</sup> See Mexico's first written submission, paragraph 224.

<sup>580</sup> See Mexico's first written submission, paragraph 225.

<sup>581</sup> See the United States' first written submission, paragraph 243.

<sup>582</sup> See the United States' first written submission, paragraph 244.

<sup>583</sup> See Mexico's first written submission, paragraph 226.

<sup>584</sup> See Mexico's first written submission, paragraph 227.

<sup>585</sup> See Mexico's first written submission, paragraph 228.

4.313 In **Mexico's** view, the Annex was not drafted to provide "market access" to foreign suppliers of basic telecommunications services<sup>586</sup>. According to Mexico, paragraph (c) of Section 2 of the Annex provides important exemptions from the application of the Annex:

"Nothing in this Annex shall be construed:

- (i) to require a Member to authorize a service supplier of any other Member to establish, construct, acquire, lease, operate, or supply telecommunications transport networks or services, other than as provided in its Schedule; or
- (ii) to require a Member (or to require a Member to oblige service suppliers under its jurisdiction) to establish, construct, acquire, lease, operate or supply telecommunications transport networks or services not offered to the public generally."<sup>587</sup>

4.314 According to **Mexico**, the services at issue in this dispute are "telecommunications transport ... services", governed by Mexico's Schedule. In Mexico's view, pursuant to Section 2(c)(i), nothing in the Annex can be construed to require Mexico to authorize service suppliers from the United States to supply these services beyond the terms and conditions inscribed in its schedule.<sup>588</sup> The **United States** submits that Section 1 of the Annex states that telecommunications has a "dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities." It further submits that Section 2(a) states that the Annex applies to "all measures" affecting access to and use of public telecommunications transport networks and services, which would include measures regulating telecommunications "as a distinct sector of economic activity . . ." The United States also recalls Section 5(a), which imposes obligations "for the supply of a service included in [a Member's] Schedule," without imposing any limits on the type of service that would be relevant, including basic telecommunications services scheduled by Mexico.<sup>589</sup>

4.315 **Mexico** maintains that the fact that Section 1 (entitled "Objectives") of the Annex on Telecommunications refers to a "dual" role of the telecommunications services sector does not mean that the Annex covers both aspects of this "dual" role. In Mexico's view, Section 1 simply confirms that the Annex is based on the recognition that, beyond constituting a service sector of their own, telecommunications services and networks are essential tools for other economic activities, such as banking, insurance, etc. According to Mexico the fact that these other activities rely heavily on telecommunications services as an underlying transport means that is the *raison d'être* of the Annex, supporting Mexico's view that the Annex is aimed at addressing the second aspect of the dual role. The first aspect – the supply of basic telecommunications services – was dealt with under the basic telecommunications negotiations that led to the Fourth Protocol to the GATS in 1997.<sup>590</sup> Although Section 1 refers to a "dual" role of the telecommunications services sector, it also stipulates that the Annex was agreed to "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".<sup>591</sup> The reference in Section 1 of the Annex to "measures affecting access to and use of" PTTNS must be contrasted with the scope of the provisions of the GATS Annex on Financial

<sup>586</sup> See Mexico's first written submission, paragraph 229.

<sup>587</sup> See Mexico's first written submission, paragraph 230.

<sup>588</sup> See Mexico's first written submission, paragraph 231.

<sup>589</sup> See the United States' answer to question No. 21 of the Panel meeting of 19 December 2002, paragraph 99, ("Can Mexico reconcile its argument that the 'Annex only address telecommunications transport services as the underlying transport means for other economic activities' with the reference, in the GATS Annex, to a 'dual' role of the telecommunications service sector?").

<sup>590</sup> See Mexico's answer to question No. 21 of the Panel meeting of 19 December 2002, paragraph 299. For question No. 21, see footnote 589 of this Report; see also Mexico's first written submission, paragraph 214.

<sup>591</sup> See Mexico's answer to question No. 21 of the Panel meeting of 19 December 2002, paragraph 300. For question No. 21, see footnote 589 of this Report.

Services. Section 1(a) of that Annex states "[t]his Annex applies to measures affecting the supply of financial services. Reference to the supply of a financial service shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement". Thus, where the negotiators of the GATS intended that an annex apply to the "supply" of a service within the broader meaning of the GATS, they did so explicitly.<sup>592</sup>

4.316 According to **Mexico** the Annex distinguishes between *access to and use of* public telecommunications transport networks and services, which is relevant to telecommunications services as an underlying transport means for other economic activities, and the *supply* of such services, which is relevant to trade in telecommunications services as a distinct sector of economic activity.<sup>593</sup> In Mexico's view, Section 2 of the Annex makes clear that the Annex is devoted solely to the guarantees of access and use. It explains that Paragraph (a) of Section 2 stipulates that the Annex "shall apply to all measures of a Member that affect access to and use of public telecommunications transport networks and services". In Mexico's view, the Annex is limited in scope and deals only with the right to access and use public telecommunications transport networks and services and not the right to provide and supply them.<sup>594</sup> Mexico contends that the services at issue in this dispute are the transport of customer-supplied information or data between two or more points, being themselves "public telecommunications transport networks and services", which cannot be supplied through access to and use of another Member's PTTNS.<sup>595</sup> It further submits that, by definition, Mexico's suppliers of "public telecommunications transport networks and services" cannot transport public telecommunications transport services supplied by other suppliers. It explains that, in the circumstances of this dispute, when suppliers from the United States hand off traffic to a Mexican supplier at the border, they rely on the PTTNS provided by that supplier and do not supply their services into Mexico. Mexico contends that basic telecommunications services are the underlying transport means for other economic activities and Mexico fails to see how they could be viewed as a transport means for the same economic activity, which is the implication of the United States' position in this dispute.<sup>596</sup>

4.317 Answering a question by the Panel<sup>597</sup>, **Mexico** submits that Section 5 of the Annex refers to access to and use of a Member's PTTNS "for the supply of a service included in its schedule", that applies only until the services scheduled by a Member can be supplied by access to and use of another Member's PTTNS.<sup>598</sup> According to Mexico, the services that are the subject of this dispute are telecommunications transport and transmission services, which cannot *ipso facto* be supplied through access to and use of another Member's PTTNS since the latter are, in themselves, "public telecommunications transport networks and services".<sup>599</sup> Mexico contends that the United States interpretation would lead to the conclusion that the Mexican postal authority would be transporting

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<sup>592</sup> See Mexico's answer to question No. 21 of the Panel meeting of 19 December 2002, paragraph 301. For question No. 21, see footnote 589 of this Report.

<sup>593</sup> See Mexico's answer to question No. 21 of the Panel meeting on 19 December 2002, paragraph 302. For question No. 21, see footnote 589 of this Report.

<sup>594</sup> See Mexico's answer to question No. 21 of the Panel meeting on 19 December 2002, paragraph 303. For question No. 21, see footnote 589 of this Report.

<sup>595</sup> See Mexico's answer to question No. 21 of the Panel meeting on 19 December 2002, paragraph 306. For question No. 21, see footnote 589 of this Report.

<sup>596</sup> See Mexico's answer to question No. 21 of the Panel meeting on 19 December 2002, paragraph 307. For question No. 21, see footnote 589 of this Report.

<sup>597</sup> See question No. 26 of the Panel of 13 March 2003, ("Please explain why Mexico says at paragraph 307 of its Responses to questions that 'by definition, Mexico's suppliers of 'public telecommunications transport networks and services' cannot transport public telecommunications transport services supplied by other suppliers.'").

<sup>598</sup> See Mexico's answer to question No. 26 of the Panel meeting on 13 March 2003, paragraph 135. For question No. 27, see footnote 597 of this Report.

<sup>599</sup> See Mexico's answer to question No. 26 of the Panel meeting on 13 March 2003, paragraph 136. For question No. 27, see footnote 597 of this Report.

United States postal services by delivering mail sent from the United States and handed over at the border, that a pipeline within Mexican territory would be transporting United States pipeline services when it transports oil received from a United States pipeline that stops at the border, and that a Mexican transport company would be performing United States transport services when it delivers the freight that was transferred to it at the border. In Mexico's view, Mexican service suppliers – including public telecommunications transport suppliers – only supply their own transport service.<sup>600</sup>

4.318 The **United States** contends that Mexico's assertion that the services at issue are "transport and transmission" services, is erroneous, as it ignores the text of the CPC codes Mexico has inscribed in its Schedule. In the view of the United States, Mexico's Schedule does not limit its cross-border commitment to only a portion of the service defined in the CPC codes, but the entirety of a telephone call's path, from its point of origin to its point of termination.<sup>601</sup> The United States further disagrees with the analogy that Mexico draws with regard to the transport of oil or of goods sent via mail. In case of the transport of goods, the goods are separate products, while a basic telecommunications service – a telephone call or a "communication" is an inseparable part of the service itself. Section 1 of the Annex draws an explicit distinction between telecommunications services as a distinct sector of economic activity and as the underlying transport means for other economic activities.<sup>602</sup>

## 2. Application of Sections 5(a) and 5(b) of the Annex

4.319 The United States submits that, its claims are related to *five* distinct situations for which, in the United States' view, Mexico has made specific commitments, and for which Mexico must comply with its Annex obligations. According to the United States, under the first two situations, in accordance with Section 5(a) of the Annex, Mexico must ensure that foreign facilities-based and non-facilities based suppliers of cross border telecommunications services are accorded access to and use of public telecommunications transport networks and services (PTTNS) on reasonable and non-discriminatory terms and conditions.<sup>603</sup> Under the third and fourth situations, the United States claims that, according to Section 5(b) of the Annex, Mexico must ensure that these suppliers have access to and use of private leased circuits.<sup>604</sup> The United States further points out that locally established non-facilities based operators (commercial agencies) must likewise be afforded access to and use of private leased circuits to supply international telephone services.<sup>605</sup>

### (a) Claims under Section 5(a) of the Annex

4.320 According to the **United States**, pursuant to the Annex, services suppliers from the United States are entitled to access and use of public telecommunications networks and services. The United States claims that interconnection is the means by which service suppliers from the United States access and use Mexico's public telecommunications networks and services. The United States asserts that its service suppliers must interconnect with the Mexican network in order to ensure they can transport their scheduled service to its final destination in Mexico. The United States further points out that without such access, a service supplier from the United States could never supply a scheduled facilities-based or non-facilities-based basic telecom service.<sup>606</sup>

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<sup>600</sup> See Mexico's answer to question No. 26 of the Panel meeting on 13 March 2003, paragraph 137. For question No. 26, see footnote 597 of this Report.

<sup>601</sup> See the United States' comments on Mexico's answer to question No. 26 of the Panel of 14 March 2003, paragraph 71.

<sup>602</sup> See the United States' comments on Mexico's answer to question No. 1 of the Panel of 14 March 2003, paragraph 5.

<sup>603</sup> See the United States' first written submission, paragraph 211.

<sup>604</sup> See the United States' first written submission, paragraph 213.

<sup>605</sup> See the United States' first written submission, paragraph 214.

<sup>606</sup> See the United States' first written submission, paragraph 216.

4.321 **United States** submits that Section 5 of the Annex requires Mexico to ensure that for the supply of a service included in its Schedule, any service supplier of any other Member is accorded access to and use of public telecom transport networks and services on reasonable terms and conditions.<sup>607</sup>

4.322 The **United States** claims that 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"). In the United States' view, Mexico undertook these obligations on a cross-border basis, with few limitations, applying to the supply of cross-border public basic telecom services supplied by facilities-based operators and commercial agencies.<sup>608</sup>

4.323 The **United States** also claims that Mexico's Annex obligations apply to any service supplier from the United States (whether facilities-based or non-facilities-based) wishing to supply the scheduled basic telecom services.<sup>609</sup>

4.324 The **United States** submits that the Annex imposes a broad obligation upon Members to ensure - by whatever measures necessary<sup>610</sup> - that service suppliers have broad access to and use of public telecom networks and services to transport their services.<sup>611</sup> In the United States' view, interconnection, as defined by Section 2.1 of the Reference Paper<sup>612</sup>, is the principal method for suppliers from the United States to obtain access and use of Mexican public telecommunications networks and services for the cross-border supply of scheduled basic telecom services.<sup>613</sup>

4.325 The **United States** claims that Mexican law prohibits foreign suppliers from owning public telecom networks and services in Mexico<sup>614</sup>, preventing such suppliers of scheduled basic telecom services to originate and terminate services over their own networks. The United States submits that its suppliers have no choice but to rely on Mexican suppliers of public telecom networks and services - such as Telmex and others - to transport their service to its final destination.<sup>615</sup> According to the United States, this interconnection of its suppliers can take two principal forms: (1) a facilities-based supplier of the scheduled basic telecom services who links its network with that of a Mexican supplier<sup>616</sup>; or (2) a supplier who does not own facilities and interconnects by leasing circuits from other operators with Mexican public networks and services.<sup>617</sup>

4.326 **Mexico** contends that in its Schedule, for the subsector of "Telecommunications services supplied by a facilities based public telecommunications network through any existing technological medium ...", it specifically inscribed in the column "Limitations on Market Access" the following limitations on the modes of supply of (1) cross border-supply and (3) commercial presence:

"(1) None, except the following:

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<sup>607</sup> See the United States' first written submission, paragraph 218.

<sup>608</sup> See the United States' first written submission, paragraph 219.

<sup>609</sup> See the United States' first written submission, paragraph 220.

<sup>610</sup> The United States refers to Section 2(a), note 14 of the GATS Annex on Telecommunications. See the United States' first written submission, paragraph 222.

<sup>611</sup> See the United States' first written submission, paragraph 222.

<sup>612</sup> As regards the definition of the term "interconnection", see Section IV.A.2 of the United States' first written submission. See also the United States' first written submission, paragraph 224.

<sup>613</sup> See the United States' first written submission, paragraph 223.

<sup>614</sup> The United States refers to Mexico's Federal Telecommunications Law, art. 12, Exhibit US-16. See the United States' first written submission, paragraph 225.

<sup>615</sup> See the United States' first written submission, paragraph 225.

<sup>616</sup> See the United States' first written submission, paragraph 227.

<sup>617</sup> See the United States' first written submission, paragraph 228.

International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).

...

- (3) A concession from the SCT is required. Only enterprises established in conformity with Mexican law may obtain such a concession.

Footnote 1 – Concession: The granting of title to install, operate or use a facilities-based public telecommunications network.<sup>618</sup>

4.327 The **United States** submits that unlike the term "non-discriminatory", the Annex does not define "reasonable". In the United States view, 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>619</sup> According to the United States, the terms and conditions that Mexico has imposed are unreasonable under the object and purpose of the Annex and the GATS.<sup>620</sup>

4.328 **Mexico** contends that the term "reasonable" set out in Section 5(a) of the Annex does not have the same meaning as the term "reasonable" set out in Section 2.2 of the Reference Paper.<sup>621</sup> In Mexico's view, although the ordinary meaning is applicable to the term "reasonable" in both provisions, Section 5(a) of the Annex and Section 2.2(b) of Mexico's Reference Paper provide different contexts for interpreting its meaning.<sup>622</sup>

4.329 **Mexico** submits that in *US – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, the Appellate Body stated that "[i]n view of the identity of the language in the two provisions, and in the absence of any contrary indication in the context, we believe that it is appropriate to ascribe the *same* meaning to this phrase in both Articles 2.1 and 2.2".<sup>623</sup> In Mexico's view, where identical language is used in two provisions, it is only appropriate to ascribe the same meaning to the language where there is an "absence of any contrary indication in the context". Mexico contends that the different context of the term "reasonable" in the two provisions necessitates that a different meaning be ascribed to the term. According to Mexico, Section 5(a) of the Annex applies to "access to and use of public telecommunications transport networks" on terms and conditions that are *inter alia*, "reasonable", while Section 2.2(b) applies to interconnection with a major supplier on, *inter alia*, cost-oriented rates that are "reasonable". In its view, the two provisions address different subject matters. Mexico claims that these different contexts are important, particularly when interpreting the meaning of a word like "reasonable". Mexico further submits that reasonableness can be judged only within the context of all relevant facts and circumstances because it is those facts and circumstances that provide a basis for reason and expectation.<sup>624</sup> Mexico further points out that, in determining whether a service supplier of another Member is accorded "access to

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<sup>618</sup> See Mexico's first written submission, paragraph 233.

<sup>619</sup> The United States refers to the customary rules of treaty interpretation reflected in Article 31(1) of the Vienna Convention. See the United States' first written submission, paragraph 232.

<sup>620</sup> See the United States' first written submission, paragraph 232.

<sup>621</sup> See Mexico's answer to question No. 23 of the Panel meeting of 19 December 2002, paragraph 315 ("*Does the term 'reasonable', as set out in Section 5(a) of the Annex on Telecommunications, have the same meaning as in Section 2.2 of the Reference Paper?*").

<sup>622</sup> See Mexico's answer to question No. 23 of the Panel meeting of 19 December 2002, paragraph 316. For question No. 23, see footnote 621 of this Report.

<sup>623</sup> Mexico refers to paragraph 96 of the Appellate Body Report, *US – Wheat Gluten*. See Mexico's second written submission, paragraph 163.

<sup>624</sup> See Mexico's answer to question No. 23 of the Panel meeting of 19 December 2002, paragraph 318. For question No. 23, see footnote 621 of this Report.

and use of public telecommunications transport networks" on terms and conditions that are *inter alia*, "reasonable", the Panel must examine all relevant facts and circumstances related to access to and use of PTTN.<sup>625</sup>

(b) Claims under Section 5(b) of the Annex

4.330 The **United States** submits that 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.<sup>626</sup> The United States further submits that, to this end, Section 5(b) of the Annex requires Mexico to ensure that foreign suppliers can access and use private leased circuits offered within and across Mexico's border and interconnect those circuits with public networks and services.<sup>627</sup> Consequently, both facilities and non-facilities based suppliers of cross-border telecom services must have access to and use of private leased circuits. Further, established non-facilities based operators (commercial agencies) must likewise be afforded access to and use of private leased circuits under reasonable terms and conditions, to supply scheduled basic telecom services. In the United States' view, Mexico's measures preclude foreign suppliers from offering scheduled basic telecom services over private leased circuits; and are therefore violating the basic obligation to provide access to and use of private leased circuits for the provision of a scheduled service by Mexico.<sup>628</sup>

4.331 **Mexico** contends that under Mexican law, only companies established in Mexico and qualifying for a "concession" may "install, operate or use a facilities-based public telecommunications network". It contends that under Mexican law, suppliers of facilities-based telecommunications services from the United States are not permitted to provide facilities-based telecommunications services in Mexico. Mexico further submits that it made clear, by specifically inscribing limitations in its Schedule, that suppliers of facilities-based telecommunications services from the United States would not be permitted to supply basic telecommunications services cross-border.<sup>629</sup>

4.332 The **United States** submits that Section 5(b) contemplates both principal forms of interconnection, as follows:

"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 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."<sup>630</sup>

4.333 **Mexico** claims that there is no basis for the allegation from the United States that Mexico committed itself to cross-border access for facilities-based suppliers of basic telecommunications.<sup>631</sup> According to Mexico, the language of Section 5(b) explicitly demonstrates that WTO Members intended and expected that "access to and use of any public telecommunications transport network or service" was something that could be "offered" or not "offered", within or across the border of a particular Member. Mexico claims that it did not "offer" or commit itself to "access to or use of" a

<sup>625</sup> See Mexico's answer to question No. 23 of the Panel meeting of 19 December 2002, paragraph 319. For question No. 23, see footnote 621 of this Report.

<sup>626</sup> See the United States' first written submission, paragraph 247.

<sup>627</sup> Ibid.

<sup>628</sup> See the United States' first written submission, paragraph 248.

<sup>629</sup> See Mexico's first written submission, paragraph 234.

<sup>630</sup> The United States refers to Section 5(b) of the GATS Annex on Telecommunications. See the United States' first written submission, paragraph 229.

<sup>631</sup> See Mexico's first written submission, paragraph 240.

public telecommunications transport network or service either within Mexico or across its border. In Mexico's view, two provisions of a treaty - Sections 2(c)(i) and 5(b) - should not be interpreted in a manner which renders one of them ineffective or inutile.<sup>632</sup>

4.334 According to the **United States**, Section 5(b) specifically guarantees that foreign service suppliers may obtain access to and use of Mexican public telecom networks and services through interconnection of private leased or owned circuits.<sup>633</sup> The United States maintain that, in both cases, its 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. In the United States' view, Mexico must therefore ensure – under Section 5 of the Annex – that suppliers of scheduled basic telecom services from the United States may interconnect with Mexican suppliers on reasonable terms and conditions.<sup>634</sup>

4.335 In **Mexico's** view, Section 2(c)(i) of the Annex exempts Mexico from allowing non-facilities-based suppliers of basic telecommunications services to supply their services cross-border over capacity that they lease from operators in Mexico. Mexico claims that to interpret the Annex otherwise would not only be inconsistent with the provisions of Section 2(c)(i) of the Annex, but would also undermine and render ineffective the express language of the limitations on Market Access inscribed in Mexico's GATS Schedule.<sup>635</sup>

4.336 According to the **United States**, private leased circuits are essentially lines that a user leases from a public telecom operator over which it transports (or supplies) its service. As an example, the United States explains that 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, or 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 the United States' view, in both cases 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).<sup>636</sup> It claims that Mexico has not ensured that suppliers from the United States 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<sup>637</sup>, failing to honour its commitments under the Annex.<sup>638</sup>

4.337 **Mexico** submits that, even if the Annex were to apply to this dispute, the terms and conditions that Mexico applies on access to and use of PTTNS would have to be considered reasonable. According to Mexico, the Annex allows WTO Members great latitude to regulate access to and use of PTTNS. In Mexico's view the word "reasonable" in Section 5(b) would have to be interpreted broadly to include all relevant facts and circumstances related to interconnection, including the economic feasibility of the terms of access to the Mexican carrier and Mexico.<sup>639</sup>

4.338 According to the **United States**, Section 5(b) of the Annex requires Mexico to ensure that service suppliers of any other Member. "*(ii) interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another*

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<sup>632</sup> See Mexico's first written submission, paragraph 239.

<sup>633</sup> See the United States' first written submission, paragraph 230.

<sup>634</sup> See the United States' first written submission, paragraph 231.

<sup>635</sup> See Mexico's first written submission, paragraph 242.

<sup>636</sup> See the United States' first written submission, paragraph 213.

<sup>637</sup> See the United States' first written submission, paragraph 214.

<sup>638</sup> See the United States' first written submission, paragraph 215.

<sup>639</sup> See Mexico's answer to question No. 25 of the Panel meeting on 19 December 2002, paragraph 322 ("*If the Annex were to apply to the services in question, would Mexico consider that the 'terms and conditions' it applies on access to and use of Public Telecommunications Transport Networks and Services (PTTNS) are 'reasonable'?*").

*supplier*". In the United States view, because the obligation in Section 5(a) of the Annex apply to paragraph (b), 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. The United States further points out that in this case, the analysis need not to 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>640</sup>, acting inconsistently with its obligations under Section 5(a) and (b) of the Annex.<sup>641</sup>

4.339 The **United States** claims that 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. The United States submits that, to avoid any confusion, the claims it makes related to private leased circuits address the delivery of scheduled public basic telecom service using private leased circuits.<sup>642</sup>

4.340 The **United States** contends that 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.<sup>643</sup> The United States recalls that according to Mexico's Schedule, commercial agencies do not supply basic telecom services over their owned facilities but over capacity they lease from a licensed facilities-based telecom operator.<sup>644</sup> The United States points out that the supply of telecommunications over leased capacity is typically known as "resale", but Mexico's Schedule uses the phrase "commercial agencies".<sup>645</sup> The United States recalls that "leased capacity" is essential to the supply of this scheduled service, because without access to such capacity, a commercial agency cannot, according to Mexico's definition, supply its service. The United States submits that 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>646</sup>

4.341 The **United States** submits that 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). According to the United States, Mexico limited this mode 1 commitment to ensure that foreign commercial agencies route international traffic through the facilities of a "concessionaire". The United States claims that 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 United States points out that the cross-border supply of a basic telecom service over leased capacity is typically known as International Simple Resale (ISR).<sup>647</sup>

4.342 The **United States** recalls that Mexico also undertook commitments for locally-established (mode 3) commercial agencies, with certain limitations. The United States points out that a foreign service supplier should be able to own 100 per cent of a locally established commercial agency, because Mexico did not schedule a foreign ownership limitation for such services. The United States

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<sup>640</sup> See the United States' first written submission, paragraph 249.

<sup>641</sup> See the United States' first written submission, paragraph 250.

<sup>642</sup> See the United States' first written submission, paragraph 251.

<sup>643</sup> See the United States' first written submission, paragraph 254.

<sup>644</sup> The United States refers to Mexico's Schedule, GATS/SC/56/Suppl.2., note 2. See the United States' first written submission, paragraph 252.

<sup>645</sup> See the United States' first written submission, paragraph 252.

<sup>646</sup> See the United States' first written submission, paragraph 253.

<sup>647</sup> See the United States' first written submission, paragraph 255.

argues that, 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>648</sup>

4.343 The **United States** contends that Mexico undertook mode 1 and mode 3 commitments for services, which require access to and use of private leased circuits for their supply. The United States claims that its suppliers cannot supply basic telecom services over leased capacity on a cross-border basis if they cannot lease private leased circuits from a Mexican supplier. The United States further points out that its suppliers can not establish a commercial presence to supply international basic telecom services over leased capacity if they cannot lease private leased circuits from a Mexican supplier. The United States recalls that Mexico does not permit its 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.<sup>649</sup>

4.344 **Mexico** submits that with respect to access through commercial presence for non-facilities based suppliers, the United States argues that Mexico committed to the establishment of commercial agencies and to the provisions of services by such agencies through private leased circuits, i.e. ISR.<sup>650</sup> Mexico claims that its mode 3 (commercial presence) commitment for commercial agencies is subject to the following limitations:

"A permit issued by the SCT is required. Only enterprises set up in accordance with Mexican law may obtain such permit.

Foreign governments may not participate in an enterprise set up in accordance with Mexican law nor obtain any authorization to provide telecommunication services.

Except where specifically approved by the SCT, public telecommunications network concessionaires may not participate, directly or indirectly, in the capital of a commercial agency.

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."<sup>651</sup>

4.345 **Mexico** submits that the permit requirement is central to the limitation. According to Mexico, because at the time the limitation was inscribed, permits were not issued by the SCT, then it is equivalent to a zero quota, falling the requirement within the category of "limitations on the number of service suppliers" in paragraph (a) of GATS Article XVI:2.<sup>652</sup>

4.346 Answering a Panel's question<sup>653</sup>, the **United States** contends that Mexico's refusal to adopt regulations necessary to issue commercial agency permits violates Mexico's obligation under Section 5(b) of the Annex on Telecommunications to ensure that service suppliers have access to and

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<sup>648</sup> See the United States' first written submission, paragraph 256.

<sup>649</sup> See the United States' first written submission, paragraph 257.

<sup>650</sup> Mexico refers to paragraphs 252-257 and 265-294 of the United States' first written submission. See Mexico's first written submission, paragraph 243.

<sup>651</sup> See Mexico's first written submission, paragraph 244.

<sup>652</sup> See Mexico's answer to question No. 6(a) of the Panel of 19 Dec 2002, paragraph 90. For question No. 6(a), see footnote 282 of this Report. For more information regarding the discussion on the scope of Mexico's commitments, see Section IV.A.3 of this Report.

<sup>653</sup> Namely, question No. 6(c) of the Panel of 19 December 2002 ("*Mexico has inscribed in its Schedule that it will not issue permits for the establishment of a commercial agency until the corresponding regulations are issued'. Does Mexico Mode 3 commitment regarding commercial agencies include an obligation, at present, to issue permits for the establishment and operation of such agencies?*").

use of private leased circuits.<sup>654</sup> The United States further submits that Telmex, through its subsidiary in the United States, assured the FCC that Mexico's WTO commitments requires Mexico "promptly" to adopt the relevant regulations and issue reseller permits.<sup>655</sup>

4.347 The **United States** submits that Mexico also undertook cross-border market access and national treatment commitments for specific public basic telecom services supplied by a facilities-based operator. According to the United States, Mexico limited this commitment to ensure that foreign service suppliers route international traffic through the facilities of a Mexican concessionaire. The United States contends that, 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 suppliers of these services provided that the service supplier, from the United States, routes international traffic through the facilities of a Mexican concessionaire.<sup>656</sup>

4.348 According to the **United States**, 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). The United States claims that Mexico has failed to ensure that private leased circuits are available for the supply of these scheduled services.<sup>657</sup>

4.349 The **United States** submits that Mexico committed under Section 5(a) and (b) to ensure that foreign facilities-based suppliers, foreign commercial agencies and locally established commercial agencies 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. The United States contends that because Mexican suppliers offer private leased circuits to their customers, then Mexico must ensure that these circuits are available to all suppliers of scheduled basic telecom services.<sup>658</sup> The United States claims that foreign suppliers do not have access to and use of private leased circuits to supply scheduled basic telecom services. The United States further submits that 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. According to the United States, these restrictions prevent foreign service suppliers from accessing and using private leased circuits to supply scheduled basic telecom services.<sup>659</sup>

4.350 The **United States** submits that its suppliers based in the United States have no access to private leased circuits for the supply of scheduled basic telecom services and even if they did, Mexican ILD Rules prevent foreign suppliers from interconnecting private leased circuits with public telecom network services, violating the obligation to provide access to and use of private leased circuits.<sup>660</sup> It claims that Telmex has refused to make private leased circuits available for the cross-

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<sup>654</sup> See the United States' answer to question No. 6(c) of the Panel of 19 Dec 2002, paragraph 32. For question No. 6(c), see footnote 653 of this Report.

<sup>655</sup> The United States refers to the Consolidated Opposition of Telmex/Sprint Communications, L.L.C. to Applications for Review, page 7, Exhibit US-54. See the United States' answer to question No. 6(c) of the Panel of 19 Dec 2002, paragraph 34. For question No. 6(c), see footnote 653 of this Report.

<sup>656</sup> See the United States' first written submission, paragraph 258.

<sup>657</sup> See the United States' first written submission, paragraph 261.

<sup>658</sup> See the United States' first written submission, paragraph 266.

<sup>659</sup> See the United States' first written submission, paragraph 267.

<sup>660</sup> See the United States' first written submission, paragraph 268.

border supply of scheduled voice telephone services<sup>661</sup>, and that Mexican authorities have done nothing to ensure that Telmex or any other supplier provides these leased circuits to suppliers from the United States for the cross-border supply of scheduled basic telecom services.<sup>662</sup>

4.351 The **United States** contends that 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.<sup>663</sup> The United States recalls that under Mexico's ILD Rule 3<sup>664</sup>, 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.<sup>665</sup> The United States submits that 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, but Mexican ILD Rules require an international port operator to be a supplier with a concession to supply long-distance services and Mexican law prohibits non-Mexican entities from holding such a concession, since Mexico inscribed this nationality restriction for concessionaires in its Schedule.<sup>666</sup>

4.352 The **United States** contends that the interconnection of a private circuit leased in Mexico with the public telecom network in the United States is essential to the cross-border provision of public basic telecom services over private leased circuits, which is a commitment included in Mexico's Schedule. Because a non facilities-based service supplier cannot be a long-distance concessionaire, it cannot interconnect a private circuit leased in Mexico with the public telecom network in the United States, as it is unable to supply the scheduled public telecom service.<sup>667</sup>

4.353 The **United States** submits that Mexico undertook cross-border commitments for "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. According to the United States, by Mexico's definition, 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. The United States claims that without such circuits, foreign suppliers cannot provide cross-border telecom services as commercial agencies.<sup>668</sup> The United States recalls that 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. In the United States' view, Mexico has failed to comply with these commitments, prohibiting foreign service suppliers from offering this "resale" service that it scheduled. The United States further points out that 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.<sup>669</sup>

4.354 The **United States** submits that the policy of the Mexican Government – since undertaking commitments for commercial agencies – 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

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<sup>661</sup> See the United States' first written submission, paragraph 269.

<sup>662</sup> See the United States' first written submission, paragraph 272.

<sup>663</sup> See the United States' first written submission, paragraph 274.

<sup>664</sup> See the United States' first written submission, paragraph 275.

<sup>665</sup> See the United States' first written submission, paragraph 274.

<sup>666</sup> See the United States' first written submission, paragraph 275.

<sup>667</sup> See the United States' first written submission, paragraph 276.

<sup>668</sup> See the United States' first written submission, paragraph 278.

<sup>669</sup> See the United States' first written submission, paragraph 279.

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".<sup>670</sup> The United States claims that, in other words, although 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 Sacristán affirmed that Government of Mexico had no intention of allowing telecom operators to do so.<sup>671</sup> The United States further submits that Secretary Ruiz Sacristán reaffirmed this position in a 8 May 1998 letter to then-USTR Charlene Barshefsky. According to the United States, Ambassador Barshefsky wrote to both Secretary Ruiz Sacristán and Secretary Herminio Blanco Mendoza (then-Secretary of Commerce and Industrial Development) on 4 April 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 international resale of telecommunications services (including international simple resale)".<sup>672</sup> The United States recalls that Secretary Ruiz Sacristán responded that Mexico's WTO commitments did not include these services.<sup>673</sup>

4.355 The **United States** contends that, by expressing his Government's refusal to permit the domestic and international resale of telecommunication services, Secretary Ruiz Sacristán acknowledged Mexico's failure to honour its scheduled commitment to allow "commercial agencies" to supply cross-border telecommunications services to third parties over leased capacity (i.e., private leased circuits).<sup>674</sup>

4.356 According to the **United States**, Mexico undertook a mode 3 commitment for commercial agencies promising to permit foreign suppliers to acquire a 100 per cent interest in a local non-facilities-based supplier and offer international telecommunications services to third parties over capacity leased from a Mexican concessionaire. The United States points out that 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.<sup>675</sup> The United States further submits that Sections 5(b) of the Annex obliges Mexico to ensure that foreign service suppliers: (1) have access to and use of the private leased circuits they need to supply this scheduled resale service; and (2) can interconnect such circuits with public telecom networks and services. The United States claims that Mexico has failed to comply with these obligations by not permitting non-facilities-based service suppliers (commercial agencies) to establish locally and supply international telecom services from Mexico over private leased circuits. The United States further points out that ILD Rule 3 prevents all commercial agencies from interconnecting private leased circuits with foreign telecom networks, preventing Mexico from complying with its commitments under the Annex.<sup>676</sup>

4.357 The **United States** submits that to its knowledge, Mexico does not permit foreign non-facilities-based suppliers to establish locally and supply third parties international telecommunications services over private leased circuits.<sup>677</sup> The United States recognizes that Mexico conditioned the mode 3 supply of "commercial agencies" on the issuance of the relevance regulations, but claims that 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. According to

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<sup>670</sup> The United States refers to the letter from Secretary Carlos Ruiz Sacristán to Chairman Hundt, 22 October 1997, Exhibit US-46. See the United States' first written submission, paragraph 281.

<sup>671</sup> See the United States' first written submission, paragraph 281.

<sup>672</sup> The United States refers to the Letter from Ambassador Charlene Barshefsky to Secretary Carlos Ruiz Sacristán, 4 April 1998, Exhibit US-47. See the United States' first written submission, paragraph 282.

<sup>673</sup> The United States refers to the Letter from Secretary Carlos Ruiz Sacristán to Ambassador Charlene Barshefsky, 8 May 1998, Exhibit US-48. See the United States' first written submission, paragraph 282.

<sup>674</sup> See the United States' first written submission, paragraph 283.

<sup>675</sup> See the United States' first written submission, paragraph 291.

<sup>676</sup> See the United States' first written submission, paragraph 292.

<sup>677</sup> See the United States' first written submission, paragraph 293.

the United States, the refusal to issue such regulations raises questions about whether Mexico ever intends to implement this scheduled mode 3 commitment for commercial agencies.<sup>678</sup>

4.358 **Mexico** replies that there is nothing in the wording of the limitations that indicates that Mexico has made a commitment to issue the corresponding regulation within a certain time-frame. According to Mexico, the issuance of the regulation is at the discretion of the Mexican authorities taking into account the transition occurring in the Mexican telecommunications market. Mexico claims that the fact that the regulation has not yet been issued does not nullify the limitation.<sup>679</sup> Furthermore, Mexico has issued regulations for the establishment and operation of commercial agencies for pay-telephone public services. Based on those regulations, Mexico has granted 59 permits for public pay phone commercial agencies. 35 of those agencies have begun operations and five of them have foreign capital.<sup>680</sup>

4.359 The **United States** submits that it is not inconsistent with the obligation under Section 5(b) of the Annex to require that cross-border service suppliers route traffic through the facilities of a Mexican concessionaire. According to the United States, the routing requirement is one way in which a member may satisfy the obligation in Section 5(b). In its view, the routing requirement included in Mexico's Schedule, interpreted according to the rules of interpretation in the *Vienna Convention*, permit service suppliers from the United States to provide basic telecommunications services into Mexico over capacity leased from a Mexican concessionaire.<sup>681</sup>

4.360 In response to question No. 27 of the Panel on 19 December 2002, **Mexico** submits that Section 5(b) relates to "access to and use of" private leased circuits and the interconnection of those circuits with the PTTNS or with other leased circuits. Mexico notes that, in the context of the claims being raised by the United States, this provision does not entitle service suppliers of any other Member to supply public telecommunications services over private leased circuits. In Mexico's view, Section 5(b) does not entitle service suppliers of the United States to offer ISR into Mexico. According to Mexico, this interpretation is confirmed by Section 2(c)(i) which: (i) refers to Schedule limitations; and (ii) which refers to available services and networks. Mexico submits that its Schedule, which includes the routing restriction, denies any market access for service suppliers from the United States to provide ISR into Mexico.<sup>682</sup> In the same line, Mexico submits that ISR services are prohibited under Mexican law as manifested in its Schedule. Therefore, ISR was "not offered to the public generally" within the meaning of Section 2(c)(i) of the Annex.<sup>683</sup>

### 3. Application of Sections 5(e), 5(f) and 5(g) of the Annex

4.361 **Mexico** contends that, even if the Annex were to apply to this dispute, the United States has failed to present a prima facie case under Section 5 of the Annex, because it has not attempted to establish the requisite elements for a challenge under that provision.<sup>684</sup> Mexico submits that although the United States acknowledges that the obligation in Section 5(a) must be applied through paragraphs

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<sup>678</sup> See the United States' first written submission, paragraph 294.

<sup>679</sup> See Mexico's first written submission, paragraph 245.

<sup>680</sup> See Mexico's answer to question No. 6(d) of the Panel of 19 December 1992, paragraphs 111-113. For question No. 6(d), see footnote 21 of this Report.

<sup>681</sup> See the United States' answer to question No. 27 of the Panel of 19 December 2002, paragraph 111 ("*How does the routing requirement under mode 1 relate to the obligation in Section 5(b) to ensure access to and use of leased circuits?*").

<sup>682</sup> See Mexico's answer to question No. 27 of the Panel of 19 December 2002, paragraph 329. For question No. 27, see footnote 681 of this Report.

<sup>683</sup> See Mexico's answer to question No. 27 of the Panel of 19 December 2002, paragraph 326-331. For question No. 27, see footnote 681 of this Report.

<sup>684</sup> See Mexico's first written submission, paragraph 247.

5(b) through 5(f)<sup>685</sup>, it interprets Sections 5(a) and 5(b) in isolation. Mexico claims that one cannot demonstrate a violation of Section 5 without adducing evidence sufficient to raise a presumption that the measures at issue are inconsistent with paragraphs (e) and (f) of Section 5, as follows:

- "(e) Each Member shall ensure that no condition is imposed on access to and use of public telecommunications transport networks and services other than as necessary:
- (i) to safeguard the public service responsibilities of the suppliers of public telecommunications transport networks and services, in particular their ability to make their networks or services available to the public generally;
  - (ii) to protect the technical integrity of public telecommunications transport networks or services; or
  - (iii) to ensure that services suppliers of any other Member do not supply services unless permitted pursuant to commitments in the Member's Schedule.
- ...
- (f) Provided that they satisfy the criteria set out in paragraph (e), conditions for access to and use of public telecommunications transport networks and services may include:
- (i) restrictions on resale or shared use of such services;
  - (ii) a requirement to use specified technical interfaces, including interface protocols, for inter-connection with such networks and services;
  - (iii) requirements, where necessary, for the inter-operability of such services and to encourage the achievement of the goals set out in paragraph 7(a);
  - (iv) type approval of terminal or other equipment with interfaces with the network and technical requirements relating to the attachment of such equipment to such networks;
  - (v) restrictions on inter-connection of private leased or owned circuits with such networks or services or with circuits leased or owned by another service supplier; or
  - (vi) notification, registration and licensing."<sup>686</sup>

4.362 **Mexico** submits that since the general obligation in Section 5(a) is required to be applied through paragraphs (e) and (f), the United States cannot establish a violation of paragraphs (a) and (b) of Section 5 without also demonstrating that Mexico's measures are not permitted by paragraphs (e) and (f). According to Mexico, these paragraphs are part of the same provision and must be read

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<sup>685</sup> Mexico refers to paragraph 249 of the United States' first written submission. See Mexico's first written submission, paragraph 250.

<sup>686</sup> See Mexico's first written submission, paragraph 251.

together to determine the meaning of a Member's obligation under Section 5.<sup>687</sup> Mexico contends that in *EC – Hormones*<sup>688</sup>, the Appellate Body found that a general rule-exception relationship between Articles 3.1 and 3.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* did not exist, bringing to the complainant the burden of proof to establish a case of inconsistency with both Articles 3.1 and 3.3. In Mexico's view, since there is no general rule-exception relationship between Section 5(a) and 5(b) of the Annex, the United States, as complaining party, has the burden of establishing a case of inconsistency with all four provisions.<sup>689</sup> Mexico claims that even if the obligations in Section 5(a) and (b) of the Annex were found to apply to the measures at issue, those measures are consistent with Mexico's rights and obligations under paragraph (e), (f) and (g) of Section 5 of the Annex.<sup>690</sup> Mexico further submits that its restrictions on access to and use of public telecommunication transport networks and services are no more than necessary to ensure that foreign suppliers of facilities-based and non-facilities-based telecommunications transport services do not illegally bypass the accounting rate regime contrary to the clear intention of the limitations on market access set forth in Mexico's Schedule. Mexico recalls the definition of "necessary" as interpreted by the Appellate Body in the context of paragraph (d) of Article XX of the GATT 1994.<sup>691</sup>

4.363 The **United States** contends that it does not consider Sections 5(e) and 5(f) necessary to establish a claim under Section 5(a) and 5(b) of the Annex and considers that Mexico's conditions on access and use are not justified by Section 5(e) and 5(f). As an example, the United States refers to Mexico's argument that its restriction on resale are consistent with Section 5(e) as necessary to enforce the limitations on market access inscribed in its Schedule<sup>692</sup>, which, according to the United States is not accurate, since Mexico's Schedule authorizes cross-border suppliers to provide basic telecommunications services, subject only to the limitation that they route traffic through the facilities of a concessionaire.<sup>693</sup>

4.364 According to the **United States**, Sections 5(e) and 5(f) are not elements of a *prima facie* claim under Sections 5(a) or (b) of the Annex. It disagrees with the analogy to Articles 3.1 and 3.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures*. In the United States' view, the Mexican assertion that "there is no general rule-exception relationship" between Sections 5(a)-(b) and 5(e)-(f) of the Annex<sup>694</sup>, has no support. The United States points out that, like Section 5(f), Article XX of the GATT includes a list of measures that may fall within the scope of the provision (Articles XX(a)-(j)). It further points out that like Section 5(e), Article XX(d) requires that to fall within the scope of the provision, a measure must be deemed "necessary" to achieve a particular goal. The United States claims that, in the context of Article XX(d), the Appellate Body has expressly found that the burden of satisfying the "necessity" test falls on the Member invoking the provision.<sup>695</sup>

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<sup>687</sup> See Mexico's first written submission, paragraph 253.

<sup>688</sup> Mexico refers to paragraph 104 of the Appellate Body Report, *EC – Hormones*. See Mexico's first written submission, paragraph 256.

<sup>689</sup> See Mexico's first written submission, paragraph 256.

<sup>690</sup> See Mexico's first written submission, paragraph 258.

<sup>691</sup> Mexico refers to paragraph 161 of the Appellate Body Report, *Korea – Various Measures on Beef*. See Mexico's first written submission, paragraphs 261-262. For a detailed discussion of the routing requirement in Mexico's specific commitments, see Section IV.A.3(c)(ii) of this Report.

<sup>692</sup> The United States refers to Mexico's first written submission, paragraph 264. See the United States' first oral statement, paragraph 49.

<sup>693</sup> See the United States' first oral statement, paragraph 49.

<sup>694</sup> The United States refers to paragraph 256 of Mexico's first written submission. See the United States' answer to question No. 26 of the Panel of 19 Dec 2002, paragraph 109 ("Is it necessary to consider Section 5 (e) and (f) to establish a claim under Section 5 (a) and (b)? Please explain").

<sup>695</sup> The United States refers to paragraph 157 of the Appellate Body Report, *Korea – Various Measures on Beef*. See the United States' answer to question No. 26 of the Panel of 19 December 2002, paragraph 109. For question No. 26, see footnote 694 of this Report.

4.365 **Mexico** submits that the obligations in Section 5(a) and 5(b) are qualified in an important manner by Section 5(e) and 5(f), constraining the rights of users under Section 5(a) and (b). According to Mexico, it is incorrect to argue that it has to provide unconditional access to and use of Mexico's PTTNS and to allow the use, and interconnection with the public networks, of private leased lines facilities-based and non-facilities-based suppliers from the United States. It further submits that paragraphs 5(e) and 5(f) are not of the nature of exceptions or affirmative defences, but key substantive provisions that define the rights of regulators to restrict the access to and use of public telecommunications transport networks and services. In Mexico's view, the United States has the burden of establishing that the terms and conditions on access and use maintained by Mexico exceed or go beyond Mexico's rights as a regulator.<sup>696</sup>

4.366 The **United States** submits that in any event, while Mexico may have imposed conditions on access to and use of public telecommunications transport networks and services that fall within the meaning of Section 5(f), those conditions are "other than as necessary" to satisfy the criteria in Sections 5(e)(i)-(iii). According to the United States, since the conditions do not "satisfy the criteria set out in Section 5(e)", Mexico is not permitted to maintain those conditions, pursuant to Section 5(f).<sup>697</sup>

4.367 According to the **United States**, three conditions are inconsistent with Sections 5(a) or 5(b) of the Annex and not necessary to achieve the goals listed in Section 5(e)(i)-(iii); first, under ILD Rule 13, Mexico conditions United States suppliers' access to and use of public telecommunications networks and services on negotiating exclusively with Telmex<sup>698</sup>; second, the refusal to make private leased circuits available to United States facilities-based suppliers, United States non-facilities-based suppliers ("commercial agencies") and locally-established commercial agencies for the supply of scheduled voice telephone services<sup>699</sup>; and third, to limit the authority to interconnect private leased circuits to international port operators. The United States claims that even if United States facilities-based suppliers, United States non-facilities-based suppliers ("commercial agencies") and locally-established commercial agencies were granted access to and use of private leased circuits from Mexican suppliers, ILD Rule 3 prohibits them from interconnecting those leased circuits with foreign public networks and services. The United States recalls that Rule 3 limits the authority to interconnect private leased circuits to an international port operator, which must be a Mexican entity.<sup>700</sup> In the United States' view, each of these three conditions is "other than as necessary" to satisfy the criteria of Section 5(e)(i)-(iii). The United States considers that the Panel does not need to define precisely what degree of "necessity" is required here.<sup>701</sup>

4.368 **Mexico** contends that even if the obligations in Sections 5(a) and (b) of the Annex were found to apply to the measures at issue, those measures are consistent with Mexico's rights and obligations under paragraph (g) of Section 5.<sup>702</sup>

4.369 The conditions or restrictions applied by Mexico on access to or use of public telecommunications networks and services by foreign suppliers of facilities-based and non-facilities-based basic telecommunications are "necessary" to enforcing the limitations on market access specifically inscribed in Mexico's Schedule. Mexico's ban of ISR is consistent with Mexico's level of development and "place[s] reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications

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<sup>696</sup> See Mexico's answer to question No. 26 of the Panel of 19 December 2002, paragraph 322. For question No. 26, see footnote 694 of this Report.

<sup>697</sup> See the United States' second written submission, paragraph 109.

<sup>698</sup> See the United States' second written submission, paragraph 110.

<sup>699</sup> See the United States' second written submission, paragraph 111.

<sup>700</sup> See the United States' second written submission, paragraph 112.

<sup>701</sup> See the United States' second written submission, paragraph 113.

<sup>702</sup> See Mexico's first written submission, paragraph 258.

infrastructure and service capability and to increase its participation in international trade telecommunications services" within the meaning of paragraph (g) of Section 5 of the Annex. These measures are integral conditions to the limitations specified in Mexico's Schedule.<sup>703</sup>

4.370 The **United States** contends that Section 5(g) explicitly requires that any conditions restricting access to and use of private leased circuits, as in Mexico, "shall be specified in the Member's Schedule." However, Mexico specified no such condition prohibiting the use of private lines in its Schedule. Mexico's inclusion of a routing restriction under mode 1 does not provide a basis for Mexico to prohibit the use of private leased circuits. As long as the circuit is leased from a concessionaire, it is consistent with the requirement to route international traffic through the facilities of a concessionaire. For this reason alone, Mexico cannot rely on Section 5(g). Even if Mexico had included such a condition in its Schedule, there is no basis to conclude that the prohibition on the use of private leased circuits in Mexico otherwise satisfies the criteria of Section 5(g). Mexico's assertion that this restriction is "necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services" is unsupported, and cannot substitute for evidence and cannot form the basis for the factual findings that would be necessary to justify Mexico's invocation of this subparagraph.<sup>704</sup>

## V. ARGUMENTS OF THE THIRD PARTIES

5.1 From the third parties in these proceedings, i.e. Australia, Brazil, Canada, Cuba, the European Communities, Guatemala, Honduras, India, Japan and Nicaragua, only Australia, Brazil, the European Communities and Japan filed their comments within the deadline and presented Oral Statements during the third party session.

### A. AUSTRALIA

#### 1. Informal Understanding on Accounting Rates

5.2 Australia recalls that this dispute raises the issue of the informal Understanding on Accounting Rates (informal Understanding) which has been in place since the 1996 Negotiations on Basic Telecommunications, and is reflected in the Report of the Group on Basic Telecommunications of 15 February 1997.<sup>705</sup>

5.3 In Australia's view, as the informal Understanding was never affirmed by the Council for Trade in Services or the General Council, and so did not become a formal Understanding, it therefore does not present a legal barrier to disputes being taken by WTO Members in respect of the application of accounting rates.<sup>706</sup>

5.4 Furthermore, Australia contends that even if the moratorium did at any time present a legal barrier to such disputes, then that legal barrier no longer exists as it expired on 1 January 2000, in accordance with the clear intention of the WTO Members as reflected in the informal Understanding.<sup>707</sup>

#### 2. Scope of "interconnection" in Section 2 of the Reference Paper

5.5 Australia submits that this dispute raises the issue of the scope of the term "interconnection" as used in section 2 of the Reference Paper.<sup>708</sup> Australia recalls that the scope of "interconnection"

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<sup>703</sup> See Mexico's first written submission, paragraphs 264-265.

<sup>704</sup> See United States' second submission, paragraphs 124-125.

<sup>705</sup> See Australia's third party submission, paragraph 3.

<sup>706</sup> See Australia's third party submission, paragraph 4.

<sup>707</sup> See Australia's third party submission, paragraph 5.

<sup>708</sup> See Australia's third party submission, paragraph 6.

has important implications for the application of the obligations in the mentioned section of the Reference Paper.<sup>709</sup>

5.6 In view of the above, Australia contends that the issue at stake is whether the term "interconnection" should be understood as applying only to interconnection within the borders of a Member that has inscribed the Reference Paper in its Schedule of Commitments (in-country interconnection), or whether it also applies to the interconnection of public telecommunications networks within such a Member's borders with telecommunications networks external to that Member's borders (international interconnection)<sup>710</sup>; and whether "interconnection" as used in section 2 of the Reference Paper covers accounting rates.<sup>711</sup>

5.7 Australia states that, as the Reference Paper does not explicitly restrict interconnection to in-country interconnection then, in principle,<sup>712</sup> the Reference Paper obligations relating to interconnection apply to international interconnection.

### **3. Interconnection and accounting rates**

5.8 Australia notes that in its view, "accounting rates" are specific sets of arrangements for the pricing of a subset of interconnection arrangements. Australia considers that, as the Reference Paper applies to international interconnection, these pricing arrangements must be consistent with the Reference Paper obligations with respect to interconnection.<sup>713</sup>

5.9 Australia notes that underpinning the informal Understanding on Accounting Rates is the assumption of Members that interconnection obligations under the Reference Paper would apply to international interconnection and, in the absence of the Understanding, give rise to disputes.<sup>714</sup>

### **4. Meaning of "cost-oriented" rates in section 2.2(b) of the Reference Paper**

5.10 Australia considers that the Reference Paper provides a framework for the competitive supply of telecommunications services in markets where there is a major supplier that can affect the terms of participation through control over essential facilities or by use of its market position.<sup>715</sup>

5.11 In Australia's view, a main concern is to develop greater clarity concerning, and acceptance of, interconnection obligations, and particularly in relation to the requirement stated in paragraph 2.2 of the Reference Paper.<sup>716</sup>

5.12 Australia further points out that the Reference Paper does not elaborate on what is meant by "cost-oriented rates". Australia submits that any interpretation of "cost-oriented rates" should be consistent with these criteria of transparency, reasonableness, economic feasibility and unbundled elements. Australia submits that the Panel must form a view of the meaning of "cost-oriented rates" that is consistent with these criteria so that the Reference Paper promotes telecommunications competition (and through that, trade in telecommunications services). Australia's view is that an interpretation of "cost-oriented rates" that is too broad would undermine the effect of the Reference Paper as a whole, and is clearly contrary to its intent.<sup>717</sup>

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<sup>709</sup> See Australia's third party submission, paragraph 7.

<sup>710</sup> See Australia's third party submission, paragraph 6.a.

<sup>711</sup> See Australia's third party submission, paragraph 6.b.

<sup>712</sup> See Australia's third party submission, paragraph 8.

<sup>713</sup> See Australia's third party submission, paragraph 9.

<sup>714</sup> See Australia's third party submission, paragraph 10.

<sup>715</sup> See Australia's third party submission, paragraph 11.

<sup>716</sup> See Australia's third party submission, paragraph 12.

<sup>717</sup> See Australia's third party submission, paragraph 13.

5.13 According to Australia, recommendations of the ITU provide some guidance on relevant cost components in the development of cost-based rates. In addition, Australia submits that the Panel should, in its interpretation of "cost-oriented rates", consider the application of dynamic costing models for interconnection in GATS Member countries that are encouraging the competitive supply of telecommunications networks and services.<sup>718</sup>

## B. BRAZIL

### 1. Introduction

5.14 According to Brazil, to analyse this dispute the Panel should take into account the scope and reach of the specific commitments of market access and national treatment undertaken by Mexico. Brazil considers that, for that purpose, the Panel should analyse Mexico's commitments in light of the national treatment discipline of the GATS as set out in its Article XVII and as qualified by footnote 15 of the GATS. Brazil submits that in conducting this analysis the Panel should take into account the applicability of the national treatment discipline in relation to the four modes of supply of services, as defined in GATS Article I:2(a) to (d), particularly as regards "mode 1".<sup>719 720</sup>

5.15 Brazil states that the Panel should consider whether the national treatment discipline applies individually to each mode of supply or whether it applies across all modes noting that, for the purposes of the application of the GATS Annex on Basic Telecommunications, the disciplines of "non-discrimination" contained in Article II (Most-Favoured Nation) and Article XVII (National Treatment) of the Agreement are qualified by the concept of "like circumstances", as set out in footnote 15 of the GATS.<sup>721</sup>

5.16 Brazil submits that it can be inferred from Article XVII.1 and footnote 15 that the meaning and the scope of the national treatment obligation lies in the definition of likeness. Brazil considers that this determination can only be made in relation to each mode of supply and not "across modes". Under Brazil's view, the scope of the national treatment obligation is given much more legal certainty by the interpretation that it applies for and within each mode of supply individually, with likeness being defined on the basis of the concept of "like circumstances".<sup>722</sup>

5.17 According to Brazil it seems inconsistent to compare with the same common reference different categories of service suppliers and the services they supply, because in that thinking a full National Treatment in mode 3 would be necessary to grant full national treatment in modes 1, 2 and 4, since they would be "like" services suppliers.<sup>723</sup>

### 2. Scope and reach of specific commitments

5.18 Brazil submits that, in the first column of its Schedule of Specific Commitments, Mexico, confined the definition of "Telecommunication Services" to those services "supplied by a facilities-based public telecommunications network (wire-based and radioelectric) through any existing technological medium". Accordingly, Brazil states that one could conclude that Mexico has not

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<sup>718</sup> See Australia's third party submission, paragraph 14 where it refers to the recognition of the role of the ITU by the GATS Annex on Telecommunications.

<sup>719</sup> See Brazil's third party submission, paragraph 3.

<sup>720</sup> See Brazil's oral statement, paragraphs 5-6.

<sup>721</sup> See Brazil's third party submission, paragraph 3.

<sup>722</sup> See Brazil's oral statement, paragraph 11.

<sup>723</sup> See Brazil's oral statement, paragraph 18.

committed to ensure the rights and obligations established in the GATS to suppliers that are not "facilities-based".<sup>724</sup>

5.19 However, Brazil argues that under subsector "o – Other" of its Schedule of Specific Commitments, Mexico undertook commitments regarding "commercial agencies", which according to Mexico's are those "which, without owning transmission means, provide third parties with telecommunication services by using capacity leased from a public network concessionaire". According to Brazil this definition seems equal to the one provided by the United States in paragraph 24 of its submission. Brazil submits that the supply of basic telecom services over leased capacity is referred to in the industry as "resale".<sup>725</sup>

5.20 According to Brazil, although Mexico's definition of "Telecommunications services" would suggest that its commitments were applicable exclusively to "facilities-based suppliers", Mexico undertook specific commitments for "commercial agencies/resale". In this regard, Brazil notes that commitments under mode 1 for "facilities based suppliers" are the same as those undertaken for "private-leased circuits".<sup>726</sup>

5.21 Brazil contends that Mexico's specific commitments regarding "commercial agencies" read, for mode 1, in the market access column "none, except as indicated in 2.C.1". Brazil recalls that in 2.C.1, for mode 1, the Schedule reads: "none, except the following: international traffic must be routed through the facilities of an enterprise that has a concession granted by the "Ministry of Communications and Transport (SCT)". Therefore, under Brazil's point of view, the limitation inscribed in 2.C.1 is equally valid for the market access column in mode 1 for "commercial agencies". Brazil recalls that in the National Treatment column, for mode 1, is written "none" for "commercial agencies".<sup>727</sup>

### 3. Non-discrimination and the concept of "like circumstances"

5.22 Brazil submits that one of the main objectives of the GATS is the achievement of progressively higher levels of liberalization and one of the main ways of accomplishing that goal is the elimination of all discrimination between services and services suppliers of the Parties to the Agreement. According to Brazil, that seems to be the basic *rationale* behind Articles II ("Most-Favoured Nation") and XVII ("National Treatment").<sup>728</sup>

5.23 According to Brazil, footnote 15 of the GATS goes one step further and establishes that: the term "non-discriminatory" is understood to refer to most-favoured-nation and national treatment as defined in the Agreement, as well as to reflect sector-specific usage of the term to mean "terms and conditions no less favourable than those accorded to any other user of like public telecommunications transport networks or services under like circumstances".<sup>729</sup>

5.24 In Brazil's view, it can be inferred from Article XVII.1 and footnote 15 that the meaning and the scope of the national treatment obligation lies in the definition of "like services and service suppliers" and "under like circumstances". According to Brazil, there is nothing in the language of Article XVII and of footnote 15 suggesting that the mode of supply is a consideration in defining the "likeness" of a service or of a service supplier. However, Brazil recalls that GATS' commitments are

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<sup>724</sup> See Brazil's third party submission, paragraph 5 where it refers to Mexico's Schedule of Specific Commitments.

<sup>725</sup> See Brazil's third party submission, paragraph 6 where it refers to the definition provided in the WTO web page.

<sup>726</sup> See Brazil's third party submission, paragraph 7.

<sup>727</sup> See Brazil's third party submission, paragraph 8 where it refers to footnote 2 in Mexico's Schedule of Specific Commitments.

<sup>728</sup> See Brazil's third party submission, paragraph 15.

<sup>729</sup> See Brazil's third party submission, paragraph 16.

inscribed in national schedules by mode of supply, which allows for the perception that the whole architecture of the Agreement stems from the clear separation between the four modes, as defined in Article I of the GATS. Brazil submits that even when full commitments are entered in all four modes in a given sector or subsector, the extent to which services and services suppliers operating in different modes can be considered "like" remains unclear. Therefore it is not evident, for Brazil, how national treatment should apply to them. According to Brazil, the same situation arises in regard to the interpretation of Mexico's commitments.<sup>730</sup>

5.25 In view of the above, Brazil contend that two possible interpretations should be considered. The first interpretation borrows from one of the approaches identified in the "jurisprudence" on trade in goods, which is to define likeness in terms of the essential characteristics of the products. In a services context this would perhaps mean that services and/or service suppliers would be considered "like" on the basis of the nature of the economic activity being performed regardless of the territorial presence of the supplier and the consumer. Under this point of view all service suppliers operating in the same sector would be considered "like service suppliers" and all the services supplied in the same sector would be considered "like services". In this case, if all services suppliers are "like" services suppliers, the only possible way of defining the national treatment obligation is to compare the treatment granted to all foreign services suppliers altogether regarding the treatment granted to national services suppliers based in their home country. Brazil states that, if the determination of likeness is independent of the mode of supply, it follows that national treatment applies across modes in relation to a same common reference: national services suppliers in their home country.<sup>731</sup>

5.26 Brazil further points out that in the second possible interpretation, the definition of "like services and service suppliers" would be based on a comparison of the service suppliers that operate under like circumstances, as mentioned in footnote 15 of GATS. Brazil considers that this logic follows the other approach to likeness identified in jurisprudence on trade in goods, which is to define it on the basis of the "aims and effects" or of the regulatory objective being pursued by a certain measure affecting the product or its producers. Brazil notes that in this connection, services and/or service suppliers would be considered "like" only if they are subject to the same regulatory framework. According to Brazil, in this interpretation, likeness becomes a function of the mode of supply, being defined only within each mode individually. Brazil states that in this possible interpretation, if one assumes that there are four categories of services suppliers, it seems inconsistent to compare those services suppliers and the services they supply with the same common reference.<sup>732</sup>

5.27 Brazil submits that the question to be answered seems to be: is Mexico under the obligation of granting foreign services and service suppliers the same treatment it accords Mexican services and services suppliers in mode 1 - for instance, the same treatment Mexico would grant to Mexican service suppliers based outside the territory of Mexico - or is Mexico under the obligation of granting foreign services and service suppliers the same treatment it accords to Mexican services and service suppliers based in the Mexican territory? According to Brazil, if this question is not given an answer, it seems to be impossible to judge any claimed violation of Mexican commitments, including as regards, for instance, Mexico's obligations under paragraphs 5(a) and 5(b) of the Annex on Telecommunications in relation to the supply of scheduled telecommunication services in mode 1.<sup>733</sup>

5.28 Brazil contends that the legal uncertainty regarding the scope of the national treatment obligation seems to be greatly reduced by the interpretation that this basic obligation applies for and within each mode of supply individually, with "likeness" being defined on the basis of the concept of "like" circumstances. Brazil submits that this interpretation would be much more in conformity with the four-mode logic that constitutes the very foundation of the GATS. Brazil considers that this logic

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<sup>730</sup> See Brazil's third party submission, paragraph 17.

<sup>731</sup> See Brazil's third party submission, paragraph 19.

<sup>732</sup> See Brazil's third party submission, paragraph 20.

<sup>733</sup> See Brazil's third party submission, paragraph 21.

implies that services and services suppliers operating through different modes cannot always be treated as "perfect substitutes" because, in reality, they will be subject to different regulatory frameworks. Brazil recalls that this approach is in keeping with the "principle of equality" (from which flows the concept of *like circumstances*), according to which the same treatment must be accorded to persons under the same condition and similarly situated.<sup>734</sup>

### C. EUROPEAN COMMUNITIES

5.29 The European Communities recalls that the United States' claims, in its first written submission to this Panel, are based exclusively on alleged violations of Mexico's additional commitments on Telecommunications under Article XVIII of the GATS as incorporated via the Fourth Protocol to the GATS and based on the Reference Paper (Sections 1.1, 2.1 and 2.2); and alleged violations of the Sections 5(a) and 5(b) of the GATS Annex on Telecommunications.<sup>735</sup>

5.30 The European Communities notes that the request for the establishment of the Panel and therefore the Panel's terms of reference also include Article XVII of the GATS. The European Communities recall that the original request for the establishment of a panel in this case also alleged violation of Article VI:1, VI:5, XVI:1, XVI:2, XVII:1, XVII:2 and XVII:3 of the GATS as well as many other provisions of the Reference Paper and the Annex on Telecommunications. Under the European Communities point of view these additional claims now seem to have been abandoned.<sup>736</sup>

5.31 Under the European Communities' view, a correct analysis of Mexico's obligations has to start by considering the relevant specific commitments of Mexico.<sup>737</sup>

#### 1. Interpretation of Mexico's specific commitment under mode 1

5.32 The European Communities recalls that the relevant commitment in telecommunications services under mode 1 and the limitations column contains the following:

"(1) None, except the following:

International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport."<sup>738</sup>

5.33 According to the European Communities, this commitment is rendered obligatory and must therefore be read in the light of Article XVI of the GATS.<sup>739</sup>

5.34 The European Communities further points out that the basic obligation expressed in Article XVI:1 is to "accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule", and that Article XVI:2 provides an exhaustive list of measures that Members shall not maintain or adopt unless otherwise specified in its schedule. The European Communities submits that these are various kinds of quantitative limitations and restrictions on the types of legal entity or joint venture (and foreign participation therein) that may be used to supply the service. According to the European Communities a Member is not restricted under Article XVI:1 from regulating the supply of services on its territory in any way other than through the measures specified in Article XVI:2. The

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<sup>734</sup> See Brazil's third party submission, paragraph 22 where it refers to Black's Law Dictionary definition of equality.

<sup>735</sup> See European Communities' third party submission, paragraph 5.

<sup>736</sup> See European Communities' third party submission, paragraph 6.

<sup>737</sup> See European Communities' third party submission, paragraph 7.

<sup>738</sup> See European Communities' third party submission, paragraph 8.

<sup>739</sup> See European Communities' third party submission, paragraph 9.

European Communities clearly states that there are other obligations under the GATS that the Member has to respect.<sup>740</sup>

5.35 The European Communities submits that the "exception" to the commitment on telecommunication services under mode 1 inscribed by Mexico in its Schedule is pointless since the measure that is specified (an obligation to route international traffic through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport) is not a measure of the kind listed in Article XVI:2.<sup>741</sup>

5.36 The European Communities recalls that the measure mentioned in the "exception" is regulatory in nature and is expressed to apply to all international traffic (whether foreign service supply or a foreign service supplier is involved or not).<sup>742</sup>

5.37 The European Communities notes that it is in fact precisely because the supply of telecommunication services is so susceptible to being affected, and even rendered impossible, by regulatory measures that the adoption of additional commitments concerning telecommunications services was so important and that the Reference Paper was a central element in the negotiations on basic telecommunications.<sup>743</sup>

5.38 According to the European Communities, Mexico relies to a great extent in its first written submission on the contention that additional commitments under Article XVIII of the GATS can only cover measures that are not subject to scheduling under Articles XVI and XVII of the GATS. The European Communities agree with this approach.<sup>744</sup>

5.39 However, under the European Communities' point of view the correct conclusion for this case is the opposite of that which Mexico submits. According to the European Communities the "exception" on which Mexico seeks to rely should be included as a limitation to any additional commitments made on regulatory measures.<sup>745</sup>

5.40 In the European Communities' view the "exception" to the commitment in Mexico's Schedule has no legal effect since it was not necessary for the purpose of allowing Mexico to maintain the measure described. According to the European Communities the "exception" to the specific commitment can only be read as an additional information to the reader about the legal situation in Mexico. The European Communities contends that the United States is correct in basing its claim only on the additional commitments of Mexico, which do not include the exception on which Mexico relies.<sup>746</sup>

5.41 The European Communities note that the "exception" inserted by Mexico in its Schedule of Commitments refers to the obligation to route traffic through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport. According to the European Communities this obligation does not exclude foreign telecommunications suppliers from supplying services in a cross-border manner provided that those suppliers reach an agreement with a Mexican enterprise, which has been granted a concession, to terminate its traffic within Mexico.<sup>747</sup>

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<sup>740</sup> See European Communities' third party submission, paragraph 10.

<sup>741</sup> See European Communities' third party submission, paragraph 12.

<sup>742</sup> See European Communities' third party submission, paragraph 13.

<sup>743</sup> See European Communities' third party submission, paragraph 14.

<sup>744</sup> See European Communities' third party submission, paragraph 15.

<sup>745</sup> See European Communities' third party submission, paragraph 16.

<sup>746</sup> See European Communities' third party submission, paragraph 17.

<sup>747</sup> See European Communities' third party submission, paragraph 18.

5.42 With regard to Brazil's concern based on the interpretation of Mexico's Schedule of Specific Commitments,<sup>748</sup> the European Communities contends that the condition in the Spanish language is that the service has to be provided "por", which in context means through or over a public telecommunication network, not limiting the concession to facilities based suppliers.<sup>749</sup>

## 2. Mexico's commitments under mode 3

5.43 In the European Communities' view, the two sentences of the statement in Mexico's Schedule referring to permits for the establishment of commercial agencies under mode 3 cannot be read in combination as making the coming into effect of the entire commitment subject to the discretion of Mexico.<sup>750</sup> According to the European Communities a consistent reading is that the regulations will be issued before permits are granted so as to ensure that no commercial agencies will be allowed to have "acquired rights" to operate without respecting the regulations.<sup>751</sup>

5.44 The European Communities considers that this position is supported by the explanatory note containing Guidelines for the Scheduling of Commitments (MTN.GNS/W/164/Add.1) which specifies under Point 8 that "according to the agreed scheduling procedures, schedules should not contain general references to laws and regulations as it is understood that such references would not have legal implications under the GATS". Thus, limitations to scheduled commitments must be set out explicitly in the schedule and not incorporated by reference to national regulations.<sup>752</sup>

5.45 The European Communities considers that Mexico's commitments for market access for commercial agencies are in force subject to the limitations legitimately included in the Schedule.<sup>753</sup>

5.46 The European Communities recalls that, on the relationship between specific commitments and additional commitments, there is no basis for holding that additional commitments cannot prevail over specific commitments, as argued by Mexico in paragraphs 211 and 212 of its first written submission. According to the European Communities there is no limitation of this kind in Article XVIII of the GATS.<sup>754</sup>

5.47 The European Communities contends that the Annex on Telecommunications is an integral part of the GATS (Article XXIX) and as such, restrictions listed as "limitations" to specific commitments cannot derogate from GATS obligations except as specifically provided. In the European Communities' view this is why the Annex on Telecommunications contains language expressly stating that it does not require the authorization of services other than as provided for in its Schedule.<sup>755</sup>

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<sup>748</sup> See Brazil's third party submission paragraph 5.

<sup>749</sup> See European Communities' oral statement, paragraphs 5 and 7.

<sup>750</sup> See European Communities' third party submission, paragraph 19 where it refers to paragraphs 265 and 294 of the United States' first written submission.

<sup>751</sup> See European Communities' third party submission, paragraphs 20-23.

<sup>752</sup> See European Communities' replies to questions from the Panel, paragraph 14.

<sup>753</sup> See European Communities' third party submission, paragraph 24.

<sup>754</sup> See European Communities' third party submission, paragraph 25.

<sup>755</sup> See European Communities' third party submission, paragraph 28 where it refers to Section 2(c)(I) of the Annex on Telecommunications of the GATS.

### 3. Application of the interconnection rules contained in the Reference Paper

5.48 The European Communities disagrees with Mexico's view that the obligations on interconnection contained in the Reference Paper do not apply to termination of international calls under the accounting rate system.<sup>756</sup>

5.49 According to the European Communities the term "interconnection", as used in Section 2 of the Reference Paper, interpreted in accordance to Article 31 of the *Vienna Convention* appears to relate to all modes of linking two operators. In the European Communities view the wording of Section 2.1 of the Reference Paper which defines "interconnection" supports this idea.<sup>757</sup>

5.50 The European Communities contends that the very object and purpose of the GATS is the liberalisation of international trade in services. In the European Communities view it is difficult to maintain that an interpretation of the Reference Paper should be limited to enhancement of "national" competition to the detriment of "international" one.<sup>758</sup>

5.51 The European Communities contends that the negotiations which led to the final Reference Paper were conducted on the assumption that termination of international calls under the accounting rate system is not fundamentally different from domestic interconnection, and it tends to suggest that accounting rates may indeed be considered as a form of "international interconnection".<sup>759</sup>

5.52 In this regard, the European Communities believes that the ordinary meaning of the term "interconnection" covers both national and international linking.<sup>760</sup>

5.53 The European Communities adds in reply to a question from the Panel that the opening words of Section 2.1 of the Reference Paper ("This section applies, *on the basis of the specific commitments undertaken ...* ") means that Section 2 of the Reference Paper only applies to the extent that there are specific commitments and cannot be used to require market access where this does not result from the specific commitments. According to the European Communities, the additional commitment is intended to *facilitate the effective exploitation* of market access to which a Member has committed itself in its Schedule. The European Communities is of the view that Mexico has committed to provide market access under mode 1 and must therefore ensure that the major supplier provides interconnection in accordance with Section 2.<sup>761</sup>

### 4. Rates relating to termination of international calls

5.54 In the European Communities' view, Telmex should be obliged to provide cost-oriented interconnection, taking into consideration Mexico's commitments. Due to the ample divergence between "costs" and "rates", the European Communities considers that it is upon Mexico to provide the Panel with proof of those costs that would justify Mexico's rates.<sup>762</sup>

5.55 As regard Japan's argument that the Spanish term "basadas en costos", which has been included in Mexico's additional commitments, requires a stricter adherence to costs than the term "cost oriented", the European Communities submits that the additional commitments introduced through the Fourth Protocol to GATS, were based on a common Reference Paper to ensure that

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<sup>756</sup> See European Communities' third party submission, paragraph 29 where it refers to paragraph 37 and heading IV.A.3 of the United States first written submission.

<sup>757</sup> See European Communities' third party submission, paragraphs 30-31.

<sup>758</sup> See European Communities' third party submission, paragraph 32.

<sup>759</sup> See European Communities' third party submission, paragraph 34.

<sup>760</sup> See European Communities' third party submission, paragraph 35.

<sup>761</sup> See European Communities' replies to questions from the Panel, paragraphs 3-4.

<sup>762</sup> See European Communities' third party submission, paragraphs 38-39.

identical obligations were undertaken by all except where expressly intended otherwise.<sup>763</sup> The European Communities submits that the term "cost-oriented" in English and "basadas en el costo" in Spanish were intended to be equivalent. It points out that the European Communities' additional commitments which are authentic in all three WTO languages uses the term "cost-oriented" in English and "basadas en el costo" in Spanish.<sup>764</sup> Since the additional commitments of the European Communities are an integral part of the GATS and were accepted by all parties to the Fourth Protocol, it is clear that the two terms were intended to be equivalent. According to the European Communities a different interpretation would vary the scope of WTO Members' obligations depending on the choice of authentic language for additional commitments.<sup>765</sup>

5.56 The European Communities further points out the fact that cost-orientation has been discussed extensively in the ITU, and some guidance can be found in ITU-T Recommendation D.140, entitled "Accounting Rate Principles for the International Telephone Service", and ITU-T Recommendation D.150 entitled "New System for Accounting in International telephony".<sup>766</sup> It notes that commercially, contractually and technically, both accounting rates and interconnection can cover many different situations: where two operators' networks connect physically at a given point that they own together, where two operators' network connect physically at a given point that is owned by either of them or by a third party, where two operators own jointly a link between their respective networks.<sup>767</sup>

5.57 The European Communities notes that the Reference Paper does not contain the detail of the ITU Recommendations and does not specify which cost standard should be applied. In the European Communities view, national authorities have discretion as to the choice of cost standard, provided that it properly reflects the cost of interconnection and is applied in a transparent, consistent and non-discriminatory way.<sup>768</sup>

## 5. The meaning of "reasonable"

5.58 The European Communities contends that the interpretation of the term "reasonable" as linked to conditions of competition is not appropriate. According to the European Communities the interpretation should be in line with the negotiating history of the Reference Paper, according to which this term it is normally used to refer to "a reasonable rate of return of the capital employed".<sup>769</sup>

5.59 In answer to a question from the Panel, the European Communities added that the requirement of reasonableness is to be understood as a discipline on the model used by national authorities to calculate the 'real' cost of interconnection. It recalls that there are several models (bottom-up or top-down models, looking at historical or current costs, in a fully-distributed or stand alone manner, among other). The European Communities considers that the Reference Paper does not mandate the use of one particular model, but the model chosen must reflect economic reality so that if the model fails to reflect reality, the resulting interconnection prices cannot be regarded as reasonable.<sup>770</sup>

5.60 In the European Communities' view, the expression 'having regard to economic feasibility' must be understood as a general qualification of (or limitation on) the obligation for major suppliers to provide interconnection on: (1) terms; (2) conditions; and (3) cost-oriented rates which are (a)

<sup>763</sup> See European Communities' oral statement, paragraph 5 where it refers to paragraph 5 of Brazil's third party written submission.

<sup>764</sup> See document GATS/SC/31/Suppl.3.

<sup>765</sup> See European Communities' oral statement, paragraph 10.

<sup>766</sup> See European Communities' oral statement, paragraph 16.

<sup>767</sup> See European Communities' replies to questions from the Panel, paragraphs 22-28.

<sup>768</sup> See European Communities' oral statement, paragraph 23.

<sup>769</sup> See European Communities' third party submission, paragraphs 40-42.

<sup>770</sup> See European Communities' replies to questions from the Panel, paragraphs 31-33.

transparent and (b) reasonable. It confirms that rates must be oriented towards, not 'equal to' or 'identical to', actual cost and that operators are allowed a reasonable rate of return on investment and provides a safeguard to ensure that major suppliers do not have to meet demands that could be excessively expensive, bearing in mind the revenues to be generated by the interconnection agreement. The European Communities submits that the ambiguity in the drafting of the different language versions of the text should be resolved in a manner that makes them consistent with one another, and which acknowledges that economic feasibility is a *general* qualification of (or limitation on) the obligation for major suppliers to provide interconnection on reasonable and transparent terms, conditions and rates.<sup>771</sup>

## 6. Requirements of Section 1

5.61 According to the European Communities, Mexico is clearly right that Section 1 imposes an obligation of means, not of result.<sup>772</sup> Section 1 requires Mexico to maintain appropriate measures for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices and does not require Mexico to open all its telecommunication markets. In view of the above, the European Communities contends that if Mexico chooses not to allow competition between telecommunication operators on a certain matter, there is no scope for anti-competitive practices relating to that matter. In that regard, the European Communities points out that it is not possible to restrict competition where competition is not allowed.<sup>773</sup>

5.62 In view of the above, the European Communities contends that one matter that could constitute an anti-competitive practice would be the negotiation by the major supplier of an accounting rate that restricts competition by other suppliers, because it would be unprofitable for them and this must be the subject of competitive safeguards.<sup>774</sup>

5.63 The European Communities submits that one anti-competitive practice that the United States seems to be complaining of is the fixing of pricing and the high level thereof. However, it argues the fixing of a uniform price cannot be an anti-competitive practice since uniform prices are required by law. In its view, the same goes for the revenue sharing system ("proportional return") since this is also mandated by law.<sup>775</sup>

5.64 The European Communities submits that Section 1 of the reference paper does create obligations in sectors that are not covered by specific commitments.<sup>776</sup>

## 7. Applicability of the Annex on Telecommunications

5.65 The European Communities recalls it shares the United States view that the GATS Annex on Telecommunications was meant to benefit not only non-telecom providers, and providers of value-added telecommunications, but also providers of basic telecommunications. The European Communities considers that to restrict the scope of the Annex to non-telecom providers would fail to give effect to one of the two distinct roles of the telecommunications sector.<sup>777</sup>

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<sup>771</sup> See European Communities' replies to questions from the Panel, paragraphs 34-39.

<sup>772</sup> See European Communities' third party submission, paragraph 48.

<sup>773</sup> See European Communities' third party submission, paragraph 49.

<sup>774</sup> See European Communities' third party submission, paragraph 52.

<sup>775</sup> See European Communities' third party submission, paragraph 53.

<sup>776</sup> See European Communities' third party submission, paragraph 56.

<sup>777</sup> See European Communities' third party submission, paragraph 58.

5.66 The European Communities further point out that the GATS Annex on Telecommunications was never meant to provide wider market access obligations for WTO Members than those established in their Schedules as regards basic telecommunications.<sup>778</sup>

5.67 According to the European Communities even though the Annex on Telecommunications does not create market access commitments that are not contained in the Schedules, it is intended to facilitate the exploitation of market access commitments that are contained in the Schedules.<sup>779</sup> The European Communities also recalled that the obligations contained in the Annex only relate to "*public telecommunications transport networks and services*", which means "*any telecommunications transport service required, explicitly or in effect, by a Member to be offered to the public generally*".<sup>780</sup>

## 8. The notion of likeness

5.68 With respect of the notion of likeness, the European Communities asserts that footnote 15 relates only to the meaning of the term non-discriminatory in the Annex on Telecommunications and is not relevant to the interpretation of "like services and service suppliers" as they appear in Articles II and XVII of the GATS. In the European Communities' view, footnote 15 cannot in the absence of a clear textual indication to the contrary, be relevant to the interpretation of "like services and service suppliers," especially since this must have the same meaning for all service sectors. The European Communities further points out that the existing case-law (*Canada – Autos*<sup>781</sup>) clearly suggests that the notion of "like services and service suppliers" requires a comparison of the activity involved and that the mode of supply is irrelevant.<sup>782</sup>

## D. JAPAN

### 1. Validity for an action by the United States

5.69 Japan contends that the Panel should first determine whether it is proper for the United States to use the dispute settlement procedure under the DSU to object to "interconnection" rates charged by Telmex based on the accounting rate system.<sup>783</sup>

5.70 Japan submits that the "Group" addressed the subject of matters that may not give rise to an action before a panel in its report dated 15 February 1997, which includes the application of the accounting rate system.<sup>784</sup>

5.71 Japan further points out that the position of the "Group" as to whether accounting rates could give rise to an action by Members under the DSU is further addressed in the report dated 10 March 1997, where the Chairman stressed that the report was merely an understanding, which could not and was not intended to have binding legal force and did not take away from Members the rights they have under the DSU.<sup>785</sup>

5.72 Japan considers that the "understanding" of the "Group" concerning the proper scope and treatment of "accounting rates" is not entirely clear. In Japan's view it is not clear whether the "rates"

<sup>778</sup> See European Communities' third party submission, paragraph 59.

<sup>779</sup> See European Communities' third party submission, paragraph 60.

<sup>780</sup> See European Communities' third party submission, paragraphs 62-63.

<sup>781</sup> See Panel Report, *Canada – Autos*.

<sup>782</sup> See European Communities' oral statement, paragraphs 28- 29.

<sup>783</sup> See Japan's third party submission, paragraph 5.

<sup>784</sup> See Japan's third party submission, paragraph 6 where it refers to the Report of the Group on Basic Telecommunications of 15 February 1997, S/GBT/4.

<sup>785</sup> See Japan's third party submission, paragraph 7 where it refers to the Report of the Group on Basic Telecommunications of 10 March 1997, S/GBT/M/9.

described in Section 2.2(b) of the Reference Paper in fact cover accounting rates, and are thus capable of being disputed under the DSU mechanism.<sup>786</sup>

5.73 According to Japan, given the lack of clarity concerning the proper scope and treatment of accounting rates, the panel needs to determine whether it is proper for the United States to bring before the panel its objections concerning the accounting rates negotiated by Telmex.<sup>787</sup>

## 2. The term "cost oriented"

5.74 According to Japan, the meaning of the term "*basadas en costos*", as used in Mexico's Reference Paper, does not automatically apply to the term "*cost-oriented*" that appears in the Reference Paper of other Members. Japan asserts that in its submission the United States provides its interpretation of the term "*basadas en costos*", as used in the context of Mexico's Reference Paper. Japan further points out that in the course of its submission, the United States at times appears to use the terms "*basadas en costos*", "cost based" and "cost-oriented" interchangeably, and implies that these terms have equivalent meanings.<sup>788</sup>

5.75 Japan submits that if the meaning of "*basadas en costos*" is based upon the term's alleged English language equivalent, "*based in cost*", such meaning in Japan's view cannot automatically be applied to the term "*cost oriented*" that appears in the Reference Papers which are attached to the Schedules of specific commitments of other Members, which chose English to be authentic.<sup>789</sup>

## 3. The term "cost-based"

5.76 Japan submits that in the English language Reference Paper of many Members, the English language equivalent of the term "*basadas en costos*" appears as "cost-oriented". Japan points out that the term "cost-oriented" is not defined in any Member's Reference Paper, and its meaning is not addressed in any other part of the WTO Agreement or in the report of any panel or Appellate Body. Japan considers that "cost-oriented" rates has an ordinary meaning that is less specific, and therefore less constraining, than "cost-based" rates, "cost-equivalent" rates, or rates calculated by application of the total element long run incremental costs adopted in the United States.<sup>790</sup>

5.77 In Japan's view the term "cost-oriented" must basically be interpreted in accordance with its ordinary meaning as stipulated under Article 31(1) of the Vienna Convention. Japan further points out that the determination of whether interconnection rates are "cost-oriented" cannot be limited to an examination of only the specific manner in which interconnection rates are established.<sup>791</sup>

5.78 According to Japan the implementation of an interconnection rate system that meets the general principles of the Reference Paper is left to the discretion of each Member's government.<sup>792</sup>

5.79 Japan notes that, according to the negotiating history of the Reference Paper, Members were not only unable to agree on an exact definition of "cost", but also avoided closely binding themselves to the term by using the expression "cost-oriented" rather than "cost-based".<sup>793</sup>

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<sup>786</sup> See Japan's third party submission, paragraph 9.

<sup>787</sup> See Japan's third party submission, paragraph 10.

<sup>788</sup> See Japan's third party submission, paragraphs 12-13.

<sup>789</sup> See Japan's third party submission, paragraph 14.

<sup>790</sup> See Japan's third party submission, paragraph 15.

<sup>791</sup> See Japan's third party submission, paragraph 16 where it refers to the Vienna Convention on the Law of Treaties.

<sup>792</sup> See Japan's third party submission, paragraph 18.

<sup>793</sup> See Japan's third party submission, paragraph 21.

5.80 Japan considers that Members adopted the term "cost-oriented" during the Negotiations on Basic Telecommunications ("NBT") on account of its ambiguity.<sup>794</sup>

#### **4. Election of a uniform accounting rate and proportionate return system**

5.81 Japan submits that the Spanish term "razonables, económicamente factibles" grants Mexico additional flexibility in determining interconnection rates. According to Japan, in the absence of any argument concerning the inapplicability of the qualification created by the term "económicamente factibles", the panel has insufficient information before it to find that the interconnection rates imposed by Mexico are not "razonables".<sup>795</sup>

5.82 Japan recalls that following the conclusion of the negotiations on basic telecommunications, a number of Members liberalized aspects of their accounting rate systems. However, many Members (including Japan and the United States), continue to maintain pre-existing accounting rate systems for settling interconnection rates with carriers from certain countries. Japan points out that it applies such pre-existing system only to non-WTO Member carriers while the United States applies it to carriers with market power, either WTO-Member or non-Member. According to Japan, these systems are similar to Mexico's accounting rate system presently under discussion.<sup>796</sup>

5.83 In Japan's view it is hard to determine that Mexico is acting unreasonably *per se* insofar as it elects to maintain a uniform accounting rate and proportionate return system similar to that which continues to be used by many Members (including the United States) to settle rates with certain countries. According to Japan, the United States has to provide a compelling argument that the mere maintenance of a uniform accounting rate and proportionate return system triggers a violation of Section 2.2(b) of the Reference Paper. Nevertheless, Japan notes its strong concern with Mexico's indiscriminate practice of applying uniform accounting rate and proportionate return system in determining accounting rates with carriers from every country, regardless of whether the country in question possesses multiple carriers or has a competitive environment.<sup>797</sup>

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<sup>794</sup> See Japan's third party submission, paragraph 22.

<sup>795</sup> See Japan's third party submission, paragraph 24.

<sup>796</sup> See Japan's third party submission, paragraph 26.

<sup>797</sup> See Japan's third party submission, paragraph 27.

## VI. INTERIM REVIEW

6.1 On 10 July 2003, pursuant to Article 15.1 of the DSU, the Panel issued the draft descriptive part of its Report. As agreed, on 25 July 2003 both parties commented on the draft descriptive part. The Panel issued its Interim Report on 21 November 2003. On 15 December 2003, pursuant to Article 15.2 of the DSU, the United States and Mexico provided comments and requested the revision and clarification of certain aspects of the Interim Report. None of the parties requested that the Panel hold a further meeting with the parties. In the absence of a meeting and further to paragraph 16 of the Panel's Working Procedures<sup>798</sup>, the parties were given until 15 January 2004 to submit further written comments on the other party's Interim Review comments. Only the United States filed further comments on that date.

6.2 Following the comments of the parties, the Panel has reviewed the claims, arguments and evidence submitted by the parties during the panel process. Where it considered it appropriate to ensure clarity and avoid misunderstandings, the Panel has revised the findings section of its Report, including the correction of typographical and editorial mistakes. It is important to note that in the findings section of a Report, a panel cannot be expected to refer to all the statements and arguments of the parties. Failure to do so does not therefore imply that the Panel has ignored statements or arguments of the parties. Taking into consideration this last statement, the Panel has addressed the following comments raised by the parties.

6.3 Generally, the United States' comments concern some additions or deletions to the text of the findings as a matter of clarity. The United States notes that it disagrees with the Panel's conclusion that Mexico's Schedule allows Mexico to prohibit market access for the cross-border supply of the services at issue into Mexico over capacity leased by the supplier (i.e., on a non-facilities basis) in Mexico. However, the United States states that it would not repeat its arguments in this respect in the comments provided to the Panel on the Interim Report.

6.4 On the other side, Mexico's comments refer to precise aspects of the Interim Report, including the identification of some evidence, the clarification of some definitions and the identification of the services at issue. Mexico submits that the review of all these aspects will help to clarify its position on certain issues.

6.5 Mexico notes in its submission dated 15 December 2003 that in paragraph 7.6 of the Interim Report (which has been deleted in this Report) and corresponding footnote the Panel identifies the services at issue in this dispute as "certain basic public telecommunications services" referring to a definition contained in paragraph 7.32 of the Interim Report to describe them. According to Mexico, the text quoted in paragraph 732 is from the definition of "Public telecommunications transport services" in Article 3(b) of the Annex on Telecommunications. Mexico further states that it understands that the Ministerial Decision on Negotiations on Basic Telecommunications refers to "basic telecommunications" as "telecommunications transport networks and services", but states that the latter term is not defined in the GATS Annex on Telecommunications. According to Mexico, Article 3 of the Annex on Telecommunications sets out two distinct definitions for the terms "Public telecommunications transport service" and "Public telecommunications transport network". Mexico states that it has argued that the services at issue in this dispute are transmission or transport services of customer-supplied information or data. In particular, Mexico requests that the Panel clarifies its

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<sup>798</sup> Paragraph 16 of the Panel's Working Procedures reads as follows: "Following issuance of the Interim Report, the parties shall have no less than 7 days to submit written requests to review precise aspects of the Interim Report and to request a further meeting with the Panel. The right to request such a meeting must be exercised no later than at that time. Following receipt of any written requests for review, in cases where no further meeting with the Panel is requested, the parties shall have the opportunity within a time-period to be specified by the Panel to submit written comments on the other parties' written requests for review. Such comments shall be strictly limited to referencing the other parties' written requests for review."

definition of "basic public telecommunications services" and its description of the nature of the services at issue. The United States alleges in its submission dated 15 January 2004 that it is not necessary for the Panel to provide a precise definition of the broad term "basic public telecommunications services." According to the United States, in order to resolve the dispute, the Panel needs only define the specific services to which the claims relate and the services subject to Mexico's commitments. In consideration of these comments, the Panel modified footnotes 745 and 753 (footnotes 829 and 840 of this Report) to clarify the link between "basic public telecommunications services" and the definition of the term "public telecommunications transport services".

6.6 With regard to paragraph 7.11 (paragraph 7.10 of this Report) Mexico disagrees with the translation of ILD Rule 2:XI and requests it to be modified. It also requests to add a sentence at the end of paragraph 7.11 (paragraph 7.10 of this Report) in order to include a reference to ILD Rule 2:VIII according to its own translation. The United States asserts that Mexico has not previously disputed the English-language copy of the ILD Rules provided to the Panel by the United States in Exhibit US-1 and that the same translation of ILD Rule 2:XI was provided in paragraph 2.8 of the draft descriptive part and was not contested by Mexico. The United States submits that it considers accurate its own translation of the ILD Rules and that it does not consider accurate the translation offered by Mexico. The Panel declines to amend the translation of ILD Rule 2:XI as requested by Mexico because the text conforms with the translation provided by the WTO Secretariat of the ILD Rules (annexed to the Report) and does not appear, in substance, to differ from the modification proposed by Mexico. As regards Mexico's request to add a sentence at the end of paragraph 7.11 (paragraph 7.10 of this Report), the Panel considers the additional language suggested by Mexico to refer to a matter already addressed in paragraph 7.12 (paragraph 7.11 of this Report).

6.7 Mexico considers that in paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report), the Panel has summarised the arguments of the United States on what constitutes the service at issue and the manner in which they are provided, but has not summarised the arguments of Mexico. Mexico requests the Panel to summarise in paragraphs 7.23 to 7.25 (paragraphs 7.22-7.23 and 7.26 of this Report), its description of the precise nature of the services at issue and the manner in which those services are supplied. Mexico also requests the Panel to clarify its description of the nature of the services at issue and to make a finding on whether the services at issue constitute transport and transmission services. The United States submits that beyond identifying the service sectors at issue as including voice telephony, circuit-switched data transmission and facsimile services, the Panel also engaged in a detailed review of the definition of those services sectors according to, among other things, the Central Product Classification codes included in the sector column of Mexico's Schedule. According to the United States it is incorrect to suggest that the Panel has not directly addressed Mexico's argument that the services at issue were only transmission and transport as it is rejected in paragraph 7.36 of the Interim Report. In the United States' view, the Panel's discussion extends beyond paragraphs 7.23-7.25 (paragraph 7.22-7.23 and 7.26 of this Report) to include the discussion culminating in paragraph 7.46 (paragraph 7.45 of this Report). The United States also submits that although paragraph 7.46 (paragraph 7.45 of this Report) already provides a concise description of the services at issue, the Panel may consider providing a precise definition of the "services at issue", at the end of that section. In view of Mexico's concerns, the Panel has modified the discussion of "services at issue" to clarify that this term on its own focuses on the service sectors, and not on the modes of supply raised in the United States' claim.

6.8 Mexico submits that it did not make the argument referred by the Panel in paragraph 7.27 of the Interim Report. According to Mexico, it argued that in order for a United States-based supplier to supply services from the United States territory into the Mexican territory, it must supply telecom transport services over the whole of the "full circuit" without having a commercial presence within the meaning of GATS Article XXVIII(d). Mexico further submits that it also explained how a full circuit regime does not require commercial presence within the meaning of the GATS. Mexico requests the Panel to replace the fourth sentence of paragraph 7.27 of the Interim Report and to add a new sentence

after the third sentence of the same paragraph. As regards Mexico's allegation, the United States considers that it is entirely reasonable for the Panel to have understood that under Mexico's interpretation, a foreign service supplier must "operate" in some sense in a foreign territory to provide scheduled services via the cross-border mode of supply. According to the United States, the Panel may clarify this by moving the fourth sentence of paragraph 7.27 of the Interim Report and making it the first sentence of paragraph 7.28 of the Interim Report, including some new editing. The United States suggests that it may be helpful for the Panel to adopt a uniform formulation such as "operates in some fashion, or is located" when it uses the word "present", "presence", "operate" or "located" in diverse paragraphs of the Interim Report. The United States submits that Mexico's assertion that the Panel did not address the argument made by Mexico is not accurate, since the Panel did in fact address and reject the relevance of Mexico's argument at paragraph 7.39 of the Interim Report. For all these reasons the United States asks the Panel to reject Mexico's request to add an additional sentence to paragraph 7.27 of the Interim Report. The Panel has amended the text of paragraphs 7.27 and 7.28 of the Interim Report to clarify Mexico's argument and adopted a uniform formulation regarding the word "present", "presence" etc., accompanied by an explanatory footnote, to clarify that the terms were not intended to refer to "commercial presence".

6.9 In relation to paragraph 7.28 of the Interim Report, Mexico submits that the issue before the Panel was whether the services provided by United States-based suppliers in the circumstances of this dispute cross the border into Mexico, and not whether cross-border "occurs only if the supplier itself operates, or is present, in the territory of both Members". Mexico requests that paragraph 7.28 of the Interim Report be accordingly replaced. In reference to the Mexico's comments, the United States submits that the reason the Panel addressed the question of whether "cross-border 'occurs only if the supplier itself operates, or is present, in the territory of both Members'" is because Mexico made that argument. The United States requests that the Panel rejects the replacement text proposed by Mexico for paragraph 7.28 of the Interim Report. In consideration of Mexico's comments, the Panel modified the wording of paragraph 7.28 of the Interim Report to define in more precise wording the "issue before the Panel" referred to in the paragraph.

6.10 Mexico, for the same reasons explained in its comments on paragraph 7.27 of the Interim Report, requests that the Panel clarifies whether by using the word "present" in paragraphs 7.28, 7.32, and 7.35 of the Interim Report, and the word "presence" in paragraphs 7.39, 7.40 and 7.88 of the Interim Report (paragraphs 7.39, 7.40 and 7.90 of this Report), it meant "commercially present" and "commercial presence" within the meaning of the GATS. Regarding the use of these terms, the United States refers the Panel to its discussion regarding Mexico's comments on paragraph 7.27 of the Interim Report. The approach taken by the Panel to address the question posed by Mexico is described above in the paragraph dealing with Mexico's initial comment regarding the use of these terms in paragraph 7.27 of the Interim Report.

6.11 As regards paragraph 7.36 of the Interim Report, the United States requests the Panel to rectify a typographical error when referring to "telephony services". The Panel notes that the term "telephony" does not appear in W/120 or the CPC. However, it is used in the translation of Mexico's scheduled service commitments, in the ITU contexts, and by the parties to this dispute. The Panel considers appropriate the suggested modification. For clarification, the Panel also added a footnote to paragraph 7.45 (paragraph 7.43 of this Report) stating that it considers the terms "telephony" and "voice telephony" (as used in the English translations of Mexico's Schedule and the claims by the United States) to be equivalent to the terms "telephone services" and "voice telephone services" (as used in the GATS sectoral classification the CPC).

6.12 Mexico submits that the Panel refers to "communications services supplied between Members" in paragraph 7.38 of the Interim Report. Since, according to Mexico, the United States has limited its challenge to "certain basic public telecommunications services", Mexico requests that the Panel clarifies what is meant by the terms "communications services" and make additional findings on whether and how such services are supplied by United States-based suppliers on a cross-border basis

from the United States into Mexico. According to the United States, the Panel's reference to "communications services" is equivalent to "telecommunications services," but suggests that the Panel may clarify it. With respect to Mexico's comments on the interpretation of the services at issue in this dispute, the United States recalls its discussion regarding Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report). To address Mexico's concern, the Panel modified the first sentence of paragraph 7.38 of the Interim Report, replacing the word "communications" with "basic telecommunications".

6.13 Mexico also notes that in paragraph 7.39 of the Interim Report the Panel states that "the CPC definition of the basic telecommunications services at issue provides for an especially high degree of interaction between operators on each side of the border". Mexico requests that the Panel identifies the specific definition to which it refers. Mexico requests that the Panel clarifies its statement in the fourth sentence of the paragraph and explain the legal basis for that statement. With respect to Mexico's comment that it "fails to see which CPC definition provides for interaction between operators 'on each side of the border'," the United States finds entirely clear that the CPC definition to which the Panel refers is CPC 75212 and that the Panel is applying the definition to the specific facts of the dispute. The Panel addressed Mexico's concern by amending paragraph 7.39 of the Interim Report to specify more precisely the reasoning that leads us to consider that the CPC definition foresees an especially high degree of interaction also between operators located in different Members.

6.14 As regards paragraph 7.41 of the Interim Report (paragraph 7.41 of this Report), Mexico recalls that the Panel states that "...all telecommunications traffic currently crossing borders would then fall outside the scope of the GATS". Mexico understands from this statement that the Panel is of the view that "telecommunications traffic currently crossing borders" is within the scope of the GATS. Mexico requests that the Panel clarifies what is meant by "traffic" and the legal basis for referring to that term. The United States considers that Mexico's comments speak to its arguments about the interpretation of the services at issue in this dispute. Therefore, the United States refers the Panel to its discussion regarding Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report). Regarding Mexico's comment on the term "traffic", the United States maintains that the Panel's reference to "telecommunications traffic currently crossing borders" is clear but suggests that the Panel could amend it to refer to "telecommunications services currently crossing borders." To address Mexico's concern the Panel had modified the third sentence of paragraph 7.41 of the Interim Report (paragraph 7.41 of this Report) to refer telecommunications "services".

6.15 Mexico contends that paragraph 7.44 of the Interim Report implies that under Mexico's arguments, the cross-border supply of basic telecommunications services would not be technically feasible. According to Mexico this is not the argument it made. Mexico states that it did not argue that the cross-border supply of basic telecommunications services required commercial presence, but rather explained how cross-border supply could occur in a "full-circuit" regime. Under Mexico's arguments, cross-border trade in telecommunications transport service is technically feasible and does not require "commercial presence" within the meaning of the GATS. For these reasons, Mexico requests that the Panel modifies paragraph 7.44. In the United States' view, the first sentence of this paragraph expresses the Panel's conclusion that the examples and definition of "cross-border" supply asserted by Mexico would virtually exclude from the cross-border supply of facilities-based services all situations in which the supplier does not have a commercial presence. According to the United States, it was quite reasonable for the Panel to conclude that the examples of a "full-circuit" regime cited by Mexico usually would only occur through commercial presence and suggests that the Panel rejects Mexico's proposed modifications. In view of Mexico's comments, the Panel deleted paragraph 7.44, since the reasoning in that paragraph relied to a large extent on a supposition that Mexico's argument did imply that commercial presence was virtually necessary to conduct cross-border supply on a facilities basis.

6.16 As regards paragraph 7.45 (paragraph 7.43 of this Report) Mexico requests the Panel to add a sentence at the beginning, in order to better reflect its position. The United States notes that Mexico

provides no citation to an earlier submission in which it raised the argument "that there is a relevant distinction between services supplied 'through' the use of telecommunications transport service and telecommunications transport service itself," and believes that Mexico has not previously made this argument. Moreover, despite Mexico's attempt to introduce the argument, the purported distinction is not relevant to the purpose of the quotation, which is to explain that the Explanatory Note supports the view that cross-border supply does not imply the presence of the service supplier in the market where the service is delivered. For these two reasons, the United States asks the Panel to reject Mexico's comment and proposed text. The Panel declined Mexico's request because it considers that the proposed addition is not directly related to the rest of paragraph 7.45 (paragraph 7.43 of this Report).

6.17 Mexico claims that the Panel refers to the "services at issue" in paragraph 7.46 of this Report without further explanation and concludes that they are supplied cross-border within the meaning of the GATS. Mexico requests that the Panel clarify what is the precise nature of the services at issue and explain how they are supplied cross-border. According to the United States, Mexico's comments reiterate its arguments about the interpretation of the services at issue in this dispute and therefore refers the Panel to its discussion regarding Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report). Regarding Mexico's comments, the Panel notes that it has already clarified what is meant by the "services at issue". And that paragraph 7.46 of this Report is a conclusion intended to summarise the preceding analysis rather than to repeat it.

6.18 Mexico submits that the Panel statement in paragraph 7.48 (paragraph 7.47 of this Report) does not accurately reflect Mexico's arguments. Mexico refers to its arguments summarized at paragraphs 63 to 76 of its second written submission, where it explained its view that in order to ascertain the nature of Mexico's mode 1 commitments, it is first necessary to define the services at issue. According to Mexico, in order to determine whether its market access commitments allow the cross-border supply of such services into Mexico, the Panel had to determine whether Mexico's Schedule permits public transmission or transport services provided by United States suppliers to cross the border into Mexico. Mexico argues that it has not inscribed specific commitments that allow such trade, because of the limitations inscribed in its Schedule. Mexico recalls that it argued that by inscribing commercial presence and nationality requirements in its mode 1 column, Mexico has prevented the suppliers of other WTO Members (both facilities-based and non-facilities-based) from supplying telecommunications transport services cross-border into Mexico. Referring the Panel to its discussion regarding Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report), the United States states that, in paragraphs 7.48-7.49 (paragraphs 7.47-7.48 of this Report), the Panel has accurately summarised Mexico's arguments on the definition of the services at issue and whether those services can be provided on a cross-border basis. The Panel declined to amend the paragraph on the basis of Mexico's comment because it considered that paragraphs 7.48-7.49 (paragraphs 7.47-7.48 of this Report) together do reflect, in summary, the points that Mexico explains above.

6.19 Mexico submits that the Panel's statement in paragraph 7.49 (paragraph 7.48 of this Report) does not accurately reflect Mexico's arguments. According to Mexico, its argument that the limitations inscribed in its Schedule make it impossible for cross-border supply to take place must be read in conjunction with its submissions on the nature of the services at issue. Mexico also notes that, as drafted, the first sentence of paragraph 7.49 (paragraph 7.48 of this Report) suggests that Mexico has argued that it did not undertake any commitment in respect of basic telecommunications. Mexico submits that, on the contrary, it has argued that it has scheduled a "standstill" under mode 1. In Mexico's view, this constituted a commitment, but did not accord market access to suppliers for cross-border supply. Mexico further submits that it inscribed commitments under mode 3. Mexico requests that the first and second sentence of paragraph 7.49 (paragraph 7.48 of this Report) be appropriately modified. According to the United States, Mexico asserts that the Panel has mischaracterized Mexico's argument by stating that it "did not undertake any commitment in respect of basic telecommunications." The United States notes that Mexico did in fact make this argument and considers that the Panel has accurately summarised Mexico's arguments. In view of Mexico's

concern, the Panel modified the first sentence of paragraph 7.49 (paragraph 7.48 of this Report) to more clearly state the Panel's understanding of Mexico's arguments.

6.20 As regards paragraphs 7.51-7.61 (paragraphs 7.58-7.68 of this Report), the United States submits that in several places in this section the reader could be left with the mistaken impression that the Panel has used the Model Schedule and Chairman's Note in a manner other than to confirm the ordinary meaning of a term, as provided for in the customary rules of interpretation of public international law reflected in the Vienna Convention on the Law of Treaties. The United States particularly recalls that the use of the words "interpret" and "interpretative" in paragraphs 7.51, 7.57, and 7.61 of the Interim Report may lead to this mistaken impression. The United States further submits that the Panel has correctly stated its approach in paragraphs 7.15-7.17 (paragraphs 7.14-7.16 of this Report). In order to avoid any potential mistaken impressions, the United States suggests that the Panel more precisely indicates that these documents are simply being used to confirm the ordinary meaning of the terms employed. In view of the United States' comments, the Panel considered it appropriate to modify the section concerned to identify more clearly its application of the rules of interpretation of the Vienna Convention on the Law of Treaties to the Model Schedule and the Chairman's Note with regard to Mexico's commitments on the services at issue.

6.21 The United States, in connection with the preceding comment, suggests modifications to the first sentence of paragraph 7.61 (paragraph 7.67 of this Report). According to the United States, the second sentence of paragraph 7.61 (paragraph 7.68 of this Report) appears to address exclusively the interpretation of schedules which are not at issue in this dispute. Accordingly, it suggests that the sentence be omitted from the final report. As regards the first sentence of paragraph 7.61, the Panel changed the wording but did not use the formulation specified by the United States. On the second suggestion, the Panel disagrees with the United States. The Panel declined the modification requested by the United States because it considers it to be sufficiently clear that, in citing an example of a schedule without categories, the Panel is simply illustrating the importance of the implications of the Model Schedule and the Chairman's Note, and not indicating how the Panel would rule with respect to such a schedule.

6.22 With regard to paragraph 7.77 (paragraph 7.79 of this Report) Mexico requests that the Panel clarifies whether it is the "international traffic" or the transportation or transmission of such traffic that is supplied cross-border. According to the United States, Mexico's comment essentially repeats its arguments about the interpretation of the services at issue in this dispute, and its insistence that those services are not provided on a cross-border basis. The United States refers the Panel to its responses to Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report) and 7.27 of the Interim Report. According to the United States, further clarification of those issues is neither required nor appropriate in this paragraph. The Panel declines Mexico's request because it considers the relevance of Mexico's requested clarification to be unclear but believes that it appears to make a link with Mexico's previously rejected definition of cross-border supply.

6.23 Mexico also requests that the Panel clarifies what is meant by the term "cross-border service suppliers" in the last sentence of paragraph 7.77 (paragraph 7.79 of this Report). The United States believes the meaning of the quoted phrase in the final sentence is sufficiently clear, but suggests the Panel to consider changing the term to "suppliers of scheduled services on a cross-border basis". Although the Panel considers the meaning of the phrase to be clear, the Panel accepts the suggestion made by the United States to modify this term in paragraph 7.77 (paragraph 7.79 of this Report).

6.24 Mexico requests that in paragraph 7.88 (paragraph 7.90 of this Report) the Panel clarifies what is meant by the terms "potential cross-border supplier" and the "supply of services by [the cross-border] mode". The Panel considers the meaning of the phrases concerned to be sufficiently clear in their context and, thus, declines Mexico's request for clarification. However, the Panel notes that the word "potential", was meant simply to indicate that no cross-border supply into Mexico is actually permitted. To avoid any misunderstanding, the Panel has deleted the word "potential".

6.25 Mexico requests the Panel to add a new sentence to paragraph 7.108 (paragraph 7.110 of this Report) in order to fully reflect Mexico's position on the use of ILD Rules to define "interconnection". The United States considers Mexico's suggested text misplaced in a paragraph that describes the conclusions of the Panel rather than the arguments of the Parties. The United States therefore requests that the Panel rejects Mexico's proposed text. The Panel considers the paragraph concerned to contain the reasoning of the Panel, not the arguments of the parties and, therefore, declines the modification requested by Mexico.

6.26 With regard to paragraph 7.111 (paragraph 7.113 of this Report) Mexico requests the Panel to clarify how competition occurs in the context of an international setting and to explain what constitutes the "services offered in each others' market". The United States believes that the meaning of the quoted sentences is sufficiently clear. The Panel does not consider the point referred to by Mexico to be unclear and, thus, declines to amend the paragraph concerned.

6.27 Mexico notes that its comment on paragraph 4.54 of the descriptive part of the Report released on 6 June 2003 (paragraph 4.56 of this Report) pointed out that, in response to a specific request from the Panel for a list of the differences between accounting rate agreements and domestic interconnection agreements, Mexico had submitted copies of standard agreements and asked the Panel to reproduce the list of the important differences identified by Mexico. Mexico claims that this comment is not reflected in the Interim Report. Mexico further notes that at paragraph 7.112 (paragraph 7.114 of this Report), the Panel states that, "[a]fter reviewing the evidence," it agrees with the United States that there are no significant differences between accounting rate and domestic interconnection agreements. However, Mexico submits that it is not aware that the United States submitted any evidence in response to the pertinent question of the Panel. For these reasons, Mexico requests that the Panel identifies the evidence on which it relied in making the finding in paragraph 7.112 (paragraph 7.114 of this Report), and that it modifies paragraph 7.112 (paragraph 7.114 of this Report) to accurately reflect Mexico's position by listing the differences between the two types of contracts identified by Mexico. With respect to Mexico's request regarding the phrase "[a]fter reviewing the evidence," the United States observes that it is within the Panel's discretion to have found that arguments raised by the United States demonstrated that Mexico's arguments and evidence lacked relevance and probative value. As regards the descriptive part, the Panel had not accepted Mexico's suggestion made earlier because it considered that the paragraph concerned adequately summarised Mexico's submission. However, in view of the importance Mexico has attached to this point, the Panel has included a new sentence to paragraph 4.56 of this Report listing the differences between accounting rate agreements and domestic interconnection agreements described by Mexico. With regard to the contested phrase the Panel agrees to clarify it, in its own language, to avoid any misinterpretation. The Panel also accepted a United States' suggestion to insert a citation of the specific source of the United States' statements in paragraph 7.112 (paragraph 7.114 of this Report).

6.28 With regard to paragraph 7.114 (paragraph 7.116 of this Report) Mexico submits that the Panel considers only the evidence provided by the United States. Mexico suggests this paragraph to be amended to fully reflect Mexico's position by adding a new sentence after the first one. The United States considers Mexico's suggested text to be misplaced since the paragraph provides the findings of the Panel rather than a recitation of arguments of the parties. The Panel declines Mexico's request because paragraph 7.114 (paragraph 7.116 of this Report) contains the Panel's reasoning, and sets out what the Panel considers are the relevant arguments for arriving at its conclusion.

6.29 According to Mexico, in paragraph 7.117 (paragraph 7.119 of this Report) the Panel does not deal with the evidence submitted by Mexico that the current contractual arrangements lowering the accounting rate have been implemented by Mexican and United States' carriers notwithstanding that the United States' FCC has refused to approve them and still officially lists the United States-Mexico accounting rate as US\$0.38 (equating to a US\$0.19 settlement rate). In Mexico's view, this evidence verifies that, to enforce an accounting rate arrangement, a domestic body would need jurisdiction over parties beyond its border. Mexico requests that the Panel adds a new sentence at the end of paragraph

4.67 of the Interim Report. According to the United States, Mexico raises an argument, with respect to the position of the United States' FCC on United States-Mexico accounting rates, that Mexico did not make during the Panel proceedings. The United States considers Mexico's suggested text misplaced in a paragraph that describes the conclusions of the Panel rather than the arguments of the parties. The United States therefore urges the Panel to reject Mexico's proposed text. The Panel declines Mexico's request to insert Mexico's proposed sentence, because paragraph 7.117 (paragraph 7.119 of this Report) contains the Panel's reasoning, and sets out what the Panel considers are relevant arguments for arriving at its conclusion.

6.30 As regards paragraph 7.118 (paragraph 7.120 of this Report), the United States requests the Panel to add a footnote referencing the paragraphs to which the final sentence of the paragraph refers. In view of the United States' request, the Panel decided to delete "as discussed later in this section", since the subsequent discussions do not address the issue alluded to in exactly the same context as in this paragraph and because it considers that the conclusion in this paragraph stands on its own.

6.31 Mexico requests that the Panel clarifies, in paragraph 7.119 (paragraph 7.121 of this Report), how telecommunications transport services are actually supplied cross border and explain what is the nature of the services that cross the border. According to the United States, Mexico's comments again speak to its arguments about the interpretation of the services at issue, and its insistence that those services are not provided on a cross-border basis. The United States sees no justification for further discussion of those issues in this paragraph. The Panel declines the clarification requested by Mexico with respect to this paragraph and notes that it has already dealt with the matter regarding the "services at issue", above.

6.32 With regard to paragraph 7.138 (paragraph 7.140 of this Report), Mexico submits that in paragraph 170 of its first written submission, it did argue that accounting rates and termination services were consciously excluded from the Reference Paper which is confirmed by the fact that they are "on the table" in the Doha Round of negotiations. Mexico requests that the Panel clarify how this argument was taken into account or respond to this argument. The United States notes that the argument cited by Mexico is only one of many put before the Panel on this issue, and as such, it would not be appropriate to single it out in this paragraph. The Panel reviewed the arguments and decided to insert additional text at the end of paragraph 7.138 (paragraph 7.140 of this Report) to reflect Mexico's argument and how it was taken into account.

6.33 Mexico requests that the Panel identifies the evidence on which it relied in reaching the conclusion in paragraph 7.140 (paragraph 7.142 of this Report) that "many of the 55 WTO Members which have committed to cost-oriented interconnection are unlikely to apply traditional accounting rate arrangements to a significant portion of their international traffic....". According to Mexico, it submitted reports from the United States' FCC that establish that United States' carriers have accounting rate arrangements with virtually every country, and that in 2001 a majority of international calls to and from the United States were made through "traditional settlement". The United States notes that support for the Panel's conclusion may be found in paragraph 38 and footnote 25 of the United States' oral statement of 13 March 2003 and paragraph 48 and footnote 51 of the United States' submission of 30 April 2003. The Panel's findings already demonstrate that it does not agree with Mexico regarding the significance of the submissions it cites. However, to accommodate Mexico's concerns, the second sentence of paragraph 7.140 (paragraph 7.142 of this Report) is modified and a footnote is added to identify the evidence on which we relied to reach our conclusion.

6.34 Mexico submits that paragraph 7.149 (paragraph 7.151 of this Report), is ambiguous in that it does not clearly define what is the service supplied by the United States suppliers and under what mode. Mexico requests that the Panel clarifies: the definition of the "services at issue" and the relevant mode of supply; whether the "Mexican operators" referred to in the paragraph are also "suppliers" of such "service" or "services"; what is meant by the term "termination of the service"; whether the United States suppliers "terminate" the "service" or "services" in question; and what is

meant by the term "outgoing services". According to the United States, Mexico's comments repeat its arguments about the interpretation of the services at issue in this dispute and its insistence that those services are not provided on a cross-border basis. Regarding Mexico's references to the Panel's use of the terms "termination of the service" and "outgoing services", the United States submits that the Panel is not employing those terms to further define the services at issue in this dispute. The United States further submits that the Panel is properly using those terms to define the relevant market, for the purpose of determining whether Telmex is a "major supplier". With respect to the definition of the "services at issue" the Panel notes that it has already addressed the matter, above. As to whether the "Mexican operators" referred to in the paragraph are also "suppliers" of such "service" or "services", the Panel does not consider this distinction to be relevant. With regard to what is meant by the term "termination of the service", the Panel considers it appropriate to add a footnote to paragraph 7.23 (paragraph 7.22 of this Report) to clarify that the term is used in our findings to refer to forms of "linking" that falls within the scope of "interconnection". As to whether the United States suppliers "terminate" the "service" or "services", the Panel considers its reasoning makes clear that suppliers do not need to "terminate" services to be "supplying" them. As regards what is meant by the term "outgoing services" the Panel has changed the term to "outgoing traffic".

6.35 Mexico argues that, in paragraph 7.150 (paragraph 7.152 of this Report), the Panel refers to the market for "termination services" and to domestic and international "communication". In the light of Mexico's arguments on the meaning of "termination services" Mexico requests that the Panel clarifies and makes additional findings on what it means when it refers to "termination services", whether "termination services" are "basic telecommunications services" or a service sector at issue in this dispute, the mode of supply of such services, and whether United States or Mexican suppliers provide such services. Mexico also requests that the Panel clarifies whether a "communication" is a service at issue in this dispute. The United States submits that with respect to Mexico's comments regarding the Panel's use of the term "termination services," the Panel is not employing this term to further define the services at issue in this dispute – that is, the services to which the United States' claims relate and the services subject to Mexico's commitments. Rather, the United States reads the paragraph as using that term to properly define the relevant market for the purposes of determining whether Telmex is a "major supplier." The Panel does not accept the inferences made by Mexico with respect to the Panel's use of the term "termination services". However for clarification, the Panel is replacing "termination services" with "termination", to emphasise that the Panel is not using that term to refer in any way to services at issue in this dispute, but rather to define the relevant market for the purposes of determining whether Telmex is a "major supplier". To address the second concern, the Panel is replacing the term "communication" with "telecommunications service".

6.36 With regard to paragraph 7.154 (paragraph 7.156 of this Report), Mexico requests a new sentence to be added to the paragraph in order to reflect Mexico's position. The United States submits that Mexico's request is not necessary or accurate. According to the United States, the decisions by the CFC were provided by the United States at Exhibits US-20 and US-21. The United States notes that the CFC's decisions relied in part on the restrictive provisions in the ILD Rules discussed at length by the Panel. The Panel accepts Mexico's point and has added the suggested sentence to the paragraph in order to reflect Mexico's argument on these points.

6.37 Mexico submits that the Panel concludes in paragraph 7.157 (paragraph 7.159 of this Report) that Telmex is a "major supplier", with respect to the "services at issue" in that it has the ability to materially affect the price of termination of calls from the United States into Mexico. Mexico requests that the Panel clarify what is meant by the "services at issue" and whether the "termination of calls" is a service at issue in this dispute. The United States submits that the Panel has already adequately described the services at issue in this dispute, as well as the "relevant market" in which Telmex is a major supplier. The Panel's conclusion in paragraph 7.157 (paragraph 7.159 of this Report) speaks to the definition of the relevant market and whether Telmex is a major supplier in that market. To clarify this point, the United States suggests that the Panel amends paragraph 7.157

(paragraph 7.159 of this Report) by adding in the first sentence the phrase "termination of". The Panel accepts the suggestion made by the United States.

6.38 With regard to paragraph 7.200 (paragraph 7.202 of this Report) the United States asks the Panel to note that it has presented evidence of the difference between the aggregated component prices and the rates charged to United States suppliers for each of the three individual "zones" in Mexico. The Panel amended the text to make clear that it is aware that the United States presented evidence of the difference between the aggregated component prices and the rates charged to United States suppliers for each of the three individual zones.

6.39 Mexico refers to paragraphs 7.206-7.208 (paragraphs 7.208-7.210 of this Report) and 7.324-7.326 (paragraphs 7.326-7.328 of this Report) and claims that the Panel has adopted the United States characterisation of settlement rates as "access charges" or "termination rates." Therefore, Mexico considers that it is especially important that the Panel set forth the factual nature of settlement charges as described by Mexico in paragraph 29 of its first written submission. Mexico also requests an addition at the end of paragraph 7.206 (paragraph 7.208 of this Report) to ensure that Mexico's arguments are fully and accurately presented. The United States submits that Mexico's suggested text is misplaced and inappropriate in paragraphs 7.206-7.208 (paragraphs 7.208-7.210 of this Report). Therefore the United States urges the Panel to reject Mexico's proposed text. The Panel considers that the arguments of the parties on differences between settlement rates and termination rates do not belong to this section and makes no change to the text of the paragraph.

6.40 With regard to paragraph 7.210 (paragraph 7.212 of this Report), the United States submits that the paragraph contains a lengthy statement from the United States, but does not provide the specific source of the statement. The Panel accepts the United States request and inserts the indicated reference in a footnote.

6.41 According to Mexico, in paragraph 7.214 (paragraph 7.216 of this Report), in arriving at its finding that "interconnection rates charged by Telmex to United States suppliers of the services at issue are not cost-oriented", the Panel did not address facts and arguments presented by Mexico. According to Mexico there is a widespread practice, both in domestic and international contexts, of using target rates to determine whether rates are acceptable, and the United States stated that "WTO Members do not have explicit requirements for settlement rates to be cost-based." Mexico also contends that the United States agreed with it that Members "can reasonably rely on competitive market dynamics to yield cost-based settlement rates". The United States submits that Mexico is inaccurately quoting the United States. According to the United States, it did not state that "WTO Members do not have explicit requirements for settlement rates to be cost-based." Nor did it agree that currently in Mexico, Members "can reasonably rely on competitive market dynamics to yield cost-based settlement rates," which is what Mexico is presumably implying. The Panel declines to make any amendments on the basis of Mexico's comments because the quotes appear to be inaccurate or out of context; even if true, they are not relevant to argument presented in this paragraph.

6.42 According to Mexico its settlement rates with the United States are consistent with the target rate recommended by ITU Study Group 3 for Mexico. According to the United States, Mexico incorrectly states that the Panel did not address Mexico's argument that its settlement rates with the United States are consistent with the target rate recommended by ITU Study Group 3 for Mexico. The Panel believes that it has adequately addressed Mexico's arguments and notes that, in any case, ITU "target rates" are just that, and are not, themselves, cost oriented rates.

6.43 Mexico submits that its settlement rates are also sufficiently below the benchmark rate for Mexico set by the United States' FCC to establish, under the FCC's own guidelines, that there is "meaningful economic competition" in Mexico. Moreover, the application by the United States of its benchmarks policy to WTO Members is inconsistent with a belief that the Fourth Protocol applies to accounting rates. The United States submits that relevant United States' arguments are included at

paragraph 36 of the United States' answers of 27 March 2003, and at footnote 42 of its second written submission of 5 February 2003. The Panel notes that it does not accept the implications of Mexico's arguments and notes, further, that the FCC benchmark rates are not, and are not claimed to be, "cost oriented" rates.

6.44 Mexico claims that the United States compares ISR rates from the United States to various countries with the United States-Mexico accounting rates, rather than comparing the United States accounting rates with those countries to the United States-Mexico accounting rates. The United States submits that relevant United States' arguments in this regard are included at paragraph 34 of the United States' answers of 27 March 2003, and at paragraph 121 of its first written submission and at Exhibit US-5. The Panel considers that Mexico's argument is not relevant since the United States' accounting rates are not subject to any claims in this dispute. Furthermore, the Panel is of the view that the United States uses ISR rates not as a substitute for accounting rates, but as a proxy for illustrating what costs may be.

6.45 With regard to paragraph 7.225 (paragraph 7.227 of this Report), Mexico requests that the Panel clarify what is meant by the "services at issue" and whether the "termination ... of the services at issue" means the "termination of calls". The United States submits that, as noted above in the United States' responses to Mexico's comments concerning paragraphs 7.149, 7.150 and 7.157 (paragraphs 7.151, 7.152 and 7.159 of this Report), the Panel's statements at paragraph 7.225 (paragraph 7.227 of this Report) speak to the definition of the relevant market, and whether Telmex is a "major supplier" in that market. To clarify this point, the United States suggests that the Panel amend the first sentence of paragraph 7.225 (paragraph 7.227 of this Report). The Panel declines Mexico's request because it notes that the issue of "services at issue" and "termination" have already been adequately addressed in response Mexico's comments above.

6.46 Mexico requests the Panel to clarify in paragraph 7.226 (paragraph 7.228 of this Report) of the Interim Report that under the Panel's finding, individual gateway operators other than Telmex are not, themselves, "major supplier[s]" within the meaning of Section 1 of Mexico's Reference Paper. The United States submits that the additional language requested is inappropriate and requests that the Panel reject the modification requested by Mexico. According to the United States, the parties have made no arguments and presented no evidence regarding whether Mexican gateway operators other than Telmex are, "viewed individually or together," "major suppliers". The Panel declines Mexico's request because the Panel does not consider it necessary or relevant to make such a finding as to whether the other suppliers are not "major suppliers".

6.47 According to Mexico, in paragraphs 7.237-7.243 (paragraphs 7.239-7.245 of this Report), the Panel sets out its reasoning that leads to its conclusion that practices required under Mexico's law can be "anti-competitive practices" within the meaning of Section 1 of Mexico's Reference Paper. Mexico submits that the Panel reasoning is incomplete. In Mexico's view, Section 1.1 of Mexico's Reference Paper is aimed at anti-competitive "practices" by major suppliers, not "measures" implemented by a WTO Member, otherwise the language of Section 1 would have gone further to prohibit Members from introducing or maintaining "anti-competitive measures". According to the United States, the Panel has included Mexico's argument in paragraph 4.257 of the Interim Report. The United States' rebuttal to Mexico's argument is included in paragraph 66 of the United States' comments on 30 April 2003 on Mexico's answers. The United States also notes that the Panel addressed at length the relationship between "measures" and "practices" at paragraphs 7.237-7.243 (paragraphs 7.239-7.245 of this Report). In view of Mexico's concerns, the Panel has added a sentence after the first sentence of paragraph 7.239 (paragraph 7.241 of this Report) to better reflect that Mexico's argument was taken into account.

6.48 According to Mexico, important legal context is provided by Article VIII:5 of the GATS. This provision imposes disciplines in situations where a WTO Member authorises or establishes a small number of service suppliers and substantially prevents competition among those suppliers in its

territory. Mexico submits that the Panel's interpretation of Section 1 of Mexico's Reference Paper must take into account this GATS provision so as not to undermine its meaning. In the United States' view, the Panel addressed Mexico's argument, and the United States rebuttal thereto, in paragraphs 4.260-4.261 of the Interim Report. Having re-examined the submission containing the argument referred to by Mexico, the Panel declines to accept Mexico's request because the Panel considers the argument to be recorded as adequately as possible in the paragraphs cited by the United States.

6.49 In Mexico's view, there is no basis in the text of Section 1 of Mexico's Reference Paper to make important and complicated distinctions between permissible and impermissible anti-competitive "measures" or to judge the legitimacy of a WTO Member's internal policies in circumstances where no agreed-upon benchmarks exist. According to the United States, the Panel addressed Mexico's argument at paragraphs 4.257 of the Interim Report, 7.228-7.236, and 7.263-7.267 (paragraphs 7.230-7.238 and 7.265-7.269 of this Report). As addressed in paragraphs 7.233-7.234 (paragraphs 7.235-7.236 of this Report), there are international agreements on certain types of anti-competitive practices that should be prohibited, including in particular price-fixing cartels. The Panel declines Mexico's request, noting that it has already addressed Mexico's argument at paragraph 7.263-7.267 (paragraphs 7.265-7.269 of this Report).

6.50 According to Mexico, at paragraphs 7.237-7.243 (paragraphs 7.239-7.245 of this Report), the Panel sets out its reasoning that leads to its conclusion that practices required under Mexico's law could be "anti-competitive practices" within the meaning of Section 1 of Mexico's Reference Paper. At paragraphs 7.255-7.262 (paragraphs 7.257-7.264 of this Report), the Panel sets out its reasoning that leads to its conclusions that the uniform settlement rate and proportionate return system under the ILD Rules require practices by a major supplier, Telmex, that are "anti-competitive" within the meaning of Section 1 of Mexico's Reference Paper. In Mexico's view, it has presented detailed arguments that the measures at issue had "pro-competitive" effects and were aimed at legitimate policy objectives. Mexico submits that although the Panel Report identifies some of these arguments, the Panel does not explain how Section 1 of Mexico's Reference Paper prohibits measures that have pro-competitive effects and legitimate policy objectives where, at the same time, they also have some anti-competitive effects. Mexico further submits that the Panel refers only to "horizontal practices such as price-fixing among competitors" and "market sharing arrangements", private actions that do not have the pro-competitive effects and legitimate policy objectives of Mexico's measures. Mexico's argument that its measures are distinguishable from such private actions and are not "anti-competitive practices" within the meaning of Section 1 and its argument that all government regulatory measures have some anti-competitive effects have not been addressed by the Panel. The United States contends that although Mexico asserts that the Panel ignored its arguments that the ILD Rules have "pro-competitive effects," the Panel in fact demonstrates that it considered this argument at paragraphs 7.221, 7.239, 7.256, 7.259 and 7.261 (paragraphs 7.223, 7.241, 7.258, 7.261 and 7.263 of this Report). In paragraph 7.259 (paragraph 7.261 of this Report), the Panel expressly evaluated Mexico's assertions, concluding that Mexico failed to provide evidence or well-founded reasons to support its assertions. Moreover, as noted above, the Panel addressed, in paragraphs 7.237-7.243 (paragraphs 7.239-7.245 of this Report) of the Interim Report, whether practices required under a Member's laws can be "anti-competitive practices" within the meaning of Section 1.1 of Mexico's Reference Paper. The Panel does not accept Mexico's request, noting that it has dealt with Mexico's arguments, as pointed out in the United States' comments, in paragraphs 7.221, 7.239, 7.256, 7.259 and especially 7.261 (paragraphs 7.223, 7.241, 7.258, 7.261 and 7.263 of this Report). The Panel confirms that its deliberations took fully into account the points and arguments identified by Mexico in its comments on the reasoning of this particular conclusion. However, the Panel declines Mexico's request because, as noted at the outset of this section, a panel cannot be expected to restate all of the statements and arguments of the parties in the findings section of a Report.

6.51 According to the United States, in paragraph 7.240 (paragraph 7.242 of this Report), the Panel discusses cross-subsidisation as an illustrative example of an anti-competitive practice listed in Section 1.2 of the Reference Paper. The United States notes that the language of Section 1.2 of the

Reference Paper does not explicitly refer to cross-subsidisation per se, but rather anti-competitive cross-subsidisation. To conform to the phrasing used in the Reference Paper, the United States suggests the text to be amended. The Panel notes the United States' comment and has modified the text to reflect the concern raised.

6.52 With regard to paragraphs 7.272-7.286 (paragraphs 7.274-7.288 of this Report), Mexico submits that the Panel sets out its reasoning that leads to its conclusion that the Annex applies to measures of a Member that affect access to and use of public telecommunications transport networks and services by basic telecommunications suppliers of any other Member. According to Mexico, the Panel's summary of Mexico's argument is incomplete. In Mexico's view, the Panel does not identify nor respond to Mexico's argument that the service at issue is not a "telephone call" or any other customer-supplied information or data, but, rather, is telecommunications transport networks or services that involve the transport or transmission of information or data between two or more points. As such, Mexican suppliers of telecommunications transport networks and services cannot transmit other telecommunications transport networks or services and cannot, therefore, constitute a mode of delivery for those services. Mexico requests that the Panel incorporate this argument in paragraph 7.274 (paragraph 7.276 of this Report) and make additional findings on the nature of the services at issue. In particular, Mexico requests that the Panel clarify what constitutes the "supply of basic telecommunications services" and "international supply of basic telecommunications services". The United States submits that Mexico's comments repeat comments on the interpretation of the services at issue in this dispute and recalls its responses to Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report). The United States maintains the issues raised here require no further development at this point in the report. The Panel declines Mexico's request, noting that Mexico's comments essentially relate to arguments and conclusions concerning the services at issue in this dispute that are already addressed earlier in this section.

6.53 With regard to paragraph 7.317 (paragraph 7.319 of this Report), Mexico fails to see how paragraph 7.178 of the Interim Report cited in footnote 924 (footnote 1023 of this Report) is relevant to the Panel's statement and requests that the Panel clarify this. The United States submits that with respect to Mexico's comments regarding footnote 924 (footnote 1023 of this Report), the Panel may have intended to refer to paragraph 7.40 in this Report or one of the surrounding paragraphs. The Panel has reviewed the reference and corrected footnote 924 (footnote 1023 of this Report) to refer to paragraphs 7.40-7.45 of this Report.

6.54 Mexico also submits that the quoted statement in paragraph 7.317 (paragraph 7.319 of this Report) does not clearly describe the nature of the "basic telecommunications services" at issue and how foreign suppliers actually supply such services into Mexico. Thus, Mexico requests that the Panel clarify and makes additional finding on: what "services" require suppliers to link their networks to those of other suppliers; whether the "services at issue" are the transport or transmission of information or data between two or more points; how Mexican suppliers can transmit "transport and transmission" services of other suppliers; and whether United States suppliers supply "transport and transmission services" into and within Mexico. According to the United States, Mexico's comments repeats those on the interpretation of the services at issue in this dispute and recalls its responses to Mexico's comments on paragraphs 7.23-7.25 (paragraphs 7.22-7.23 and 7.26 of this Report). The United States maintains the issues raised here have been amply addressed and require no further development at this point in the Report. The Panel notes that Mexico's comments relate to arguments and findings that have already been addressed earlier in this section.

6.55 As regards paragraph 7.322 (paragraph 7.324 of this Report), the United States considers that it would be helpful for the Panel to include a cross-reference to the paragraphs it has in mind when it refers, at the beginning of the third sentence of this paragraph, to "our earlier analysis." The United States also suggests that the third sentence of paragraph 7.322 (paragraph 7.324 of this Report) should be re-arranged in harmony to paragraph 7.304 (paragraph 7.306 of this Report). The Panel accepts the

United States suggestions and adds a footnote cross-referencing paragraph 7.304 (paragraph 7.306 of this Report). It also modifies the paragraph as suggested by the United States.

6.56 As regards paragraph 7.369 (paragraph 7.371 of this Report), Mexico requests that the Panel clarifies and notes the fact that Mexico has issued regulations for the establishment and operation of commercial agencies for pay-telephone public services. The United States notes that Mexico's argument is reflected in paragraph 4.323 of the Interim Report. If Mexico's request is accepted by the Panel then the United States requests that the Panel also note the United States' observation that the service suppliers at issue in the United States' claim under Section 5(b) of the Annex on Telecommunications are locally-established commercial agencies offering international telecommunications services over private circuits leased from a Mexican concessionaire. Noting that pay phone services are not subject to the claims made by the United States in this dispute, the Panel does not consider it necessary to include in the Panel's findings the argument identified by Mexico on this point.

## VII. FINDINGS

### A. INTRODUCTION

7.1 The United States presents three main claims. First, that Mexico has failed to ensure that its major telecommunications supplier provides interconnection "on terms, conditions ... and cost-oriented rates that are ... reasonable", in accordance with Section 2 of its Reference Paper commitments. Second, that Mexico has not maintained appropriate measures to prevent Telmex, a major supplier, from engaging in "anti-competitive practices", in accordance with Section 1 of its Reference Paper commitments. Third, that Mexico has failed to ensure "access to and use of" its public telecommunications transport networks and services, including private leased circuits, on "reasonable and non-discriminatory terms and conditions", in accordance with its obligations under Section 5 of the GATS Annex on Telecommunications.

7.2 This case is the first panel proceeding in the WTO to deal solely with trade in services under the GATS. It is also the first WTO panel proceeding to deal with telecommunications services. The Panel is fully aware that the interpretation of the complex layers of GATS Articles, Annexes, Protocols and Schedules with GATS market access commitments, national treatment commitments and additional commitments poses many challenges to WTO Members and WTO dispute settlement bodies. This is especially so in the early years of GATS jurisprudence when the sometimes different approaches used by governments in the drafting of their respective GATS schedules may give rise to divergent understandings and expectations. Just as the interpretation and application of GATT provisions have dynamically evolved in response to the several hundred GATT dispute settlement proceedings since 1948, so the interpretation and clarification of GATS provisions is likely to evolve over time. The diverse backgrounds of the panelists, and the assistance granted by the Secretariat pursuant to Article 27.1 of the DSU, have ensured that this Panel was fully aware of the legal and technical complexity of the regulation of telecommunications services, including their rapid technological evolution<sup>799</sup> and the drafting history of GATS provisions to which both parties to this dispute referred extensively.

7.3 The Panel's legal task is "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". This task requires us, as provided in Article 3.2 of the DSU, "to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law" in order "to preserve the

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<sup>799</sup> For instance, some of the telecommunication provisions seem to be technology-specific and may no longer reflect prevailing industry practices.

rights and obligations of Members under the covered agreements" and to provide "security and predictability to the multilateral trading system". We have approached our daunting task with the utmost prudence and, in several parts of our findings, have decided to exercise "judicial economy". WTO negotiators sometimes praise the political wisdom of resorting to "constructive ambiguity" as a diplomatic means of enabling consensus on WTO rules.<sup>800</sup> The limited legal task of dispute settlement findings is very different. It is to decide on the legal claims, in a particular dispute, based on the "ordinary meaning" of the WTO provisions concerned "in their context" and in light of the "object and purpose" of the agreement. Our legal findings are thus limited to the disputed meaning and scope of certain GATS obligations and commitments of Mexico in the very particular context of this bilateral dispute, and do not go beyond what we consider indispensable for deciding on the legal claims submitted to this Panel. Our focus on telecommunications services may mean that certain elements of our findings in this particular services sector may not be relevant for other services sectors with different legal, economic and technical contexts. Our findings also do not adversely affect the large degree of regulatory autonomy which WTO Members, individually and collectively, retain under the GATS, including the right to modify specific GATS commitments pursuant to the procedures and conditions set out in Article XXI of the GATS.

## **1. Telecommunications in the WTO**

7.4 This case concerns obligations undertaken by Mexico as part of the GATS. The GATS, which is an integral part of the WTO Agreement, consists of a number of articles in its main body and several annexes, including an Annex on Telecommunications (the "Annex"). Both the main body of the GATS and the Annex are applicable to every WTO Member. In addition, each WTO Member has attached its own schedule to the GATS, in which the Member makes individual specific commitments on market access, national treatment, and any additional commitments the Member may wish to make. These specific commitments are inscribed by service sector and mode of supply of the service, and may be subject to limitations on market access and national treatment.

7.5 Special GATS negotiations intended to deepen and widen commitments in basic telecommunications were concluded in 1997. Members participating in these negotiations made commitments, or further commitments, in their schedules on market access or national treatment. Many, including Mexico, also made additional commitments in the form of a "Reference Paper", which contained a set of pro-competitive regulatory principles applicable to the telecommunications sector.

## **2. Measures at issue in this dispute**

7.6 The government measures at issue in these proceedings are:

- (a) The "Federal Telecommunications Law" ("FTL") (*Ley Federal de Telecomunicaciones*) of 18 May 1995.
- (b) The "Rules for Long Distance Service" (*Reglas del Servicio de Larga Distancia*) published by the Secretariat of Communications and Transportation ("SCT") (*Secretaría de Comunicaciones y Transporte*) on 21 June 1996.
- (c) The International Long Distance Rules ("ILD Rules") (*Reglas para prestar el servicio de larga distancia internacional*) published by the SCT on 11 December 1996.<sup>801</sup>

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<sup>800</sup> Cf. former WTO Director-General Mike Moore, "A World Without Walls – Freedom, Development, Free Trade and Global Governance", Cambridge, Cambridge University Press, 2003, p. 111.

<sup>801</sup> See footnote 25 of this Report.

- (d) The "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" (*Acuerdo de la SCT por el que se establece el procedimiento para obtener concesión para la instalación, operación o explotación de redes públicas de telecomunicaciones interestatales, al amparo de la Ley Federal de Telecomunicaciones*) published on 4 September 1995.

### 3. Mexico's legal framework for the regulation of telecommunications services

7.7 The Federal Telecommunications Law (the "FTL") of Mexico provides the legal framework for the regulation of telecommunications activities in Mexico.<sup>802</sup> The FTL authorizes the SCT, *inter alia*, to grant concessions required for "installing, operating or exploiting public telecommunications networks".<sup>803</sup> A concession may only be granted to a Mexican individual or company, and any foreign investment therein may not exceed 49%<sup>804</sup>, except for cellular telephone services.<sup>805</sup>

7.8 Special rules apply to "*comercializadoras*" ("commercial agencies").<sup>806</sup> A commercial agency is any entity which, "without being the owner or possessor of any transmission media, provides telecommunications services to third parties using the capacity of a public telecommunications network concessionaire."<sup>807</sup> A concessionaire of a public telecommunications network may not, without permission of the SCT, have "any direct or indirect interest in the capital" of a commercial agency.<sup>808</sup> The establishment and operation of commercial agencies is "subject, without exception, to the respective regulatory provisions".<sup>809</sup>

7.9 The "interconnection" of public telecommunications networks with foreign networks is carried out through agreements entered into by the interested parties.<sup>810</sup> Should these require agreement with a foreign government, the concessionaire must request the SCT to enter into the appropriate agreement.<sup>811</sup>

7.10 International Long-Distance Rules ("ILD Rules") are issued by the Federal Telecommunications Commission ("*Comisión Federal de Telecomunicaciones*"), a semi-autonomous agency of the Secretariat of Communications and Transportation.<sup>812</sup> The ILD Rules serve "to regulate the provision of international long-distance service and establish the terms to be included in agreements for the interconnection of public telecommunications networks with foreign networks."<sup>813</sup>

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<sup>802</sup> See FTL ("*Ley Federal de Telecomunicaciones*"), published in the Federal Gazette ("*Diario oficial de la Federación*") on 7 June 1995, entered into force on 8 June 1995.

<sup>803</sup> See FTL, Article 11.

<sup>804</sup> See FTL, Article 12. Foreign investment in cellular telephone services may however be greater than 49%, with the permission of the Commission on Foreign Investment.

<sup>805</sup> See FTL, Article 12.

<sup>806</sup> Also referred to in English language translations of the FTL as "telecommunications service marketing companies".

<sup>807</sup> See FTL, Article 52.

<sup>808</sup> See FTL, Article 53.

<sup>809</sup> See FTL, Article 54.

<sup>810</sup> See FTL, Article 47, paragraph 2.

<sup>811</sup> See FTL, Article 47, paragraph 4.

<sup>812</sup> See *Rules for the Provision of International Long-Distance Service To Be Applied by the Licensees of Public Telecommunications Networks Authorized to Provide this Service* (Reglas para Prestar el Servicio de Larga Distancia Internacional que deberán aplicar los Concesionarios de Redes Públicas de Telecomunicaciones Autorizados para Prestar este Servicio) Issued by the Commission; published in the Federal Gazette on 11 December 1996; entered into force on 12 December 1996.

<sup>813</sup> See ILD Rule 1.

International long-distance service is defined as the service whereby all international switched traffic is carried through long-distance exchanges authorized as international gateways".<sup>814</sup>

7.11 Direct interconnection with foreign public telecommunications networks in order to carry international traffic may only be carried out by "international gateway operators".<sup>815</sup> These are long-distance service licensees authorized by the Commission "to operate a switching exchange as an international gateway"<sup>816</sup>, that is, the exchange is "interconnected to incoming and outgoing circuits authorised by the Commission to carry international traffic".<sup>817</sup> Traffic is "switched" when it is "carried by means of a temporary connection between two or more circuits between two or more users, allowing the users the full and exclusive use of the connection until it is released."<sup>818</sup>

7.12 Each international gateway operator must apply the same "uniform settlement rate" to every long-distance call to or from a given country, regardless of which operator originates or terminates the call.<sup>819</sup> The uniform settlement rate for each country is established, through negotiations with the operators of that country, by the long-distance service licensee having the greatest percentage of outgoing long-distance market share for that country in the previous six months.<sup>820</sup>

7.13 Each international gateway operator must also apply the principle of "proportionate return". Under this principle, *incoming* calls from a foreign country must be distributed among international gateway operators in proportion to each international gateway operator's market share in *outgoing* calls to that country.<sup>821</sup>

#### 4. Rules of interpretation

7.14 The GATS constitutes an integral part of the WTO Agreement. As such, the GATS (including its annexes and schedules of specific commitments that are made an integral part of it under GATS Article XX:3) is one of the "covered agreements" and is therefore subject to the Dispute Settlement Understanding (the "DSU").

7.15 Article 3.2 of the DSU provides that panels are to clarify the provisions of "covered agreements" in accordance with customary rules of interpretation of public international law. In *US – Gasoline*, the Appellate Body stated that the fundamental rule of treaty interpretation as set out in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the "Vienna Convention")<sup>822</sup> had "attained the status of a rule of customary or general international law" and "forms part of the 'customary rules of interpretation of public international law'".<sup>823</sup> Since the commitments provided for in Mexico's Schedule are part of the terms of the treaty, the only rules which may be applied in interpreting the meaning of a commitment are the general rules of interpretation as set out in the Vienna Convention.<sup>824</sup>

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<sup>814</sup> See ILD Rule 2:XI.

<sup>815</sup> See ILD Rules 3, and 6.

<sup>816</sup> See ILD Rule 2:VII.

<sup>817</sup> See ILD Rule 2:VIII.

<sup>818</sup> See ILD Rule 2:XV.

<sup>819</sup> See ILD Rules 2:XII(a) and (b); and 10.

<sup>820</sup> See ILD Rule 13.

<sup>821</sup> See ILD Rules 2:XII, 10, 13, 16, 17, and 19.

<sup>822</sup> Vienna Convention on the Law of Treaties, done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; (1969) 8 International Legal Materials 679.

<sup>823</sup> See Appellate Body Report, *US – Gasoline*, DSR 1996:I, 3, at 16.

<sup>824</sup> See Appellate Body Report, *EC – Computer Equipment*, paragraph 84. The conclusions of the Appellate Body in that case applied to concessions made by Members in their GATT Schedules. We consider that such conclusions can equally well be applied to commitments made by Members in their GATS schedules.

7.16 Article 31(1) of the Vienna Convention requires a treaty interpreter to determine the meaning of a term in accordance with the "ordinary meaning" to be given to the term "in its context", and in light of the "object and purpose" of the treaty. If, after applying the rule of interpretation set out in Article 31(1), it is desirable to confirm the meaning of the term, or the meaning of the treaty term remains ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable, Article 32 allows the treaty interpreter to have recourse to "supplementary means of interpretation, including the preparatory work on the treaty and the circumstances of its conclusion".<sup>825</sup>

## 5. Order of analysis of the claims

7.17 The United States has presented its two claims concerning Mexico's Reference Paper commitments first, followed by its claim concerning Section 5 of the Annex on Telecommunications. We have decided to examine these claims in the order presented by the United States since we consider that this order will allow us to analyse the issues in the most efficient manner.

### B. WHETHER MEXICO HAS FULFILLED ITS COMMITMENTS UNDER SECTIONS 2.1 AND 2.2 OF THE REFERENCE PAPER

7.18 The United States claims that Mexico has not met its commitment under Sections 2.1 and 2.2 of its Reference Paper with respect to certain basic telecommunications services supplied cross-border into Mexico by facilities-based and non-facilities-based United States suppliers. In particular, the United States claims that Mexico has failed to ensure that Telmex provide interconnection to United States basic telecommunications suppliers on a cross-border basis with cost-based rates and reasonable terms and conditions. Mexico contests this claim, stating that its GATS schedule contains no specific commitments that would trigger the Section 2 commitments in the Reference Paper, and that in any case the Reference Paper provisions on interconnection do not extend to services which originate abroad, or are subject to international accounting rates. Even if interconnection in the sense of the Reference Paper were to apply, Mexico claims that Telmex is not a "major supplier", as specified under Section 2.2, and that, in any case, the terms and conditions of interconnection offered to United States telecommunications suppliers are in fact "reasonable", and the rates are "cost-oriented".

7.19 The basis of this first claim by the United States are Sections 2.1 and 2.2 of the Reference Paper, as incorporated in Mexico's GATS schedule under additional commitments.<sup>826</sup> These provisions state, in relevant part:

#### "2. Interconnection

2.1 This 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.

#### 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

...

<sup>825</sup> See Appellate Body Report, *EC – Computer Equipment*, paragraph 86.

<sup>826</sup> Mexico has undertaken specific commitments for telecommunications services (Schedule of Specific Commitments) under Articles XVI (Market Access), XVII (National Treatment), and Article XVIII (Additional Commitments). Its additional commitments consist of undertakings known as the "Reference Paper". These commitments are reproduced in Annex B.

- (b) in a timely fashion, 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; ...<sup>827</sup>

7.20 In determining whether commitments in Sections 2.1 and 2.2 have been met by Mexico, we shall first examine whether Mexico has *undertaken* an interconnection commitment with respect to the telecommunications services at issue in this case. In the event that we conclude that Mexico has indeed undertaken an interconnection commitment in respect of the telecommunications services at issue, we will then determine whether, with respect to the services at issue, Mexico has *fulfilled* any Section 2 interconnection commitment.

**1. Whether Mexico has undertaken an interconnection commitment, in Section 2 of its Reference Paper, with respect to the telecommunications services at issue**

7.21 Section 2.1 of Mexico's Reference Paper commitment on interconnection specifies that it applies only "on the basis of the specific commitments undertaken" (*"respecto de los cuales se contraigan compromisos específicos"*). We must first therefore determine what the *services* at issue are, and through which of the four modes specified in Article I:2 of the GATS they are supplied.<sup>828</sup> Only then can we determine whether Mexico has undertaken, with respect to these services, a commitment "on the basis" of which the interconnection commitment in Section 2.2 applies. Finally, in determining whether Mexico has undertaken interconnection commitments with respect to the services and modes of supply at issue, we must examine whether the "linking" of suppliers referred to in Section 2.1 of the Reference Paper covers not only domestic interconnection, but also *international* interconnection, understood as the linking of suppliers cross-border, including linking which involves traditional "accounting rate" regimes.

- (a) What are the services at issue?

7.22 The United States focuses its first claim on the supply of certain basic public telecommunications services<sup>829</sup> for which United States suppliers seek to interconnect at the border

<sup>827</sup> English translation. The authentic version of Mexico's Schedule is Spanish. It reads:

"2 *Interconexión*

2.1 *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.*

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 (incluyendo normas técnicas y especificaciones) 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>828</sup> The modes of supply are commonly known as: (a) cross-border supply; (b) consumption abroad; (c) commercial presence; and (d) presence of natural persons. They are also referred to numerically as modes 1, 2, 3 and 4. For the text of Article I:2 of the GATS, see paragraph 7.29.

<sup>829</sup> For the definition of basic public telecommunication services, see Section 3(b) of the GATS Annex on Telecommunications, which defines "public telecommunications transport services" 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

with Telmex, or other Mexican operators, for termination<sup>830</sup> in Mexico, and for which, according to the United States, Mexico has undertaken specific commitments in its schedule. The specific public telecommunications services subject to the claims are voice telephony, circuit-switched data transmission and facsimile services. These services are, according to the United States, of two types depending on how the service is provided. First, there are "facilities-based" services, whereby the service supplier provides the services over its own facilities. Second, there are "non-facilities-based" services (services supplied by "comercializadoras" or "commercial agencies"), whereby the service supplier provides telecommunications services using facilities leased from other operators.<sup>831</sup>

7.23 We will refer to the public voice telephony, circuit-switched data transmission and facsimile services, both "facilities-based" and by a "commercial agency", that are raised by the United States in its first claim as "the services at issue".<sup>832</sup>

7.24 The United States' claims regarding the services at issue relate to the GATS mode of supply known as cross-border supply of these services. However, the parties do not agree that the services at issue are actually being supplied by this mode of supply. Consequently, the Panel must now turn to the issue of whether or not the services at issue are supplied cross-border.

(b) Are the services at issue supplied cross-border?

7.25 The United States contends that their claims regarding the services at issue relate to the cross border supply of these services. According to the United States, these services are supplied from the United States into Mexico, within the meaning of GATS Article I:2(a), which defines what is commonly referred to as "cross-border" trade in services.<sup>833</sup> Specifically, facilities-based operators in the territory of the United States deliver traffic consisting of the services at issue from United States customers to the Mexican border where, under Mexican law, the traffic is transferred to Mexican operators, who then terminate the United States operators' traffic, consisting of the services at issue, in Mexico. According to the United States, non-facilities-based operators (commercial agencies) would, if permitted by Mexican regulations, also supply services on a cross-border basis into Mexico.<sup>834</sup> Whether a service is facilities-based or non-facilities based, for the supply of cross-border services, is determined, according to the United States, by the use or not of a supplier's own facilities in the market from which the service is supplied.<sup>835</sup>

7.26 To illustrate the cross-border supply of the services at issue, the United States points to the supply of services by AT&T, WorldCom and Sprint which, as facilities-based operators, "use their own networks in the United States to offer voice telephony, circuit-switched data and facsimile

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end-to-end change in the form or content of the customer's information." This definition is applicable because the Ministerial Decision on Negotiations on Basic Telecommunications (part of the Final Act of the Uruguay Round) specified that "telecommunications transport networks and services" were "basic telecommunications", a term which would encompass both "public telecommunications transport services" and non-public "telecommunications transport services".

<sup>830</sup> The word "termination" is used in our findings to refer to one of the forms of "linking" that falls within the scope of the "interconnection". This is supported by the language of Section 2 which states that the section applies to linking "in order to allow the users of one supplier to communicate with users of another supplier".

<sup>831</sup> See the United States' first written submission, paragraph 59. These services are listed in Mexico's Schedule under headings 2.C.(a), (c) and (d).

<sup>832</sup> The Panel considers the terms "telephony" and "voice telephony" (as used in the English translations of Mexico's Schedule and the claims by the United States) to be equivalent to the terms "telephone services" and "voice telephone services" (as used in the GATS sectoral classification and the CPC).

<sup>833</sup> See the United States' first written submission, paragraph 54.

<sup>834</sup> See the United States' first written submission, paragraph 57.

<sup>835</sup> See the United States' answer to question No. 2(a) of the Panel of 14 March 2003. For question No. 2(a), see footnote 212 of this Report.

services between the United States and Mexico".<sup>836</sup> These operators must link their network at the border to that of a Mexican operator. The United States does not illustrate the current supply of "commercial agency" services from the United States into Mexico, claiming that Mexico maintains measures that prohibit the cross-border supply of this type of service.

7.27 Mexico claims that the services at issue are not supplied cross-border in accordance with the terms of Article I:2(a). According to Mexico, the essential nature of the services at issue is the *transmission* of customer data. In order to transmit customer data cross-border "from" one Member "into" another Member, the supplier must *itself transmit* the customer data within the territory of that other Member. Mexico's view is that no country imposes restrictions on the quantity of incoming or outgoing calls, but rather only on services relating to the transmission of the calls, and therefore that the GATS commitments would be meaningless if they related to the calls rather than their transmission. Thus, an operator who simply "hands off" traffic at the border to another operator would not, argues Mexico, be supplying cross-border within the meaning of Article I:2(a). According to Mexico, a hand-off of traffic at the border amounts to a "half-circuit" provision of telecommunications services; only "full-circuit" or "end-to-end" provision by the same operator constitutes cross-border supply within the meaning of Article I:2(a).<sup>837</sup>

7.28 Mexico's argument that the supplier must *itself transmit* the customer data within the territory of that other Member implies, in effect, that cross-border supply within the meaning of Article I:2(a) can only occur if the supplier operates, or is present<sup>838</sup> in some way, on the other side of the border. Absent this, the supplier would presumably not have the capability to *itself transmit* there. The issue before us is therefore whether, with respect to the telecommunications services at issue, cross-border supply between two Members under Article I:2(a) occurs only if the supplier *itself* operates, or is present, on the other side of the border, or if cross-border supply can occur also if a supplier simply "hands off" traffic at the border. We now examine this fundamental issue.

7.29 The scope of the GATS is defined in Article I:1 as covering "measures by Members affecting trade in services". Trade in services is then defined in Article I:2 as "the supply of a service" through any of four modes of supply:

- "(a) from the territory of one Member into the territory of any other Member;
- (b) in the territory of one Member to the service consumer of any other Member;
- (c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
- (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member."

7.30 Subparagraph (a) describes what is referred to as "cross-border", or "mode 1", supply of trade in services.<sup>839</sup> The ordinary meaning of the words of this provision indicate that the *service* is supplied from the territory of one Member into the territory of another Member. Subparagraph (a) is silent as regards the *supplier* of the service. The words of this provision do not address the service

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<sup>836</sup> See the United States' answer to question No. 2(a) of the Panel of 14 March 2003, paragraph 2. For question No. 2(a), see footnote 212 of this Report.

<sup>837</sup> See Mexico's answer to question No. 3(a) of the Panel of 19 December 2002, paragraph 56. For question No. 3(a), see footnote 187 of this Report.

<sup>838</sup> Mention in this section of the Report of the "presence" of a service supplier, or of a service supplier that is "present", should be understood in the general sense of these terms. The use of the terms "present" and "presence" in this section are not intended to refer specifically to the supply of a service through "commercial presence", in the sense of Article I:2(c).

<sup>839</sup> See footnote 828.

supplier or specify where the service supplier must operate, or be present in some way, much less imply any degree of presence of the supplier in the territory into which the service is supplied. The silence of subparagraph (a) with respect to the supplier suggests that the place where the supplier itself operates, or is present, is not directly relevant to the definition of cross-border supply.

7.31 We now examine the context of subparagraph (a) to determine whether our interpretation, based on the ordinary meaning of the words of the provision, is correct. Subparagraph (a) is one of four modes of supply which, as indicated above, are listed in Article I:2. If we look at the wording of the other modes of supply, we note that the silence in subparagraph (a) as regards the presence of the supplier of the service is in marked contrast to the modes of supply described in subparagraphs (c) ("commercial presence") and (d) ("presence of natural persons"). In both cases, the presence of the service supplier within the territory where the service is supplied is specifically mentioned. The context provided by subparagraphs (c) and (d) therefore suggests that, where the presence of the service supplier was required to define a particular mode of supply, the drafters of the GATS expressed this clearly.

7.32 Further contextual evidence that cross-border supply of the services at issue does not require the supplier to operate, or be present in some way, on both sides of the border is suggested by the definition of the basic telecommunications services at issue, which are defined in the GATS Annex on Telecommunications. The services at issue are "basic" telecommunications services and involve:

"the real-time *transmission* of customer-supplied *information* between *two or more points* without end-to-end change in the form or content of the customer's information."<sup>840</sup> (emphasis added)

7.33 We note that this definition contains two closely linked elements that are relevant to our analysis: the *transmission* itself, and that which is transmitted – customer-supplied *information*. In our view, reading the word "transmission" alone as constituting the service, as Mexico does, fails to recognize the close link explicit in this definition. Moreover, the ownership or control of the means of transmission are nowhere addressed in this definition.

7.34 According to the definition, basic telecommunications services are services supplied "between two or more points". The definition nowhere indicates that a *single* supplier must undertake the transmission between the "points". The words "between two or more points" suggest, in fact, the contrary. Transmission to the various "points" requested by a customer requires ownership of or access to an expansive transmission infrastructure. It would be unreasonable to assume that the definition of telecommunications services applies only where a telecommunications supplier itself owns or controls a complete global infrastructure allowing it to reach every potential "point" requested by its customers. Had WTO Members intended this to be the case, they surely would have made it explicit in the definition.

7.35 We note that most WTO Members, including Mexico, scheduled their basic telecommunications services using the 1991 UN Provisional Central Product Classification ("CPC").<sup>841</sup> The CPC references provide more detailed descriptions of the services included in the GATS sectoral listing.<sup>842</sup> With respect to the facilities-based telecommunications services at issue, further support for our conclusion that cross-border supply under Article I:2(a) does not require a supplier to operate, or to be present in some way, on both sides of the border, is provided by an

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<sup>840</sup> GATS Annex on Telecommunications, section 3(b). See also footnote 829.

<sup>841</sup> United Nations, Statistical Papers, Series M No. 77, Provisional Central Product Classification, 1991.

<sup>842</sup> The *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164 (3 September 1993), paragraph 16, states that "[w]here it is necessary to refine further a sectoral classification, this should be done on the basis of the CPC or other internationally recognized classification".

examination of the CPC description of "public long distance voice telephone services" (CPC 75212), that is referred to under the item "voice telephone services" in the GATS sectoral list (W/120).<sup>843</sup> The CPC description of this service states, in relevant part:

*"Switching and transmission services necessary to establish and maintain communications between local calling areas. This service is primarily designed (used) to establish voice communications, but may serve other applications such as text communication (facsimile or teletex) and may be provided on a toll or flat fee basis. This service provides the customer with access to the supplier's and connecting carrier's entire telephone network or, in some instances, to a limited number or exchange areas (WATS service)." (emphasis added)*

7.36 This definition makes clear that the service of long-distance telephony consists of giving a customer access to both "the supplier's *and connecting operator's* entire telephone network" (emphasis added). The definition of voice telephony services thus anticipates interworking of both operating networks in order for the service to be performed. No element of the definition implies or requires "end-to-end" service by one and the same operator. Moreover, when more than one operator is involved, the service supplied to customers includes access to the "entire networks" of both operators. The service supplied is not therefore the simple transmission of a voice message "up to" a connecting operator's network; rather, the service is defined as spanning both operators' networks. It therefore follows that *supply* of the service involves call completion spanning both operators' networks.

7.37 The CPC definition also specifies that the switching and transmission services supplied are those "necessary to establish and maintain communications" between local calling areas. We note the statement made by the United States on this point that:

*"[m]aintaining 'communications' requires active coordination between operators on each side of the border, and is not two discrete services provided by different companies. For example, in order to complete a call, AT&T's switch must communicate with Telmex's switch, which is located within Mexico, not on the border."*<sup>844</sup>

7.38 We observe that basic telecommunications services supplied between Members do require, during the delivery of the service, a high degree of interaction between each other's networks, since the service typically involves a continuous, rapid and often two-way flow of intangible customer and operator data. The interaction results in a seamless service between the originating and terminating segments, which suggests that the service be considered as a single, cross-border service.

7.39 Mexico seeks to draw an analogy with services involving the distribution of tangible products, such as mail, trucking or pipeline services. Mexico argues that these services are similar to the telecommunications services at issue, in that they are not supplied cross-border unless the supplier operates, or is present in some way, on both sides of the border. It is not in the Panel's mandate to make findings on whether, or to what extent, situations regarding the supply of these services fall within the scope of Article I:2(a), and we expressly do not make such findings. We observe, however, that the CPC definition of the "public long distance voice telephone services", one of the basic telecommunications services at issue, provides for an especially high degree of interaction between operators. The CPC definition does not explicitly restrict the scope of these services to those supplied between operators within the same jurisdiction. We infer that the CPC definition foresees an especially high degree of interaction also between operators located in different Members. Because of

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<sup>843</sup> *Services Sectoral Classification List*, Note by the Secretariat. MTN.GNS/W/120, 10 July 1991. See also footnote 858.

<sup>844</sup> See the United States' second oral statement, paragraph 18.

this high degree of interaction implicit in the definition of the service, we do not agree that these other services mentioned by Mexico provide persuasive evidence of the argument presented by Mexico.

7.40 A basic telecommunications operator, in other words, must typically link with other operators in order to supply a complete service to its customers. Likewise, those other operators will link with it, in order to give their customers a complete service. Public telecommunications networks are in fact often legally obligated to interconnect. In sum, telecommunications services normally involve or require linking with another operator to complete the service, and the operation, or presence in some way, of the supplier on both ends of the service cannot therefore be a necessary element of the definition of cross-border supply.

7.41 If linking with another operator implied that the originating operator were no longer "supplying" the service, an absurd consequence would result. Not only would telecommunications services delivered in this manner not be "supplied" cross-border in the sense of Article I:2(a), they would also not be "supplied" under *any* of the other modes of supply under the GATS. Nearly all telecommunications services currently supplied across borders would then fall outside the scope of the GATS. Present and future liberalization of this form of international telecommunications trade would not be possible within the WTO, without a new or amended treaty. Such an interpretation would be inconsistent with the fact that the GATS "applies to ... trade in services" (Article I:1), and that "trade in services" is defined comprehensively as the supply of services through four modes of supply.<sup>845</sup> The GATS creates a wide-ranging agreement covering all services and modes of supply, in order to allow progressive liberalization of trade in services between Members. This suggests that the supply of basic telecommunications services – the "transmission of customer supplied information" – must include supply by means which involve or require linking to another operator to complete the service.

7.42 More generally, a supplier of services under the GATS is no less a supplier solely because elements of the service are subcontracted to another firm, or are carried out with assets owned by another firm. What counts is the service that the supplier offers and has agreed to supply to a customer. In the case of a basic telecommunications service, whether domestic or international, or supplied cross-border or through commercial presence, the supplier offers its customer the service of completing the customer's communications. Having done so, the supplier is responsible for making any necessary subsidiary arrangements to ensure that the communications are in fact completed. The customer typically pays its supplier the price of the end-to-end service, regardless of whether the supplier contracts with, or uses the assets of, another firm to supply the service.

7.43 Additional evidence, for the view that cross-border supply does not imply the presence of the service supplier in the market into which the service is delivered, is contained in a document entitled "Scheduling of Initial Commitments in Trade in Services: Explanatory Note" (the "Explanatory Note"), issued by the GATT Secretariat as a working document for the Group of Negotiations on Services.<sup>846</sup> The Explanatory Note states that the supply of a service through telecommunications is an example of cross-border supply "since the service supplier is *not present within the territory* of the Member where the service is delivered".<sup>847</sup> (emphasis added) We accord substantial interpretative weight to this statement. The Explanatory Note was requested by the Group of Negotiations on Services, and issued in September 1993, during a period of intense drafting of initial commitments to meet the deadline for the completion of schedules in December of that year. During and after that

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<sup>845</sup> The comprehensive coverage of the GATS is also reflected in Article I:3(b) of the GATS which provides that "services" – for the purposes of the Agreement – "includes any services in any sector except services supplied in the exercise of governmental authority". The Preamble to the GATS also refers in expansive terms to the "growing importance" of trade in services for the "world economy", and the desire to establish a multilateral framework of principles and rules for the "expansion" of such trade in order to promote "economic growth" and "development".

<sup>846</sup> *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*. MTN.GNS/W/164 (3 September 1993). We refer to this document as the "Explanatory Note".

<sup>847</sup> *Ibid.*, paragraph 19(a).

period, the Explanatory Note was heavily relied upon by negotiators to interpret their own and other negotiators' commitments. The Explanatory Note was revised somewhat in 2001 – without however modifying the statement with respect to the presence of cross border suppliers – and was adopted by the Council on Trade in Services as "Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)" (the "Scheduling Guidelines").<sup>848</sup> Even though the Explanatory Note and the Scheduling Guidelines each state that they cannot be considered as "authoritative" or "legal" interpretations of the GATS, we find that the source, content, and use by negotiators of the Explanatory Note, together with its later adoption by Members as the Scheduling Guidelines, provides an important element with which to interpret the provisions of the GATS.

7.44 In interpreting the scope of cross border supply in Article I:2(a) of the GATS, we need not decide whether the Explanatory Note provides "context" (as an agreement or instrument made in connection with the conclusion of the GATS) under paragraph 2 of Article 31 of the Vienna Convention, or whether it can be "taken into account", together with the context, as a subsequent agreement or practice under paragraph 3 of the same provision. In any case, we consider that the source, content and use of the Explanatory Note make it part of the "circumstances" of the conclusion of the GATS, within the meaning of Article 32 of the Vienna Convention. We may therefore properly have recourse to the Explanatory Note to confirm our understanding of the ordinary meaning of Article I:2(a) of the GATS.<sup>849</sup>

7.45 For these reasons, we find that the services at issue, in which United States suppliers link their networks at the border with those of Mexican suppliers for termination within Mexico, without United States' suppliers operating, or being present in some way, in Mexico, are services which are supplied cross-border within the meaning of Article I:2(a) of the GATS.

(c) Has Mexico undertaken commitments on the cross-border supply of the services at issue?

7.46 The United States argues that Mexico, with respect to the cross-border supply of the services at issue, has inscribed in its schedule commitments granting full national treatment and full market access. The one apparent limitation (the "routing restriction"), which Mexico has inscribed in the market access column does not, according to the United States, fall within the defined categories of market access restrictions in Article XVI:2, and therefore does not limit the full market access which Mexico has committed with respect to the cross-border services at issue.

7.47 Mexico initially argues that it cannot have undertaken any cross-border commitments with respect to the supply of the services at issue through the linking of networks of different operators at the border, since the supply of these services in this manner is not within the definition of cross-border trade in services in the sense of Article I:2(a). We have rejected this argument in the previous section.

7.48 Mexico then argues that, even if cross-border supply were understood to include the linking of networks of different operators at the border, Mexico has still undertaken no commitment to allow the cross-border supply of the services at issue, because the limitations Mexico has inscribed in its schedule make it impossible for cross-border supply to take place. In particular, Mexico argues that the routing requirement in its commitments requires a cross-border supplier to link its network with that of a Mexican operator at the border and that this requirement, read together with other restrictions in its schedule, requires a potential cross-border supplier to obtain a "concession". To obtain a

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<sup>848</sup> *Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)*, adopted 23 March 2001, S/L/92 (28 March 2001), chart following paragraph 26, and paragraph 28. We refer to this document as the "Scheduling Guidelines". See discussion of the *Guidelines* in paragraph 7.67.

<sup>849</sup> See paragraphs 7.53-7.57.

concession, Mexico argues, foreign suppliers would have to have both a commercial presence in Mexico and Mexican nationality.

7.49 It remains for us therefore to examine whether, in the light of the limitations inscribed in its schedule, Mexico has made any specific commitments with respect to the cross-border supply of the services at issue and, if so, whether these represent full market access and national treatment commitments, in the sense of Articles XVI and XVII.

(i) *Cross-border services in Mexico's Schedule*

7.50 We first examine Mexico's Schedule to determine which *service sectors* Mexico has made subject to cross-border commitments. We will start our analysis by looking at the inscriptions that Mexico has made in the *sector* column of its schedule, with respect to the services at issue.

aa) Service sectors inscribed in Mexico's Schedule

7.51 Mexico has set out the telecommunications services sectors that are subject to commitments by it by making the following inscription in the service sector column of its schedule.<sup>850</sup>

"2.C. Telecommunications Services

Telecommunications services supplied by a facilities based public telecommunications network (wire-based and radioelectric) through any existing technological medium, included in subparagraphs (a), ... (c), (f), ... and (o).

...

(a) Voice telephony (CPC 75211, 75212)

...

(c) Circuit-switched data transmission services (CPC 7523\*)

(f) Facsimile services (CPC 7521\*\* + 7529\*\*)

(o) Other

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...

— Commercial agencies<sup>3</sup>

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...

<sup>3</sup>Agencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire."

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<sup>850</sup> The Spanish language version, which Mexico has designated as the only authentic version, reads:

"2.C. *Servicios de Telecomunicaciones*

*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), ... c), f), ... y o).*

...

(a) *Servicios de telefonía (CCP 75211, 75212)*

...

(c) *Servicios de transmisión de datos con conmutación de circuitos (CCP 7523\*\*)*

(f) *Servicios de facsímil (CCP 7521\*\*+7529\*\*)*

(o) *Otros*

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...

- Comercializadoras<sup>3</sup>

-

...

<sup>3</sup> *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."*

7.52 The services listed in Mexico's Schedule – "voice telephony", "circuit-switched data transmission services", "facsimile services", and "commercial agencies" – appear to cover the services at issue raised by the United States in this case. However, these services are listed under, and are subordinate to, a introductory heading, that describes the listed services as "[t]elecommunications services supplied by a facilities based public telecommunications network (wire-based and radioelectric) through any existing technological medium". We must therefore carry our examination further and determine whether, or to what extent, the introductory heading affects the scope of the individual listed services.

bb) Introductory heading

7.53 The parties interpret differently the introductory heading, and disagree on its implications for the scope of the commitments undertaken. Mexico argues that the introductory heading refers only to "the physical and technical aspects of signal transmission" and "does not define the specific nature of either the services or the supply thereof".<sup>851</sup> Mexico implies, therefore, that the introductory heading has little or no effect. The United States takes a different view, maintaining that the introductory heading limits the scope of the sector generally to services of suppliers who, in the market from which the service is supplied, *own* facilities. Services of suppliers who *lease* facilities in the market from which the service is supplied are, according to the United States, nonetheless covered by the particular subsector on "commercial agencies".<sup>852</sup>

7.54 We recall that the introductory heading of Mexico's Schedule covers "[t]elecommunications services supplied by a facilities based public telecommunications network (wire-based and radioelectric) through any existing technological medium". A simple parsing of the terms of the heading indicates that telecommunications services within its scope must have four main attributes: these services must be supplied by: (i) a "telecommunications network", that is; (ii) "public"; (iii) "facilities based"; and (iv) utilises "any existing technological medium". In examining the first two requirements – that the service be supplied by a "telecommunications network" that is "public" – we recall the definition in the GATS Annex on Telecommunications of a "public telecommunications transport network". This is defined in the Annex as the public telecommunications "infrastructure" which permits telecommunications between and among defined network termination points.<sup>853</sup> Moreover, the meaning of "public" is revealed in the accompanying definition in the Annex of "public telecommunications transport service", which refers to a service "explicitly or in effect ... required to be offered to the public generally."<sup>854</sup> The first two requirements of the introductory heading thus appear to be straightforward, indicating simply that the service supplied is for *public use*, and is based on some sort of network *infrastructure*. Likewise, the fourth requirement – that supply be through "any existing technological medium" is straightforward, excluding "new" technologies from the scope of the commitments. The parties do not dispute the claims made by the United States that the services at issue relate to "public" services, transported over a "network", and using "existing" technologies.

7.55 However, the meaning of the third requirement of the introductory heading – that the service be supplied by a "facilities-based" network – is much less clear. The ordinary meaning of the term "facilities", with respect to a telecommunications service, suggests "infrastructure", or the physical elements by means of which the service is supplied. The term "facilities-based", under this

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<sup>851</sup> See Mexico's answer to question No. 2(c) of the Panel of 14 March 2003, paragraphs 2 and 3 (*What does the phrase "by a facilities based public telecommunications network" add to the sector inscription in Mexico's Schedule? Without these words in the sector column, what other forms of supplying services would be allowed?*).

<sup>852</sup> See the United States' answer to question No. 2(c) of the Panel of 14 March 2003, paragraph 19. For question No. 2(c), see footnote 851 of this Report.

<sup>853</sup> See GATS Annex on Telecommunications, Section 3(c).

<sup>854</sup> See GATS Annex on Telecommunications, Section 3(b).

interpretation, would on its face suggest that the telecommunications services committed in Mexico's Schedule must be supplied by or through telecommunications "infrastructure". Yet if the term "facilities-based" simply means "infrastructure", then the term would add little or no meaning to Mexico's commitment, since a service supplied by or through a public telecommunications network must, as the Annex on Telecommunications suggests, be ultimately supplied by or through some form of telecommunications infrastructure. The introductory heading in Spanish, which is the authentic language of Mexico's Schedule, uses the term "*basada en infraestructura*", which gives rise to the same interpretative difficulties.<sup>855</sup>

7.56 We recognize that, in examining the meaning of the expression "facilities-based" in Mexico's introductory heading, we need to give meaning and effect to all its terms, and not adopt an interpretation that would result in reducing any of its terms to redundancy.<sup>856</sup> In seeking to give meaning to the term "facilities-based", we observe that the requirement that the supply of the service be "based" on facilities logically implies that there could in principle exist supply that is *not* "based" on facilities. This suggests that a "facilities-based" network refers not to the existence of infrastructure (upon which any telecommunication service ultimately has to rely), but to the *relationship* between the infrastructure and the service. Under this interpretation, the term "facilities-based" in the introductory heading of Mexico's Schedule could plausibly refer to services transported by an operator over its *own* infrastructure, and not over infrastructure leased from another operator.

7.57 Under this interpretation, a further issue arises as to whether the meaning of "facilities-based" qualifies only those services transported by an operator over its own infrastructure in the market *from which* the service is supplied, as the United States suggests. Examining the ordinary meaning of the terms in Mexico's Schedule, in their context, the words "facilities-based public telecommunications networks" do not, on their own, suggest any geographical distinction. Mexico has placed this phrase in the column of its schedule entitled "sector", which suggests that the phrase refers to the overall nature of the service, and not to the nature of the service with respect to any particular location of the supplier. Aspects of the supply of the service that relate to the *location* of the supplier are addressed in GATS by the four modes of supply. In a schedule, the inscriptions that inform the reader concerning the nature of the commitments in relation to the four modes of supply are found in the market access and national treatment columns, not in the sector column. Thus, the inscriptions in the market access and national treatment columns must be used to determine what limitations, if any, may affect the supply of a service based on the location of the supplier or its status (facilities-based or not) in a particular location. We therefore see no reason to read this geographical qualification into the meaning of "facilities-based". Accordingly, we are not convinced by the United States' argument that the phrase "facilities-based public telecommunication networks" found in the sector column of Mexico's Schedule means, in itself, that Mexico's commitments extend to any of the services at issue supplied by a cross-border supplier that uses its own infrastructure (and not leased capacity) in the market *from which it is supplying*, regardless of how these services are terminated in Mexico.

cc) Supplementary documents used to schedule commitments

7.58 We have arrived at this interpretation of the introductory heading in Mexico's Schedule based on the wording of the heading within the context of the schedule. We now seek confirmation of the meaning of the introductory heading in the light of three important documents used by Members to provide guidance in drawing up their schedules: the Draft Model Schedule, the related Note by the Chairman, and the Scheduling Guidelines. We refer to these documents as the "supplementary documents".

i) Description of the supplementary documents

<sup>855</sup> See Spanish text of the main sector heading reproduced in footnote 850.

<sup>856</sup> See Appellate Body Report, *US – Gasoline*, DSR 1996:I, 3, at 21.

– Draft Model Schedule

7.59 The Draft Model Schedule arose from discussions by negotiators at the close of the Uruguay Round. Once the Negotiating Group on Basic Telecommunications was established in May 1994, the Secretariat was asked to provide a Note on the background on the previous Uruguay Round discussions on basic telecommunications. The resulting Note included the Draft Model Schedule that, after discussion in the Group, was reissued with minor revisions.<sup>857</sup> The Draft Model Schedule was specifically intended "to assist participants in the drafting of their offers and final schedules." It contains a list of basic telecommunications sectors based on the standard GATS sectoral classification list (W/120)<sup>858</sup>, including cross-references to the United Nations CPC, and explanatory notes.<sup>859</sup>

7.60 The Draft Model Schedule lists the services subsectors, considered as the basic telecommunications services subject to the negotiations, as follows:

"2.C. <u>Telecommunications Services</u>	UNCPC
a. Voice telephone services	7521
b. Packet-switched data transmission services	7523**
c. Circuit-switched data transmission services	7523**
d. Telex services	7523**
e. Telegraph services	7522**
f. Facsimile services	7521**+7529**
g. Private leased circuit services	7522**+7523**
o. Other"	

7.61 The "sector or subsector" column of the Draft Model Schedule also lists a number of "categories" into which the services can be further subdivided. The Draft Model Schedule explains:<sup>860</sup>

"Depending on the services being offered or on the limitations existing in the regulatory regime concerned, the specific commitments on these services [a. through g. and o.] may be subdivided into the categories as noted."

7.62 The listed "categories" are reproduced as follows:<sup>861</sup> (emphasis added)

"Local/long distance/international service

- wire-based
- radio-based
- *on a resale basis*
- *facilities-based*

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<sup>857</sup> Formulated by negotiators during 1993, prior to the conclusion of the Uruguay Round, it was included in a formal document at the outset of the telecom negotiations, as an attachment to *Negotiations on Basic Telecommunications*, Note by the Secretariat, TS/NGBT/W/1, 2 May 1994. It was slightly revised by the Group and reissued in *Draft Model Schedule of Commitments on Basic Telecommunications*, Informal Note by the Secretariat, Job. No. 1311, 12 April 1995.

<sup>858</sup> *Services Sectoral Classification List*, Note by the Secretariat, MTN.GNS/W/120, 10 July 1991. Subsectors (h) to (n) of the standard WTO sectoral listing for telecommunications services contained in document W/120 were considered to be "value-added", not "basic", telecommunications services, and therefore omitted. The asterisks appearing against CPC numbers indicate that the listed subsector comprises only *part* of that CPC code.

<sup>859</sup> United Nations, Statistical Papers, Series M, No. 77, Provisional Central Product Classification, 1991.

<sup>860</sup> Draft Model Schedule, Footnote b. See footnote 857.

<sup>861</sup> Note by the Chairman, 16 January 1997. S/G/W/2/Rev.1. The Note states that a category has to be explicitly mentioned in a Member's sector column in order to have effect.

- for public use
- for non-public use"

7.63 We note particularly the use of the terms "on a resale basis" and "facilities-based" as categories by which specific commitments may be subdivided.

– *The Note by the Chairman*

7.64 A Note by the Chairman of the Negotiating Group on Basic Telecom, entitled "Notes for Scheduling Basic Telecom Services Commitments" was issued on 16 January 1997.<sup>862</sup> The purpose was "to produce a brief and simple note on assumptions applicable to the scheduling of commitments in basic telecoms."<sup>863</sup> Although the Note states that it is "not intended to have any binding legal status", it specifies that its purpose is "to assist delegations in ensuring the transparency of their commitments and to promote a better understanding of the meaning of commitments."<sup>864</sup> The Note draws on the Draft Model Schedule, restating its categories and confirming that they are to be used in scheduling commitments. The Note states an important assumption: that, "unless otherwise noted in the sector column" any telecommunications service listed in the sector column "encompasses" or "may be provided" by or through all of the different "categories" of the service.

7.65 The Note by the Chairman was attached to the final Report of the Group on Basic Telecommunications, which was adopted on 15 February 1997.<sup>865</sup> The Report states that the Chairman issued a Note "reflecting his understanding of the position reached in discussion of the scheduling of commitments" and that this Note "set out a number of assumptions applicable to the scheduling of commitments and was intended to assist in ensuring the transparency of commitments".<sup>866</sup>

– *Scheduling Guidelines*

7.66 The Note by the Chairman, together with the Draft Model Schedule, were attached to the "Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS)", (the "Scheduling Guidelines") which were adopted by Members in the Council on Trade in Services on 23 March 2001.<sup>867</sup> The Scheduling Guidelines were an update of the Explanatory Note issued in 1993 for the Group of Negotiations on Services.<sup>868</sup> The objective of the Scheduling Guidelines is "to explain, in a concise manner, how specific commitments should be set out in schedules in order to achieve precision and clarity."

ii) *Interpretative value of the supplementary documents*

7.67 The Draft Model Schedule and the Note by the Chairman were documents given considerable prominence by Members, since they were attached to the final Report adopted by the Negotiating Group on Basic Telecommunications in 1997.<sup>869</sup> Members gave further prominence to these two documents by attaching them to the Scheduling Guidelines adopted by the Council for Trade in Services in 2001. Annex 2 of the Scheduling Guidelines is entitled "List of attached documents

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<sup>862</sup> *Notes for Scheduling Basic Telecommunications Services Commitments*, Note by the Chairman. S/GBT/W/2/Rev.1.

<sup>863</sup> Note by the Chairman, 16 January 1997. S/G/W/2/Rev.1, preamble.

<sup>864</sup> Note by the Chairman, 16 January 1997. S/G/W/2/Rev.1, preamble.

<sup>865</sup> Report of the Group on Basic Telecommunications, S/GBT/4 of 15 February 1997.

<sup>866</sup> Report of the Group on Basic Telecommunications, S/GBT/4 of 15 February 1997, paragraph 5.

<sup>867</sup> *Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)*, adopted 23 March 2001, S/L/92 (28 March 2001).

<sup>868</sup> *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*. MTN.GNS/W/164 (3 September 1993).

<sup>869</sup> Report of the Group on Basic Telecommunications, S/GBT/4 of 15 February 1997.

*relevant* for scheduling purposes". (emphasis added) Nonetheless, a footnote to the title of Annex 2 states that "[t]he fact that these documents are annexed to these guidelines should not be interpreted as changing their status." We accept that the footnote means that the attachment of the Draft Model Schedule and the Note by the Chairman to the Scheduling Guidelines should not in itself affect the existing interpretative status of the two documents. However, the footnote does not affect the interpretative status that the Draft Model Schedule and the Note by the Chairman might otherwise have, including the interpretative value derived from being attached to the Report by the Negotiating Group on Basic Telecommunications. Consequently, even if the Draft Model Schedule and the Note by the Chairman cannot be seen as part of the "context" under paragraph 2 of Article 31, nor be "taken into account" under Article 31 – a legal question that we leave open – we find that these documents are, with respect to the GATS Protocol on Telecommunications (to which Mexico's Schedule was attached) an important part of the "circumstances of its conclusion" within the meaning of Article 32 of the Vienna Convention. Under the terms of Article 32, we may therefore use the Draft Model Schedule and the Note by the Chairman to confirm the ordinary meaning, arrived at through the application of Article 31 of the Vienna Convention, of Mexico's GATS commitments on telecommunications services.

7.68 Confirmation of the interpretative value of the supplementary documents is provided by the extensive use in Members' schedules of the categories indicated in the Chairman's Note and Draft Model Schedule. Schedules on occasion indicate even finer distinctions in categories, where needed, to reflect accurately the nature of the services on which Members were undertaking commitments. In some cases, the categories are used to limit the scope of a subsector by distinguishing the categories of services that are being committed. In other cases, the categories are used to specify different levels of commitments for some categories of a subsector, as compared with other categories of the subsector. Typical examples in schedules include commitments that offer greater levels of access for a given service supplied on a facilities basis, or that specify that public telephony remains under monopoly while non-public telephony does not. The categories are often cited in the sector column of schedules, as provided in the Chairman's Note. In some schedules, however, categories are listed in the market access column instead of the sector column. In these cases, the entries nonetheless appear to clarify the category or categories of *service* to which the market access limitation itself applies. Indeed, for those schedules that use not categories at all, it is only by reference to these understandings that there can be certainty that the commitments "encompass" all of the forms in which the services may be supplied. Because of this extensive use in Members' schedules of principles set out in the Draft Model Schedule and the Note by the Chairman, we consider that substantial interpretative weight can be given to the supplementary documents.

dd) Mexico's cross-border telecommunications commitments

7.69 We now examine the sector column of Mexico's Schedule in the light of the Model Schedule and the Chairman's Note. We recall that the introductory heading in Mexico's Schedule is contained in the column which describes *services*, and our earlier reasoning that this heading must therefore qualify a type of *service*. We next observe that the words "facilities based", "public", "wire-based" and "any ... technological medium" used in Mexico's Schedule all reflect categories included in the Chairman's Note.<sup>870</sup> Mexico appears therefore to have adopted the sectoral approach set out in the Chairman's Note, and can be assumed to have scheduled its commitments according to the assumptions contained in that Note.

7.70 The category "facilities-based" which appears in the Chairman's Note and the Draft Model Schedule is used solely to describe the "facilities-based" supply of a service, and not generally to describe the simple existence of a network infrastructure. As indicated in the Chairman's Note "unless otherwise noted in the sector column", the commitment is presumed to encompass all of the categories cited in the Note. We recall that these categories include "facilities-based" and "on a resale basis". If,

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<sup>870</sup> See our previous discussion of the Chairman's Note in paragraphs 7.62-7.68 of this Report.

as discussed earlier, Mexico's reference to supply by or through "facilities" were understood simply to refer to supply by means of an infrastructure, then the term would be redundant, since any supply of the service is ultimately possible only through a network of physical assets of some operator. In consideration of the categories of the Chairman's Note, however, it becomes apparent that such an interpretation would also make redundant the contrasting categories of supply – "facilities-based" and "by resale". Were this the case, it would not be possible, as provided by the Chairman's Note, for Members to use these categories as a basis for distinguishing between types of supply of basic telecommunications services being committed and those that are not.

7.71 We find therefore that the use of the word "facilities-based" in the phrase "facilities-based public telecommunication network" contained in the introductory heading to Mexico's telecommunications commitments means that Mexico has undertaken commitments for the services at issue supplied only on a facilities basis over such networks – and not by resale or leased capacity. The examination of the supplementary documents thus confirm our interpretation of the ordinary meaning of the terms "facilities-based" in Mexico's Schedule.

7.72 Nonetheless, Mexico's services sector listing does contain a subsector listing for "commercial agencies" ("*comercializadoras*"), defined as "[a]gencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire." This subsector listing can be read only as an exception, for the services at issue that are supplied through leased capacity, to the general exclusion of such services expressed in the introductory heading. The separate commitment on supply of telecommunications services through leased capacity has meaning in the context of Mexico's Schedule, since supply in this manner is subject to market access limitations that are somewhat different from those inscribed with respect to facilities-based supply.

(ii) *Market access and national treatment commitments for cross-border supply*

7.73 We now consider what cross-border commitments Mexico has undertaken with respect to the services listed in the sector column of its schedule. For the services at issue, Mexico has inscribed certain cross-border commitments for market access and national treatment. In the *national treatment* column of its schedule, Mexico has inscribed "None". This term is a GATS scheduling convention which means "no limitations" – in other words, a full commitment.<sup>871</sup> Mexico has therefore undertaken a full national treatment commitment for the cross-border supply of the services at issue.

7.74 With respect to *market access* for the cross-border supply of the services at issue, Mexico has inscribed the following:

"None, except the following: International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT)."<sup>872</sup>

7.75 The words "None, except" appear at the beginning of Mexico's inscription. The words that follow indicate that Mexico intends to grant full market access, subject only to the limitation described. Since Article XVI and scheduling conventions require that the inscription of a limitation

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<sup>871</sup> *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*. MTN.GNS/W/164 (3 September 1993) paragraph 24. See also *Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services (GATS)*. Adopted 23 March 2001. S/L/92 (28 March 2001), paragraph 42.

<sup>872</sup> In Spanish: "*1) Ninguna, excepto la siguiente: 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).*"

must be read to mean that full market access is granted, subject only to any measures specifically inscribed, the inscription of the words "None, except" was not necessary.<sup>873</sup>

7.76 We now examine what sort of limitation, if any, on market access is achieved by Mexico's inscription that "[i]nternational traffic must be routed through the facilities of an enterprise that has a concession ...". Article XX:1(a) sets out the general requirement for Members to "specify" the terms, limitations and conditions on market access for committed sectors in their schedule. "Specifying" requires that an entry describe each measure concisely, indicating the elements that make it inconsistent with Article XVI:2.<sup>874</sup>

(iii) *Mexico's "routing restriction"*

7.77 We now examine whether the terms of the "routing restriction" in the market access column of Mexico's Schedule indicate that it comes within the scope of Article XVI:2. This provision contains six categories of measures that restrict market access. These categories differ depending on whether they place limitations on:

- (a) the number of service suppliers;
- (b) the value of services transactions or assets;
- (c) the number of service operations or quantity of service output;
- (d) the number of natural persons that may be employed;
- (e) the forms of legal entity; or
- (f) the participation of foreign capital.<sup>875</sup>

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<sup>873</sup> *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164 (3 September 1993), paragraph 4.

<sup>874</sup> *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, MTN.GNS/W/164 (3 September 1993), paragraphs 21 and 25.

<sup>875</sup> A summary of the six categories. GATS Article XVI:2 reads in full:

"In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
- (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
- (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
- (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
- (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment."

7.78 Mexico's routing restriction contains three main elements. The first element relates to "international traffic". The second element concerns traffic that "must be routed through the facilities of" an enterprise. The third and final element concerns "an enterprise that has a concession". We assess each of these elements in turn, with respect to their relevance to the six categories of market access measure set out in Article XVI:2.

aa) "International traffic"

7.79 The first element of the routing restriction narrows its scope to "international traffic". This element reflects one of the "categories" contained in the Chairman's Note, and can be contrasted with other categories of local and domestic long-distance service. Since the services at issue are services supplied cross-border, they would necessarily involve traffic that is international in character. Even if "domestic" services were to transit borders, they would do so as international "traffic". Therefore, Mexico has not, through use of this element, placed a substantive limitation on the number of suppliers of scheduled services on a cross-border basis, the quantity of the cross-border services supplied, or on any of the other categories of measure described in Article XVI:2.

bb) "Routed through the facilities"

7.80 The second element requires that international traffic "must be routed through the facilities" of a Mexican concessionaire. The United States argues that the requirement that services supplied cross-border "through the facilities" of a Mexican concessionaire means simply that United States calls must be terminated using the *assets or equipment* of a Mexican concessionaire, and that these include the use of leased lines and other leased capacity.<sup>876</sup> Mexico disagrees, specifying that "through the facilities" means "through an international gateway" of a Mexican concessionaire, which it claims is its meaning in Mexican legislation.

7.81 In examining the meaning of this element of the routing restriction, we note that the ordinary meaning of the term "facilities" (in the Spanish authentic text "*instalaciones*"), on its own, is very broad. A specialized telecommunications dictionary defines "telecommunications facilities" as follows:

"The aggregate of equipment, such as telephones, teletypewriters, facsimile equipment, cables, and switches, used for various modes of transmission, such as digital data, audio signals, image and video signals."

7.82 The same dictionary defines "transmission facility" as:

"A piece of a telecommunication system through which information is transmitted for example, a multi pair cable, a fiber optic cable, a coaxial cable, or a microwave radio."<sup>877</sup>

7.83 Neither of these broad definitions makes clear whether supply of the services at issue routed through the "facilities" would include supply using capacity *leased* to another operator. It is therefore necessary to examine further the meaning of the term "facilities", viewed in its context within Mexico's Schedule.

7.84 We recall that the Chairman's Note provided guidance for Members making commitments in basic telecommunications.<sup>878</sup> The use of the word "facilities" in the Note corresponds to a possible category by which a service sector could be narrowed down or refined. The category is referred to as

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<sup>876</sup> See the United States' first written submission, paragraph 57.

<sup>877</sup> Newton's Telecom Dictionary, 19<sup>th</sup> Edition, March 2000.

<sup>878</sup> See paragraphs 7.58-7.68 of this Report.

the "facilities-based" supply of a service. We therefore find that the phrase "through the facilities of", placed in the context of the categories of the Chairman's Note, refers not to a requirement simply to use the equipment or physical assets of a Mexican concessionaire, but to supply the service on a facilities-basis, and not through capacity leased to the cross-border supplier.

7.85 We now assess whether this element of the routing restriction introduces a market access restriction in the sense of Article XVI:2, with respect to the cross-border supply of the service. To this end, it is necessary to assess the effect of this element on the relevant services listed by Mexico in its schedule. With respect to services falling under the main sectoral heading, this element would appear to reinforce the inscription in the main sectoral heading that the services committed must be supplied on a facilities-basis. However, this element of the routing restriction also further specifies that the terminating segment of cross-border supply not only *may*, but *must*, be supplied on a facilities-basis. This element of the routing restriction means, therefore, that supply of the service by means of one of the categories (over leased capacity) within Mexico is prohibited, and is subject to a zero quota in the sense of Article XVI:2(a), (b) and (c). We note that, while this limitation prohibits services that originate on a facilities basis from being terminated over leased circuits, it does not prevent these services from being supplied when they fall within the facilities-based category with respect to termination.

7.86 With respect to Mexico's commitments falling under the subsector heading of "commercial agencies", this element of the routing restriction would mean that *even if* the originating segment of the cross-border service is supplied over leased capacity, it is nevertheless restricted only to facilities based supply on the terminating segment within Mexico. Therefore, with respect to the commercial agencies (*comercializadoras*) services described as a subsector, this routing restriction prohibits the cross-border supply upon termination within Mexico by means of the very "leased capacity" which defines this type of service. While this element of the routing restriction does not expressly prohibit cross-border supply over leased capacity on the originating segment, it means that supply over leased capacity on the terminating segment is prohibited. Therefore, this element of the routing restriction prohibits end-to-end International Simple Resale (ISR), and effectively eliminates the possibility of any cross-border supply of services over leased capacity. In this sense, with respect to cross border services supplied by commercial agencies, the routing restriction falls within the scope of Article XVI:2(a), (b) and (c).

cc) "Enterprise that has a concession"

7.87 The third element requires that the traffic be routed through the facilities of an "enterprise that has a concession". In particular, Mexico argues that the requirement that international traffic be "routed through the facilities" of an enterprise that has a "concession" must be read in conjunction with the use of the term "concession" contained in its market access column for the supply of the services at issue through *commercial presence*.

7.88 Mexico's Schedule, with respect to the supply of the services at issue through *commercial presence* reads, in relevant part:

"A *concession*<sup>1</sup> from the SCT is required. Only *enterprises established* in conformity with Mexican law may obtain such concession.

<sup>1</sup> Concession: The granting of title to install, operate or use a facilities-based public telecommunications network.

Direct *foreign investment up to 49 percent* is permitted in an enterprise set up in accordance with Mexican law." (emphasis added)

7.89 Thus, the "concession" needed to supply the services at issue through commercial presence requires: (a) the establishment of an enterprise; with (b) no more than 49% foreign ownership. For Mexico, the use of the word "concession" has the same meaning in the context of cross-border supply as it does in the context of commercial presence. Therefore, in Mexico's view, a concessionaire entitled to route international traffic into Mexico must be a juridical person of Mexican nationality. Mexico then reasons that the mention of the word "concession" in the routing restriction for cross-border supply "creates commercial presence and nationality requirements to supply basic telecommunications services in Mexico".<sup>879</sup> Since a foreign service supplier wishing to supply cross-border can neither have Mexican nationality nor supply through commercial presence, Mexico concludes that its cross-border commitments for the services at issue effectively allow zero access for foreign service suppliers wishing to supply cross-border, and that this constitutes "limitations on the number of service suppliers", as provided for in paragraph (a) of Article XVI:2.<sup>880</sup>

7.90 Even if we were to accept Mexico's argument that the term "concession" in its cross-border commitments has the same meaning as in its commercial presence commitments, we do not see how the nationality and commercial presence requirements for the concessionaire – the entity which routes the calls transferred to it by United States suppliers at the border – amounts to a commercial presence and a Mexican nationality requirement for a *cross-border supplier*, effectively preventing any supply by that mode. Accepting Mexico's argument in this regard would require acceptance of Mexico's argument that the same supplier must undertake the transmission of a call on both sides of the border, implying that the supplier operate, or be present in some way, in the market being supplied. The Panel has earlier examined and rejected this interpretation.<sup>881</sup> Based on a correct understanding of cross-border supply under Article I:2(a) of the GATS, Mexico's conclusion simply does not follow. The third element of the routing restriction – the concession requirement – does not therefore fall into any of the six categories of market access restrictions contained in Article XVI:2.

7.91 We find overall therefore that the inscription in Mexico's Schedule of the routing requirement prohibits market access for the supply of the services at issue on a non-facilities basis (over capacity leased by an operator) in Mexico, but allows full access for the services at issue supplied on a facilities-basis (*not* over capacity leased by an operator) in Mexico – subject to routing the traffic through Mexican enterprises that have a "concession".

(d) Do Mexico's specific commitments provide "the basis" for its additional commitment on interconnection?

7.92 Section 2.1 of the Reference Paper stipulates that Mexico's interconnection obligation applies "on the basis of the specific commitments undertaken" ("*respecto de los cuales se contraigan compromisos específicos*"). The specific commitments referred to in Section 2.1 must refer only to the market access and national treatment commitments undertaken by Mexico, and not Mexico's *additional* commitments, since otherwise the interconnection provision (itself a specific commitment) would provide the basis for its own application. The United States argues that once *any* level of commitment is made, Section 2 of the Reference Paper applies fully within the modes of supply in which the commitments have been taken, unless there is an inscription in the schedule explicitly limiting the applicability of the Reference Paper.<sup>882</sup> Mexico disagrees and, basing itself on the

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<sup>879</sup> See Mexico's answer to question No. 2(a) of the Panel of 19 December 2002, paragraph 35. For question No. 2(a), see footnote 225 of this Report.

<sup>880</sup> See Mexico's first written submission, paragraph 145.

<sup>881</sup> See paragraphs 7.28-7.45.

<sup>882</sup> See the United States answer to question No. 1(c) of the Panel of 19 December 2002, paragraph 7. For question No. 1(c), see footnote 221 of this Report.

language of its Reference Paper, states that Section 2 applies only within the bounds of inscribed market access.<sup>883</sup>

7.93 We recall that Section 2.1 reads:

"2. Interconnection

2.1 This 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.<sup>884</sup>  
(emphasis added)

7.94 Section 2.1 requires that the interconnection obligation be "on the basis" of these specific commitments undertaken ("*respecto de los cuales se contraigan compromisos específicos*"). The wording of this phrase suggests that the specific commitments should in some way "justify" or "provide the scope for" the interconnection obligation. This conclusion is supported by an examination of the phrase in its context. The wording of Section 2 of the Reference Paper as a whole suggests that the purpose of the interconnection obligation is to enable suppliers supplying a basic telecommunications service committed by a Member in its schedule not to be restricted by unduly onerous interconnection terms, conditions and rates imposed by a major supplier. It would not appear to be the purpose of Section 2 to provide the benefits of the interconnection to a supplier in *any* telecommunications subsector or mode of supply, simply because *other* subsectors and modes of supply have been committed. It would seem reasonable to conclude, therefore, that the right to interconnect accorded by Section 2.2 should apply where, *with respect to a particular subsector and mode of supply*, a Member's market access and national treatment commitments specifically accords the right to supply that service. We therefore do not agree with the United States argument that a limitation inscribed in either the market access or the national treatment column cannot limit the applicability of an additional commitment under Article XVIII.

7.95 We have found in previous sections that Mexico has undertaken specific commitments – national treatment and market access – with respect to the supply of services on a facilities basis (not over capacity leased by an operator) in Mexico. We therefore find that these specific commitments form the "basis" on which Section 2.1 of Mexico's Reference Paper applies to the services at issue supplied on a *facilities* basis in Mexico.

(e) Do Mexico's additional commitments on interconnection apply to suppliers of cross-border services?

7.96 The United States argues that, based on ordinary meaning, the Reference Paper applies to interconnection with a cross-border supplier since, in the wording of Section 2.1, there is a "linking" of basic telecommunications suppliers in order to "allow the users of one supplier to communicate with users of another supplier". That certain provisions in Section 2 may be more relevant to

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<sup>883</sup> See Mexico's answer to question No. 1(b) of the Panel of 19 December 2002, paragraphs 14-24. For question No. 1(b), see footnote 232 of this Report.

<sup>884</sup> In the authentic Spanish version of Mexico's Schedule:

"2. *Interconexión*

2.1 *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."*

domestic interconnection than to international interconnection is not determinative. In the United States view, there are no important technical differences between international and domestic interconnection, and the underlying reasons for competition disciplines in both cases are the same. Call termination is simply a form of interconnection. According to the United States, even Mexico's own laws and regulations governing such cross-border termination refer to "interconnection" with foreign suppliers.

7.97 The United States further argues that the existence of international "accounting rate" regimes which may apply to certain cases of cross-border interconnection does not mean that cross-border interconnection is excluded from the scope of the Reference Paper. There are no explicit words to this effect. The United States argues that, while early drafts of the Reference Paper specifically provided for transparency in accounting rates, it does not follow that deletion of this discipline from the final version indicates that interconnection under such regimes is excluded from the scope of the Reference Paper. The United States also contends that it is not relevant that accounting rate regimes are temporarily exempt from WTO dispute settlement procedures through an understanding on accounting rates ("Understanding") contained in a 1997 Chairman's Note.<sup>885</sup> That exclusion, the United States points out, is non-binding, and was intended solely to provide cover from the MFN obligations in Article II of the GATS, and not commitments contained in the Reference Paper. The United States finally argues that International Telecommunication Union ("ITU") instruments are not relevant to this dispute, since they are separate from the WTO Agreement and, in any case, they do not conflict with Mexico's WTO obligations, and the definition of "accounting rate" in the ITU is consistent with Section 2.1 of the Reference Paper.

7.98 Mexico disagrees and claims that the Reference Paper provisions on interconnection do not apply to the cross-border supply of a service. It argues that Reference Paper commitments are additional commitments undertaken under Article XVIII, and they cannot therefore apply to cross-border interconnection, a market access issue covered by Article XVI. Mexico further argues that Reference Paper commitments are a matter exclusively of domestic regulation, and cannot cover cross-border supply in which the operator is located outside a Member's territory.

7.99 Mexico also argues that the existence of accounting rate regimes governing the cross-border supply of telecommunications services between many countries, and which are inconsistent with Reference Paper obligations, shows that these cross-border services were never intended to be covered by the Reference Paper disciplines on interconnection. In addition, Mexico argues that the negotiating history of the Reference Paper must be used as a supplementary means of interpretation. Although a section containing obligations relating explicitly to accounting rates was contained in early drafts of the Reference Paper, Mexico argues, they were later removed. Mexico also argues that the non-binding Understanding, contained in the 1997 Chair Note, which excludes the application of accounting rates from WTO dispute settlement, is evidence of an intention to exclude cross-border interconnection from the Reference Paper.

7.100 In order to determine whether Mexico's additional commitment on interconnection applies on the basis of its commitment on *cross-border* supply of the services at issue, we re-examine the terms of Section 2.1 of Mexico's Reference Paper. As already indicated before, Section 2.1 states that the interconnection provisions in Section 2.2 apply 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, on the basis of the specific commitments are undertaken."

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<sup>885</sup> See the United States' first oral statement, paragraph 25. See also the United States' second written submission, paragraph 49.

7.101 We note that this delimitation of the type of interconnection which falls within the scope of Section 2.2 contains four main elements: (a) a "linking"; (b) with "suppliers of public telecommunications networks and services"; (c) "to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier"; and (d) "on the basis of the specific commitments undertaken". We examine the scope of the interconnection provided for in Section 2 in the light of these elements.

(i) *Ordinary meaning*

7.102 The ordinary meaning of the word "linking" is very broad. The general dictionary meaning of "link" is "a connecting part, whether in material or immaterial sense; a thing (*occas.* a person) serving to establish or maintain a connexion; a member of a series or succession; a means of connexion or communication." Similarly, the meaning of the verb form of "link" is "to couple or join with", and the phrase "to link up with" includes "by means of transport or system of communication".<sup>886</sup> The dictionary meaning of the term link thus suggests that linking can involve *any* kind of connection between networks. The ordinary meaning of linking is broad and does not, in particular, imply any particular location of the object being linked. This ordinary meaning of link is consistent with the definition provided by a telecom glossary of a link as "a general term used to indicate the existence of communications facilities between two points".<sup>887</sup>

7.103 Section 2 of Mexico's Reference Paper describes the form of linking to which it applies as that occurring "with suppliers providing public telecommunications transport networks or services". A "public telecommunications transport *service*"<sup>888</sup> is defined in the Annex as:

"a 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."<sup>889</sup>

7.104 A "public telecommunications transport *network*"<sup>890</sup> is defined in the Annex as "the public telecommunications infrastructure which permits telecommunications between and among defined network termination points".<sup>891</sup>

7.105 Accordingly, the phrase "suppliers providing public telecommunications transport networks or services" means that, under Section 2, the "linking" is with suppliers of basic telecommunications services that are required to be offered to the public generally.<sup>892</sup> Thus there is no obligation to ensure such linking with suppliers that do not provide basic telecommunications services or with suppliers of basic telecommunications services that are not required to offer their services to the public generally. However, neither that provision, nor any other provision of Section 2, makes any reference to the

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<sup>886</sup> *The Shorter Oxford English Dictionary*, 3rd edition, (Clarendon Press, 1990), Vol. I, page 1219.

<sup>887</sup> *ANS T1.523-2001, Telecom Glossary 2000*; <http://www.atiss.org/tg2k/>.

<sup>888</sup> (emphasis added).

<sup>889</sup> Annex on Telecommunications, Section 3(b).

<sup>890</sup> (emphasis added).

<sup>891</sup> Annex on Telecommunications, Section 3(c).

<sup>892</sup> Section 3(b) of the Annex on Telecommunications 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.". Section 3(c) of the Annex on Telecommunications defines "Public telecommunications transport network" as "the public telecommunications infrastructure which permits telecommunications between and among defined network termination points."

entity that is entitled to be linked to the public telecommunications transport networks or services; no language thus exists that would circumscribe the scope, geographic or otherwise, of the basic telecommunications suppliers to be linked. This provision therefore could not be read to exclude suppliers outside of Mexico from "linking" to public telecommunications transport networks and services in Mexico.

7.106 Section 2 also states that the purpose of the linking is "to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier". Allowing the users of one supplier to communicate with users of another supplier should consist, at the very least, of allowing a basic telecommunications supplier who originates a voice telephone call for its customer to interconnect with a supplier of public telecommunications transport networks and services for the purpose of terminating that call with whichever user its customer wishes to communicate with. Again, there is nothing in this wording that suggests that the geographical location of the users that communicate, the services to be accessed, or service suppliers to be linked is relevant, much less circumscribed. Finally, the definition limits the scope of interconnection to situations "on the basis of the specific commitments undertaken". This condition likewise is silent as to the location of the suppliers or the network.

7.107 That the drafters did not explicitly limit the scope of Section 2 by, for example, inserting the word "domestic", must have some meaning. This silence could be seen as an indication that the scope of interconnection under Section 2 is comprehensive and includes international interconnection. However, the fact that there is no hint of any language limiting the geographic location of the network of the supplier seeking to be linked in this Section does not conclude our task of determining the meaning of interconnection under Section 2. Other interpretative elements could, as argued by Mexico, indicate a different result.<sup>893</sup>

(ii) *Context provided by the term "interconnection"*

7.108 We note that the "linking" referred to in Section 2.1 falls under the Section 2 heading of "interconnection", and is therefore informed by this term. The verb form "interconnect", in its general dictionary sense, means simply "to be or become mutually connected".<sup>894</sup> This suggests that the term "interconnection" is simply a form of linking of suppliers, which does not indicate any distinction with respect to the location of the suppliers being linked. Interconnection is, however, a term which may be given a "special meaning", according to Article 31.4 of the Vienna Convention, "if it is established that the parties so intended." Since the provision is a technical one that appears in a specialized service sector, we are entitled to examine what "special meaning" it may have in the telecommunications context, and whether the "linking" referred to in Section 2.1 is circumscribed by that special meaning. A specialized dictionary meaning of "interconnection" is:

"The linking together of interoperable systems. The linkage used to join two or more communications units, such as systems, networks, links, nodes, equipment, circuits, and devices."<sup>895</sup>

7.109 We note that this definition makes no distinction with respect to the national or geographic origin of the supplier or the location of the supplier to be linked.

7.110 The term "interconnection" also appears as a technical term with a possible "special meaning" in national laws and regulations. Mexico's Federal Communications Law, for example, although it does not directly define "interconnection", unambiguously uses the term to include cross-border

<sup>893</sup> See Appellate Body Report, *US – Carbon Steel*, paragraph 104.

<sup>894</sup> *MerriamWebster Dictionary*, Merriam Webster Online, 2003; <http://www.webster.com/>

<sup>895</sup> *ANS T1.523-2001, Telecom Glossary 2000*; <http://www.atis.org/tg2k/>.

interconnection.<sup>896</sup> Article 47 of the law states that "[i]nterconnection of public telecommunications networks *with foreign networks* shall be carried out through agreements entered into by the interested parties".<sup>897</sup> The ILD Rules likewise do not define "interconnection" directly, but again, usage of the term in the Rules makes it clear that it includes interconnection with foreign networks. The introductory clauses of the ILD Rules state that the Federal Telecommunications Commission has the authority to "oversee the efficient interconnection of public telecommunications networks and equipment, *including interconnection with foreign networks*".<sup>898</sup> Likewise, the stated purpose of the ILD Rules is to "regulate the provision of international long-distance service and establish the terms to be included in agreements for the *interconnection* of public telecommunications networks *with foreign networks*".<sup>899</sup> This confirms that the term "interconnection" is used in Mexico for interconnection between domestic networks, and between domestic and foreign networks.

7.111 We have not been provided evidence of laws or regulations of other Members which offer definitions or usage that indicate that the definition of "interconnection" is inconsistent with the ordinary meaning of the term "linking" in Section 2 of Mexico's Reference paper.<sup>900</sup> We note that under EC law, the term "interconnection" is defined comprehensively in a manner that is consistent with the ordinary meaning of the term "linking":

"the physical and logical linking of public communications networks used by the same or a different undertaking in order to allow the users of one undertaking to communicate with users of the same or another undertaking, or to access services provided by another undertaking. Services may be provided by the parties involved or other parties who have access to the network. Interconnection is a specific type of access implemented between public network operators."<sup>901</sup>

7.112 A "special meaning" of the term "interconnection" in Section 2, inconsistent with the ordinary meaning of this term, is also not evident from an examination of the differences between domestic and international interconnection from *commercial, contractual, or technical* points of view.

7.113 From a *commercial* perspective, we disagree with Mexico that international interconnection under a traditional, "joint service" regime is distinctive because the two operators cooperate, and do not compete for the same customers, unlike in domestic interconnection. In a domestic setting, it is true that two operators in the same geographic area and providing the same type of service will usually compete directly for the same customers. In an international setting, two operators may however also compete for the same customers through subsidiaries or services offered in each others'

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<sup>896</sup> A glossary published by Cofetel, does, however, offer a formal definition of interconnection, in similar terms to Section 2.2(b) of Mexico's Reference Paper: "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." English translation. Source: [www.cft.gob.mx/html/la\\_era/glo\\_pub2de4.html#I](http://www.cft.gob.mx/html/la_era/glo_pub2de4.html#I).

<sup>897</sup> Federal Communications Law, Article 47. (emphasis added)

<sup>898</sup> Rules for the Provision of International Long-Distance Service to be Applied by the Licensees of Public Telecommunications Networks Authorized to Provide this Service, Decision No. RES PC 961207 of 4 December 1996 ("ILD Rules"). Preambular clause. (emphasis added)

<sup>899</sup> ILD Rules, Rule 1. (emphasis added)

<sup>900</sup> See notably, for the United States: "Interconnection is the linking of two networks for the mutual exchange of traffic. This term does not include the transport and termination of traffic. " 47 CFR Ch. I §51.5 (10-1-02 Edition) (FCC) [*Interconnection regulations implementing ss. 251-252 of the Communications Act of 1934*];

<sup>901</sup> Article 2 of EC Directive 2002/19/EC (Access Directive) (OJ 2002 L108, p. 33). In this respect, see also the "Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services" (2002/C 165/03), Official Journal of the European Communities 165/6, 11.7.2002. The Panel is aware that the EC Access Directive regulates a common market for telecommunications among EC member States.

markets. Even if they do not, there is still an incentive for a major supplier to set interconnection rates at anti-competitive rates, and not to provide optimal service to the other supplier in terms of quality and timeliness. Domestic and international interconnection do not therefore differ significantly in this respect.

7.114 From a *contractual* perspective, we also find that there are no significant differences between the domestic and international interconnection, including through accounting rate arrangements. We cannot accept Mexico's assertion that "most of the provisions of one agreement are either not applicable or can never be a provision in the other agreement."<sup>902</sup> From a contractual point of view, domestic and international interconnection, including the accounting rate regime, do not form two distinct regimes that cannot overlap. After reviewing the evidence before it, including copies of standard agreements furnished by Mexico, and the arguments of the parties, the Panel agrees substantially with the statement by the United States that interconnection agreements between suppliers in the same or different countries, including through accounting rate regimes:

"may include a wide variety of rates, terms and conditions concerning such matters as specific services covered by the agreement, the rates applicable to specific services, payment schedules, procedures for dispute resolution, time duration of the agreement, restrictions on assignments of rights, and various network technical considerations. Interconnection arrangements may provide for one-way or two-way traffic flows, with the same or different rates applying in each direction, and two-way traffic flow. Interconnection arrangements may also provide for 'net' payment arrangements under which the two carriers set off their interconnect payments with one carrier remitting the balance to the other carrier."<sup>903</sup>

7.115 Even Telmex's contractual arrangements with United States suppliers do not adhere fully to the traditional accounting rate regime described by the ITU in which "a net settlement payment is made on the basis of excess traffic minutes, multiplied by half the accounting rate".<sup>904</sup> In fact, United States suppliers are charged three different rates depending on the destination zone in Mexico, while a still different rate applies to traffic from Mexico to the United States.

7.116 From a *technical* perspective, we find that the United States provides convincing evidence that the "mid-point" cross-border link-up, which Mexico argues is particular to international interconnection, arises also in certain situations of domestic interconnection.<sup>905</sup> More generally, we consider that technical issues arise under both domestic and international interconnection, including through accounting rate arrangements, and that these are solved in both cases through the use of technical standards and agreements, joint planning and coordination.

7.117 In sum the ordinary meaning, in the heading of Section 2 of Mexico's Reference Paper, of the term "interconnection" – that it does not distinguish between domestic and international interconnection, including through accounting rate regimes – is confirmed by an examination of any "special meaning" that the term "interconnection" may have in telecommunications legislation, or by taking into account potential commercial, contractual or technical differences inherent in international interconnection. We find that any "special meaning" of the term "interconnection" in Section 2 of

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<sup>902</sup> See Mexico's answer to question No. 8 of the Panel of 19 December 2002. For question No. 8, see footnote 77 of this Report. See also Mexico's answer to question No. 17 of the Panel of 14 March 2003. For question No. 17, see footnote 146 of this Report.

<sup>903</sup> See United States' answer to question No. 8 of the Panel of 19 December 2002, paragraph 44. For question No. 8, see footnote 77 of this Report.

<sup>904</sup> *Accounting Rate Reform Undertaken by ITU-T Study Group 3*, Communication from the International Telecommunication Union, Informal Note, Council for Trade in Services, Job. no. 2947, 11 May 2000, paragraph 2.

<sup>905</sup> See the United States' answer to question No. 8 of the Panel of 19 December 2002, paragraph 47. For question No. 8, see footnote 77 of this Report.

Mexico's Reference Paper does not justify a restricted interpretation of interconnection, or of the term "linking", which would exclude international interconnection, including accounting rate regimes, from the scope of Section 2 of the Reference Paper.

(iii) *Other contextual elements*

7.118 We now consider whether any other contextual elements within Mexico's Reference Paper may assist us in our interpretation of the scope of interconnection within Section 2. Mexico argues that certain obligations which arise from the interconnection commitment in Mexico's Reference Paper indicate that international interconnection, including through accounting rate regimes, should be excluded. Section 2.2 requires that interconnection be ensured "at any technically feasible point in the network". However, as already noted, this would not, contrary to Mexico's views, exclude linking to a point in a Mexican concessionaire's network that is located at the border. There is no reason why such a point would not be a "technically feasible point" in a network. Likewise, the requirement in Section 2.2(a) that the interconnection takes place "under non-discriminatory terms ... and rates" does not in itself indicate that interconnection is restricted to domestic calls. Further, for the purposes of Section 2, it is just as necessary to ensure the interconnection of a cross-border service supplied "on the basis of the specific commitments", as it is for a supplier who is commercially present in the market.

7.119 The existence of dispute settlement provisions in Section 2.5 does not, in our view, provide contextual evidence that the scope of interconnection is restricted to domestic networks only. Section 2.5 provides for an "independent domestic body", which will "resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously." The fact that the adjudicating body is "domestic" does not suggest that it would have no jurisdiction over the conditions of linking of a foreign network with a domestic network at the border. Domestic regulations applicable within a Member, and subject to adjudication by the domestic bodies of that Member, can clearly also be applied by that Member at the border.

7.120 A further element that may be taken into account, together with the context, in interpreting the notion of interconnection is "subsequent practice" by WTO Members. Article 31.3(b) of the Vienna Convention requires that the treaty interpreter take into account "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation". The Appellate Body has defined this concept as a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation".<sup>906</sup> Mexico claims that "all fifty-five WTO Members that inscribed the interconnection commitments in Section 2.2(b) of the Model Reference Paper maintain the traditional joint service accounting rate regime", including the United States. However, maintenance of a "joint service regime" that may be inconsistent with Reference Paper obligations does not necessarily establish that interconnection commitments under Section 2 were meant to exclude coverage of all *international* interconnection.

(iv) *Object and purpose*

7.121 A consideration of the *object and purpose* of the treaty – the GATS – would support the interpretation of "interconnection" derived through an examination of the ordinary meaning of the term in its context. Article I:1 of the GATS provides that the agreement extends to "measures affecting trade in services". Trade in services is defined in Article I:2 to include the cross-border supply of a service "from the territory of one Member into the territory of any other Member". This mode of supply, together with supply through commercial presence, is particularly significant for trade in international telecommunications services. There is no reason to suppose that provisions that ensure

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<sup>906</sup> See Appellate Body Report, *Japan – Alcoholic Beverages II*, DSR 1996:I, 97, at 106.

interconnection on reasonable terms and conditions for telecommunications services supplied through the commercial presence should not benefit the cross-border supply of the same service, in the absence of clear and specific language to that effect. Since the GATS deals specifically with international trade in services by four modes of supply that are considered comprehensive, it would indeed be unusual for interconnection disciplines not to extend to an obvious and important mode of international supply of telecommunications services – cross border.

(v) *Supplementary means – the "Understanding"*

7.122 The rules of the Vienna Convention provide that "supplementary means" of interpretation may be applied in two cases.<sup>907</sup> First, to *confirm* the meaning resulting from the application of the primary rules of interpretation – those we have applied up to this point.<sup>908</sup> Second, to *determine* the meaning when the application of the primary rules leaves the meaning "ambiguous or obscure" or leads to a result that is "manifestly absurd or unreasonable". The supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.<sup>909</sup>

7.123 Mexico has presented extensive arguments, based on the preparatory work of the GATS and the circumstances of its conclusion, to show that a reading of the term "interconnection" to include interconnection with foreign suppliers and networks would lead to a result which is "manifestly absurd or unreasonable". Mexico refers specifically to early drafts of the Reference Paper, and to an understanding on accounting rates reached by negotiators. In order to "confirm the meaning" resulting from the application of the primary rules of interpretation, it would therefore be appropriate to examine these supplementary means of interpretation.

7.124 The text cited by Mexico (the "Understanding") is contained in a Report by the Group on Basic Telecommunications made on 15 February 1997, at the close of the negotiations on the Fourth Protocol – the instrument which contained Members' new commitments on basic telecommunications, including Mexico's Reference Paper commitments. The Report, which appended the draft schedules of Members, states:

"7. The Group noted that five countries had taken *Article II exemptions* in respect of the application of differential accounting rates to services and service suppliers of other Members. In the light of the fact that the accounting rate system established under the International Telecommunications Regulations is the usual method of terminating international traffic and by its nature involves *differential rates*, and in order to avoid the submission of further such exemptions, it is the understanding of the Group that:

- the application of such accounting rates would not give rise to action by Members under dispute settlement under the WTO; and
- that this understanding will be reviewed not later than the commencement of the further Round of negotiations on Services Commitments due to begin not later than 1 January 2000." (emphasis added)

7.125 The Report was introduced by the Chair of the Group on Basic Telecommunications at the 15 February meeting in the following terms (as reported in a Secretariat note):

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<sup>907</sup> Vienna Convention, Article 32, *supra*, footnote 822.

<sup>908</sup> The "primary" rules of interpretation are set out in Article 31, the "supplementary" rules are set out in Article 32.

<sup>909</sup> Vienna Convention, Article 32, *supra*, footnote 822.

"Introducing the revised draft of this report, the Chairman drew attention to a new paragraph dealing with accounting rates systems. It had been noted that some delegations had submitted Article II exemptions with respect to accounting rates systems; though their right to do so was not in question, it would have been undesirable that a large number of other delegations felt it necessary to take similar exemptions on the basis of uncertainty about the interpretation of the issue of accounting rates in these negotiations. In order to avoid such an outcome he suggested that a paragraph be inserted in the Report recording the understanding of the Group that the application of accounting rates under the International Telecommunications Regulations would not give rise to dispute settlement action under the WTO. The Chairman stressed that this was merely an understanding, which could not and was *not intended to have binding legal force*. It therefore did not take away from Members the rights they have under the Dispute Settlement Understanding; it was *merely intended to give Members who had not taken MFN exemptions on accounting rates some degree of reassurance*. He also drew attention to the statement in the paragraph that this understanding will be reviewed before the commencement of the next Round of negotiations. Some delegations suggested some other changes, which were incorporated in the Report." (emphasis added)

7.126 In interpreting the Understanding, it is important to note at the outset that it cannot affect *directly* the scope of Mexico's obligations under Section 2 of the Reference Paper. The Understanding is not, under the WTO Agreement, an agreed interpretation (Article IX:2), or a waiver (Article IX:3), or an amendment (Article X) of a provision, all of which require special rules and procedures. Even according to its own terms, the Understanding is explicitly non-binding, and concerns only procedural rights to dispute settlement, not substantive obligations. Any interpretative value of the Understanding must lie in the guidance it may lend in determining the scope of the interconnection provision in Section 2 of Mexico's Reference Paper.

7.127 The operative clause of the Understanding is that "the application of *such accounting rates* would not give rise to action by Members under dispute settlement under the WTO" (emphasis added). The term "such accounting rates" refers to an earlier statement in the Understanding that the "accounting rate system established under the International Telecommunications Regulations is the usual method of terminating international traffic and by its nature involves differential rates". The accounting rates referred to in the Understanding can therefore be taken to be those imposed under an accounting rate system: (a) "established under the International Telecommunications Regulations", and; (b) that "involves differential rates". The underlying purpose of the Understanding is "to avoid the submission of [MFN] exemptions", by providing temporarily "some degree of reassurance" for Members to maintain "differential" rates.

7.128 The main interpretative issue arising from the Understanding is whether the non-binding decision to exclude from the scope of WTO dispute settlement "differential" accounting rates "established under the International Telecommunication Regulations" for the purposes of the MFN obligation, implies also an intent to exclude from the substantive scope of the Reference Paper international interconnection – in particular, the international linking of the networks of Mexican and United States suppliers.

7.129 In addressing this issue, we need first to examine what is meant in the Understanding by "differential" accounting rates "established under the International Telecommunication Regulations". The International Telecommunication Regulations are a binding set of rules with treaty status, last revised in 1988, and agreed by ITU members, which include both Mexico and the United States.<sup>910</sup> The Regulations are intended to "establish general principles which relate to the provision and

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<sup>910</sup> Forming part of the Final Acts of the World Administrative Telegraph and Telephone Conference, Melbourne, 1988 (WATTC-88).

operation of international telecommunications services offered to the public as well as to the underlying international telecommunications transport means used to provide such services".<sup>911</sup>

7.130 The Regulations deal in part with "accounting rates", which are defined as "the rate agreed between administrations in a given relation that is used for the establishment of international accounts." An "administration" includes a "recognized private operating agency".<sup>912</sup> A "relation" is defined as the "exchange of traffic between two terminal countries". The principal obligation with respect to accounting rates is set out in Article 6.2:

"6.2 *Accounting rates*

6.2.1 For each applicable service in a given relation, administrations shall by mutual agreement establish and revise accounting rates to be applied between them, in accordance with the provisions of Appendix I and taking into account relevant CCITT Recommendations and relevant cost trends." [footnote omitted]

7.131 Article 6.2 refers to Appendix I, which sets out in more detail the establishment and settling of accounts. Article 1.1 of the Appendix provides two methods of establishing accounting rates. First, by mutual agreement of administrations, taking into account ITU recommendations and "trends in cost".<sup>913</sup> Second, by each administration establishing terminal and transit shares, and adding these together.<sup>914</sup>

7.132 According to the ITU, the most common system of remuneration historically has been the "accounting rate revenue division procedure".<sup>915</sup> This envisages an international call as a single "joint-service", for which the two operators negotiate an agreed "accounting rate". The accounting rate is then divided in half (the "settlement rate") and applied to traffic flows in both directions.<sup>916</sup> Since both traffic flows are priced the same, the scheme results overall in a net payment from the operator originating more traffic to the operator originating less traffic, based solely on the difference in volume of traffic in each direction.

7.133 The traditional "accounting rate revenue division procedure" based on a negotiated rate resulted in pricing which, in practice, depended on many factors other than cost, including the dynamics of different bilateral negotiations. When the supplier, public or private, had monopoly rights within a Member's territory, any different pricing of services that occurred on the basis of a Member's territory might also, under GATS Article VIII:1, lead to MFN inconsistencies under GATS Article II. Under Article VIII:1, a Member "shall ensure that any monopoly supplier of service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that Member's obligations under Article II [MFN] and specific commitments." This possible inconsistency with the MFN principle was the particular concern that was addressed in the Understanding, which speaks of "differential rates" being inherent in accounting rates.

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<sup>911</sup> ITR Article 1.1(a).

<sup>912</sup> The use of the word "administrations" is systematically footnoted in the ITRs to include "recognized private operating agency(ies)".

<sup>913</sup> ITR, Appendix 1, Article 1.1.

<sup>914</sup> ITR, Appendix 1, Article 1.2.

<sup>915</sup> *Accounting Rate Reform Undertaken by ITU-T Study Group 3*, Communication from the International Telecommunication Union, Informal Note, Council for Trade in Services, Job. no. 2947, 11 May 2000, paragraph 2. See also Exhibit MEX-59 (which presents Section 8 on "International Interconnection" of *ITU Trends in Telecommunications Reform: Interconnection Regulation*, 3rd edition, pp. 93-107).

<sup>916</sup> This assumes that the traffic does not transit through third countries.

7.134 Relevant, non-binding recommendations referred to in Article 6.2 of the Regulations are the ITU-T Recommendations D.140 and D.150.<sup>917</sup> They deal with methods of compensating administrations for the cost of international telecommunications. At the time of the WTO negotiations on basic telecommunications, Recommendation D.140 already contained the principle of cost-orientation, transparency and non-discrimination. Subsequent to the WTO negotiations, ITU Members modified these Recommendations, adding principles for determining costs, transitional periods for achieving cost oriented rates, and explicit alternatives to the traditional accounting rate procedures between administrations.

7.135 Read together, the Regulations, its Appendix, and the related Recommendations result today in a number of different ways in which operators in different countries can be compensated for international traffic exchanged between them, ranging from traditional methods to more modern alternatives.<sup>918</sup> Regardless of whether the traditional or new alternative arrangements are being used, the ITU instruments require that the arrangements be cost-oriented and non-discriminatory.

7.136 We therefore conclude that the accounting rates described in the Understanding should be understood to be limited to: (a) a traditional accounting rate that is not cost-oriented; (b) that can be interpreted as a measure of a Member, or that triggers a Member's obligations under Article VIII on monopolies; and (c) that applies discriminatory rates on the basis of the national origin of the cross-border traffic, and thus may be inconsistent with the MFN principle in Article II.

7.137 Based on this delineation of the "accounting rates" that are within the scope of the Understanding, we can make several observations. First, not *all* international interconnection pricing was excluded from dispute settlement by the Understanding, only traditional accounting rate regimes with "differential rates". Second, the exclusion was from dispute settlement, not from the substantive obligations of the GATS, including its schedules of commitments. Third, the explicit aim of the exclusion was the MFN obligation under GATS Article II. Other obligations or specific commitments in the GATS, such as Section 2 of Mexico's Reference Paper were not specified. Fourth, not all traditional accounting rate regimes would be MFN inconsistent, even if they were *not* cost-oriented. In order to demonstrate the MFN inconsistency of a traditional accounting system regime, one would have to show that the rate is either a "measure" of a Member, or that it falls within a Member's obligations under Article VIII:1 on monopolies, and that different rates for different international routes amount to treatment less favourable with respect to one "like service" compared to another "like service". Finally, the existence of the Understanding demonstrates that, even though negotiators considered at length the issue of rates for international interconnection, they chose not to adopt wording that would have expressly excluded certain types of interconnection from the scope of the Reference Paper.

7.138 In sum, the Understanding seeks to exempt a very limited category of measures, temporarily, and on a non-binding basis, from the scope of WTO dispute settlement. Simply because Members wished to shield a *certain type* of cross-border interconnection from dispute settlement, because of *possible* MFN inconsistencies (with respect to differential rates), it does not follow that they wished to shield *all* forms of cross-border interconnection from dispute settlement. The clear intention to do so is not expressed in the Understanding. This suggests that the content and purpose of the

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<sup>917</sup> The CCITT no longer exists. Its functions have been subsumed by the ITU-T, whose Study Group 3 is responsible for development and revision of ITU-T D Series Recommendations such as D.140 and D.150.

<sup>918</sup> ITU Recommendation ITU-T D.150, (06/1999) paragraph 2. Recommendation D.150, which has existed in some form since 1968 was revised in 1999 to reflect the new telecommunication environment. In its present form, Section 2 describes different procedures for remuneration that include modern alternatives to the "accounting rate revenue division procedure". See also, *Accounting Rate Reform Undertaken by ITU-T Study Group 3*, Communication from the International Telecommunication Union, Informal Note, Council for Trade in Services, Job. no. 2947, 11 May 2000, paragraph 2. See also Exhibit MEX-59 (which presents Section 8 on "International Interconnection" of *ITU Trends in Telecommunications Reform: Interconnection Regulation*, 3rd edition, pp. 93-107).

Understanding is of limited assistance in interpreting the scope of application of the term "interconnection" in Section 2.1 of Mexico's Reference Paper.

7.139 Before leaving the Understanding, we note that the Understanding could arguably be considered as part of the interpretative "context" under the primary rules of interpretation in Article 31.2 of the Vienna Convention. In that case, the Understanding has to be seen as an instrument made "in connection with the conclusion of the treaty", and "accepted by the other parties as an instrument related to the treaty". Since the Report attaches draft schedules of commitments, including Mexico's Reference Paper commitments, to be appended to the Fourth Protocol, the Understanding might well be viewed as being made "in connection with the conclusion of the treaty". As the Understanding reflects the common view of negotiators on a matter affecting access to WTO dispute settlement on telecommunications matters, it would be difficult for parties to deny that it was an instrument "related to" the Fourth Protocol. However, even if viewed as "context", and not as a "supplementary means" of interpretation under Article 32 of the Vienna Convention, we would arrive at the same interpretative conclusion.

(vi) *Supplementary means – other*

7.140 In addition to the Understanding, Mexico refers to the drafting history of the Reference Paper. Mexico provides evidence that a transparency requirement with respect to accounting rates existed in earlier drafts of the Reference Paper, but asserts that these references were subsequently deleted, indicating the intention to exclude accounting rates from its scope. However, the opposite argument can equally well be made that negotiators considered, based on the plain meaning of the word "interconnection", that the matter was covered, and that the special provision was no longer needed. The available records of the negotiations simply do not contain sufficient material to permit the Panel to determine the reason for the deletion of the separate provision.<sup>919</sup> In the absence of a clear record of the negotiations on this point, which might give firm evidence of the reasons for the deletion, we find it difficult to arrive at the interpretation which Mexico is seeking.<sup>920</sup> The introduction and deletion of the specific provision on accounting rate transparency is therefore not helpful in arriving at an interpretation of the scope of the provisions of Mexico's Reference Paper on "interconnection". Mexico argues further that the conscious exclusion from the Reference Paper of accounting rates and termination services is confirmed by the fact that they are "on the table" in the Doha Round of negotiations. The Panel does not however see this as providing the confirmation that Mexico claims. In the Doha Round, the main issue for Members with respect to the Understanding has been whether it should be maintained, and not what its scope might be. With respect to termination services, a proposal by a Member to make specific commitments on these services demonstrates no more than an interest, on the part of one Member, in market access or national treatment commitments for these services. These discussions do not lead to any particular conclusion with respect to the scope of Section 2 of the Reference Paper.

7.141 Finally, consideration must be given to Mexico's argument that the interpretation of "interconnection" in Section 2 of the Reference Paper as including international interconnection leads, under Article 32 of the Vienna Convention, to a result that is "manifestly absurd or unreasonable". Mexico claims that such an interpretation would require all 55 WTO Members who have accepted cost-oriented interconnection to apply these low rates to terminate traffic from *all* other WTO Members, even from the 89 WTO Member with no cost-oriented pricing commitments because they have not committed to the Reference Paper. Mexico states that this situation would result in a net outflow of payments from countries subject to cost-oriented pricing disciplines, which would lead to operators in those countries to "choose between bankruptcy and refusing to pay".<sup>921</sup> This would result

<sup>919</sup> Available records of the negotiations consist of all documents in the series S/NGBT/1 - 18 and S/NGBT/W1 - W19 and in the series S/GBT/1 - 4, S/GBT/M1 - M9, and S/GBT/W1 - W13.

<sup>920</sup> See Appellate Body Report, *India – Quantitative Restrictions*, paragraph 94.

<sup>921</sup> See Mexico's second written submission, paragraph 34.

in "the complete collapse of the accounting rate regime without a viable replacement, possibly even leading to interruptions in international traffic."<sup>922</sup>

7.142 We are not convinced by Mexico's argument that a broad interpretation of interconnection would lead in this sense to a result that is "manifestly absurd or unreasonable". First, a large and increasing proportion of all international traffic is routed outside the traditional accounting rate system.<sup>923</sup> Second, the "outflows" predicted by Mexico would only occur if those other countries without cost-oriented international interconnection were able to maintain high interconnection charges, and at the same time were high net recipients of incoming calls. Third, traditional accounting rate regime charges are falling quickly, under influences such as the ITU-T D.140 Annex E Benchmarks, the 1997 United States FCC Benchmarks, use of leased lines, and new technology such as voice-over-IP. In sum, Mexico has not demonstrated that a requirement for Members having undertaken Reference Paper commitments to grant international interconnection at cost-oriented pricing to all other WTO Members would lead to results which were "manifestly absurd or unreasonable".

7.143 We find, therefore, that Section 2 of Mexico's Reference Paper applies to the interconnection of cross-border suppliers.

7.144 Since we have already found that Mexico has undertaken market access and national treatment commitments in its schedule with respect to the cross-border supply of the services at issue; and that these commitments can provide the basis for interconnection commitments in Section 2.2(b) of Mexico's Reference Paper; we are able to find overall that Section 2.2(b) of Mexico's Reference Paper applies to United States service suppliers supplying or seeking to supply the services at issue.

**2. Whether Mexico has fulfilled its interconnection commitment, in Section 2.2(b) of its Reference Paper, with respect to the services at issue**

7.145 We now consider whether Mexico has *fulfilled* the commitment contained in Section 2.2 of its Reference Paper, notably to ensure, with a major supplier, cost-oriented interconnection. We consider first the preliminary issue of whether Telmex is a "major supplier".

(a) Is Telmex a "major supplier"?

7.146 The United States claims that Mexico has not met its commitment under Sections 2.1 and 2.2 of its Reference Paper because it has failed to ensure that Telmex, a major supplier, provides interconnection to United States basic telecommunications suppliers on a cross-border basis with cost-based rates and reasonable terms and conditions. Mexico refutes this claim and also contests the United States assertion that Telmex is a major supplier.

7.147 We examine first the definition of the term "major supplier", as it appears in the Reference Paper:

"A major supplier is 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

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<sup>922</sup> See Mexico's second written submission, paragraph 34.

<sup>923</sup> Estimates are that as much as half of all international traffic is outside the traditional accounting rate system. ITU Trends in Telecommunications Reform 2000-2001, Section 8.2 (Exhibit MEX-59).

- (b) use of its position in the market."<sup>924</sup>

7.148 It is not in dispute that Telmex is a *supplier* of basic telecommunications services. In order to determine whether Telmex is a "major supplier", Mexico's Reference Paper indicates that we must examine three factors. First, what the "relevant market" is. Second, whether, in that market, Telmex has "the ability to materially affect the terms of participation (having regard to price and supply) in that market". Third, whether that ability results either from "control over essential facilities", or "use of its position in the market". We consider each of these factors in turn.

- (i) *What is the "relevant market for basic telecommunications services"?*

7.149 The United States argues that the relevant market is the *termination* of the services at issue – voice telephony, facsimile and circuit-switched data transmission services – supplied cross-border from the United States to Mexico. According to the United States, this results from an application of basic principles of United States antitrust law and Mexican competition law, which define the relevant market in terms of demand substitution. Under this principle, it contends that international telecommunications services (whether supplied cross-border or through commercial presence) cannot substitute for domestic telecommunications services. Likewise, within international telecommunications services, originating traffic cannot substitute for terminating traffic, which is a separate market.<sup>925</sup>

7.150 Mexico contests this analysis. It argues that the United States fails to explain how the supply of cross-border services is relevant to the market for *termination*, which are supplied through commercial presence, a different mode of supply. Even if the market for termination were in principle relevant, Telmex does not provide such services, and Mexico does not permit trade in them. Instead, it argues, Telmex completes international calls on a shared-revenue basis, under a traditional accounting rate regime, and the relevant market would thus have to include two-way traffic.<sup>926</sup>

7.151 The services at issue are basic telecommunications services – voice, switched data and fax – originating in the United States, and for which United States suppliers are seeking interconnection with Mexican concessionaires for termination of the service in Mexico. United States suppliers have a choice of Mexican operators with whom they may interconnect and terminate, even though these operators, by Mexican law, must charge a single price set by the operator with the largest volume of outgoing traffic, and Telmex controls the majority of international gateways necessary to terminate the services. Contrary to Mexico's arguments, therefore, there does exist supply and demand – a "market" – in Mexico for termination. The fact that arrangements for interconnection and termination may take the form of "joint service" agreements, and may not be price-oriented, does not change the fact that the market exists. Nor is it pertinent to the determination of the "relevant market", as Mexico suggests, that most WTO Members have not undertaken market access commitments specifically in "termination services"; facilities for the termination and interconnection are *essential* to the supply of the services at issue in this case.

7.152 Is this market for termination the "relevant" market? For the purposes of this case, we accept the evidence put forward by the United States, and uncontested by Mexico, that the notion of demand

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<sup>924</sup> In the authentic Spanish version:

*"Proveedor principal, es aquel proveedor que tiene la capacidad de afectar materialmente los términos de participación en el mercado relevante de servicios básicos de telecomunicaciones (teniendo en cuenta el precio y la oferta), como resultado del:*

(a) *control sobre los recursos esenciales; o*  
 (b) *uso de su posición en el mercado."*

<sup>925</sup> See the United States' first written submission, paragraphs 72-78.

<sup>926</sup> See Mexico's second oral statement, paragraphs 67-74.

substitution – simply put, whether a consumer would consider two products as "substitutable" – is central to the process of market definition as it is used by competition authorities. Applying that principle, we find no evidence that a domestic telecommunications service is substitutable for an international one, and that an outgoing call is considered substitutable for an incoming one. One is not a practical alternative to the other. Even if the price difference between domestic and international interconnection would change, such a price change would not make these different services substitutable in the eyes of a consumer. We accept, therefore, that the "relevant market for telecommunications services" for the services at issue – voice, switched data and fax – is the termination of these services in Mexico.

(ii) *Does Telmex have "the ability to materially affect the terms of participation (having regard to price and supply)" in that market?*

7.153 The United States maintains that, within the market for termination, Telmex "can materially affect the terms of participation (having regard to price and supply)". It argues that this notion corresponds to the concepts of "market power", used by United States competition authorities, and "substantial power", used by Mexican competition authorities. A firm has market power if it has the ability profitably to maintain prices above competitive levels for a significant period of time, which implies both the ability to maintain prices well above costs, and protection (either governmental limitations or market circumstances) against a rival's entry or expansion. The United States argues that, in determining whether a firm has market power, United States antitrust authorities examine factors such as market share, barriers to entry, capacities of firms in the market, availability of substitutes, and opportunities for coordinated behaviour among firms.<sup>927</sup>

7.154 Within the market for termination in Mexico, the ILD Rules accord Telmex special powers. ILD Rule 13 provides:

"The long-distance service licensee having the greatest percentage of outgoing long-distance market share for the six months prior to negotiations with a given country shall be the licensee that is authorized to negotiate settlement rates with the operators of said country. These rates shall be submitted to the Commission for its approval."

7.155 Rule 13 effectively grants to the long-distance licensee with the highest volume of outgoing traffic on a particular international market the sole right to negotiate settlement rates which, under Rule 10, all other operators must apply. Since Telmex has always had the largest share of outgoing traffic in every international market, including to the United States, it is, and has consistently been under the Rules, the "licensee authorized to negotiate settlement rates". In these circumstances, since Telmex is *legally* required to negotiate settlement rates for the entire market for termination of the services at issue from the United States, we find that it has patently met the definitional requirement in Mexico's Reference Paper that it have "the ability to materially affect the terms of participation", particularly "having regard to price".

(iii) *If Telmex has the ability to materially affect the terms of participation in that market, does it result from "control over essential facilities", or "use of its position in the market"?*

7.156 The United States argues that Telmex has market power with respect to the termination of the services at issue mainly because of its right under the International Long Distance Rules ("ILD Rules") to determine the single price applicable to *all* suppliers in the market. It contends that Mexico's own competition authority, the CFC, found in 2001 that Telmex had substantial power in *international* services markets based on: a market share of 74% in international traffic, control of nearly 75% of international gateway capacity, a right to set prices because of its large market share, as well as advantages arising from vertical integration. Mexico for its part argues that the United States

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<sup>927</sup> See the United States' first written submission, paragraphs 79-81.

relies on a market determination by the Mexican competition authority that is under review by Mexican courts precisely because it was based on data from 1996, that is, when the telecommunications market was not yet fully open.<sup>928</sup> The United States argues that the substantial power of Telmex in the international market would apply automatically to the market for *termination*, since the ILD Rules guarantee that Telmex, as an originator of international services, is entitled to terminate services in the same proportion. The United States notes that the FCC has also made a finding that Telmex is dominant in the provision of international telecommunications services between the United States and Mexico.<sup>929</sup>

7.157 The United States also argues that Telmex continues to have market power with respect to the cross-border termination of the services at issue. It contends that Telmex has over 60% of the Mexican international switched market, and has never been below that level; that the United States market is over 80% of that market; that it is not necessary to analyse separately incoming and outgoing minutes, since the proportionate return system links the two; that there have been no significant new entrants since competition was opened in the Mexican international telecommunications market; and that Telmex has demonstrated the ability over a sustained period to maintain prices well above costs.<sup>930</sup>

7.158 In examining this issue, we have already shown that Telmex possesses the "ability to materially affect the terms of participation" in the relevant market, primarily through its ability to impose its negotiated settlement rate for an international route on its competitors. The ability to impose uniform settlement rates on its competitors is the "use" by Telmex of its special "position in the market", which is granted to it under the ILD Rules.

7.159 Overall, we find therefore that Telmex is a "major supplier", with respect to termination of the services at issue, in that it has the ability to materially affect the price of termination of calls from the United States into Mexico, as a result of its special position in the market, which allows it to set a uniform price applying to all its competitors on terminating calls from the United States.

(b) Are the Telmex interconnection rates "cost-oriented"?

7.160 The United States claims that the interconnection rates negotiated by Telmex are not cost-oriented. The United States argues that the ordinary meaning of "cost-oriented" suggests that the cost at issue must be "related to the *cost incurred* in providing the good or service".<sup>931</sup> This meaning is amplified, according to the United States, by the use of this term in many WTO Members' telecommunications laws and regulations, a usage which amounts to a "special meaning" in the sense of Article 31 of the Vienna Convention. The term "cost-oriented" in the context of Mexico's Reference Paper should therefore be interpreted as "the *cost incurred* in providing interconnection".<sup>932</sup> The United States contends that this meaning is confirmed through the practice of WTO Members, including the United States, the European Communities and Mexico.<sup>933</sup> Mexican law, in particular, requires the use of "long run average incremental cost" ("LRAIC") principles, which are consistent with interconnection rates that relate to the cost of providing that service.<sup>934</sup> Furthermore, according to the United States, this meaning is consistent with the pro-competitive object and purpose of the Reference Paper commitments, since requiring a major supplier to set interconnection rates based on

<sup>928</sup> Mexico's argument on this issue is summarized at paragraph 4.156 of this Report.

<sup>929</sup> See the United States' first written submission, paragraphs 82-92.

<sup>930</sup> See the United States' first written submission, paragraphs 93-98.

<sup>931</sup> See the United States' first written submission, paragraph 107.

<sup>932</sup> See the United States' first written submission, paragraph 108.

<sup>933</sup> See the United States' first written submission, paragraphs 109 and 112.

<sup>934</sup> See the United States' first written submission, paragraph 110.

the cost of providing the interconnection is an important way of ensuring that competitors are on an equal footing.<sup>935</sup>

7.161 The United States argues that, to the extent that the term "having regard to economic feasibility" qualifies the term "cost-oriented" rates, it simply confirms that interconnection rates should cover "both direct costs and common costs, and should permit a reasonable return on the investor's investment".<sup>936</sup> According to the United States, the LRAIC method used by Mexico to develop its domestic interconnection rates includes the cost of capital to finance interconnection facilities, which already includes a reasonable rate of return. The United States agrees with the EC that the language in the EC Interconnection Directive served as a model for the phrase "having regard to economic feasibility", and it is intended there simply to ensure the return on an operator's investment is "reasonable".<sup>937</sup>

7.162 The United States also argues that the phrase "having regard to economic feasibility" does not temper the obligation to provide interconnection at cost-oriented rates, in light of an overall policy goal such as expanding a country's telecommunications infrastructure. Section 2.2(b) requires a relationship between interconnection rates and the cost of *interconnection*, not the cost of national infrastructure roll-out.<sup>938</sup> According to the United States, its interpretation is contextually supported by Section 2.2(b), which provides that a purchaser of unbundled interconnection "need not pay for network components or facilities that it does not require for the [interconnection] service to be provided", and by Section 3, which provides separate and particular requirements for Members wishing to impose universal service obligations.<sup>939</sup>

7.163 The United States presents detailed evidence aimed at showing that the current interconnection rates for terminating United States calls charged by Telmex and approved by Mexican authorities (5.5 cents, 8.5 cents, or 11.75 cents per minute, depending on the geographical area in Mexico where the call is terminated) are much higher on average than the prices Telmex charged for purely domestic use of the same network components. The United States also uses three other proxy methods, showing that the interconnection rates that Telmex charges United States cross-border suppliers greatly exceeds grey market retail rates for calls into Mexico, wholesale rates for the termination of calls into other countries, and rates Mexican operators charge each other for settling accounts relating to international calls.

7.164 Mexico argues that the United States incorrectly defines "cost-oriented" rates as requiring that the rate equal the "bare cost" of providing the service. Instead, according to Mexico, the term "*tarifas basadas en costos*" ("cost-oriented rates") must be interpreted taking into account the qualifying phrase "*que sean transparentes, razonables, económicamente factibles*" ("that are transparent, reasonable, economically feasible") which also appears in Section 2.2(b) of its Reference Paper. In assessing whether cost-oriented rates were "reasonable", Mexico states that relevant factors include the state of a WTO Member's telecommunications industry; the coverage and quality of its telecommunications network; the return on investment; and whether the rates derive from an accounting rate regime. In assessing whether the cost-oriented rates were "economically feasible", Mexico states that rates meet this standard if they are "consistent with the efficient use of income and wealth that is suitable, reflecting the needs of the operator and the policy goals of the country".<sup>940</sup> In this respect, account had to be taken of Mexico's policy goal of promoting universal access to telecommunications services, which depended to a large extent on accounting rate revenues.

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<sup>935</sup> See the United States' first written submission, paragraphs 115-116.

<sup>936</sup> See the United States' second written submission, paragraph 68.

<sup>937</sup> See the United States' answer to question No. 14(a) of the Panel of 19 December 2002, paragraph

76. For question No. 14(a), see footnote 359 of this Report.

<sup>938</sup> See the United States' second written submission, paragraph 71.

<sup>939</sup> See the United States' first written submission, paragraph 107.

<sup>940</sup> See Mexico's second written submission, paragraphs 87-97.

7.165 In resolving the issue of whether Mexico has ensured that Telmex charges "cost-oriented rates" to United States suppliers of the services at issue, we first examine the meaning of this term. In the light of this, we then determine whether the United States has provided evidence that Mexico has failed to ensure that Telmex has met this standard.

(i) *Meaning of "cost-oriented" rates*

7.166 Section 2.2(b) of Mexico's Reference Paper requires that Mexico ensure interconnection "at cost-oriented rates that are ... reasonable, having regard to economic feasibility".<sup>941</sup> We will first look at the ordinary meaning of the wording.

7.167 With respect to the term "cost-oriented", we note that Japan, a third party to these proceedings, drew the Panel's attention to a discrepancy between the original Spanish term "*basadas en costos*" and its translation into English "cost-oriented". It was said that the correct translation of "*basadas en costos*" should have been "based on costs" and that there was a difference in the meaning between those two terms. Although the Panel agreed with this second translation as being the closer to the original Spanish, both parties indicated to the Panel that they did not see any substantive difference in meaning between "*basadas en costos*" and "cost-oriented". Therefore, in the absence of disagreement between the parties on this point, the Panel considers that "*basadas en costos*" and "cost-oriented" are interchangeable.

7.168 In examining the ordinary meaning of "cost-oriented", we note that the dictionary meaning of "to orient" is "to adjust, correct, or bring into defined relations, to known facts or principles".<sup>942</sup> Rates that are "cost-oriented" thus suggest rates that are *brought into a defined relation to known costs or cost principles*. Rates that are "cost-oriented" would not need to equate exactly to cost, but should be founded on cost. The degree of flexibility inherent in the term "cost-oriented" suggests, moreover, that more than one *costing methodology* could be used to calculate "cost-oriented" rates.

7.169 As we did in the case of the term "interconnection", we will now examine whether the term "cost-oriented" has a "special meaning", in the sense of Article 31:4 of the Vienna Convention since it is a technical term that may have such a meaning in the telecommunications sector. As already noted, this provision requires that "a special meaning shall be given to a term if it is established that the parties so intended". We consider that Article 31.4 includes cases in which the term at issue is a technical one that is in common use in its field, and which the parties can be presumed to have been aware of. We find this to be the case with "cost-oriented rates".

7.170 The term "cost-oriented rates" is of central importance in national and international telecommunications regulation. Within the ITU, the notion of "cost-oriented rates" is a key concept which has been in common use since 1991. It figures in a key ITU-T series Recommendation D.140, which lays down guidelines for establishing accounting rates for international telephone services.<sup>943</sup> Recommendation D.140 states that accounting rates "should be 'cost-orientated' and should take into account relevant cost trends", and that cost-orientation should apply "to all relations on a non-discriminatory basis".<sup>944</sup>

7.171 Recommendation D.140 also enumerates the *cost elements* to be taken into account when determining accounting rates. Annexed guidelines enumerate these "cost elements": network elements (international transmission facilities, international switching facilities, and the national extension), related costs (direct, and indirect or common costs – including a "reasonable return on

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<sup>941</sup> In the authentic Spanish version: "*en ... tarifas basadas en costos que sean ..., razonables, económicamente factibles*".

<sup>942</sup> *The Shorter Oxford English Dictionary*, 3rd edition, (Clarendon Press, 1990), page 1463.

<sup>943</sup> ITU Recommendation ITU-T Rec. D.140 (06/2002) paragraph 1.

<sup>944</sup> ITU Recommendation ITU-T Rec. D.140 (06/2002) paragraph 2.

equity"), and "other related costs" to be agreed between the parties.<sup>945</sup> The guidelines specify that several of the related direct costs are relevant only "if applicable", or "directly attributable" to the particular international telephone service. Likewise, related indirect or common costs "cannot be solely attributed to the international telephone service and thus must be allocated". The guidelines suggest therefore that the relevant cost elements are only those that relate to the actual cost of providing the service.

7.172 The principle of "cost-orientation" is confirmed in a related ITU Recommendation, D.150, which was amended in 1999 to describe possible procedures for the "remuneration of the Administration of the country of destination" for international telecommunications traffic. These procedures are: flat rate price, traffic-unit price, accounting revenue division, settlement rate, termination charge, and "other" procedures. For each of these procedures, the Recommendation states that administrations "should apply the principles of ... cost-orientation".<sup>946</sup>

7.173 Recommendation D.140 also specifies that cost elements need be valued according to a cost *model* in order to arrive at specific cost figures. A set of principles adopted in 1999 and annexed to the Recommendation D.140 requires that administrations, in developing and using a cost model, adhere to a "principle of causality" between the service and the resources used to provide it:

"Principle of causality"

The demonstration of a clear cause and effect relationship between service delivery on the one hand and the network elements and other resources used to provide it on the other hand, taking into account the relevant underlying cost determinants."<sup>947</sup>

7.174 In sum, Recommendation D.140 requires in its present form that the cost *elements* and the cost *model* both be clearly related to the cost of delivering the service. This special meaning of "cost-orientated", in the context of the ITU, is thus consistent with the ordinary meaning of the term as it appears in Section 2.2(b) of Mexico's Reference Paper. As both parties to this dispute as well as most WTO Members are also members of the ITU, the special definition adds precision to the ordinary meaning by classifying allowable cost *elements*, and establishing the causality between the cost elements and the services provided. While leaving a margin of discretion to national authorities to choose the precise cost method by which to arrive at "cost-oriented" rates, the ITU recommendations indicate that the term "cost-oriented rates" can be understood as rates related to the cost *incurred in providing the service*.

7.175 In examining further the "special meaning" of the term "cost-oriented", we note that the ITU states in a report that "incremental cost methodologies are becoming the de facto standard for interconnection pricing around the world".<sup>948</sup> These methods focus on the additional future fixed and variable costs that are attributable to the service. Setting rates in line with long run incremental costs reflects the view that the regulator should require prices from dominant or major suppliers that most closely imitate a fully competitive market, where prices are driven down towards marginal or

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<sup>945</sup> ITU Recommendation ITU-T Rec. D.140 (06/2002) Annex A.

<sup>946</sup> ITU Recommendation ITU-T D.150, (06/1999) paragraph 2. Although the Recommendation uses the form "cost-orientation", we do not attach any interpretative significance to this.

<sup>947</sup> ITU Recommendation ITU-T Rec. D.140 (06/2002) Annex F.

<sup>948</sup> ITU, *Trends in Telecommunications Reform: Interconnection Regulation*, 3rd edition, sec. 4.2.1.2, p. 40. This paragraph also states that countries that apply long run incremental cost methodologies include United States, Australia, EC, Colombia, and South Africa, and that "numerous developing countries have adopted or proposed" some form of this model.

incremental costs.<sup>949</sup> The increasing use of incremental cost methodologies indicates the special meaning that the term "cost-oriented" is acquiring among WTO Members.

7.176 Mexico is among the WTO Members that implements a type of long run incremental cost methodology, known as LRAIC. Article 63 of Mexico's Federal Law on Telecommunications gives the authority to impose on any public telecommunications licensee with substantial market power rates that aim at "recovery, at least, of the long run average incremental cost".<sup>950</sup> This measure is aimed at avoiding predatory pricing.

7.177 We find therefore that the increasing and wide-spread usage of incremental cost methodologies among WTO Members supports the interpretation of the term "cost-oriented" as meaning the costs incurred in supplying the service, and that the use of long term incremental cost methodologies, such as those required in Mexican law, is consistent with this meaning.

7.178 So far, we have examined the meaning of "cost-oriented rates" without taking into account the subsequent phrase in Section 2.2(b) of Mexico's Reference Paper: "that are transparent, reasonable, having regard to economic feasibility". We now examine what interpretative effect should be given this phrase. We recall that Section 2.2(b) requires a Member to ensure that interconnection is provided by a major supplier:

"in a timely fashion, 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 ... "<sup>951</sup> (emphasis added)

7.179 We first examine the relationship of the phrases "reasonable" and "having regard to economic feasibility" with the other elements of the Section 2.2(b). We note that the provision isolates certain key elements in the relationship of interconnection between a supplier and a major supplier – "terms", "conditions" and "rates". It then lists some general qualifiers – including "reasonable", and "having regard to economic feasibility".

7.180 The phrase "terms and conditions" is commonly used to designate the elements of a contract or an agreement. The word "terms", in its specialized legal sense, can mean "conditions, obligations, rights, price, etc., as specified in contract or instrument"<sup>952</sup>; while "condition" may be defined as "a provision in a will, contract, etc., on which the force or effect of the document depends."<sup>953</sup> Therefore "rates" can be seen as special types of "terms" or "conditions", and that whatever qualifies "terms" or "conditions" also qualifies "rates". Further, it is clear that "reasonable" must qualify "terms" and "conditions", since these two expressions are not otherwise qualified. Based on these two observations, we conclude that the term "reasonable" must also, at a minimum, impart some meaning to "cost-oriented rates".

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<sup>949</sup> ITU, *Trends in Telecommunications Reform: Interconnection Regulation*, 3rd edition, sec. 4.2.1.2, p. 40.

<sup>950</sup> Federal Law on Telecommunications, Article 63.

<sup>951</sup> In the authentic Spanish version:

"(b) de manera oportuna, en términos, condiciones (incluyendo normas técnicas y especificaciones) 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>952</sup> *Black's Law Dictionary*, 6th edition, 1990.

<sup>953</sup> See Panel Report, *US – Stainless Steel*, paragraph 6.75.

7.181 The phrase "having regard to economic feasibility" could act as a general qualifier in the same way as "reasonable" or, because it begins with the connecting participle "having ...", it could be interpreted as being attached to and qualifying only the word "reasonable" which precedes it. Either way – directly or through qualifying the term "reasonable" – the phrase imparts meaning to "cost-oriented rates". We note, however, that because the word "rates" is qualified directly and specifically by the expression "cost-oriented", that this expression should have a preponderant weighting.

7.182 We now consider what additional meaning the terms "reasonable" and "having regard to economic feasibility" impart to "cost-oriented rates". We start with the term "reasonable". The ordinary meaning of the word "reasonable" suggests something that is "not irrational, absurd or ridiculous".<sup>954</sup> Defined positively, reasonable can be defined as something "of such an amount, size, number, etc., as is judged to be *appropriate or suitable to the circumstances or purpose*".<sup>955</sup> The term "reasonable" thus suggests that the interconnection rates should be "suitable to the circumstances or purpose" – in other words, that they reflect the overall objectives of the provision that the rates represent the costs incurred in providing the service. The word "reasonable" thus emphasizes that the application of the cost model chosen by the Member reflects the costs incurred for the interconnection service. Flexibility and balance are also part of the notion of "reasonable".<sup>956</sup>

7.183 The qualification of "cost-oriented rates" by the word "reasonable" would not therefore permit costs to be included in the rate that were not incurred in the supply of the interconnection service. Thus, contrary to Mexico's position, the general state of the telecommunications industry, the coverage and quality of the network, and whether rates are established under an accounting rate regime, are not relevant to determining a proper cost-oriented rate.

7.184 We now examine the qualifier "having regard to economic feasibility". We have established that the phrase imparts meaning to "cost-oriented" either directly, or indirectly through the term "reasonable". Normally, however, a "cost-oriented" rate must meet an "economic feasibility" standard, since the cost-oriented rate by definition covers all incurred costs, including a reasonable rate of return. The application of the "economic feasibility" standard would thus appear to have more meaning when applied to "terms" and "conditions". Its use here to qualify "cost-oriented rates" serves merely to underline that the major supplier is entitled to rates that allow it to undertake interconnection on an "economic" basis, that is, to make a reasonable rate of return.

7.185 This interpretation is supported to some extent by negotiating history. The phrase "having regard to economic feasibility" was, according to the United States, adapted from language being developed for the EC Interconnection Directive. The European Communities claims that this phrase is understood to mean that the operators must be allowed a "reasonable rate of return on investment".<sup>957</sup>

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<sup>954</sup> *The Shorter Oxford English Dictionary*, 3rd edition, (Clarendon Press, 1990), Vol. II, page 1758.

<sup>955</sup> *Ibid.*

<sup>956</sup> The Appellate Body in *US – Hot-Rolled Steel* stated: "...The word 'reasonable' implies a degree of flexibility that involves consideration of all of the circumstances of a particular case. What is 'reasonable' in one set of circumstances may prove to be less than 'reasonable' in different circumstances. This suggests that what constitutes a reasonable period or a reasonable time, under Article 6.8 and Annex II of the Anti-Dumping Agreement, should be defined on a case-by-case basis, in the light of the specific circumstances of each investigation. In sum, a "reasonable period" must be interpreted consistently with the notions of flexibility and balance that are inherent in the concept of "reasonableness", and in a manner that allows for account to be taken of the particular circumstances of each case. This was in the context of the *Anti-Dumping Agreement*, but we believe it is equally pertinent in the context of GATS." See Appellate Body Report, *US – Hot-Rolled Steel*, paragraphs 84-85.

<sup>957</sup> Article 7(2) of the EC Interconnection Directive (Directive 97/33/EC) of 30 June 1997 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP), (OJ 1997 L 199, p. 32) which provides

(ii) *Does Telmex interconnect United States suppliers at cost-oriented rates?*

7.186 We now examine whether the United States has presented evidence demonstrating that Mexico has not ensured that Telmex has interconnected United States suppliers of the services at issue at cost-oriented rates, as required by Section 2.2 of Mexico's Reference Paper.

7.187 The United States uses four methods to show that Telmex does not charge cost-oriented rates to United States suppliers of the services at issue. First, it presents evidence that the same network elements used to interconnect United States suppliers, when used for domestic interconnection, cost on average 75% less. Second, it presents evidence that grey market rates for a variety of international routes to Mexico are far lower than the rates charged by Telmex. Third, it presents evidence that wholesale rates to terminate calls between various countries with competitive long-distance operators is much lower than the rates charged by Telmex. Fourth, the United States presents evidence that the financial arrangements related to "proportionate return" procedures among Mexican operators pursuant to the ILD Rules show that Telmex's rates are above cost. We examine in turn each of these methods.

7.188 We note that Mexico did not offer comments on the specific methods of evaluating costs and settlement charges presented by the United States, nor did it take up the Panel's invitation to submit its own calculations.<sup>958</sup>

aa) Comparison with domestic prices in Mexico for the same network components

7.189 We start with an examination of the first method offered by the United States to demonstrate that the rate charged by Telmex to United States suppliers of the services at issue are not cost-oriented. The United States argues that, in the absence of Telmex data on costs, the maximum cost to Telmex of interconnecting a United States supplier can be estimated by identifying the network components used by Telmex to terminate calls from the United States, and then adding together the published prices of these components established by Cofetel or Telmex. Since the published component prices are set to cover Telmex's costs, the sum total of the component prices is a "cost-ceiling" for the aggregate network components.

7.190 Mexico argues that the type of cost analysis proposed by the United States is not in the GATS. There is not, for Mexico, a common understanding of the meaning of the term "cost-oriented".<sup>959</sup> Furthermore, the United States analysis could not apply to settlement rates for international calls; it could only be used for interconnection under a "full-circuit", and usually a domestic regime.<sup>960</sup>

7.191 We find that the United States' basic methodology provides a useful indication of the costs incurred by Telmex in interconnecting United States suppliers and terminating their calls in Mexico.

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"[c]harges for interconnection shall follow the principles of transparency and cost orientation. The burden of proof that charges are derived from actual costs including a reasonable rate of return on investment shall lie with the organization providing interconnection to its facilities".

<sup>958</sup> See e.g., question No. 11 (a. Does Mexico consider that the estimates of the cost of terminating incoming international calls in Mexico given in the United States submission are roughly correct? b. If not, please give reasons and outline how more satisfactory figures might be obtained) at the first meeting of the Panel; questions No. 12 (Is there a margin for an adequate rate of return that can be interpreted into the terms "cost-oriented rates that are ... reasonable." If so, what would be an adequate margin of return. Please provide examples.) and No. 14 (How do Mexico's considerations on elements to be included in the establishment of cost-oriented rates relate to its obligations under Section 3 of its Reference Paper?) at the second meeting of the Panel.

<sup>959</sup> See Mexico's first written submission, paragraph 186.

<sup>960</sup> See Mexico's answer to question No. 11(b) of the Panel of 19 December 2002. For question No. 11(b), see footnote 407 of this Report.

We think it is justified to presume that the aggregate price charged by Telmex for the use of network components, when used for purely domestic traffic, is an indication of the cost-oriented rate, in the sense of Section 2.2(b) of Mexico's Reference Paper, for the use of these same network components in terminating an international call. We cannot accept Mexico's arguments to the contrary, which it bases on an overly flexible meaning of "cost-oriented", and the fact that an "accounting rate regime" applies to the services at issue. We have already made findings that reject these arguments.

7.192 In examining the *application* of the United States methodology, we are not convinced that the implicit traffic distribution used to weigh costs and settlement charges of the three groups of Mexican localities, which would indicate that the bulk of incoming international calls go to small localities, is representative of what could be expected, and we believe might understate the difference between average settlement and costs. Nonetheless, the cost figures put forward by the United States, and uncontested by Mexico, are such that the conclusions of our analysis remain substantively unchanged, even assuming that a greater proportion of traffic goes to the larger cities.

7.193 We now examine the main elements of the United States analysis, the individual factual elements of which are not contested by Mexico despite specific requests from the Panel.<sup>961</sup> The United States presents evidence successively on: the identification of relevant network components; Telmex prices for these components; the calculation of the aggregate component prices for each of three types of destination in Mexico; and the calculation of the differences between the aggregate prices and Telmex rates. We examine each of these elements in turn.

i) Relevant network components

7.194 The United States identifies four Telmex network components that are used to interconnect United States cross-border suppliers:

- (a) international transmission and switching
- (b) local links
- (c) subscriber line, and
- (d) long-distance links.

7.195 These components are consistent with the categories recommended by the ITU, which is considered good international practice. The network components used for international telephone services are categorized as follows: international transmission and switching facilities (component (a) above), and the national extension (components (b) to (d) above).<sup>962</sup> The ITU also specifically includes "direct" and "indirect" costs.

7.196 The evidence presented by the United States identifying the relevant Telmex network components is uncontested by Mexico. We find, on the basis of the evidence before us, that the relevant network elements are international transmission and switching, local links, subscriber line, and long-distance links.

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<sup>961</sup> See paragraph 7.188 and footnote 958.

<sup>962</sup> See ITU-T Rec. D.140, footnote 945.

ii) Prices for the relevant network components

7.197 The United States presents evidence that either Telmex or Cofetel has established rates for each of the relevant network elements. The rates established by Cofetel are published, and relate to international transmission and switching, and terminating interconnection to cities where there is long-distance competition. The rates established by Telmex are also published, and relate to local and long-distance links. Both Cofetel and Telmex are legally required to set prices that recover at least the total cost of these network components.<sup>963</sup>

7.198 The United States classifies all calls to Mexico into three price categories, according to the use they make of Telmex's network. These three zones are: (1) calls terminating in Mexico City, Guadalajara, and Monterrey; (2) calls terminating in approximately 200 medium size cities; and (3) calls terminating in other locations in Mexico. We now examine the pricing evidence which the United States presents for each of these three zones.

– *Termination in Zone 1 (large cities)*

7.199 The United States presents evidence that in these cities (Mexico City, Guadalajara, and Monterrey) United States suppliers need only use three network components. These components are charged at the following rates: international transmission and switching (1.5 cents/minute); local link (0.022 cents/minute) and subscriber line (1.003 cents/minute). Together these charges amount to 2.525 cents/minute. However, Telmex currently charges 5.5 cents per minute, or 120% more than the maximum cost it incurs to terminate these calls into zone 1.

– *Termination in Zone 2 (medium cities)*

7.200 The United States presents evidence that in these medium-sized cities, which do not have an international gateway switch, an additional network component – a "long-distance link" – is needed. The components are charged at the following rates: international transmission and switching (1.5 cents/minute); local link (0.022 cents/minute); long-distance link (0.536 cents/minute); and subscriber line (1.003 cents/minute). Together these charges amount to 3.061 cents/minute. However, Telmex currently charges 8.5 cents per minute, or 175% more than the maximum cost it incurs to terminate these calls into zone 2.

– *Termination in Zone 3 (other cities)*

7.201 Finally, the United States presents evidence for certain cities that Telmex has not opened to originating competition. Telmex uses the same network components for termination of calls to these cities as it does to zone 2 cities. However, for these cities, no unbundled pricing information is available for the long-distance link and subscriber line. The United States therefore uses a proxy cost (7.76 cents/minute) based on the "reventa" rate that Telmex charges its competitors to terminate calls to these cities. The components are charged at the following rates: international transmission and switching (1.5 cents/minute); local link (0.022 cents/minute); terminating interconnection (7.76 cents/minute). Together these charges amount to 9.28 cents/minute. However, Telmex currently charges 11.75 cents per minute, or 27% more than the maximum cost it incurs to terminate these calls into zone 3.

iii) Difference between component prices and Telmex rates

7.202 Based on the aggregate component prices for the termination of calls into each of the three zones, the United States presents evidence of a difference between the aggregated component prices and the rates charged to United States suppliers for each of the three individual zones. Overall, and

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<sup>963</sup> See the United States' first written submission, paragraph 124.

based on figures for traffic during the months of March to May 2002, the Telmex blended cost ceiling is 5.2 cents/minute, and the Telmex blended rate is 9.2 cents/minute, which is 77% more than the cost ceiling.

7.203 We earlier accepted in principle the United States method for determining the difference between interconnection rates charged by Telmex to the United States suppliers of the services at issue, and the aggregate costs for relevant network components. We found earlier that it is a justified presumption that any substantial difference between the two figures was evidence that the Telmex interconnection rates were not "cost-oriented" in the sense of Article 2.2(b) of Mexico's Reference Paper. The evidence reveals that the blended average difference in costs is in the order of 77%. Mindful of the fact that the cost-ceiling figures used are conservative (since they are based in part on *retail* rates for private lines, and Telmex's interconnection rates to cities without competition in call origination), we find that a difference of over 75% above Telmex's demonstrated cost-ceiling is unlikely to be within the scope of regulatory flexibility allowed by the notion of "cost-oriented" rates, in the sense of Section 2.2(b) of Mexico's Reference Paper.

bb) Comparison with "grey market" prices on the Mexico-United States route

7.204 We now examine the second method used by the United States to demonstrate that the rates charged by Telmex to United States suppliers of the services at issue are not "cost-oriented". The method is based on the use of data on exchange traded capacity (which the United States labels grey market). These grey market arrangements, which are based on the lease of cross-border links, bypass the uniform settlement rates required under Mexican regulations, and are technically illegal in Mexico. The United States presents evidence, derived from a major traffic exchange company, that grey market rates for transport and termination of international traffic into Mexico, sold in London, Los Angeles and New York also show that Telmex interconnection rates are not cost-oriented.

7.205 Mexico objects that this method is not legitimate, since it is based on methods of supply of the service (such as international simple resale) that are not permitted under Mexican law. We do not accept Mexico's argument, since what is relevant here is solely the determination of actual costs incurred in terminating an international service within Mexico, and not the legitimacy of such practices. Even though Mexico does possess all the relevant information concerning cost elements, it does not show that grey-market or bypass services do not cover the costs of the various components at issue, nor that any costs are not recovered in such rates. We find therefore that recourse to this subsidiary method by the United States is in principle justifiable for the purpose of estimating the costs of Telmex in interconnecting United States suppliers and terminating their calls.

7.206 The United States presents evidence that rates offered by grey market operators from Los Angeles, New York and London to cities in Mexico range from 1.3 cents/minute to 9.6 cents/minute, depending on the city of destination, compared to 5.5 cents/minute to 11.75 cents/minute for Telmex. Telmex rates therefore ranged from 22% to 323% above grey market rates, depending on the city of destination in Mexico. According to the United States, the grey market rates likely overstated the real costs of the relevant network components within Mexico, since the grey market rates also included the cost of transmission of the signal to the Mexican border, the regulatory risk due to the illegal nature of the activity in Mexico, and the higher cost of low-efficiency links frequently used by such operators.

7.207 As Mexico has not submitted evidence to the contrary, we find that this methodology points to Telmex interconnection rates in the range of 22% to 323% above grey market rates for international calls into Mexico. We are not convinced however that the use of data on exchange traded capacity is fully warranted, as such capacity may be priced at short-term incremental cost (well below long-term incremental cost as required under Mexican law for calculating interconnection charges) and may also result in lower service reliability and quality. For this reason, and since these figures are based on the

prices of only one major traffic exchange company<sup>964</sup> on 13 September 2002, we would not make an *independent* finding, based solely on these figures, that Telmex rates are not cost-based in the meaning of Section 2.2(b) of Mexico's Reference Paper. We find nonetheless that the substantial difference in costs goes some way to support the finding under the first method described above.

cc) Comparison with termination rates on other international routes

7.208 We now examine the third method used by the United States to demonstrate that the rates charged by Telmex to United States suppliers of the services at issue are not "cost-oriented". The method is based on a comparison of the market for wholesale transportation and termination of international calls. We accept that this method is a valid method for estimating costs of network components used for interconnection

7.209 The United States presents evidence, based on wholesale rates on a major exchange<sup>965</sup> to terminate calls to countries, like Mexico, that have more than one long-distance provider. The rates range from 1.2 cents/minute to 6.23 cents/minute, compared to Telmex blended average interconnection rate of 9.2 cents/minute. Telmex interconnection rates are therefore 48% to 667% above these wholesale rates.

7.210 We find that this method results in Telmex interconnection rates of between 48% to 667% above wholesale rates into other international markets with more than one long distance provider. We find that the results of this method lend credibility to the result under the first method. However, since this evidence is based only on the data of one major operator on one particular day, and does not concern traffic into Mexico, we would not base a finding solely on this evidence.<sup>966</sup>

dd) "Proportionate return" procedures among Mexican operators

7.211 We now examine the fourth and final method offered by the United States to demonstrate that the rates charged by Telmex to United States suppliers of the services at issue are not cost-oriented. The method is based on the "proportionate return system" required under the ILD Rules.<sup>967</sup> Under this system, operators of international gateways in Mexico allocate *incoming* calls among themselves in proportion to each operator's share of *outgoing* calls. Since the operators do not always receive traffic at their gateways in the proportion of their outgoing calls, Rule 16 provides for a transfer of these calls to another gateway operator, who may deduct a fee for its gateway services. The remainder of the settlement rate from the foreign operator goes to the operator to whom the call is transferred. Rule 17 allows "financial compensation agreements" to be negotiated between gateway operators, instead of the physical transfer of calls.

7.212 The United States points out that, under Rule 17 financial compensation agreements:

"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."<sup>968</sup>

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<sup>964</sup> The company is Arbinet. See the United States' first written submission, footnote 134.

<sup>965</sup> Arbinet.

<sup>966</sup> Arbinet prices on 13 September 2002.

<sup>967</sup> ILD Rules 2:XIII, 16, 17.

<sup>968</sup> See United States' first written submission, paragraph 153.

7.213 We observe that the Rule 17 arrangements, which on the uncontested evidence of the United States, involve "most" of the market allocation adjustments, can only exist if there is a "surplus" to distribute after the full costs of interconnection have been deducted by the operator receiving the call. This surplus can only exist if the Telmex settlement rate does not reflect the operator's costs, and there is consequently something left to distribute. We find therefore that the existence and use of the "financial compensation agreements", which implement the "proportionate allocation" rules, are further evidence of the fact that Telmex interconnection rates are not cost-oriented in the sense of Section 2.2(b) of Mexico's Reference Paper.

7.214 More generally, Mexico argues that commitments made by developing country Members have to be interpreted in the light of paragraph 5 of the preamble to the GATS, and GATS Article IV which recognize that these Members need to "strengthen their domestic services capacity and efficiency and competitiveness".<sup>969</sup> However, we note that these provisions describe the types of commitments that Members should make with respect to developing country Members; they do not provide an interpretation of commitments already made by those developing country Members.

7.215 The following table summarizes the various cost estimates presented by the United States:

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<sup>969</sup> See Mexico's second oral statement, paragraph 81.

Table 1

**Mexico - summary of comparisons between interconnection costs and settlement rates**

<b>Method</b>	<b>Cost</b> (US cents/min)	<b>Settlement rate</b> (in Mexico US cents/min)	<b>Multiple</b> (Settlement as multiple of cost)
<b>1. Cost of components in Mexico</b>			
3 largest cities	2.5	5.5	2.2
200 medium-size cities	3.0	8.5	2.8
Other localities	9.3	11.8	1.3
Weighted average <sup>970</sup>	5.2	9.2	1.8
<b>2. Exchange traded capacity</b> <sup>971</sup>			
3 largest cities	1.5		
200 medium-size cities	6.1		
Other localities	9.3		
<b>3. International comparators</b> <sup>972</sup>	2.5		

7.216 The Panel decided, after having received no evidence from Mexico in response to our questions relating to the United States cost estimates (*see* paragraph 7.188 and footnote 958 above), to base itself on the methodologies presented to the Panel by the United States and not refuted by Mexico. On this basis, we conclude overall that the interconnection rates charged by Telmex to United States suppliers of the services at issue are not "cost-oriented" within the meaning of Section 2.2(b) of Mexico's Reference Paper, since by any of the methodologies presented to the Panel by the United States, they are substantially higher than the costs which are actually incurred in providing the interconnection. Therefore, we find that Mexico has failed to fulfil its commitments under Section 2.2(b) of the Reference Paper by failing to ensure that a major supplier in terms of Section 2.2 of the Reference Paper provides interconnection to United States basic telecom suppliers of the services at issue on a facilities basis under cost-oriented rates.

(iii) *Are the Telmex interconnection terms and conditions "reasonable"?*

7.217 The United States argues that Section 2.2 of Mexico's Reference Paper also requires that the "terms and conditions" of interconnection must be "reasonable". An interpretation of that word in its context, and in the light of the object and purpose of the GATS suggests, according to the United States, that terms and conditions on interconnection are not "reasonable" if they "restrict the

<sup>970</sup> Weighted by distribution of traffic from ATT to Telmex in March-May 2002.

<sup>971</sup> Price per minute of circuits between Los Angeles, New York, and London and selected destinations in Mexico as posted by Arbinet, a major traffic exchange company, on 13 September 2002. Figure shown in table is simple average of figures for individual destinations. Includes international transmission in addition to termination in Mexico.

<sup>972</sup> The simple average of wholesale termination rates of a major operator in 29 countries having several long-distance providers. The United States lists these countries in a table in paragraph 146 of its first written submission, and claims that the rates are those posted by Arbinet on 13 September 2002.

supply of the service". The United States points to the *de jure* monopoly power granted by Mexican law to Telmex under the ILD Rule 13 to set the interconnection rate, and impose that rate on all other Mexican long-distance operators; it also points to the rejection by Mexican authorities of requests by both Mexican and United States suppliers to negotiate lower interconnection rates. For the United States, these measures result in "unreasonable" terms and conditions for interconnection with Telmex, since they restrict the supply of scheduled services through raising prices, reducing demand and lessening competition.

7.218 The United States argues that the term "having regard to economic feasibility" qualifies the requirement for "reasonable" terms and conditions.<sup>973</sup> In this sense, it limits the obligation to provide interconnection on reasonable terms and conditions in cases including where revenues from interconnecting operators would not cover costs due to insufficient demand or because of increased costs of rapid installation of facilities.

7.219 Mexico replies that the United States has not shown that either the ILD Rules regarding settlement rates, or the Mexican refusal to permit alternative rates, are "terms and conditions" of interconnection with a "major supplier" that are not "reasonable". The United States had not shown, according to Mexico, that factors concerning *rates* of interconnection are "terms and conditions" of interconnection and, even if they were, that these rates were terms and conditions of interconnection with a "major supplier", as required by Section 2.2(b) of Mexico's Reference Paper. Even if Telmex were considered a "major supplier", the requirements in the ILD Rules that the United States objects to could hardly be said to be "unreasonable": the need to interconnect through an international port; the need to interconnect through an interconnection agreement; and the right of Telmex to negotiate its own settlement rates. The fact that other Mexican operators have to apply the rate negotiated by Telmex is not, according to Mexico, a term and condition of interconnection with a "major supplier", since no one suggests that the other Mexican suppliers have that status.<sup>974</sup> Nor does the refusal of Mexican authorities to permit alternative rates constitute "terms and conditions" of interconnection with a "major supplier".

7.220 Mexico argues that the United States' interpretation of "reasonable" has no merit. All forms of government regulation relate to the terms and conditions of supply of a service and have some impact on the level of supply of that service. It could hardly be said, however, that merely because a government regulation has that effect, that it is not "reasonable". In any case, according to Mexico, it is not the "terms and conditions" of interconnection that restrict the supply of basic telecommunications, but the valid limitations on cross-border supply that Mexico has inscribed in its schedule. Even if the United States definition of "reasonable" were accepted, argues Mexico, Mexico's ILD Rules do not violate that standard, in that they do not restrict in any way the supply of a scheduled service.

7.221 We do not consider it necessary for our findings on Mexico's commitments under Section 2.2(b) of the Reference Paper to also decide on the additional claims by the United States that Mexico has failed to ensure that the terms and conditions of interconnection with Telmex are reasonable as required by Section 2.2(b) of the Reference Paper. Having found that the phrase "terms and conditions" may cover also interconnection rates, we are inclined to find that the approval by the Mexican authorities of the above cost rate (including reasonable profits) – and the imposition of that above cost rate as a uniform interconnection rate in a manner excluding price competition in the relevant Mexican market – may also constitute, as claimed by the United States, "failure" by Mexico to "ensure" that interconnection with a major supplier is provided on reasonable terms and conditions.<sup>975</sup> We note, however, that the interpretation of "reasonable terms and conditions" of interconnection with a major supplier in Section 2.2(b) of the Reference Paper may also be informed

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<sup>973</sup> See the United States' second written submission, paragraph 68.

<sup>974</sup> See Mexico's second written submission, paragraph 103.

<sup>975</sup> See paragraph 7.180

by the interpretation of Mexico's obligations under Section 1 of the Reference Paper regarding "competitive safeguards", which we examine in the following Section C of our report. Moreover, in Section D of our report, we have to examine the claim by the United States that Mexico does not permit interconnection of United States suppliers on "reasonable terms and conditions" contrary to Section 5(a) of the GATS Annex on Telecommunications. Having already found an inconsistency with Mexico's obligations under Section 2.2(b) of the Reference Paper, we consider it wiser and justified to exercise "judicial economy" with regard to the United States claim of an additional inconsistency with the requirement in Section 2.2(b) of "reasonable" terms and conditions.

#### C. WHETHER MEXICO HAS MET ITS COMMITMENT UNDER SECTION 1 OF ITS REFERENCE PAPER

7.222 The United States argues that Mexico has not met the requirements of Section 1.1 of its Reference Paper, which provides that "[a]ppropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices." In the absence of a precise definition of "anti-competitive practices", the United States argues that the term encompasses, at a minimum, practices usually proscribed under national law: abuse of dominant position, monopolization, and cartelization. The United States argues that, far from proscribing such behaviour, Mexico maintains measures that *require* Mexican telecommunications operators to adhere to a horizontal price-fixing cartel led by Telmex. This requirement is contained in ILD Rule 13, which obliges the Mexican operator with the most outgoing traffic on a particular international route to negotiate with the suppliers of that country a single settlement rate, which then applies, by virtue of ILD Rule 23, to all other Mexican operators. Anti-competitive practices are also evidenced, according to the United States, by the required "proportionate return" system defined in ILD Rule 2:XIII, by which a Mexican operator is entitled to receive as much incoming traffic as it sends outgoing traffic.

7.223 In response, Mexico argues that its Reference Paper commitments apply only to matters within its border, and not to services supplied under an accounting rate regime. In any case, Mexico contends, it has put in place "appropriate measures" to prevent anti-competitive practices under its general competition laws. As for the ILD Rules they are, according to Mexico, aimed at increasing competition – by stopping new entrants from being undercut on pricing, and by preventing foreign operators from dictating prices to their Mexican affiliates. The United States had not shown that Telmex is a "major supplier" in the relevant market, and behaviour legally required under Mexican law could not be an "anti-competitive practice".

7.224 We examine first the terms of Section 1.1 of Mexico's Reference Paper. It reads:

"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.<sup>976</sup>

7.225 We note that Section 1.1 contains three key elements: (i) a "major supplier"; (ii) "anti-competitive practices"; and (iii) "appropriate measures" which must be maintained. We examine each of these elements in turn.

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<sup>976</sup> In the authentic Spanish version:

"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.*"

## 1. Is Telmex a "major supplier"?

7.226 Section 1 provides that the anti-competitive practices to be prevented are those of "suppliers who, alone or together, are a major supplier". The United States claims that Telmex has always had the largest share of the United States – Mexico market for the termination of voice telephony, facsimile and circuit-switched data transmission services, and it is thus a "major supplier" in that market. Mexico counters that the market for "termination" services is not relevant to the case, since termination services can only be supplied through commercial presence, and not on a cross-border basis. Even if termination services were potentially relevant, Mexico argues that Telmex does not in fact provide these services.

7.227 In our earlier analysis of the United States claim under Section 2.2 of Mexico's Reference Paper, we found that Telmex is a "major supplier" within the meaning of Mexico's Reference Paper, with respect to the services at issue.<sup>977</sup> We based this finding on the ability of Telmex to affect the terms of participation through use of its position in the relevant market, which we found to be the termination in Mexico of the services at issue. We see no reason to alter our analysis of the same term, with respect to same services, in examining Mexico's commitments under Section 1 of its Reference Paper. We find therefore that Telmex, for the purposes of Section 1 of its Reference Paper, is a "major supplier."

7.228 We note that Section 1 establishes an obligation with respect to "suppliers who, alone or together, are a major supplier". The practices at issue involve not only Telmex, but all the other Mexican suppliers who are gateway operators. Since we have already found that Telmex alone is a "major supplier" within the meaning of Section 1, and that the practices at issue involve acts of all the Mexican suppliers who are gateway operators, we can conclude also that Telmex and all the other Mexican gateway operators are *together* a "major supplier".

## 2. What are "anti-competitive practices"?

7.229 We next examine the meaning of "anti-competitive practices", and whether such practices can result from the requirements of a Member's laws.

### (a) Meaning of "anti-competitive practices"

7.230 The term "anti-competitive practices" is not defined in Section 1 of Mexico's Reference Paper. The dictionary meaning of the word "practices" is very general. Its meanings include "the habitual doing or carrying on of something; usual, customary, or constant action; action as distinguished from profession, theory, knowledge, etc.; conduct."<sup>978</sup> The word "practices" thus indicates "actions" in general, or can mean actions that are "usual" or "customary". The dictionary meaning of the word "competitive" includes "characterized by competition; organized on the basis of competition".<sup>979</sup> The word "competition", in its relevant economic sense, is in turn defined as "rivalry in the market, striving for custom between those who have the same commodities to dispose of".<sup>980</sup> Consistent with these meanings, the word "anti-competitive" has been defined as "tending to reduce or discourage competition."<sup>981</sup> On its own, therefore, the term "anti-competitive practices" is broad in scope, suggesting actions that lessen rivalry or competition in the market.

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<sup>977</sup> See paragraph 7.159 of this Report.

<sup>978</sup> *The Shorter Oxford English Dictionary*, 3rd edition, (Clarendon Press, 1990), Vol. II, page 1645.

<sup>979</sup> *Ibid*, page 382.

<sup>980</sup> *Ibid*.

<sup>981</sup> *Merriam Webster Dictionary*, Merriam Webster Online, 2003; <http://www.webster.com/>.

7.231 We now examine the term "anti-competitive practices" in the context of the Reference Paper. Examples of "anti-competitive practices" are set out in paragraph 2 of Section 1, which states that such practices "shall include in particular":

- "(a) engaging in anti-competitive cross-subsidization;
- (b) using information obtained from competitors with anti-competitive results; and
- (c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services."

7.232 The list is introduced by the phrase "shall include in particular", indicating that this list is not exhaustive and that therefore the above examples do not represent all "anti-competitive practices" within the scope of the provision. The examples do however illustrate certain practices that were considered to be particularly relevant in the telecommunications sector. The first example – on cross-subsidization – indicates that "anti-competitive practices" can include *pricing actions* by a major supplier. All three examples show that "anti-competitive practices" may also include action by a major supplier *without collusion or agreement* with other suppliers. Cross-subsidization, misuse of competitor information, and withholding of relevant technical and commercial information are all practices which a major supplier can, and might normally, undertake on its own.

7.233 Further context is provided by the narrowing of the scope of Section 1 of Mexico's Reference Paper to practices of a "major supplier". We recall that the term "major supplier" is defined in Mexico's Reference Paper 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."

7.234 The use of the term "major supplier" in Section 1, examined in the light of the definition of this term, suggests that the focus of "anti-competitive practices" is on a supplier's "ability to materially affect the terms of participation (having regard to price and supply)" – in other words, on monopolization or the abuse of a dominant position in ways that affect prices or supply. The definition of a major supplier in terms of suppliers "alone or together" and the requirement in Section 1.1 of "preventing suppliers from engaging in or continuing anti-competitive practices" also suggests that *horizontal coordination* of suppliers may be relevant. This is supported by the requirement in Section 1.1 of "preventing suppliers from engaging in or continuing anti-competitive practices."

7.235 The meaning of "anti-competitive practices" is also informed by the use of this term in Members' own competition legislation.<sup>982</sup> Many WTO Members maintain laws to ensure that firms do not undermine competition in their markets. The term "anti-competitive practices" is often used in these laws to designate categories of behaviour that are unlawful. The range of anti-competitive practices that are prohibited varies between Members, but practices that are unlawful under the competition laws of Members having such laws include cartels or collusive horizontal agreements

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<sup>982</sup> "Overview of Members' National Competition Legislation", Note by the Secretariat, WT/WGTC/W/128/Rev.2, 4 July 2001.

between firms, such as agreements to fix prices or share markets, in addition to other practices such as abuse of a dominant position and vertical market restraints.<sup>983</sup>

7.236 In addition, the meaning of "anti-competitive practices" is informed by related provisions of some international instruments that address competition policy. Article 46 of the 1948 Havana Charter for an International Trade Organization already recognized that restrictive business practices, such as price-fixing and allocation of markets and of customers, could adversely affect international trade by restraining competition and limiting market access. The importance of ensuring that firms refrain from engaging in horizontal price fixing agreements, market or customer allocation arrangements and other forms of collusion is likewise emphasized in the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.<sup>984</sup> It is also worth pointing out, since both Mexico and the United States are members of the OECD, that the OECD has adopted a Recommendation calling for strict prohibition of cartels.<sup>985</sup> In the work of the WTO Working Group on the Interaction between Trade and Competition Policy, reference has been made to the pernicious effects of cartels, and to the consensus that exists among competition officials that price-fixing "hard core cartels" ought to be banned.<sup>986</sup> Cartels were also described as the most unambiguously harmful kind of competition law violation.<sup>987</sup>

7.237 An examination of the object and purpose of the Reference Paper commitments made by Members supports our conclusion that the term "anti-competitive practices", in addition to the examples mentioned in Section 1.2, includes horizontal price-fixing and market-sharing agreements by suppliers which, on a national or international level, are generally discouraged or disallowed. An analysis of the Reference Paper commitments shows that Members recognized that the telecommunications sector, in many cases, was characterized by monopolies or market dominance. Removing market access and national treatment barriers was not deemed sufficient to ensure the effective realization of market access commitments in basic telecommunications services. Accordingly many Members agreed to additional commitments to implement a pro-competitive regulatory framework designed to prevent continued monopoly behaviour, particularly by *former* monopoly operators, and abuse of dominance by these or any other major suppliers. Members wished to ensure that market access and national treatment commitments would not be undermined by anti-competitive behaviour by monopolies or dominant suppliers, which are particularly prevalent in the telecommunications sector. Mexico's Reference Paper commitment to the prevention of "anti-competitive practices" by major suppliers has to be read in this light.

7.238 Based on this analysis, we find that the term "anti-competitive practices" in Section 1 of Mexico's Reference Paper includes practices in addition to those listed in Section 1.2, in particular horizontal practices related to price-fixing and market-sharing agreements.

(b) Whether practices required under a Member's law can be "anti-competitive practices"

7.239 We now take up the issue of whether acts by a major supplier can be "anti-competitive practices" if they are *required* by a Member's law, and not freely undertaken by a major supplier.

7.240 The United States argues that anti-competitive practices do not change their nature simply because they are required by national laws and regulations. In the view of the United States, "[j]ust because Mexican regulation *requires* the suppliers to collude does not mean they are not indeed

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<sup>983</sup> Ibid.

<sup>984</sup> United Nations Set (1980), Part D, paragraph 3.

<sup>985</sup> OECD Council Recommendation Concerning Effective Action Against Hardcore Cartels (adopted by the OECD Council at its 921<sup>st</sup> Session on 25 March 1998 [C/M(98)7/PROV]).

<sup>986</sup> Report (2002) of the Working Group on the Interaction between Trade and Competition Policy to the General Council (WT/WGTCP/6), paragraph 61.

<sup>987</sup> Report (2003) of the Working Group on the Interaction between Trade and Competition Policy to the General Council (WT/WGTCP/7), paragraph 41.

colluding or, in other words, engaging in horizontal price fixing." It argues further that any other interpretation would render the provision self-defeating and meaningless, since a Member "could easily avoid the obligation to maintain appropriate measures to prevent 'anti-competitive practices' by formally requiring such practices."<sup>988</sup>

7.241 Mexico argues that the ILD Rules are part of the regulatory framework of laws intended to increase competition. Mexico also contends that in any case the focus of Section 1.1 of its Reference Paper is on anti-competitive "practices" by a major supplier that are not required under a Member's law. Otherwise, the language of Section 1.1 would have gone further and specifically prohibited anti-competitive "measures" implemented or maintained by a WTO Member. The European Communities, as third party to these proceedings, believes that under the ILD Rules "the fixing of a uniform price cannot be an anti-competitive practice since uniform prices are required by law. The same goes for the revenue sharing system ("proportional return") since this is also mandated by law."<sup>989</sup> The European Communities concludes that "[if] Mexico chooses not to allow competition between telecommunications operators on a certain matter, there is no scope for anti-competitive practices relating to that matter. It is not possible to restrict competition where competition is not allowed."<sup>990</sup>

7.242 We have examined the meaning of the term anti-competitive practices in the previous section. We now look at whether anti-competitive practices, as this term is used in Section 1 of the Reference Paper, also covers practices by a major supplier that are required by a Member's law. The first illustrative example in Section 1.2 of anti-competitive practices is anti-competitive cross-subsidization. Cross-subsidization was and is a common practice in monopoly regimes, whereby the monopoly operator is required by a government to cross subsidize, either explicitly or in effect, usually through government determination or approval of rates or rate structures. Once monopoly rights are terminated in particular services sectors, however, such cross-subsidization assumes an anti-competitive character. This provision, therefore, provides an example of a practice, sanctioned by measures of a government, that a WTO Member should no longer allow an operator to "continue". Accordingly, to fulfil its commitments with respect to "competitive safeguards" in Section 1 of the Reference Paper, a Member would be obliged to revise or terminate the measures leading to the cross-subsidization. This example clearly suggests that not all acts required by a Member's law are excluded from the scope of anti-competitive practices.

7.243 Sections 1 and 2 of Mexico's Reference Paper impose obligations on Members with respect to the behaviour of major suppliers. Section 2.1 illustrates that Members did not hesitate to undertake obligations, with respect to a major supplier, that defined an objective outcome – "cost-oriented" interconnection. There is no reason to suppose, and no language to suggest, that the desired outcome in Section 1 – preventing major suppliers from engaging in anti-competitive practices – should depend entirely on whether a Member's own laws made such practices legal.

7.244 The Panel is aware that, pursuant to doctrines applicable under the competition laws of some Members, a firm complying with a specific legislative requirement of such a Member (e.g. a trade law authorizing private market-sharing agreements) may be immunized from being found in violation of the general domestic competition law. The reason for these doctrines is that, in most jurisdictions, domestic legislatures have the legislative power to limit the scope of competition legislation. International commitments made under the GATS "for the purpose of preventing suppliers ... from engaging in or continuing anti-competitive practices"<sup>991</sup> are, however, designed to limit the regulatory powers of WTO Members. Reference Paper commitments undertaken by a Member are international

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<sup>988</sup> See the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 47. For question No. 23(a), see footnote 545 of this Report.

<sup>989</sup> See the European Communities' third party submission, paragraph 53.

<sup>990</sup> See the European Communities' third party submission, paragraph 49.

<sup>991</sup> Section 1.1 of the Reference Paper.

obligations owed to all other Members of the WTO in all areas of the relevant GATS commitments. In accordance with the principle established in Article 27 of the Vienna Convention<sup>992</sup>, a requirement imposed by a Member under its internal law on a major supplier cannot unilaterally erode its international commitments made in its schedule to other WTO Members to prevent major suppliers from "continuing anti-competitive practices".<sup>993</sup> The pro-competitive obligations in Section 1 of the Reference Paper do not reserve any such unilateral right of WTO Members to maintain anti-competitive measures.

7.245 For these reasons, we conclude that practices required under Mexico's law can be "anti-competitive practices" within the meaning of Section 1 of Mexico's Reference Paper.

### 3. Do the ILD Rules require a major supplier to engage in "anti-competitive practices"?

7.246 We now examine whether, as the United States claims, the ILD Rules do require "anti-competitive" practices by "suppliers who, alone or together, are a major supplier", and would therefore not be "appropriate measures" within the meaning of Section 1 of Mexico's Reference Paper. We first identify the relevant requirements placed by the ILD Rules on Telmex and other Mexican operators, and then assess whether these requirements would constitute "anti-competitive practices."

(a) What acts do the ILD Rules require of Telmex and other Mexican operators?

7.247 The relevant measures invoked by the United States are the ILD Rules that require Mexican operators to apply a "uniform settlement rate", and to ensure a "proportionate return" of incoming calls, compared to outgoing calls.

(i) *Uniform settlement rate*

7.248 The ILD Rules require all "international gateway operators", including Telmex, to apply a uniform settlement rate in the following terms:

"[t]he same settlement rates are applied by international gateway operators to all long-distance calls from a given country, regardless of which operator originates the call abroad and which licensee terminates the call within Mexican territory."<sup>994</sup>

7.249 The uniform settlement rate is implemented through ILD Rule 13, which gives the Mexican operator with the greatest share of outgoing calls to a particular country in the previous six months – in this case Telmex – the sole right to negotiate settlement rates with the operators of that country. ILD Rule 13 states:

"The long-distance service licensee having the greatest percentage of outgoing long-distance market share for the six months prior to negotiations with a given country shall be the licensee that is authorized to negotiate settlement rates with the operators

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<sup>992</sup> See the Vienna Convention on the Law of Treaties, 1969, Art. 27. *See also* Ian Brownlie, *Principles of Public International Law* (Clarendon Press, 1998, 5<sup>th</sup> ed.), page 34.

<sup>993</sup> Section 1.1 of the Reference Paper.

<sup>994</sup> Rule 2:XII(a), also confirmed by Rule 10.

"Regla 2. Para efectos de las presentes Reglas, los siguientes términos tendrán el significado que a continuación se indica:

XII. Sistema de tarifas de liquidación uniformes: aquél por el cual:

a) las mismas tarifas de liquidación son aplicadas por los operadores de puerto internacional a las llamadas de larga distancia provenientes de un país determinado, independientemente del operador que las origine en el extranjero y del concesionario que las termine en territorio nacional, y ..."

of said country. These rates shall be submitted to the Commission for its approval."<sup>995</sup>

7.250 Telmex is an "international gateway operator", and the "long-distance service licensee" authorized to negotiate settlement rates with United States operators on the United States – Mexico route.

(ii) *Proportionate return*

7.251 The ILD Rules also require international gateway operators to apply the system of "proportionate return", and distribute among themselves *incoming* calls from a country in proportion to the *outgoing* calls the operator sends to that country.<sup>996</sup> The system is implemented through ILD Rule 16 and 2:XIII.

7.252 Rule 2:XIII sets out, in relevant part, the principle of the scheme:

"international gateway operators shall have the right to receive, regardless of the type of call, incoming call attempts from a given country during any one-month period, based on the percentages established for the previous monthly period."<sup>997</sup>

7.253 Rule 16 provides for the redistribution of calls:

"In the event that an international gateway operator receives a greater share of incoming traffic than that to which it is entitled under the terms of subparagraph XIII of Rule 2, the operator shall distribute the surplus to another international gateway operator as to remain within the bound of its own percentage."<sup>998</sup>

7.254 In redistributing the incoming traffic, ILD Rule 17 provides that operators may also "negotiate financial compensation agreements among themselves, according to the rights that are generated for each of them". These agreements are notified to and approved by Mexican authorities.<sup>999</sup>

7.255 The principle of a uniform settlement rate must be applied by operators to all international incoming and outgoing traffic, and the principle of proportionate return must be applied by operators to all international incoming traffic, and both must appear in all interconnection agreements made by Mexican operators with foreign operators.<sup>1000</sup>

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<sup>995</sup> ILD Rule 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>996</sup> ILD Rule 2:XIII.

<sup>997</sup> "los operadores de puerto internacional tendrán derecho a recibir, en forma aleatoria respecto del tipo de llamada, los intentos de llamadas de entrada provenientes de un país determinado en cualquier periodo de un mes, en función a los porcentajes establecidos en el periodo mensual anterior".

<sup>998</sup> "En caso de que un operador de puerto internacional reciba tráfico de entrada en una proporción mayor a la que le corresponde conforme al inciso XIII de la Regla 2, dicho operador deberá distribuir a otro operador de puerto internacional el excedente para cumplir con el porcentaje correspondiente. En tal caso, el operador deberá descontar la contraprestación a que tiene derecho por prestar los servicios de conmutación, enrutamiento y contabilidad en el puerto internacional, y pagar el monto restante de la tarifa de liquidación a los operadores de puerto internacional a los que transfiera dicho tráfico. A su vez, estos últimos deberán pagar la tarifa de interconexión correspondiente al operador local que termine la llamada."

<sup>999</sup> ILD Rule 17.

<sup>1000</sup> ILD Rule 23.

7.256 In sum, these measures impose two main requirements on Telmex, which is the "major supplier", on the United States – Mexico route. First, Telmex must negotiate a settlement rate for incoming calls with suppliers in the other markets wishing to supply the Mexican market and apply, subject to approval by the Mexican authorities and in common with the other Mexican suppliers, that single rate to interconnection for incoming traffic from the United States. Second, Telmex must give up traffic to, or accept traffic from, other suppliers depending on whether the proportion of incoming traffic surpasses, or falls short of, its proportion of outgoing traffic. To this end, Telmex may enter into "financial compensation agreements"<sup>1001</sup> with other operators, which are to be approved by Mexican authorities.

(b) Are the acts required of Telmex and other Mexican operators "anti-competitive practices"?

7.257 The United States argues that the uniform settlement rate (that restricts price) together with the proportionate return system (that allocates market shares) has the "classic features of a cartel".<sup>1002</sup> According to the United States:

"It is the setting of the rate by the monopolist (since Telmex is given the exclusive authority, it is acting as a monopolist in this context) and the use of this rate by all other suppliers (horizontal price fixing) that comprise the anti-competitive practices that form the basis for the United States' claim under Section 1 of the Reference Paper."<sup>1003</sup>

7.258 Mexico argues that the principles of uniform rates and proportionate return contained in the ILD Rules in fact *favour* competition. According to Mexico, the uniform rate requirement protects new entrants from predatory pricing by incumbent suppliers, and from being played off against each other by major foreign operators, while the proportionate return system prevents foreign operators from imposing predatory pricing on their Mexican affiliates.

7.259 In addition, Mexico states that it differs with the United States with respect to the relevant market in which competition must be promoted and protected.<sup>1004</sup> Mexico states:

"Mexican policy, as shown by the ILD Rules, is that domestic carriers should share in and split agreements for incoming calls in terms of their success in securing a share on the domestic market and generating outbound calls. The United States sees it differently ... the only market worth protecting is the one for terminating United States traffic to Mexico. The United States is acting as if new operators should compete to carry incoming international traffic calls instead of competing for new customers in Mexico. According to the criterion set by the United States, an operator who has made a minimal investment in Mexican infrastructure should be allowed to do so on an unlimited basis, taking all the revenue for international calls from the operators who have made such investments and have obtained successful results in acquiring a share of the market."<sup>1005</sup>

7.260 We now examine the two specific elements of the ILD Rules that the United States has invoked.

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<sup>1001</sup> ILD Rule 17.

<sup>1002</sup> See the United States' first oral statement, paragraph 38.

<sup>1003</sup> See the United States' answer to question No. 23(a) of the Panel of 14 March 2003, paragraph 47.

For question No. 23(a), see footnote 545 of this Report.

<sup>1004</sup> See Mexico's answer to question No. 25 of the Panel of 14 March 2003, paragraph 132, ("*Please explain whether the effect of Rule 13 of the ILD Rules is pro-competitive or anti-competitive, and support your argument with the appropriate illustrative figures and examples*").

<sup>1005</sup> See Mexico's answer to question No. 25 of the Panel of 14 March 2003, para 132. For question No. 25, see footnote 1004 of this Report.

(i) *Uniform settlement rate*

7.261 With respect to the uniform settlement rate, we have found that the ILD Rules require Telmex to negotiate a price, that is then approved by Mexican authorities and applied by Telmex and the other Mexican suppliers to the termination of the services at issue. Mexico justifies this uniform pricing scheme as pro-competitive since, according to Mexico, it removes the possibility that Telmex, or Mexican operators which are foreign affiliates, engage in predatory pricing, or are played against each other by major foreign operators. This Mexican argument admits that one purpose of the uniform pricing requirement is to limit price competition such as "predatory pricing". Yet Mexico gives no evidence that its existing competition laws are inadequate to deal with predatory pricing, or that it has well-founded reasons for believing that predatory pricing or unfair treatment by foreign affiliates would occur in Mexico absent the uniform settlement rate in the ILD Rules. Nor does Mexico show that predatory pricing could not be dealt with by telecommunications regulations in ways other than through uniform pricing.

7.262 We find the United States argument convincing that the removal of price competition by the Mexican authorities, combined with the setting of the uniform price by the major supplier, has effects tantamount to those of a price-fixing cartel. We have previously found that horizontal practices such as price-fixing among competitors are "anti-competitive practices" under Section 1 of Mexico's Reference Paper. We have also found that a GATS obligation "of preventing suppliers ... from engaging in or continuing anti-competitive practices" cannot be unilaterally abrogated by a national regulation *requiring* such an anti-competitive practice within the meaning of Section 1 of Mexico's Reference Paper (see paragraphs 7.243 to 7.245 above). For the same reasons, anti-competitive price fixing by telecommunications suppliers cannot be unilaterally exempted from the scope of Section 1 by a government requirement imposing such price fixing. To find otherwise would enable WTO Members unilaterally to detract from the effectiveness of their Section 1 obligations to maintain competitive safeguards by requiring such anti-competitive practices. We find, therefore, that the uniform settlement rate under the ILD Rules requires practices by a major supplier, Telmex, that are "anti-competitive" within the meaning of Section 1 of Mexico's Reference Paper.

(ii) *Proportionate return*

7.263 With respect to the "proportionate return" system, we have found that Telmex and other Mexican operators terminating the services at issue are required under the ILD Rules to give up traffic to, or accept traffic from, one another depending on whether the proportion of incoming traffic surpasses, or falls short of, their proportion of outgoing traffic. We have also found that Mexico permits Mexican suppliers to negotiate financial compensation agreements between themselves instead of actually transferring surplus traffic among themselves. Mexico justifies this system on substantially the same grounds as the uniform settlement system which the proportionate return system supports. For the reasons explained already in paragraph 7.261 above, we are not convinced by Mexico's justification of this restrictive allocation among competing suppliers of incoming traffic calls and market shares.

7.264 We find that the allocation of market share between Mexican suppliers imposed by the Mexican authorities, combined with the authorization of Mexican operators to negotiate financial compensation between them instead of physically transferring surplus traffic, has effects tantamount to those of a market sharing arrangement between suppliers. We have previously found that certain horizontal practices, such as market sharing arrangements, are "anti-competitive practices" in Section 1 of Mexico's Reference Paper. We recall our previous finding that practices of a major supplier, even if they result from a legal requirement, can be anti-competitive practices within the meaning of Section 1 of Mexico's Reference Paper. We find therefore that the proportionate return system under the ILD Rules requires practices by a major supplier, Telmex, that limit rivalry and competition among competing suppliers and are "anti-competitive" within the meaning of Section 1 of Mexico's Reference Paper.

**4. Has Mexico maintained "appropriate measures" to prevent anti-competitive practices by a major supplier?**

7.265 Section 1.1 requires Mexico to maintain "appropriate measures" to prevent anti-competitive practices by a major supplier. The word "appropriate", in its general dictionary sense, means "specially suitable, proper".<sup>1006</sup> This suggests that "appropriate measures" are those that are suitable for achieving their purpose – in this case that of "preventing a major supplier from engaging in or continuing anti-competitive practices".

7.266 We recognize that measures that are "appropriate" in the sense of Section 1 of Mexico's Reference Paper would not need to forestall in every case the occurrence of anti-competitive practices of major suppliers. However, at a minimum, if a measure *legally requires* certain behaviour, then it cannot logically be "appropriate" in *preventing* that same behaviour. Since we have found already that Mexico maintains measures (the ILD Rules concerning uniform interconnection rate and proportionate return) which legally require anti-competitive conduct by a major supplier, we find that Mexico has failed to maintain "appropriate measures" to prevent such acts, contrary to Section 1 of its Reference Paper. As Mexico has not claimed that its general competition law is applicable to the anti-competitive practices mandated by the ILD rules, we do not consider it necessary to examine the broader issue of whether Mexico's competition laws are, in general, "appropriate measures" in terms of Section 1.1.

7.267 We underline that our interpretation of Section 1 of the Reference Paper does not unduly limit the broad regulatory autonomy of WTO Members in the field of trade in services, including telecommunications. Although we find that measures required by a Member under its internal laws may fall within the scope of Section 1, the measures addressed in the case before us are exceptional, and require a major supplier to engage in acts which are tantamount to anti-competitive practices which are condemned in domestic competition laws of most WTO Members, and under instruments of international organizations to which both parties are members. Section 1 is a voluntary, additional commitment to maintain certain "appropriate" measures, which reserves a degree of flexibility for Members in accepting and implementing such an additional commitment. Finally, the measures to be maintained under Section 1 refer only to practices of "major suppliers" and not to those of other suppliers in the market.

7.268 We also recognize that – beyond our findings regarding horizontal price-fixing and market allocations among competing suppliers of basic telecommunications services – the term "anti-competitive practices" in Section 1 of the Reference Paper may be interpreted differently by different WTO Members. Our finding is limited to the interpretation of Mexico's GATS obligations under Section 1 of its Reference Paper, with respect to the United States, and with respect to the very specific anti-competitive measures in the relevant market for telecommunications discussed above.

7.269 We therefore find that Mexico has failed, in violation of Section 1.1 of its Reference Paper, to maintain "appropriate measures" to prevent anti-competitive practices by maintaining measures that require anti-competitive practices among competing suppliers which, alone or together, are a major supplier of the services at issue.

**D. WHETHER MEXICO HAS MET ITS OBLIGATION UNDER SECTION 5 OF THE GATS ANNEX ON TELECOMMUNICATIONS**

7.270 The United States claims that Mexico has not met its obligations under Section 5 of the GATS Annex on Telecommunications ("the Annex"), that is, to ensure that United States suppliers of basic telecommunications services have access to and use of Mexico's public telecommunications transport networks and services. In particular, the United States argues that Mexico does not permit

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<sup>1006</sup> *The Shorter Oxford English Dictionary*, 3rd edition, (Clarendon Press, 1990), page 94.

interconnection of United States suppliers on *reasonable terms and conditions*, contrary to Section 5(a), and prohibits altogether *access to private leased circuits*, contrary to Section 5(b).

7.271 The United States claim relates to five distinct situations for which, the United States argues, Mexico has made specific commitments, and for which Mexico must comply with Annex obligations:

- Under Section 5(a) of the Annex, the United States argues that Mexico must ensure that:
  - (i) suppliers of *facilities-based* basic telecommunications services from the United States into Mexico (cross-border) are accorded access to and use of "public telecommunications transport networks and services" on "reasonable terms and conditions";
  - (ii) suppliers of basic telecommunications services on a *non-facilities* basis from the United States into Mexico (cross-border) are accorded access to and use of public telecommunications transport networks and services on reasonable terms and conditions;
- Under Section 5(b) of the Annex, the United States argues Mexico must ensure that:
  - (iii) suppliers of *facilities-based* basic telecommunications services from the United States into Mexico (cross-border) have access to and use of private leased circuits, and must be permitted to interconnect these private leased circuits to public telecommunications transport networks and services in Mexico;
  - (iv) suppliers of basic telecommunications services on a *non-facilities* basis from the United States into Mexico (cross-border) have access to and use of private leased circuits, and must be permitted to interconnect these private leased circuits to public telecommunications transport networks and services in Mexico;
  - (v) suppliers of basic telecommunications services on a *non-facilities* basis through a *commercial presence* in Mexico must likewise be afforded access to and use of private leased circuits to supply international telephone services.

7.272 Mexico argues that the Annex does not apply to the access to and use of public telecommunications transport networks and services for the supply of basic telecommunications services. Further, it reiterates that it has not made any commitments on cross-border supply, either for facilities-based suppliers or commercial agencies, and that it therefore has no Annex obligations related to such services. With respect to locally established commercial agencies, Mexico states that it has not committed to issue permits for their establishment prior to issuing the corresponding regulations.

7.273 Before we consider whether Mexico has violated obligations arising from Section 5 of the Annex, we will examine whether the Annex *applies* to the telecommunications services at issue, which we have described in detail in Part B of these findings as basic telecommunications services.

**1. Whether the Annex imposes obligations on Mexico to ensure access to and use of public telecommunications transport networks and services for the supply of the basic telecommunications services scheduled by Mexico**

- (a) Does the Annex apply to access to and use of public telecommunications transport networks and services for the supply of basic telecommunications services?

7.274 Mexico submits that the Annex applies only to access to and use of public telecommunications transport networks and services as a *transport* means for other economic activities, and not to the supply of basic telecommunications services *per se*.<sup>1007</sup>

7.275 The United States argues that the Annex states in Section 1 that telecommunications has a "dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities". As further context, it points out that Section 2(a) states that the Annex applies to "*all measures ... that affect access to and use of public telecommunications transport networks and services*", which would include measures regulating telecommunications "as a distinct sector of economic activity". Finally, Section 5(a) imposes obligations "for the supply of a service included in [a Member's] Schedule".<sup>1008</sup>

7.276 Mexico maintains that the Annex does not cover access for the purpose of supplying basic telecommunication services, but only access for services that require basic telecommunications services as an underlying means of transport, including enhanced telecommunications services. In Mexico's view, the fact that Section 1 (entitled "Objectives") of the Annex refers to a "dual" role of the telecommunications services sector does not imply that the Annex covers both aspects of that "dual" role. Rather, Section 1 simply confirms that the Annex is based on the recognition that, beyond constituting a service sector of their own, telecommunications services and networks are essential tools for other economic activities, such as banking or insurance services. According to Mexico, the fact that these other activities rely heavily on telecommunications services as an underlying means of transport points to the fundamental purpose of the Annex. Section 1 therefore shows that the Annex is aimed at addressing the second aspect of the dual role. Mexico argues that the first aspect – the supply of basic telecommunications services – was dealt with under the basic telecommunications negotiations that led to the Fourth Protocol to the GATS in 1997.

7.277 Our first task is to establish whether the Annex applies to measures affecting access to and use of public telecommunications transport networks and services by suppliers of basic telecommunications services. We start with Section 2 of the Annex, entitled "Scope". It reads:

"2. Scope

- (a) This Annex shall apply to all measures of a Member that affect access to and use of public telecommunications transport networks and services.<sup>14</sup>

(footnote original) <sup>14</sup> 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.

- (b) This Annex shall not apply to measures affecting the cable or broadcast distribution of radio or television programming.

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<sup>1007</sup> See Mexico's answer to question No. 21 of the Panel of 19 December 2002, paragraph 303. For question No. 21, see footnote 589 of this Report.

<sup>1008</sup> See the United States' first oral statement, paragraph 45. See also the United States' second written submission, paragraphs 99-100. See also the United States' answer to question No. 21 of the Panel of 19 December 2002. For question No. 21, see footnote 589 of this Report.

- (c) Nothing in this Annex shall be construed:
- (i) to require a Member to authorize a service supplier of any other Member to establish, construct, acquire, lease, operate, or supply telecommunications transport networks or services, other than as provided for in its schedule; or
  - (ii) to require a Member (or to require a Member to oblige service suppliers under its jurisdiction) to establish, construct, acquire, lease, operate or supply telecommunications transport networks or services not offered to the public generally."

7.278 Section 2(a) provides that the Annex shall apply to "all measures" of a Member that affect access to and use of public telecommunications transport networks and services. We observe that the wording of Section 2(a) does not specify that the provision is limited to measures affecting access to and use of public telecommunications transport networks and services by only *certain* services or service sectors. The ordinary meaning of the words in Section 2(a) suggests therefore that the scope of the Annex includes *all* measures that affect access to or use of public telecommunications transport networks and services with regard to *all* services, including basic telecommunications services.

7.279 In further assessing whether the Annex applies to access to and use of public telecommunications transport networks and services, we next examine the context provided by Section 1 of the Annex, entitled "Objectives":

"Recognizing the specificities of the telecommunications services 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. Accordingly, this Annex provides notes and supplementary provisions to the Agreement." (emphasis added)

7.280 We note that Section 1 recognizes the dual role of the telecommunications services sector as "a distinct sector of economic activity and as the underlying transport means for other economic activities". Such recognition is not however conclusive as to whether the Annex contains provisions addressing telecommunications services as a "distinct sector of economic activity", and not only as an "underlying transport means for other economic activities". Section 1 goes on to state, however, that the purpose of the Annex is "elaborating on the provisions of the Agreement with respect to measures affecting access to and use of public telecommunications transport networks and services". As in the case of Section 2(a) on scope, Section 1 on objectives contains no language suggesting that access to and use of public telecommunications transport networks and services for the supply of basic telecommunications services is meant to be excluded from the scope of the Annex. The "notes and supplementary provisions to the Agreement" that the Annex "provides" do not appear in any way to exclude any measures covered by the Agreement, including measures affecting the access to and use of public telecommunications transport networks and services for the supply of basic telecommunications services.

7.281 Similarly, we note that Section 5 (a) of the Annex states that the obligation to ensure access to and use of public telecommunications transport networks and services shall apply for the benefit of "any service supplier of any other Member" for the supply of "a service included in its schedule". This language does not explicitly exclude suppliers of basic telecommunications services. On the contrary, Section 5(a) speaks of "any" service supplier. It also speaks of a "service included" in a Member's schedule which, in the case of any Member, can, and for many Members does, include

basic telecommunications services. We consider this to be a further indication that the Annex is not limited in its application to exclude measures ensuring the access to and use of public telecommunications transport networks and services for the supply of any service, including basic telecommunications services.

7.282 Mexico contrasts the scope provision of the Annex with the provisions on "Scope and Definition" contained in Section 1 of the Annex on Financial Services, and argues that the former only applies to access to and use of public telecommunications transport networks and services, whereas the latter applies to "supply". Mexico is of the view that, where the negotiators of the GATS intended that an Annex was to apply to the "supply" of a service, they stated this explicitly. According to Mexico, the Annex distinguishes between *access to and use of* public telecommunications transport networks and services, which is relevant to telecommunications services as an underlying transport means for other economic activities, and the *supply* of such services, which is relevant to trade in telecommunications services as a distinct sector of economic activity.<sup>1009</sup>

7.283 We agree that the Annex addresses measures affecting "access to and use of" public telecommunications transport networks and services, and *not* the supply of services. However, "access to and use of" public telecommunications transport networks and services are to be granted in order to enable the supply of services. Section 5 explicitly seeks to ensure that access to and use of public telecommunications transport networks and services is granted *for the supply of a service* included in [a Member's] Schedule".<sup>1010</sup> While the Annex is neutral as to the services that can be supplied through access to and use of public telecommunications transport networks and services, the Annex on Financial Services only "applies to measures affecting the supply of financial services".<sup>1011</sup> The fact that Members devoted an annex to measures affecting the supply of services in one specific services sector – financial services – does not provide a basis for interpreting the scope of another annex – on telecommunications networks and services – which differs significantly in structure and objective.

7.284 Mexico further argues that basic telecommunications are excluded from the Annex, since these services "as a distinct economic activity" were dealt with through Members making specific commitments only after the Annex entered into force; therefore, basic telecommunications services were not included in the GATS until 1997, when the Fourth Protocol was agreed.<sup>1012</sup> The provisions of the GATS, however, do not support this argument. Article I:1 of the GATS provides that the "Agreement applies to measures by Members affecting trade in services". Article I:3 (b) clarifies that the term "services" "includes *any* service in *any* sector except services supplied in the exercise of governmental authority" (emphasis added). The sectoral listing used by Members to schedule commitments on trade in services (document "W/120") explicitly lists a set of telecommunications services that includes both basic and value added services. Therefore all telecommunications services, like all other services, were part of the sectoral coverage of the GATS at the time the Annex entered into force. The fact that many Members made substantive specific commitments on basic telecommunications services only in 1997 should not be confused with the question of whether basic telecommunications was a services sector within the scope of the Agreement.

7.285 An interpretation of the Annex to exclude measures ensuring access to and use of public telecommunications transport networks and services for the supply of basic telecommunications

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<sup>1009</sup> See Mexico's answer to question No. 21 of the Panel of 19 December 2002, paragraphs 301-302. For question No. 21, see footnote 589 of this Report.

<sup>1010</sup> (emphasis added)

<sup>1011</sup> See Annex on Financial Services, Section 1 (a) (Scope and Definition): "This Annex applies to measures affecting the supply of financial services. Reference to the supply of a financial service in this Annex shall mean the supply of a service as defined in paragraph 2 of Article I of the Agreement."

<sup>1012</sup> See Mexico's first written submission, paragraph 214.

services would lead to unreasonable results. Public voice telephone services, for example, can only be supplied properly through access to and use of public telecommunications transport networks and services of other suppliers, except in markets where monopoly supply is maintained. While monopoly supply can and does exist in domestic telecommunications markets, the international market has always involved multiple suppliers. With respect to the supply of public voice telephony, whether on a cross-border basis or through commercial presence, it is essential that suppliers be able to access and use public telecommunications transport networks and services of other suppliers to complete calls placed by their customers to a user on another supplier's network.

7.286 While access to and use of public telecommunications transport networks and services may be important generally for the supply of services, such access is indispensable for the supply of basic telecommunications services. If the Annex did not apply to measures affecting access to and use of public telecommunications transport networks and services for basic telecommunications services, Members could effectively prohibit any supply other than that which originated and terminated within the same suppliers' network, even where commitments were undertaken, thereby rendering most basic telecommunications commitments without economic value.

7.287 Finally, if Members had made such a far-reaching decision, they would surely have stated specifically that basic telecommunications services were excluded from the application of the Annex, in the same way that they specifically stated in Section 2(b) that the Annex "shall not apply to measures affecting the cable or broadcast distribution of radio or television programming".

7.288 It would thus be unreasonable to suppose that the access and use of public telecommunications transport networks and services that is essential to the international supply of basic telecommunications services was not intended to be covered by the Annex. We find therefore that the Annex applies to measures of a Member that affect access to and use of public telecommunications transport networks and services by basic telecommunications suppliers of any other Member.

(b) Does Section 5 of the Annex apply to the basic telecommunications commitments scheduled by Mexico?

7.289 The United States maintains that the "obligations under the Annex trigger only to the extent to which [a Member] has undertaken commitments in its schedule".<sup>1013</sup> Mexico expresses a similar view, arguing that the Annex neither overrides a schedule, nor imposes obligations without regard to specific commitments taken.<sup>1014</sup> We now examine whether, and to what extent, Section 5 applies to the basic telecommunications commitments scheduled by Mexico.

7.290 We recall the wording of Section 2(c)(i) of the Annex, which determines the scope of the Annex. It states, in relevant part:

"Nothing in this Annex shall be construed:

- (i) to *require a Member to authorize* a service supplier of any other Member to establish, construct, acquire, lease, operate, or supply telecommunications transport networks or services, *other than as provided for in its Schedule*;" (emphasis added)

7.291 This provision is explicit. The Annex does not require a Member to authorize the supply of a basic telecommunications transport service "other than as provided for in its Schedule".

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<sup>1013</sup> See the United States' first written submission, paragraph 219.

<sup>1014</sup> See Mexico's first written submission, paragraphs 229-231.

7.292 Paragraph (e)(iii) of Section 5 provides further support for this interpretation, clarifying Members' rights to prevent the supply of services that are not permitted in the Members schedule. It reads:

"(e) Each Member shall ensure that no condition is imposed on access to and use of public telecommunications transport networks and services other than as necessary:

(iii) to ensure that service suppliers of any other Member *do not supply services unless permitted pursuant to commitments in the Member's Schedule.*" (emphasis added)

7.293 We infer, and the parties recognize, that the obligations contained in the Annex, and particularly in Section 5, are aimed at facilitating the exploitation of scheduled commitments, and do not create a right to supply a service where no commitments exist.

7.294 We have earlier examined Mexico's specific commitments with regard to the cross-border supply of telecommunications services supplied on both a facilities and non-facilities basis. We concluded that Mexico, through its description of the services committed, and through the inscription of a routing requirement, prohibits market access for the cross-border supply of the services at issue over capacity leased by the supplier (i.e. on a non-facilities basis) in Mexico.<sup>1015</sup> Absent a commitment, we find that the Annex cannot trigger any obligations on the part of Mexico to ensure access to and use of private leased circuits with regard to the situations described under (iii) and (iv) of the United States claim, in paragraph 7.271.

7.295 We will therefore examine, under Section 5(a) of the Annex, obligations arising with regard to basic telecommunications services supplied on a facilities-basis in Mexico, for which we have found that Mexico has granted market access through cross-border supply (situations (i) and (ii)).<sup>1016</sup> We will then examine whether Mexico has an obligation resulting from Section 5(b) with regard to the basic telecommunications services supplied on a non-facilities-basis in Mexico, through commercial presence (situation (v)).<sup>1017</sup>

## 2. Whether Mexico has fulfilled its obligations under Section 5 of the Annex

7.296 With respect to Section 5 of the Annex, the United States claims that Mexico has violated paragraphs (a) and (b). Paragraph (a) is a general obligation to ensure access to and use of public telecommunications transport networks and services on "reasonable and non-discriminatory terms and conditions". Paragraph (b) is a more specific obligation to ensure access to and use of public telecommunications transport networks and services, including "private leased circuits".

7.297 Mexico, however, claims that a violation of paragraphs (a) or (b) of Section 5 cannot be determined without also examining paragraphs (e) and (f). Paragraph (e) prohibits the imposition of any "condition" on access to and use of public telecommunications transport networks and services

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<sup>1015</sup> See paragraph 7.91.

<sup>1016</sup> See, paragraph 7.271: claim by the United States that Mexico must ensure that: (i) suppliers of facilities-based basic telecommunications services from the United States into Mexico (cross-border) are accorded access to and use of public telecommunications transport networks and services ("public networks") on "reasonable terms and conditions"; and (ii) suppliers of basic telecommunications services on a non-facilities basis from the United States into Mexico (cross-border) are accorded access to and use of public telecommunications transport networks and services ("public networks") on reasonable terms and conditions.

<sup>1017</sup> See paragraph 7.271: claim by the United States that Mexico must ensure that suppliers of basic telecommunications services on a non-facilities basis through a *commercial presence* in Mexico must likewise be afforded access to and use of private leased circuits to supply international telephone services.

"other than as necessary" to achieve any of three stated policy objectives. Paragraph (f) sets out an illustrative list of six types of regulatory conditions through which these objectives may be achieved.

7.298 Our first interpretative task is therefore to examine the structure of Section 5 and determine the relationship between the paragraphs at issue in this dispute.

(a) Structure of Section 5

7.299 In Mexico's view, Section 5 has to be interpreted as a whole, and paragraphs (a) and (b) are qualified by paragraphs (e) and (f). The paragraphs of Section 5 are, for Mexico, part of the same provision and must be read together to determine the meaning of a Member's obligation under that provision. Since the general obligation in Section 5(a) is required, by its language, to be applied *through* paragraphs (e) and (f), a violation of paragraphs (a) and (b) cannot be demonstrated without also showing that Mexico's measures are not permitted by paragraphs (e) and (f). Mexico maintains that, as the complaining party, the United States has the burden of establishing a case of inconsistency with all four provisions.<sup>1018</sup>

7.300 The United States contests that Sections 5(e) and (f) are elements of a *prima facie* case under Sections 5 (a) and (b) of the Annex. According to the United States, Sections (e) and (f) relate to these obligations like exceptions, much as Article XX of the GATT relates to GATT obligations. Therefore, for the United States, the burden of proof rests on the party invoking these exceptions.<sup>1019</sup>

7.301 Our first task is to determine whether a claim under paragraph (a) or (b) requires examination of any of the elements contained in other paragraphs of Section 5. Paragraph (a) reads:

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

7.302 We note that the obligation in paragraph (a) "shall be applied, *inter alia*, through paragraphs (b) through (f)". This wording differs from the text of the GATT provisions referred to by the United States. The provision on "General Most-favoured Nation Treatment" in GATT Article I does not include a similar proviso that it shall be applied through the "General Exceptions" provision in GATT Article XX. An obligation cannot be applied "through" another provision if that obligation is read in isolation from that provision. For an obligation in one provision to be applied "through" another provision, it is evident that the two provisions must be interrelated and must inform each other. We read paragraph (a), in other words, as containing an obligation that *informs* paragraphs (b) through (f), and must be read taking into account paragraphs (b) through (f).

7.303 We now examine paragraph (e), which reads:

"(e) Each Member shall ensure that no condition is imposed on access to and use of public telecommunications transport networks and services *other than as necessary*:"

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<sup>1018</sup> See Mexico's first written submission, paragraphs 253-256.

<sup>1019</sup> See the United States' second written submission, paragraph 107. See also the United States' answer to question No. 26 of the Panel of 19 December 2002. For question No. 26, see footnote 694 of this Report.

- (i) to safeguard the public service responsibilities of suppliers of public telecommunications transport networks and services, in particular their ability to make their networks or services available to the public generally;
- (ii) to protect the technical integrity of public telecommunications transport networks or services; or
- (iii) to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in the Member's Schedule." (emphasis added)

7.304 Paragraph (e) requires Members to ensure that the only conditions that are imposed on access to and use of public telecommunications transport networks and services are those "necessary" to achieve the three policy objectives set out in subparagraphs (i) to (iii).

7.305 Paragraph (f) contains an illustrative list of types of regulatory conditions that may be imposed if "necessary" to achieve a policy goal mentioned in paragraph (e). Paragraph (f) reads:

- "(f) Provided that they satisfy the criteria set out in paragraph (e), conditions for access to and use of public telecommunications transport networks and services may include:
- (i) restrictions on resale or shared use of such services;
  - (ii) a requirement to use specified technical interfaces, including interface protocols, for inter-connection with such networks and services;
  - (iii) requirements, where necessary, for the inter-operability of such services and to encourage the achievement of the goals set out in paragraph 7(a);
  - (iv) type approval of terminal or other equipment which interfaces with the network and technical requirements relating to the attachment of such equipment to such networks;
  - (v) restrictions on inter-connection of private leased or owned circuits with such networks or services or with circuits leased or owned by another service supplier; or
  - (vi) notification, registration and licensing."

7.306 We determined earlier that paragraph (a) should be read together with the other paragraphs of Section 5. We note that paragraph (a) addresses "terms and conditions" for access to public telecommunications transport networks and services, which must be "reasonable and non-discriminatory". Paragraph (e) requires that no condition other than as necessary to achieve any of three policy objectives contained in subparagraphs (e)(i) to (iii) shall be imposed by a Member. We infer that whenever a condition is "necessary" under paragraph (e), it must, in addition, be "reasonable and non-discriminatory" under paragraph (a). Conversely, if a condition is not "necessary" to fulfil at least one of the three policy objectives set out under subparagraphs (i) to (iii), paragraph (e) *prohibits* the imposition of such a condition, which suggests that there may be no need to analyse in that case whether that condition would otherwise be "reasonable and non-discriminatory".

7.307 We next examine the relationship of paragraph (b) of Section 5 with the other elements of Section 5. This relationship is more straightforward. Paragraph (b) obligates Members to ensure that suppliers of other Members "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". To this end, suppliers must be permitted, "subject to paragraphs (e) and (f)":

- "(i) to purchase or lease and attach terminal or other equipment which interfaces with the network and which is necessary to supply a supplier's services;
- (ii) to interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another service supplier; and
- (iii) to use operating protocols of the service supplier's choice in the supply of any service, other than as necessary to ensure the availability of telecommunications transport networks and services to the public generally."

7.308 The obligations in paragraph (b) apply "subject to paragraphs (e) and (f)". We understand this to mean that the obligations in paragraph (b) are *subordinated to*, and are, therefore, *qualified by*, paragraphs (e) and (f). The obligations in paragraph (b) are therefore *subject to* any condition that a Member may impose that is necessary to achieve one of the policy objectives set out in paragraph (e)(i) to (iii).<sup>1020</sup> We recall that paragraph (b) is informed also by paragraph (a), and that the obligation in the latter provision to ensure reasonable and non-discriminatory access also applies to paragraph (b).

7.309 Based on the foregoing, we make the following conclusions with respect to Sections 5(a) and 5(b). We conclude that the obligation contained in Section 5(a) informs the other paragraphs of Section 5, and is likewise informed by elements of these paragraphs. We cannot therefore examine what constitutes "reasonable terms and conditions" for access to and use of public telecommunications transport networks and services in isolation from the question of whether or not a particular condition may be imposed, an issue that is addressed in paragraph (e). We conclude that an obligation arises for a Member under paragraph 5(b) subject to any term or condition that a Member may impose in a manner consistent with the provisions of paragraphs (a) and (e).

(b) Claim under Section 5(a)

7.310 Having established that the analysis of a claim under paragraph (a) requires an examination of whether any conditions that are imposed on access to and use of public telecommunications transport networks and services are "necessary" in the meaning of paragraph (e), we now examine the specifics of the United States claim under Section 5(a).

7.311 The United States claims that Mexico has failed to ensure that cross-border suppliers of facilities-based basic telecommunications services from the United States into Mexico are accorded access to and use of public telecommunications transport networks and services on reasonable terms and conditions. For the United States, the rates that foreign suppliers must pay constitute unreasonable, above-cost rates for access and use to the networks and services provided by Mexico's long-distance operators. Cofetel's approval of the United States – Mexico settlement rate violates Mexico's obligation under Section 5(a) to ensure, by whatever means necessary, that access and use is provided on reasonable terms and conditions. The United States also challenges as "unreasonable" the requirements that it considers responsible for the rates that are charged by Mexican suppliers of public telecommunications transport networks and services. These require that foreign suppliers must

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<sup>1020</sup> For an interpretation of the words subject to, *see also*: Appellate Body Report, *Canada – Dairy*, paragraph 134.

negotiate exclusively with Mexico's long-distance licensee with the greatest percentage of outgoing long-distance market share over the preceding six months (ILD Rule 13), and prohibit foreign suppliers from concluding alternative terms and conditions with other Mexican suppliers of such networks and services (ILD Rules 3, 6, 10, 13, 22 and 23).

7.312 We now examine whether the substantive elements for a claim under Section 5 (a) are met. We recall that this provision reads:

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

7.313 The "access to and use of" referred to in this provision must be granted: (a) to "any service supplier of any other Member"; (b) with respect to "public telecommunications transport networks and services"; (c) for the supply of a "service included in its schedule"; and (d) on "reasonable... terms and conditions". In order to determine whether Mexico has met the requirements of the Section 5(a), we need to examine each of these elements.

(i) *"Any service supplier of any other Member"*

7.314 The obligation of Section 5(a) arises only with respect to "any service supplier of any other Member". It is uncontested that facilities-based suppliers (such as AT&T, WorldCom/MCI, and Sprint) as well as commercial agencies supply or are seeking to supply the services at issue, and are suppliers "of any other Member", in this case, the United States.

(ii) *"With respect to 'public telecommunications transport networks and services'"*

7.315 The United States submits that a United States supplier of basic telecommunications must access and use Mexican public telecommunications transport networks and services to transport its service (such as a phone call originating in the United States) to its final destination in Mexico. This is done through interconnection, which the United States considers the "principal method", by which United States suppliers obtain access to and use of Mexican public telecommunications transport networks and services for the cross-border supply of scheduled telecom services.<sup>1021</sup> The United States refers to Section 2.1 of Mexico's Reference Paper, which defines interconnection as the "linking of suppliers ... to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier".

7.316 We observe that Mexico's market access inscription on cross-border supply requires that international traffic be routed through the facilities of a Mexican concessionaire. The facilities of Mexican concessionaires are clearly "public telecommunications transport networks and services", as this term is defined in the Section 3 of the Annex. Mexico has not argued otherwise. We find therefore that the facilities of the Mexican concessionaires which are relevant to the United States claim with respect to access and use are "public telecommunications transport networks and services".

(iii) *"For the supply of a service included in its schedule"*

7.317 The obligation in Section 5(a) on a Member to ensure access to and use of public telecommunications transport networks and services arises only "for the supply of a service *included* in its schedule". This language might suggest that the obligation in paragraph (a) arises as soon as *any* level of commitment is inscribed in a schedule. However the overall scope of the Annex, as

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<sup>1021</sup> See the United States' first written submission, paragraph 223.

determined in Section 2, limits a Member's obligations under the Annex to those "provided for in its Schedule". Similarly, paragraph (e)(iii) of Section 5 permits the imposition of conditions on access and use "to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in a Member's schedule". In the present case, we recall our findings that Mexico has made market access commitments, subject to a routing requirement, and full national treatment commitments on the supply of basic telecommunications services. Therefore, even under a restrictive reading of the obligation under paragraph (a), these services are "included" in Mexico's Schedule.

7.318 In Mexico's view, however, the services at issue in this dispute are the *transport* of customer-supplied information or data between two or more points, which, being themselves public telecommunications *transport* networks and services, cannot be supplied through access to and use of public telecommunications transport networks and services. Therefore, according to Mexico, its suppliers of "public telecommunications transport networks and services" cannot transport public telecommunications transport services supplied by other suppliers.<sup>1022</sup>

7.319 We have addressed earlier the question of the nature of the services at issue, and have found that the Annex applies to the access to and use of public telecommunications transport networks and services for the supply of *all* transportation services, including basic telecommunications services. The nature of the basic telecommunications services at issue, as inscribed in Mexico's Schedule and described therein with reference to CPC numbers, includes services which require suppliers to link their networks to those of other suppliers.<sup>1023</sup> The definition in Section 3(b) of the Annex of "public telecommunications transport networks and services" also speaks of a transmission "between two or more points". We therefore consider that foreign suppliers of basic telecommunications services require access to and use of public telecommunications transport networks and services *for the supply* of their services.

7.320 We now examine whether access to and use of public telecommunications transport networks and services for the supply of the services at issue is accorded on "reasonable terms and conditions".

(iv) *"On reasonable ... terms and conditions"*

7.321 The United States considers that the access to and use of public telecommunications transport networks and services accorded to its suppliers through interconnection, by routing through the facilities of a concessionaire, is *not* based on "reasonable terms and conditions". For the United States the exclusive negotiating right of the dominant supplier as mandated by ILD Rule 13, the impossibility of concluding alternative arrangements, and the above-cost rates for access to and use of public telecommunications transport networks and services, are not "reasonable". Footnote 1 to Section 2 of the Annex obliges Members to take "whatever measures necessary" to carry out their obligations under the Annex, including the obligation to ensure that foreign suppliers have access to and use of public telecommunications transport networks and services on reasonable terms and conditions. Therefore, in the United States view, the Annex prevents domestic operators from hindering the expansion of trade in scheduled services, in accordance with the trade-liberalizing goal of the GATS.<sup>1024</sup> The United States argues that the measures taken by Mexico are anti-competitive and contravene the purpose of the Annex, which is to prevent suppliers of basic telecommunications from engaging in unfair, restrictive or anti-competitive conduct. Instead of ensuring access to and use of public telecommunications transport networks and services "by whatever measures necessary," the Mexican rules unreasonably concentrate all power in the hands of a dominant supplier.

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<sup>1022</sup> See Mexico's answer to question No. 21 of the Panel meeting of 19 December 2002, paragraph 306. For question No. 21, see footnote 589 of this Report.

<sup>1023</sup> See paragraphs 7.40-7.45 of this Report.

<sup>1024</sup> See the United States' first written submission, paragraph 233.

7.322 Mexico states that "reasonableness" must be judged only within the context of all of the relevant facts and circumstances. If Section 5 were to apply in this case, it would apply to Mexico's accounting rate regime, and the "reasonableness" of any "terms and conditions" of that accounting rate regime would have to be evaluated in the light of all of the facts and circumstances related to that regime. The terms and conditions which the United States considers unreasonable were widespread in accounting rate regimes around the world, and existed even in the United States' regime. Accordingly, there was no basis for the United States to demonstrate that Mexico's measures were "unreasonable" within the meaning of Section 5(a) of the Annex.

aa) Rates charged for access and use

7.323 In assessing whether Mexico has ensured access to and use of public telecommunications transport networks and services on "reasonable ... terms and conditions", we first examine the *rates* that are charged by Telmex and other Mexican concessionaires. We look at whether the rates constitute "terms" or "conditions" in the sense of Section 5(a), and then whether the rates are "reasonable". We note that the United States does not claim that the rates, or any aspect of the ILD Rules, constitute "discriminatory" terms or conditions.

7.324 Although paragraph (a) speaks of "terms and conditions", paragraph (e) refers only to "conditions". Since we earlier found that paragraphs (a) and (e) inform each other, we now analyse whether "rates" are "terms", or whether they are "conditions". Building on our earlier analysis,<sup>1025</sup> if the rates are terms, they would have to meet the "reasonable" standard in Section (a); if they are "conditions," they would, in addition, have to meet the "necessary" standard in Section (e).

7.325 As discussed in part B of these findings, the words "terms and conditions" may have many meanings. In relation to contracts and agreements, the word "terms" is defined to mean "conditions, obligations, rights, price, etc., as specified in contract or instrument"<sup>1026</sup>, while "condition" is defined, *inter alia*, as "a provision in a will, contract, etc., on which the force or effect of the document depends".<sup>1027</sup> Although the words "terms" and "conditions" are closely related, and are frequently used concurrently, the ordinary meaning of the word "terms" suggests that it would include pricing elements, including rates charged for access to and use of public telecommunications transport networks and services.

7.326 We now examine whether the word "conditions", as used in Section 5 of the Annex, would also include pricing elements such as access rates. Pricing is a fundamental element of any access and use. Moreover, the importance of pricing-related measures for access and use suggests that the word "conditions" would also include pricing elements, such as conditions that relate to or affect the rate or price. However, Section 5 (f), which lists examples of "conditions," does not refer to specific pricing measures. In fact, pricing measures do not appear to be similar to any of the conditions included in paragraph (f), such as restrictions on resale or interconnection, and requirements to use specified technical interfaces. Given the importance of pricing measures for access to and use of public telecommunications transport networks and services, we cannot infer that Section 5 (f) would have omitted pricing from its illustrative list, if the Annex had considered access charges to fall under "conditions". Moreover, if access rates themselves constituted "conditions", a Member would have to ensure that *no* rates were imposed "other than as necessary" to fulfil one of the policy objectives in subparagraphs (i) to (iii) of Section 5(e). Yet, with respect to access to and use of public telecommunications transport networks and services supplied on a commercial basis, it is evident that some type of charge will be levied. Therefore, whether or not to charge, or the existence of a price, does not appear to fit within the meaning of the language of 5(f) and its subparagraphs.

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<sup>1025</sup> See paragraph 7.309 of this Report.

<sup>1026</sup> *Black's Law Dictionary*, 6th edition, 1990.

<sup>1027</sup> See Panel Report, *US – Stainless Steel*, paragraph 6.75.

7.327 We find therefore that rates charged for the access to and use of public telecommunications transport networks and services are "terms" within the meaning of Section 5(a), but not "conditions" within the meaning of Section 5(e).

7.328 We next examine whether the rates that are charged to United States suppliers for access to and use of Mexican public telecommunications transport networks and services constitute "reasonable" terms. The dictionary meaning of the word "reasonable" means "being in accordance with reason", "not extreme or excessive".<sup>1028</sup> The word "reasonable" implies a degree of flexibility that involves consideration of the circumstances of a particular case. What is "reasonable" in one set of circumstances may prove to be less than "reasonable" in different circumstances. The elements of "balance" and "flexibility", as well as the need for a "case-by-case analysis", are inherent in the notion of "reasonable".<sup>1029</sup>

7.329 We note that the "terms" in paragraph (a) must be "reasonable and nondiscriminatory". Unlike the word "reasonable", the word "non-discriminatory" is defined in the Annex. Footnote 2 states:

"The term 'non-discriminatory' is understood to refer to most-favoured-nation and national treatment as defined in the Agreement, as well as to reflect sector-specific usage of the term to mean 'terms and conditions no less favourable than those accorded to any other user of like public telecommunications transport networks or services under like circumstances'."

7.330 This footnote clarifies that no discrimination is permitted with respect to other foreign suppliers, to domestic suppliers, or to other users of like public telecommunications transport networks and services under like circumstances. The word "non-discriminatory" therefore addresses the conditions of competition of service suppliers in relation to other suppliers who are *users* of public telecommunications transport networks and services. The word "reasonable" would, on the other hand, appear to include obligations that go beyond the non-discrimination requirement. This interpretation is supported by an examination of the objectives of the Annex as expressed, for example, by references in Section 1 and Section 5(a) to access to telecommunications transport networks and services.

7.331 We now consider Mexico's argument that the term "reasonable" in Section 5(a) cannot refer to rates for interconnection, because such an interpretation would render a significant part of Section 2.2(b) of Mexico's Reference Paper redundant or *inutile*.<sup>1030</sup> The Panel noted that, although the obligations in the Annex and the Reference Paper may overlap in certain respects, there are clear differences between the two instruments. First, the Annex sets out general obligations for access to and use of public telecommunications transport networks and services, applicable to *all* Members and *all* sectors in which specific commitments have been undertaken. Reference Paper obligations, as additional commitments, are applicable only by Members that have included them in their schedules, and they apply only to basic telecommunications. Second, while the Annex applies to all operators of public telecommunications transport networks and services within a Member, regardless of their

<sup>1028</sup> Merriam Webster Online Dictionary; <http://www.webster.com/cgi-bin/dictionary>.

<sup>1029</sup> The Appellate Body in *US – Hot-Rolled Steel*, paragraphs 84-85, stated that "[i]n sum, a 'reasonable period' must be interpreted consistently with the notions of flexibility and balance that are inherent in the concept of 'reasonableness', and in a manner that allows for account to be taken of the particular circumstances of each case". Although the Appellate Body was interpreting a "reasonable" period of time in the context of a different WTO Agreement, we consider that the same basic elements of the word "reasonable" also apply in the present context.

<sup>1030</sup> See Mexico's answer to questions No. 22 (If Section 5(a) and (b) of the Annex already ensure interconnection at reasonable rates, what is the value-added of Section 2.2 of the Reference Paper?) and No. 23 of the Panel of 19 December 2002, paragraphs 309-311, 313-317. For question No. 23, see footnote 621 of this Report.

competitive situation, the Reference Paper obligations on interconnection apply only with respect to "major suppliers". Third, the Annex broadly deals with "access to and use of" public telecommunications transport networks and services, while the Reference Paper focuses on specific "competitive safeguards" and on "interconnection".

7.332 In spite of these differences, the Annex recognizes that its provisions relate to and build upon the obligations and disciplines contained in the Articles of the GATS – the Annex states expressly that it "provides notes and supplementary provisions to the Agreement".<sup>1031</sup> Similarly, many of the provisions of the Reference Paper also draw from and add to existing obligations of the GATS, such as Articles III, VI, VIII and IX and the Annex on Telecommunications. Accordingly, there is a degree of overlap between the obligations of the Annex and the Reference Paper, despite their differences in scope, level of obligations, and specific detail provided. To the extent that the Reference Paper requires cost-oriented interconnection on reasonable terms and conditions, it supplements Annex Section 5, requiring additional obligations as regards "major suppliers". The Reference Paper commitments do not in this sense subtract from the Annex or render it redundant.

7.333 Consequently, we do not accept Mexico's argument that a reading of a pricing element into the analysis of reasonable terms in Section 5(a) would render parts of Section 2.2(b) of Mexico's Reference Paper *inutile*. We find therefore that access to and use of public telecommunications transport networks and services on "reasonable" terms includes questions of *pricing* of that access and use.

7.334 We now examine what constitutes access to and use of public telecommunications transport networks and services on "reasonable" terms. We have previously noted that Mexico's Reference Paper contains obligations additional to those in the Annex. We consider therefore that rates charged for access to and use of public telecommunications transport networks and services may still be "reasonable", even if generally higher than rates for interconnection that are cost-oriented in terms of Section 2.2(b) of Mexico's Reference Paper. If this were not the case, it would have been redundant for Members to have made commitments additional to Annex obligations on access, especially on cost-oriented rates for interconnection, one of the most important forms of access. Further, those Members who took Reference Paper commitments did so in order to establish specific disciplines only for *major* suppliers, and especially for *interconnection*. This would not have been necessary if Members already had an obligation to ensure that *all* suppliers, major or not, would have to provide cost-based access and use, including interconnection.

7.335 In order to arrive at a finding in the present case, we do not consider it necessary to determine the exact point at which a rate for access to and use of public telecommunications transport networks and services is no longer "reasonable". We have already determined in part B of these findings that the rates charged to interconnect United States suppliers of the services at issue to public telecommunications transport networks and services in Mexico exceed cost-oriented rates by a substantial margin.<sup>1032</sup> We find that rates which exceed cost-based rates to this extent, and whose uniform nature excludes price competition in the relevant market of the telecommunications services bound under Mexico's Schedule, do not provide access to and use of public telecommunications transport networks and services in Mexico "on reasonable ... terms". Consequently, we conclude that Mexico has failed to meet its obligations under Section 5(a) of the GATS Annex on Telecommunications, by failing to ensure that service suppliers of the United States are accorded access to and use of public telecommunications transport networks and services in Mexico on reasonable terms.

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<sup>1031</sup> For example, footnote 2 of the Annex expressly refers to most favoured nation treatment (Article II) and national treatment (Article XVII). Section 4 (Transparency) builds upon Article III (Transparency). The Annex further elaborates on concepts contained in Articles VI (Domestic Regulation), VIII (Monopolies and exclusive service suppliers), and IX (Business Practices).

<sup>1032</sup> See paragraph 7.216.

7.336 We arrived at this finding based on our determination that rates for access to and use of public telecommunications transport networks and services are "terms" under Section 5(a), but not "conditions" under Section 5(e). We now examine whether our finding would differ if, in the alternative, we considered access rates to be "conditions" within the meaning of Section 5(e). Under this alternative, Section 5(e) would require that no access rate is "imposed" other than "as necessary" to fulfil one of the objectives in subparagraphs (i) through (iii). The question would then arise as to how the words "as necessary" would be interpreted.

7.337 The word "necessary" in its ordinary meaning signifies something "that cannot be dispensed with or done without, requisite, essential, needful".<sup>1033</sup> A law dictionary notes that the term may vary in meaning, in that it:

"may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity."<sup>1034</sup>

7.338 The term "necessary" in Section 5(e) describes the relationship between a "condition" of access to and use of a public telecommunications transport networks and services, and one of the three listed policy goals. What may be "necessary" with respect to one policy goal may not be with respect to another. As the Appellate Body has noted under a different provision in a different WTO Agreement, the term "necessary" can refer to a *range* of degrees of necessity, depending on the context, and the object and purpose of the provision in which it is used. At one end of this continuum, "necessary" can be understood to mean "indispensable" to achieving a policy goal; at the other end, "necessary" can be taken to mean simply "making a contribution to" a policy goal.<sup>1035</sup>

7.339 We consider first an interpretation that "necessary" in Section 5(e) is closer in meaning to "indispensable". This interpretation would imply that the rates charged for access and use would be "indispensable" for the attainment of one of the three listed objectives. The relevant objective, with respect to a condition which is an access charge, would most likely be that listed in paragraph (e)(i):

"to safeguard the public service responsibilities of suppliers of public telecommunications transport networks and services, in particular their ability to make their networks or services available to the public generally".

7.340 Under an interpretation that "necessary" means "indispensable", the access rates would have to be set at a level that was no more than the *minimum* to achieve that objective. Minimum access rates, however, would imply levels that reflected the approximate cost of access and use, because the policy objective listed in paragraph (e)(i) could be fulfilled if public telecommunications transport networks and services were charging this rate, and it would not be "indispensable" to charge more than this rate. Further, it could be argued that the responsibility of operators of public telecommunications transport networks and services to make these public telecommunications transport networks and services available to the public generally would require that no rates be charged in excess of the cost incurred.

7.341 The interpretation of the word "necessary" in Section 5(e) as meaning "indispensable" would however leave no room for an analysis of whether terms were "reasonable". If cost-based rates were "indispensable" to reach the policy objective, then these rates surely could not also be unreasonable. Such an interpretation would empty the "reasonable" standard in Section 5(a) of much of its meaning.

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<sup>1033</sup> *The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. II, page 1895.

<sup>1034</sup> *Black's Law Dictionary*, (West Publishing, 1995), page 1029. Cited in the Report of the Appellate Body, *Korea – Various Measures on Beef*, paragraph 160.

<sup>1035</sup> See Appellate Body Report, *Korea – Various Measures on Beef*, paragraph 161.

It would also mirror the obligation of cost-based interconnection in the Reference Paper, with the important difference that the general Annex obligation would encompass *all* suppliers of public telecommunications transport networks and services, while the obligation in the Reference Paper only refers to *major* suppliers. The Annex would in this respect achieve the same depth of obligation as the Reference Paper, but on a broader level, and applicable to *all* WTO Members, making any particular Reference Paper commitments redundant. We would therefore reject an interpretation of "necessary" in Section 5(e) that would mean that a condition must be "indispensable" to achieve the policy goals listed in subparagraphs (i) to (iii).

7.342 We now examine whether the word "necessary" in Section 5(e) is closer to the meaning of "making a contribution to" one of the objectives listed in subparagraph (e)(i) to (iii). In this case, an access rate would only have to be found to be "making a contribution" to one of these policy goals, in order to satisfy the requirements of paragraph (e). In this case, it would be relatively easy to meet the objectives listed in paragraph (e), especially subparagraph (e)(i), and we consider that an examination of whether the access rates were also "reasonable" under paragraph (a) would still have to be undertaken. Even if a particular level of access rate were considered only to be "making a contribution" to one of the policy goals listed in subparagraph (e)(i), an examination under paragraph (a) of whether that rate was also "reasonable" would still have meaning.

7.343 We conclude that if access rates, in the alternative, were considered to be "conditions" under Section 5(e), then the term "necessary" in that provision would have a meaning that required a determination of whether the access rates were "reasonable" under Section 5(a). We would therefore arrive at the same finding that we have made in paragraph 7.334, that the access rates charged are not "reasonable", and that Mexico has therefore not met its obligations under Section 5(a) to ensure that such access rates are "reasonable".

bb) Underlying ILD Rules

7.344 The United States also claims that Mexico unreasonably conditions access to and use of public telecommunications transport networks and services in violation of Mexico's obligations under Section 5(a) of the GATS Annex on Telecommunications, by granting the exclusive authority to negotiate settlement rates with foreign suppliers to the long-distance licensee with the greatest percentage of outgoing long-distance market share over the preceding six months (ILD Rule 13), and by imposing the rate negotiated by that operator on all other operators of public telecommunications transport networks and services, thereby preventing foreign suppliers from reaching alternative agreements for access to and use of the public telecommunications transport networks and services in Mexico (ILD Rules 3, 6, 10, 13, 22 and 23). In addition, the United States claims that Mexican authorities have rejected petitions by Mexican and foreign operators to be permitted to conclude alternative terms and conditions.

7.345 The United States is of the view that these ILD Rules, and their application by the Mexican authorities, are not reasonable, as they contravene the purpose of the Annex, which is to prevent suppliers of public telecommunications transport networks and services from engaging in unfair, restrictive, or anti-competitive conduct. Far from ensuring this goal "by whatever measures necessary", the Mexican measures concentrate all power and control over access to and use of Mexico's public telecommunications transport networks and services in the hands of the dominant supplier of such networks, thereby impairing the ability of United States and other foreign suppliers of basic telecommunications services to negotiate fair and competitive access to and use of these networks.<sup>1036</sup>

7.346 Having already found that Mexico has failed, in violation of Section 5(a) of the Annex, to ensure that the interconnection rates resulting from Mexico's application of its ILD Rules provide

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<sup>1036</sup> See the United States' first written submission, paragraphs 237-241.

access to and use of public telecommunications transport networks and services in Mexico on reasonable terms (see paragraph 7.335 above), the Panel does not consider it necessary to examine whether, and to what extent, the individual ILD Rules themselves are also inconsistent with Mexico's obligations under Section 5(a) of the Annex.

(c) Claim under Section 5(b) of the Annex

7.347 The United States argues that Mexico has failed to ensure that *non-facilities-based, commercially present* suppliers (commercial agencies) have access to and use of private leased circuits, and are permitted to interconnect these circuits to public telecommunications transport networks and services or with circuits of other service suppliers. According to the United States, Mexico's commitments allow locally established, foreign-owned commercial agencies to provide international basic telecommunications services (for example, from Mexico to United States) over leased capacity.<sup>1037</sup> Contrary to its commitments, however, Mexico prohibits the commercial presence of non-facilities-based foreign telecommunications suppliers. Even if permitted to establish, ILD Rule 3 would prohibit the interconnection of these circuits to any foreign public telecommunications transport networks and service, thereby preventing a foreign non-facilities based supplier from using a private leased circuit from any point in Mexico to any foreign destination.<sup>1038</sup>

7.348 According to the United States, five years had elapsed since Mexico finalized its Mode 3 commitment in February 1997 (and four years had elapsed since this commitment had entered into force in February 1998), and Mexico still had not issued – and had indicated no intention to issue – the relevant regulations which provide the basis for the authorization for the establishment of a commercial presence by commercial agencies. Mexico's refusal to issue such regulations raised questions about its intentions ever to implement its scheduled mode 3 commitment for commercial agencies.

7.349 Mexico responds that the commitment in its schedule, and any resulting obligation under Section 5(b) with respect to the *non-facilities-based supply* of basic telecommunications services through *commercial presence*, are conditioned on the prior issuance of regulations which has yet to occur. In Mexico's view, the entry in its schedule indicates that, at the time of the inscription, no such permits were being issued, which was consistent with Mexico's intention to make a "standstill" commitment. According to Mexico, the entry establishes a "zero quota" on mode 3 access for commercial agencies, which amounts to a market access limitation under GATS Article XVI:2(a).<sup>1039</sup> Mexico is of the view that nothing in its entry committed Mexico to issuing the corresponding regulations. If Mexico had made commitments to take certain actions in the future, those commitments would have been inscribed in the fourth column of its schedule as "additional commitments" under GATS Article XVIII, similar to the practice other Members had followed in making promises of review or other conditional undertakings.<sup>1040</sup>

7.350 The United States argues that Mexico's mode 3 limitation, if read as Mexico interpreted it, rendered the commitment without effect or "inutile". The United States points to interpretations of

<sup>1037</sup> See the United States' first written submission, paragraph 291.

<sup>1038</sup> See the United States' first written submission, paragraph 295.

<sup>1039</sup> See Mexico's answer to question No. 2(a) of the Panel of 19 December 2002, paragraph 39. For question No. 2(a), see footnote 225 of this Report. See also Mexico's answer to question No. 6(a) of the Panel of 19 December 2002, paragraphs 89-91. For question No. 6(a), see footnote 282 of this Report. See also Mexico's answer to question No. 6(c) of the Panel of 19 December 2002, paragraph 108; II 135. For question No. 6(c), see footnote 653 of this Report.

<sup>1040</sup> See Mexico's answer to question No. 6(c) of the Panel of 19 December 2002, paragraph 108. For question No. 6(c), see footnote 653 of this Report.

Mexico's commitments by Telmex/Sprint in testimony given to the FCC in 1997, that indicate that Telmex/Sprint believed that Mexico would issue the required regulations shortly.<sup>1041</sup>

7.351 We recall the terms of Section 5(b) of the Annex, which states in relevant part:

"(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, and to this end shall ensure, subject to paragraphs (e) and (f), that such suppliers are permitted:

...

(ii) to interconnect private leased or owned circuits with public telecommunications transport networks and services or with circuits leased or owned by another service supplier;"

7.352 In examining the United States claim under Section 5(b), we will first examine whether Mexico has a commitment in effect to allow the supply of the services at issue through commercial presence (mode 3) in Mexico by commercial agencies of other Members. We will then examine the extent of any such commitments, in particular whether that commitment extends to international services from Mexico to the United States supplied through commercial agencies commercially present in Mexico. Finally, we will examine whether Mexico has fulfilled its commitment under Section 5(b) with respect to "access to and use of" of private leased circuits, and under Section 5(b)(ii) to "interconnect private leased or owned circuits" with public telecommunications transport networks and services, or with circuits leased or owned by another supplier, taking into account Section 2(c)(ii) and Section 5(e), (f) and (g) of the Annex.

(i) *Whether Mexico has a commitment in effect to allow commercial agencies to supply the services at issue through commercial presence (mode 3)*

7.353 Mexico has included a commercial presence (mode 3) commitment in its schedule with respect to services supplied by "commercial agencies". It has entered "None" in the column relating to national treatment, and inscribed limitations in the market access column, which read in relevant part:

*"A permit issued by the SCT is required. Only enterprises set up in accordance with Mexican law may obtain such a permit.*

...

*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."* (emphasis added)

7.354 We consider first Mexico's argument that the entry in its schedule establishes a limitation on market access, under Article XVI:2(a) of the GATS. This provision states that, in sectors where market access commitments are undertaken, the measures, which a Member shall not maintain or adopt, unless otherwise specified in its schedule, are :

*"limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;"*<sup>1042</sup> (emphasis added)

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<sup>1041</sup> See the United States' answer to question No. 6(c) of the Panel of 19 December 2002. For question No. 6(c), see footnote 653 of this Report. See also the United States' first oral statement, paragraph 17.

7.355 According to the first sentence in Mexico's entry, "a permit issued by the SCT is required" for the supply of the service. Such a permit, according to the entry, may only be obtained by "enterprises set up in accordance with Mexican law". This language does not indicate that Mexico maintains a quantitative limitation "on the number of suppliers". On the contrary, it suggests that any supplier who is set up in accordance with Mexican law is eligible for a permit.

7.356 Mexico's entry goes on to state that "the establishment and operation of commercial agencies is invariably subject to the relevant regulations". It further states that "permits for the establishment of a commercial agency [will not be issued] until the corresponding regulations are issued". Mexico argues that at the time when the limitation was inscribed, no permits were issued, and no market access was granted.<sup>1043</sup> Mexico appears to argue that the issuance of regulations is a condition, the fulfilment of which is entirely at the discretion of Mexican authorities. If the meaning of Mexico's entry is that Mexico has full discretion whether or not to issue regulations, then it follows that Mexico has indeed not undertaken any commitment on the number of suppliers – in other words, it has left market access "unbound" with regard to the number of suppliers.

7.357 We now consider whether Mexico's entry is equivalent to an "unbound" entry with respect to market access through the supply, through commercial presence, of the services at issue. The wording of the limitation, that "permits for the establishment of a commercial agency [will not be issued] until the corresponding regulations are issued", does not specify that a numerical *quota* was to be imposed on the issuance of permits. Rather, the sentence seems to introduce a *temporal* qualification as to *when* establishment will be permitted – namely, after the issuance of the regulations.

7.358 The six categories of measures in Article XVI:2 refer to the types of market access limitations that can be imposed on the supply of a service. However, none of the six categories relate to *temporal* limitations – such as dates for entry into force or for the implementation of commitments. This suggests that temporal limitations cannot constitute limitations on market access under Article XVI:2 of the GATS.

7.359 Article XX:1 of the GATS provides useful context which supports this interpretation. Article XX:1 describes how schedules are to be drawn up. It reads:

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<sup>1042</sup> GATS Article XVI:2 reads in full:

"In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
- (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
- (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
- (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
- (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment."

<sup>1043</sup> See Mexico's answer to question No. 6(a) of the Panel of 19 December 2002, paragraph 90. For question No. 6(a), see footnote 282 of this Report.

"Each Member shall set out in a schedule the specific commitments it undertakes under Part III of this Agreement. With respect to sectors where such commitments are undertaken, each schedule shall specify:

- (a) terms, limitations and conditions on market access;
- (b) conditions and qualifications on national treatment;
- (c) undertakings relating to additional commitments;
- (d) where appropriate the time-frame for implementation of such commitments; and
- (e) the date of entry into force of such commitments."

7.360 Article XX:1 provides that Members "shall specify" certain elements in their schedules of specific commitments. The need to specify entries with regard to the *substantive* elements in Articles XVI (market access), Article XVII (national treatment), and Article XVIII (additional commitments) is dealt with in subparagraphs (a) to (c) of Article XX:1 respectively. Article XX:1 *reiterates* the need to "specify" the limitations for market access to be scheduled under Article XVI. Article XX:1 appears however to *add* to the requirements for the scheduling of national treatment limitations under Articles XVII (which reads "subject to any conditions and qualifications set out [in the schedule]"), and additional commitments under Article XVIII (which reads "commitments shall be inscribed in a Member's schedule").

7.361 The need for specificity on the *temporal* aspects of commitments is dealt with in subparagraphs (d) and (e) of Article XX:1. Subparagraph (e) requires that each schedule shall specify the date of entry into force of the commitments undertaken. Subparagraph (d) requires that a schedule "shall specify ... where appropriate the time-frame for implementation of such commitments". The separate listing of temporal elements of entry into force and implementation in Article XX:1 confirms, in our view, that temporal elements are not part of the substantive elements that can be market access limitations under Article XVI:2.

7.362 Consequently, we find that Mexico's scheduled requirement that commercial agencies obtain permits, and that these permits be based on regulations, is a temporal limitation that is not a market access limitation within the meaning of Article XVI:2(a).<sup>1044</sup>

7.363 Since we have found that Mexico's entry in the market access column of its schedule for services supplied by commercial agencies through commercial presence is not a market access limitation, we now need to determine what meaning it does have. We return to Article XX:1, which specifies how Members should inscribe their specific commitments in their schedules. In particular, we examine Mexico's entry under the criteria set out in subparagraphs (d) (time-frame for implementation) and (e) (date of entry into force).

7.364 We note at the outset that Mexico's commitment on commercial agencies, along with Mexico's other commitments on basic telecommunications, was attached to the Fourth Protocol on

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<sup>1044</sup> The Addendum to the Explanatory Note on Scheduling of initial commitments on Trade in Services (MTN.GNS/W/164/Add.1 , 30 November 1993, corroborates this finding: "The requirement to obtain an approval or a licence is not in itself a trade restriction and therefore does not need to be scheduled. However, if the criteria for granting licenses or approval contain a market access restriction (e.g. economic needs test) or discriminatory treatment, the relevant measures would need to be scheduled if a Member wishes to maintain them as limitations under Article XVI or XVII. It has been pointed out that in some offers the granting of licences is subject to review, meaning they are granted on a discretionary basis. In such a case the right to supply the service is unbound."

15 February 1997, and entered into force on 5 February 1998. Mexico has not included a date in its schedule to indicate that its specific commitment on commercial agencies was to enter into force at a date different from 5 February 1998. We consider therefore that Mexico's entry relates to the time-frame for *implementation*, and not the entry into force of the commitment.

7.365 We recall that Article XX:1 (d) requires, with respect to sectors where commitments are undertaken, that each schedule shall specify "where appropriate the time-frame for implementation of such commitments".

7.366 A "time-frame" is defined as "a period of time especially with respect to some action or project".<sup>1045</sup> The term does not require the setting of a precise date, but it does imply a beginning and an end of a time period. Where not expressed by beginning and end dates, a time-frame may be also expressed in terms of maximum duration (for example: within three years). Unlike a condition which may or may not occur, a time-frame is not open-ended and does not leave the time of the occurrence in doubt.

7.367 We consider that the obligation to specify "where appropriate" a time-frame for implementation of a commitment must be considered in the overall context of Article XX:1. The wording of that Article seeks to ensure a high degree of clarity and specificity as to the exact terms of commitments made by Members. Members must be able to infer from each schedule the precise conditions for market access, national treatment and, where inscribed in the schedule, any additional commitments a Member has undertaken. By the same token, specificity as to when a commitment enters into force and when it has to be implemented is equally important. A market access commitment that leaves in doubt when a commitment takes effect is of little practical value. Unlike for the implementation of GATT tariff reductions which entered into force on 1 January 1995, and for which paragraph 2 of the Marrakesh Protocol provided a time-frame for implementation, the dates of entry into force and implementation of specific commitments under the GATS coincide in principle.

7.368 Article XX:1(d) permits Members who wish to depart from this general rule to specify a "time-frame" within which they implement their commitments. We consider that the words "where appropriate" in that subparagraph must be understood to refer to situations where the date of implementation differs from the date of entry into force of a commitment. The consistent practice of WTO Members in the scheduling of commitments supports this understanding. During the extended negotiations on basic telecommunications alone, twenty-seven Members who attached schedules of commitments to the Fourth Protocol, but wished to implement their commitments at a later time than the entry into force of their schedule, specified a time-frame for implementation – typically by entering dates upon which certain limitations would be removed. We consider that Article XX, the objective of which is to ensure clarity and precision with regard to the scheduling of commitments, cannot be interpreted to allow a window of discretion with regard to temporal aspects of these commitments that could erode the practical value of a commitment.

7.369 Mexico asserts that had it wished to schedule commitments to take future actions, it would have done so as *additional commitments* under GATS Article XVIII. In its view, this reasoning is "confirmed" by a Secretariat background note which includes a reference to "future undertakings conditional upon the passing of legislation" in its description of measures that Members had inscribed in the additional commitments column of schedules.<sup>1046</sup>

7.370 In addressing Mexico's argument, we recall first that Article XX:1(d) relates to time-frames for implementation of commitments under *either* Articles XVI, XVII, or XVIII. We therefore cannot subscribe to Mexico's view that *any* future actions should be scheduled only as additional

<sup>1045</sup> Merriam Webster Dictionary, Merriam Webster Online, 2003; <http://www.webster.com/>.

<sup>1046</sup> See, *Additional Commitments Under Article XVIII of the GATS: Note by the Secretariat*, S/CSC/W/34, 16 July 2002, paragraph 8.

commitments; we described earlier how Members have, in fact, consistently inscribed time-frames in the market access column of their schedules. Second, Mexico has inscribed its commitment in the market access column, and not in the column relating to additional commitments. This difference indicates Mexico's intention to make a commitment on market access (that is, to permit the commercial presence of "commercial agencies"), and not an additional commitment "with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII". Third, the Secretariat note mentioned by Mexico merely contains "examples of inscriptions found in the additional commitments column", and an examination of such examples in Attachment I to that note shows that only one of a total of fifty-two inscriptions contains a condition similar to the one in Mexico's schedule.

7.371 We therefore consider that subparagraph (d) of Article XX:1 requires the specification of a time-frame for implementation should a Member wish to implement a commitment *after* its entry into force. Where a Member does not specify a time-frame, implementation must be deemed to be concurrent with the entry into force of the commitment. We have seen that the entry in Mexico's Schedule does not contain language that expresses a condition "whether" regulations and permits would be issued, but only "when" the permits would be issued. Interpreted in the context of Article XX, this entry implies that regulations were not in place when Mexico finalized its commitments on 15 February 1997, but expresses a commitment that these regulations would be issued. Even if Mexico had needed time to complete the issuance of the regulations beyond the time of entry into force of its commitment on 5 February 1998, Mexico should, at the very minimum, have initiated that process leading to the issuance of the regulations. There is no evidence, however, that Mexico has taken *any* steps to comply with its commitment. We do not consider it necessary to rule on the length of a time period within which the implementation of Mexico's commitment might reasonably have been concluded, as more than five years have passed since the entry into force of Mexico's commitment, and Mexico still has indicated no date by which it intends to issue the relevant regulations and permits. Therefore, we find that Mexico's refusal to authorize the supply of services by commercial agencies is inconsistent with the market access commitment inscribed in its schedule.

(ii) *Whether Mexico's commitments on the supply of the services at issue by commercial agencies through commercial presence include the supply of international telecommunications services (from Mexico to the United States) through mode 3*

7.372 The United States argues that the supply of the services at issue through commercial presence under mode 3 includes the supply of such services from Mexico into the United States.

7.373 In assessing this issue, we note that the supply of a service through commercial presence (mode 3) is defined in Article I:2 (c) of the GATS as the supply of a service "by a service supplier of one Member, through commercial presence in the territory of any other Member".

7.374 "Commercial presence" is defined in Article XXVIII (Definitions), as follows:

"(d) 'commercial presence' means any type of business or professional establishment, including through

- (i) the constitution, acquisition or maintenance of a juridical person, or
- (ii) the creation or maintenance of a branch or a representative office,

within the territory of a Member for the purpose of supplying a service;"

7.375 The definition of services supplied through a commercial presence makes explicit the location of the service supplier. It provides that a service supplier has a commercial presence – any type of business or professional establishment – *in the territory* of any other Member. The definition is silent

with respect to any other territorial requirement (as in cross-border supply under mode 1) or nationality of the service consumer (as in consumption abroad under mode 2). Supply of a service through commercial presence would therefore not exclude a service that originates in the territory in which a commercial presence is established (such as Mexico), but is delivered into the territory of any other Member (such as the United States).

7.376 We observe further that the Chairman's Note for *Scheduling Basic Telecommunications Services Commitments*, states that:

"Unless otherwise noted in the sector column, any basic telecom service listed in the sector column:

- (a) encompasses local, long distance and international services for public and non-public use;"<sup>1047</sup>

7.377 In our analysis of Mexico's commitments in part B of these findings, we found that the Chairman's Note is an important part of the circumstances of the conclusion of the negotiations, and should be given considerable weight. We note that Mexico did not exclude international services in the sector column, or elsewhere in its schedule, from the scope of services that commercial agencies may supply. We are therefore entitled to assume that Mexico's mode 3 commitment at issue includes supply of basic telecommunications services within Mexico, and from Mexico into any other country.

7.378 Having concluded that Mexico has a commitment in effect to allow the supply through commercial presence (mode 3) of the services at issue by commercial agencies, we now consider whether Mexico has fulfilled its obligations in Section 5(b) to ensure that suppliers of any other Member have access to and use of any public telecommunications transport networks and services offered within or across Mexico's border, including private leased circuits.

(iii) *Access to and use of private leased circuits*

7.379 Mexico argues that Section 2(c)(ii) of the Annex renders Section 5 inapplicable in this case. Section 2(c)(ii) establishes that nothing in the Annex, including Section 5, "shall be construed ... to require a Member (or to require a Member to oblige service suppliers under its jurisdiction) to establish, construct, acquire, lease, operate or supply telecommunications transport networks or services not offered to the public generally". According to Mexico international simple resale is prohibited in Mexico, and is therefore not offered to the public generally.<sup>1048</sup> The United States argues that Mexican suppliers of public telecommunications transport networks and services do in fact offer private leased circuits to the public generally.<sup>1049</sup>

7.380 The Panel cannot accept Mexico's argument that Section 2(c)(ii) makes Section 5(b) inapplicable in this case. Whether "international simple resale" (international services transmitted over leased capacity) is offered to the public generally is a different issue from whether "private leased circuits" are offered to the public generally in Mexico. Whether a supplier is entitled under Section 5(b) to *access to and use of* services, such as private leased circuits, that are offered to the public generally is determined by a Member's scheduled commitments on the service to be supplied. In this respect, the fact that a particular service is restricted under domestic law cannot be invoked under Section 2(c)(ii), since the obligations under Section 5 refer not to domestic law but to scheduled GATS commitments.

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<sup>1047</sup> Notes for the *Scheduling Basic Telecommunications Services Commitments*; Note by the Chairman. S/GBT/W/2/Rev.1.

<sup>1048</sup> See Mexico's second written submission, paragraphs 147-151.

<sup>1049</sup> See the United States' first written submission, paragraph 264, footnote 230, in which the United States states that COFETEL's website lists Telmex private line tariffs.

7.381 The Panel notes that the United States presents evidence that "private leased circuits" are in fact "offered to the public generally" in Mexico. Further, the Panel recalls that it has found that, although Mexico has not committed to allow commercial agencies to use leased capacity for cross border supply, it has committed to allow commercial agencies to use leased capacity for the supply of the services at issue. We also recall that Mexico indicates no restriction on the geographic market (i.e. local, long distance, international) for the services that may be supplied by the commercial agencies established in Mexico. Mexico has inscribed no routing restriction – as it did for cross border supply – for supply through commercial presence. Therefore, the Panel considers Mexico to have undertaken commitments on the supply of the services at issue by commercial agencies through commercial presence, for which access to and use of private leased circuits is not only relevant but , by Mexico's own definition in its schedule, is essential. Therefore, we find that Mexico has failed to ensure access to and use of private leased circuits for the supply of the committed services in a manner consistent with the Section 5(b) of the Annex on Telecommunications.

(iv) *Interconnection of private leased circuits*

7.382 The United States maintains that according to Section 5(b)(ii), foreign suppliers must be permitted to interconnect private leased circuits to foreign public telecommunications transport networks and services. In its view, ILD Rule 3 would prohibit commercial agencies, even if they were permitted to establish, to interconnect any private leased circuits to foreign public telecommunications transport networks and services.

7.383 We note that ILD Rule 3 reads:

"Only international gateway operators shall be authorized to interconnect directly with the public telecommunications networks of other countries' operators for the purpose of carrying international traffic."

7.384 Under this rule, only international gateway operators may interconnect with foreign public telecommunications transport networks and services to supply international telecom services. The ILD Rules require an international gateway operator to be a facilities-based supplier. ILD Rule 2:VII defines a gateway operator as a supplier with a concession to supply long distance services, and ILD Rule 7:3 requires such an operator to have infrastructure in at least three Mexican states. As discussed in part B, a gateway operator must always be a "concessionaire", and a commercial agency can never be a concessionaire. Therefore, a commercial agency can never be an international gateway operator. Thus, ILD Rule 3 prohibits a commercial agency to interconnect "directly with the public telecommunications networks of other countries' operators for the purpose of carrying international traffic".

(v) *Subject to paragraphs (e) and (f)*

7.385 We note that the obligation in Section 5(b) is made subject by the terms of the provision to paragraphs (e) and (f). Paragraph (e)(iii) permits Mexico to impose conditions "to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in the Members' Schedule". ILD Rule 3, as discussed above, would be a restriction on resale in the sense of paragraph (f)(i) of Section 5. We have found that Mexico has undertaken a mode 3 commitment on the supply of the telecommunications services at issue by commercial agencies. This commitment does not exclude supply of non-facilities-based services from Mexico into any other country. Therefore, ILD Rule 3 does not impose a condition necessary to achieve the objective set out in paragraph (e)(iii). Rather, this ILD Rule prevents interconnection to private leased circuits for a service on which a specific commitment has been taken. Therefore, we find that ILD Rule 3 is inconsistent with Mexico's obligations under Section 5(b) of the Annex.

(d) Invocation of Section 5(g)

7.386 Mexico argues that it is necessary to condition access to its networks for the purpose of strengthening its domestic telecommunication infrastructure in accordance with paragraph (g) of Section 5 of the Annex.<sup>1050</sup> According to Mexico, this Section gives cover to its measures.

7.387 Section 5(g) reads:

"Notwithstanding the preceding paragraphs of this section, a developing country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. Such conditions shall be specified in the Member's schedule."

7.388 Section 5(g) recognizes the *right* of developing countries *to inscribe* limitations in their schedules for the objectives recognized in Section 5(g). The Panel notes that Mexico's Schedule of Specific Commitments does not include any limitations referring to Section 5(g) or to the development objectives mentioned therein. Without such limitations in Mexico's Schedule, Section 5(g) does not permit a departure from specific commitments which Mexico has voluntarily and explicitly scheduled. Moreover, even if – contrary to our views – Section 5(g) could be used as a defence for imposing conditions inconsistent with a Member's specific commitments, Mexico has not demonstrated that anti-competitive price-fixing and market sharing arrangements are "reasonable" and "necessary" conditions for enhancing the development objectives referred to in Section 5(g).

7.389 We therefore conclude that Mexico has failed to meet its obligations under Section 5(b) of the GATS Annex on Telecommunications, by failing to ensure that commercially present commercial agencies of the United States have access to and use of private leased circuits and are permitted to interconnect these circuits to public telecommunications transport networks and services or with circuits of other service suppliers.

## VIII. CONCLUSIONS AND RECOMMENDATION

8.1 In the light of our findings, we conclude that:

- (a) Mexico has not met its GATS commitments under Section 2.2(b) of its Reference Paper since it fails to ensure that a major supplier provides interconnection at cost-oriented rates to United States suppliers for the cross-border supply, on a facilities basis in Mexico, of the basic telecommunications services at issue ;
- (b) Mexico has not met its GATS commitments under Section 1.1 of its Reference Paper to maintain "appropriate measures" to prevent anti-competitive practices, since it maintains measures that require anti-competitive practices among competing suppliers which, alone or together, are a major supplier of the services at issue;
- (c) Mexico has not met its obligations under Section 5(a) of the GATS Annex on Telecommunications since it fails to ensure access to and use of public telecommunications transport networks and services on reasonable terms to United States service suppliers for the cross-border supply, on a facilities basis in Mexico, of the basic telecommunications services at issue;

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<sup>1050</sup> See Mexico's second written submission, paragraphs 265-266.

- (d) Mexico has not met its obligations under Section 5(b) of the GATS Annex on Telecommunications, since it fails to ensure that United States commercial agencies, whose commercial presence Mexico has committed to allow, have access to and use of private leased circuits within or across the border of Mexico, and are permitted to interconnect these circuits to public telecommunications transport networks and services or with circuits of other service suppliers.

8.2 The Panel has found that, contrary to claims of the United States :

- (a) Mexico has not violated Section 2.2(b) of its Reference Paper, with respect to cross-border supply, on a *non-facilities* basis in Mexico, of the basic telecommunications services at issue;
- (b) Mexico has not violated Section 5(a) of the GATS Annex on Telecommunications, with respect to the cross-border supply, on a *non-facilities* basis in Mexico, of the basic telecommunications services at issue;
- (c) Mexico has not violated Section 5(b) of the GATS Annex on Telecommunications, with respect to the cross-border supply, on a *non-facilities* basis into Mexico, of the basic telecommunications services at issue.

8.3 The Panel notes that, pursuant to Article 12.11 of the DSU, it has taken into account in its findings GATS provisions on differential and more-favourable treatment for developing country Members. In particular, the Panel has examined Mexico's arguments that commitments of such Members have to be interpreted in the light of Article IV of the GATS, paragraph 5 of the preamble to the GATS, and paragraph 5(g) of the Annex on Telecommunications. The Panel emphasizes that its findings in no way prevent Mexico from actively pursuing the development objectives referred to in these provisions by extending telecommunications networks and services at affordable prices in a manner consistent with its GATS commitments.

8.4 The Panel notes that Article 19 of the DSU provides that "[w]here a panel ... concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement."<sup>1051</sup> Unlike some other covered agreements (e.g. GATT Article XXIII:1 in connection with Article 3.8 of the DSU), the GATS does not require that, in the case of a violation complaint (GATS Article XXIII:1), "nullification or impairment" of treaty benefits has to be claimed by the complaining WTO Member and examined by a Panel. Whereas Article XXIII:1 of the GATT specifically conditions access to WTO dispute settlement procedures on an allegation that a "benefit" or the "attainment of an objective" under that agreement are being "nullified or impaired", the corresponding provision in the GATS (Article XXIII:1) permits access to dispute settlement procedures if a Member "fails to carry out its obligations or specific commitments" under the GATS. In this respect, we note that the Appellate Body in *EC – Bananas III* stated that the panel in that case "erred in extending the scope of the presumption in Article 3.8 of the DSU to claims made under the GATS".<sup>1052</sup> Having found that Mexico has violated certain provisions of the GATS, we are therefore bound by Article 19 of the DSU to proceed directly to the recommendation set out in that provision.

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<sup>1051</sup> Footnotes in the original omitted.

<sup>1052</sup> See Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas ("EC – Bananas III")*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, at paragraph 250.

8.5 We therefore recommend that the Dispute Settlement Body request Mexico to bring its measures into conformity with its obligations under the GATS.

## IX. ANNEXES

### A. ABBREVIATIONS USED FOR DISPUTE SETTLEMENT CASES REFERRED TO IN THE REPORT

SHORT TITLE	FULL TITLE
<b><i>Canada – Autos</i></b>	Panel Report, <i>Canada – Certain Measures Affecting the Automotive Industry</i> , WT/DS139/R, WT/DS142/R, adopted 19 June 2000, as modified by the Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, DSR 2000:VII, 3043.
<b><i>Canada – Dairy</i></b>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/AB/R, WT/DS113/AB/R and Corr.1, adopted 27 October 1999, DSR 1999:V, 2057.
<b><i>EC – Computer Equipment</i></b>	Appellate Body Report, <i>European Communities – Customs Classification of Certain Computer Equipment</i> , WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998.
<b><i>EC – Hormones</i></b>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> ("EC – Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.
<b><i>India – Quantitative Restrictions</i></b>	Appellate Body Report, <i>India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , WT/DS90/AB/R, adopted 22 September 1999, DSR 1999:IV, 1763.
<b><i>Japan – Alcoholic Beverages II</i></b>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97.
<b><i>Korea – Various Measures on Beef</i></b>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001.
<b><i>US – Carbon Steel</i></b>	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> ("US – Carbon Steel"), WT/DS213/AB/R and Corr.1, adopted 19 December 2002.
<b><i>US – Gasoline</i></b>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3.
<b><i>US – Hot-Rolled Steel</i></b>	Appellate Body Report, <i>United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan</i> , WT/DS184/AB/R, adopted 23 August 2001.
<b><i>US – Stainless Steel</i></b>	Panel Report, <i>United States – Anti-Dumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea</i> , WT/DS179/R, adopted 1 February 2001.
<b><i>US – Wheat Gluten</i></b>	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> ("US – Wheat Gluten"), WT/DS166/AB/R, adopted 19 January 2001, DSR 2001:II, 717.

B. MEXICO: SCHEDULE OF SPECIFIC COMMITMENTS, SUPPLEMENT 2

# WORLD TRADE ORGANIZATION

**GATS/SC/56/Suppl.2**

11 April 1997

(97-1326)

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## Trade in Services

### MEXICO

#### Schedule of Specific Commitments

#### Supplement 2

(This is authentic in Spanish only)

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This text supplements the Telecommunication services section contained on pages 20 to 22 of document GATS/SC/56.

## MEXICO - SCHEDULE OF SPECIFIC COMMITMENTS

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
<p><b>2.C. TELECOMMUNICATIONS SERVICES</b></p> <p>Telecommunications 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).</p> <p>Radio broadcasting, cable television, satellite transmissions of DTH and DBS services and of audio digital services are excluded.</p>	<p>(1) None, except the following:</p> <p>International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport (SCT).</p> <p>(2) None</p> <p>(3) A concession<sup>1</sup> from the SCT is required. Only enterprises established in conformity with Mexican law may obtain such a concession.</p> <p>Concessions for spectrum frequency bands for specific uses will be granted by public invitation to tender.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p>	<p>Mexico undertakes the obligations contained in the reference paper attached hereto.</p>

<sup>1</sup> Concession: The granting of title to install, operate or use a facilities-based public telecommunications network.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
	<p>Foreign governments may not participate in an enterprise set up in accordance with Mexican law nor obtain any authorization to provide telecommunications services.</p> <p>Direct foreign investment up to 49 per cent is permitted in an enterprise set up in accordance with Mexican law.</p> <p>Telecomunicaciones de Mexico (Telecomm) has exclusive rights to links with Intelsat and Inmarsat.</p> <p>Services other than international long-distance services which require use of satellites must use Mexican satellite infrastructure until the year 2002.</p>		
(a) Voice telephony (CPC 75211, 75212)	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section.	
(b) Packet-switched data transmission services (CPC 7523**)	(1) None, except as indicated in 2.C.1.	(1) None	
	(2) None	(2) None	
	(3) As indicated in 2.C.3.	(3) None	
(c) Circuit-switched data transmission services (CPC 7523**)	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section.	

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
(f) Facsimile services (CPC 7521** + 7529**)	<p>(1) None, except as indicated in 2.C.1.</p> <p>(2) None</p> <p>(3) As indicated in 2.C.3.</p> <p>A permit issued by the SCT is required in order to provide a public facsimile service. Only enterprises set up in accordance with Mexican law may obtain such a permit.</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	
(g) Private leased circuit services (CPC 7522** + 7523**)	<p>(1) None, except as indicated in 2.C.1.</p> <p>(2) None</p> <p>(3) As indicated in 2.C.3.</p> <p>Operators of private networks wishing to exploit services commercially must obtain a concession from the SCT, whereupon such networks assume the character of public networks.</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
(o) Other	(1) None, except as indicated in 2.C.1.	(1) None	
- Paging services (PC 75291)	(2) None	(2) None	
	(3) As indicated in 2.C.3.	(3) None	
	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section.	
- Cellular telephone services (75213**) on the "A" and "B" bands <sup>2</sup>	(1) None, except as indicated in 2.C.1.	(1) None	
	(2) None	(2) None	
	(3) As indicated in 2.C.3.	(3) None	
	Foreign investment in excess of 49 per cent of an enterprise's capital will be permitted following a favourable decision by the Foreign Investment Commission		
	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section.	

<sup>2</sup> Frequencies 825-835/870-880 and 835-845/880-890 Mhz.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
- Commercial agencies <sup>3</sup>	<p>(1) None, except as indicated in 2.C.1.</p> <p>(2) None</p> <p>(3) None, except: A permit issued by the SCT is required. Only enterprises set up in accordance with Mexican law may obtain such a permit.</p> <p>Foreign governments may not participate in an enterprise set up in accordance with Mexican law nor obtain any authorization to provide telecommunications services.</p> <p>Except where specifically approved by the SCT, public telecommunications network concessionaires may not participate, directly or indirectly, in the capital of a commercial agency.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p>	

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<sup>3</sup> Agencies which, without owning transmission means, provide third parties with telecommunications services by using capacity leased from a public network concessionaire.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
	<p>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.</p> <p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(4) Unbound, except as indicated in the horizontal section</p>	

## REFERENCE PAPER

### Scope

The following are principles and definitions on the regulatory framework for the basic telecommunications services.

### Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications network of service that:

- (a) Are exclusively or predominantly provided by a single or limited number of suppliers; and
- (b) cannot feasibly be economically or technically substituted in order to provide a service.

A major supplier is 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.

### 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.

#### 1.2 Safeguards

The anti-competitive practices referred to in the above paragraph shall include in particular:

- (a) Engaging in anti-competitive cross-subsidization;
- (b) using information obtained from competitors with anti-competitive results; and
- (c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

### 2. Interconnection

2.1 This 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.

## 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:

- (a) Under non-discriminatory terms, conditions (including technical standards and specifications) and rates and of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;
- (b) in a timely fashion, 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; and
- (c) upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

## 2.3 Public availability of the procedures for interconnection negotiations

The procedures applicable for interconnection to a major supplier will be made publicly available.

## 2.4 Transparency of interconnection arrangements

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

## 2.5 Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either:

- (a) At any time; or
- (b) after a reasonable period of time which has been made publicly known

to an independent domestic body, which may be a regulatory body as referred to in paragraph 5, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

## 3. Universal service

Any Member has the right to define the kind of universal service obligation it wishes to maintain. Such obligations will not be regarded as anti-competitive *per se*, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.

4. Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

- (a) All the licensing criteria and the period of time normally required to reach a decision concerning an application for a licence; and
- (b) the terms and conditions of individual licences.

The reasons for the denial of a licence will be made known to the applicant upon request.

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

6. Allocation and use of scarce resources

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner. The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.

C. ILD RULES

**RULES FOR THE SUPPLY OF INTERNATIONAL LONG-DISTANCE SERVICES**

To be Applied by the Licensees of Public Telecommunications Networks  
Authorized to Provide Such Services

*11 December 1996*

In the margin, a stamp displaying the Mexican Coat-of-Arms and the words "United Mexican States – Ministry of Communications and Transport, Federal Telecommunications Commission".

On the basis of Article 36 of the Basic Law on the Federal Public Administration; Articles 1 and 3 and other relevant articles of the Federal Law on Administrative Procedure; Articles 7 and 47, Transitional Article Ten, and other relevant articles of the Federal Telecommunications Law; Articles 2 and 37 *bis* of the Rules of Procedure of the Ministry of Communications and Transport; Articles 1, 2, 3, and 5 of the Decree establishing the Federal Telecommunications Commission, and other applicable provisions; and

WHEREAS:

Pursuant to Article 7 of the Federal Telecommunications Law, the Ministry of Communications and Transport shall promote the efficient development of telecommunications, and foster fair competition among the various telecommunications service providers so that users may be offered a better price, range, and quality of services;

Transitional Article Ten of the Federal Telecommunications Law establishes that licensees of public telecommunications networks that have concluded interconnection agreements, under the terms of said Law, with licensees of public networks wishing to provide national and international basic public long-distance telephone services, may begin to operate their respective interconnections as of 1 January 1997;

In the Regulations on Long-Distance Services, published in the *Diario Oficial de la Federación* [Official Journal] of 21 June 1996, the Ministry of Communications and Transport has determined the procedures that must be followed by licensees of public telecommunications networks authorized to provide basic public long-distance telephone services for their operations with other licensees or permit-holders, as well as for the supply of services to end users;

It is therefore necessary to establish the procedure applicable to those licensees of long-distance services wishing to establish and operate international gateways in order to interconnect with foreign telecommunications networks for the purpose of carrying international traffic, as well as promoting the efficient interconnection of public telecommunications networks within Mexican territory;

By means of a decree published in the *Diario Oficial de la Federación* of 9 August 1996, the Federal Executive established the Federal Telecommunications Commission as a decentralized agency of the Ministry of Communications and Transport, with technical and operational autonomy, for the purpose of regulating and promoting the efficient development of telecommunications;

As established in Articles 7(II) and 47 of the Federal Telecommunications Law, as well as Article 37 *bis* (XIII) and (XIV) of the Rules of Procedures of the Ministry of Communications and Transport, it is within the authority of the Federal Telecommunications Commission to promote and oversee the efficient interconnection of public telecommunications networks and equipment,

including interconnection with foreign networks, as well as to approve the corresponding interconnection agreements and authorize the installation of telecommunications equipment and means of transmission that cross the country's borders;

Under the terms of the aforementioned provisions, the Federal Telecommunications Commission may establish the terms to be included in agreements for the interconnection of public telecommunications networks with foreign networks whenever it is deemed that such agreements prejudice the interests of Mexico in general, of users, or of other licensees of public telecommunications networks;

As established in Article 7(III) of the Federal Telecommunications Law, Article 2(1) of the Decree establishing the Federal Telecommunications Commission, and other applicable provisions of the said Decree, as well as in Article 37 *bis* (I) of the Rules of Procedure of the Ministry of Communications and Transport, it is within the authority of the Federal Telecommunications Commission to issue administrative provisions in the area of telecommunications; and

In view of the imminent opening up of the market for international long-distance telephone services, in a plenary session on 4 December 1996, and by means of Decision No. RES PC 961207, the Commission unanimously approved the following:

**Rules for the Supply of International Long-Distance Services to be Applied by the Licensees of Public Telecommunications Networks Authorized to Provide Such Services**

**General Provisions**

**Rule 1.** The purpose of these Rules is to regulate the supply of international long-distance services and to establish the terms to be included in agreements for the interconnection of public telecommunications networks with foreign networks.

**Rule 2.** For the purposes of these Rules, the following definitions shall apply:

I. Auditor: firm retained by the Commission to audit the uniform settlement rate and proportionate return systems, as well as to perform other functions authorized under these Rules.

II. Commission: Federal Telecommunications Commission.

III. Committee: the Long-Distance Operators Committee to which Chapter VI of the Long-Distance Rules published in the *Diario Oficial de la Federación* of 21 June 1996 refers.

IV. Long-distance service licensee: natural or legal person having a licence to instal, operate, or exploit a public telecommunications network authorized to provide long-distance services.

V. Call attempt: any call origination provided by a foreign operator to an international gateway operator, regardless of whether or not the call is terminated.

VI. Law: Federal Telecommunications Law.

VII. International gateway operator: long-distance service licensee authorized by the Commission to operate a switching exchange as an international gateway;

VIII. International gateway: switching exchange interconnected to incoming and outgoing circuits, authorized by the Commission to carry international traffic.

IX. Network terminal connection point: the site at which end-user facilities and equipment are connected to a public telecommunications network, or, as applicable, the site at which other telecommunications networks are connected to that network.

X. Ministry: Ministry of Communications and Transport.

XI. International long-distance service: service whereby all international switched traffic is carried through long-distance exchanges authorized as international gateways.

XII. Uniform settlement rate system: the system whereby:

- (a) The same settlement rates are applied by international gateway operators to all long-distance calls from a given country, regardless of which operator originates the call abroad and which licensee terminates the call within Mexican territory; and
- (b) The same settlement rates are applied by the operators of a given country to long-distance calls originating within Mexican territory and delivered to such operators, regardless of which long-distance service licensee originates the call within Mexican territory or which operator terminates the call abroad.

XIII. Proportionate return system: the system under which international gateway operators distribute call attempts entering Mexican territory in accordance with the following procedure:

- (c) The total settlements paid over a one-month period by all international gateway operators to all operators of a given country shall be determined;
- (d) The percentage of the total amount of the above-mentioned settlements generated by each of the international gateway operators during the said period shall also be determined;
- (e) Regardless of the type of call, international gateway operators shall have the right to receive incoming call attempts from a given country during any one-month period, on the basis of the percentages established for the previous monthly period, in accordance with subparagraphs (a) and (b), above; and
- (f) For this purpose, any international gateway operator that receives incoming traffic in an amount exceeding its percentage pursuant to the above subparagraph shall, regardless of the type of call, (i) retain its own call attempts; and (ii) distribute the excess call attempts to each of the international gateway operators in order to meet the percentages indicated.

XIV. Settlement rate: the rate which:

- (g) An international gateway operator charges a foreign operator for receiving traffic from a given country; and
- (h) A foreign operator charges an international gateway operator for receiving traffic originating in Mexican territory.

XV. Switched circuit traffic: traffic which is carried by means of the temporary connection of two or more circuits between two or more users, allowing the said users the full and exclusive use of the connection until it is released.

**Rule 3.** Only international gateway operators shall be authorized to interconnect directly with the public telecommunications networks of other countries' operators for the purpose of carrying international traffic.

**Rule 4.** In order to establish a private cross-border network, capacity must be leased from a long-distance service licensee. Cross-border traffic carried through dedicated infrastructure that forms part of a private network shall be originated and terminated within the same private network.

Pursuant to Article 47 of the Law, only international gateway operators or persons expressly authorized by the Commission may install telecommunications equipment and means of transmission that cross the country's borders.

International gateway operators or persons expressly authorized by the Commission to install telecommunications equipment and means of transmission that cross the country's borders shall apply for prior authorization from the Commission before making any modifications to the said equipment or means of transmission.

**Rule 5.** In order to provide international long-distance services in Mexico, a licence granted by the Ministry under the terms of the Law shall be required. No foreign operator may make use of means of transmission or switching for the direct supply of international long-distance services in Mexico without the participation of a duly authorized Mexican licensee.

### **International Gateways**

**Rule 6.** Long-distance service licensees may only carry international switched circuit traffic through international gateways, and solely in accordance with the provisions of these Rules.

**Rule 7.** Only long-distance service licensees may apply to the Commission for authorization to operate international gateways. For this purpose, applicants shall submit to the Commission an application for each of the switching exchanges they wish to establish as an international gateway and shall indicate which other exchanges, either belonging to the applicant or to other licensees, will be interconnected with each of said international gateways.

Applicants for international gateway authorization and a record of the exchanges that are to be interconnected with each such gateway shall be submitted at least ten calendar days prior to the date on which the applicant wishes to begin operations at the international gateway in question. The Commission shall issue its decision on an application within ten calendar days of the date of receipt of the application.

The Commission shall authorize the installation and operation of international gateways to those long-distance service licensees that have complied with the obligations stipulated in their respective licences; that show that they have interconnected, via their own infrastructure, cities in at least three States of Mexico; and that have at least one interconnection agreement, previously approved by the Commission, with a foreign operator.

Where the Commission decides to grant an international gateway application submitted by a long-distance service licensee, the licensee shall register the international gateway in question with the Public Telecommunications Register.

**Rule 8.** The Commission shall authorize exclusively the installation of international gateways having the capacity to identify the technical and commercial parameters necessary to effect the required invoicing and to exchange accounts with their correspondents.

For this purpose, international gateways shall be equipped with the systems necessary to keep daily accounts comprising at least the following information:

- I. Incoming and outgoing traffic volume in minutes for each type of call;
- II. Total revenue from incoming and outgoing calls;
- III. Duration of each call;
- IV. Type of traffic, broken down into the following categories:
  - (i) Telephone-to-telephone;
  - (j) person-to-person;
  - (k) country-direct;
  - (l) collect-call traffic;
  - (m) calls to 800 numbers;
  - (n) transit traffic; and
  - (o) other categories to be established by the Commission.
- V. Time at which call was carried;
- VI. Operators involved in traffic interexchange;
- VII. Countries of call origination and termination;
- VIII. Geographical area of destination within Mexican territory, where applicable, when traffic from a given country is subject to separate settlement rates; and
- IX. Geographical area in the destination country, where applicable, when outgoing traffic from Mexican territory is subject to separate settlement rates for different geographical areas.

After consulting with the Committee, the Commission may at any time eliminate the requirement stated under this Rule that one or more systems for the identification of technical and commercial parameters be available at international gateways.

**Rule 9.** Once an international gateway is authorized, its operator shall apply for prior authorization from the Commission before making any modification in the assignment of exchanges interconnected with that international gateway. The Commission shall issue its decision on an application within ten calendar days of the date of receipt of the application.

**Rule 10.** International gateway operators shall carry international incoming and outgoing traffic, using the uniform settlement rate system and the proportionate return system.

**Rule 11.** The Commission may at any time require international gateway operators to show that the international gateways they own are equipped with each and every technical facility and capability needed to distribute traffic in accordance with the proportionate return system, without prejudice to the terms of Rule 17.

**Rule 12.** International gateway operators may supply, on a non-discriminatory basis, traffic switching, routing, and accounting services to any long-distance service licensees that request them.

### **Settlement Rate**

**Rule 13.** The long-distance service licensee having the highest percentage of the outgoing long-distance market for the six months prior to negotiations with a given country shall be the licensee that is authorized to negotiate settlement rates with the operators of the said country. These rates shall be submitted to the Commission for approval.

**Rule 14.** Long-distance service licensees may register any rates or services, supplementary to those already filed, that they wish to offer within Mexican territory in coordination with one or more foreign operators. Their proposals shall be recorded in the Telecommunications Register to allow the Commission and the Committee to make comments. The Commission shall approve the proposal or request further information within 30 calendar days of the date of its receipt. Where the Commission requests further information from the long-distance service licensee, the Commission shall issue its decision within 15 calendar days of the date of receipt of the additional information.

**Rule 15.** The weighted average rates long-distance service licensees charge the public for the supply of international long-distance services may not be lower than the weighted average settlement rate for the specific service provided.

Notwithstanding the foregoing, the Commission reserves the right to issue any administrative provisions it deems appropriate in the event that rates established in accordance with this Rule are inconsistent with the objectives and conditions established by the Law for the supply of services.

**Rule 16.** International gateway operators that receive international incoming traffic shall charge their foreign correspondence the applicable settlement rate and shall pay the local operator that terminates the call the applicable interconnection rate.

Where an international gateway operator receives a greater share of incoming traffic than that to which it is entitled under the terms of subparagraph XIII of Rule 2, the said operator shall distribute the surplus to another international gateway operator so as to remain within the limits of its own percentage. In such cases, the operator concerned shall deduct any offsetting adjustments due to it for the supply of switching, routing, and accounting services at the international gateway and shall pay the remaining balance of the settlement rate to the international gateway operators to which it transfers the traffic in question. The latter operators shall, in turn, pay the applicable interconnection rate to the local operator that terminates the call.

**Rule 17.** International gateway operators may negotiate financial compensation agreements among themselves, according to the rights applicable to each of them, under the terms of the proportionate return system established in these Rules. Such agreements shall be duly notified to the Commission and shall meet the requirements of fair competition and non-discrimination.

**Rule 18.** International gateway operators shall pay the local operator having registered the destination number a percentage of the settlement rate in effect for incoming traffic, as determined in accordance with the applicable provisions.

**Rule 19.** After consulting with the parties and taking into consideration the average long-term incremental costs, as well as the trends in international references for interconnection rates and settlement rates for Mexico's traffic with its principal trading partners and the growth and development of the telecommunications market in Mexico, *inter alia*, the Commission may establish the offsetting adjustments to which international gateway operators are entitled for the supply of switching, routing, and accounting services for any excess international traffic they distribute pursuant to Rule 16. International gateway operators shall require payment of the above-mentioned offsetting adjustments, on a uniform and non-discriminatory basis, from all long-distance service licensees that request the said operators to supply the above-mentioned services.

**Rule 20.** International gateway operators that receive international incoming traffic or send outgoing collect-call traffic and that receive the corresponding settlement rate from their foreign correspondents shall have a period not exceeding ten working days as of the date of receipt of the said rate in which to make payment to the local operator pursuant to Rule 16. Such payment shall be made at the exchange rate in effect on the day the local operator is paid, in the currency in which the settlement rate is to be paid pursuant to the interconnection agreement concluded with the foreign correspondent and in accordance with applicable provisions. The local access rate shall be paid within the time-period agreed in the relevant contract.

If after 180 calendar days the international gateway operator has not received payment of the settlement rate from his foreign correspondent, the said international gateway operator shall be liable for immediate payment of the rate to the local operator in question.

**Rule 21.** Under the terms of Article 71 of the Law, the Ministry may penalize long-distance service licensees that commit acts intended to avoid paying the local operator for international interconnections, without prejudice to any civil and criminal liability incurred.

#### **Interconnection Agreements.**

**Rule 22.** Pursuant to Article 47 of the Law, the interconnection of public telecommunications networks with foreign networks shall be carried out by means of an agreement to be concluded by the parties concerned.

**Rule 23.** Long-distance service licensees wishing to establish interconnection agreements with foreign operators must submit the said agreements to the Commission for approval before they are formally concluded.

Such agreements shall comply with the following requirements. They shall:

- I. Expressly knowledge the authority of the Commission to approve all the terms of the said agreements;
- II. Recognize the principles of the uniform settlement rate and proportionate return systems established in these Rules;
- III. Stipulate that incoming and outgoing traffic may be carried only through international gateways previously authorized by the Commission;
- IV. Establish the last day of the calendar year as the date of expiry of the agreement;
- V. Establish the first five working days of each month as the period for making settlement payments;

- VI. Set the first day of each calendar month as the deadline for making adjustments in the percentages determined under the proportionate return system;
- VII. Provide mechanisms for automatic renewal and for the compulsory settlement of disputes that, in the Commission's view, avoid the potential interruption of traffic among interconnected operators;
- VIII. Incorporate the settlement rates approved by the Commission; and
- IX. Stipulate, where applicable, the geographical areas previously approved by the Commission in which the same settlement rate shall be applied.

Where a long-distance service licensee submits an interconnection agreement to the Commission, the latter shall have 15 calendar days from the receipt of the respective agreement to issue its decision, it is being understood that the international gateway operator that submits the interconnection agreement for the Commission's approval shall first sign a contract with the Auditor for the supply of professional services.

**Rule 24.** Any international interconnection agreement between a long-distance service licensee and a foreign operator shall be recorded in the Public Telecommunications Register. Long-distance service licensees that conclude international interconnection agreements with foreign operators shall have 15 calendar days from the date the agreement in question is concluded to submit it to the Commission, which shall record it in the Public Telecommunications Register.

#### **Contracts for the Supply of International Gateway Services**

**Rule 25.** In order to carry international switched-circuit traffic, long-distance service licensees shall either have an international gateway or shall enter into a contract with international gateway operators so that the latter may provide the long-distance licensees with international traffic switching, routing, and accounting services.

**Rule 26.** Long-distance service licensees that do not have an international gateway shall be responsible for interconnecting with one or more international gateway operators to handle their traffic, and for having owned or leased capacity in order to terminate the call at its final destination.

**Rule 27.** Long-distance service licensees that do not have an international gateway may negotiate financial compensation agreements with international gateway operators to carry the international traffic such licensees originate.

**Rule 28.** The contracts to which Rule 25 refers shall be approved in advance by the Commission.

If, at the conclusion of 30 calendar days from the submission of the request for approval of the contract, the Commission has not issued its decision, the contract shall be deemed to be approved.

Where the Commission determines that the terms established in the above-mentioned contracts do not comply with the principles established in the Law and in these Rules, it may request that the contracts be modified in any way it deems necessary.

**Rule 29.** Any contract for the supply of international traffic switching, routing, and accounting services between a long-distance service licensee and an international gateway operator shall be recorded in the Public Telecommunications Register. International gateway operators that enter into contracts with long-distance service licensees shall have a period of five working days from

the date the contract is concluded to file it with the Commission, which shall record it in the Public Telecommunications Register.

**Rule 30.** Any international gateway operator involved in a long-distance call shall be responsible for the quality of the service on its own network until the call reaches the network terminal connection point at which interconnection with the next licensee participating in the call is made. For this purpose, the international gateway operators and licensees participating in the call shall establish the necessary mechanisms and procedures to maintain the levels of quality agreed upon by the parties and provided for in their licences or permits.

#### **International Long-Distance Responsibilities of the Long-Distance Operators Committee**

**Rule 31.** The Committee shall have the following responsibilities, *inter alia*:

- I. To coordinate and oversee the implementation and operation of the uniform rate settlement and proportionate return systems;
- II. To inform the Commission of any irregularities detected in the implementation of the said systems that may affect the supply of international long-distance services;
- III. To hire the Auditor, subject to prior authorization by the Commission;
- IV. To propose to the Commission the adoption of measures for the efficient operation of international long-distance services and of the uniform settlement rate and proportionate return systems;
- V. To assist the satisfactory supply of international long-distance services; and
- VI. To propose to the Commission a structure and format to be followed for the monthly report that international gateway operators are required to submit to the Auditor for the purpose of complying with the procedure for implementation of the proportionate return system.

**Rule 32.** The Committee shall adopt by consensus the percentages for call attempts to which each international gateway operator is entitled under the procedure established in subparagraph XIII of Rule 2; if no consensus is reached, the Commission shall have the authority to request that the Auditor make a recommendation concerning the establishment of such percentages.

**Rule 33.** In the Committee, each long-distance service licensee shall have the right to express its opinion and may propose measures related to international long-distance services and to the uniform settlement rate and proportionate return systems.

Proposals meeting with the consensus of the long-distance service licensees shall be submitted to the Commission for its consideration. Where any proposal formulated fails to obtain the consensus of all long-distance service licensees, the procedure described in the Long-Distance Rules published in the *Diario Oficial de la Federación* of 21 June 1996 shall be followed.

Where, in the opinion of the Commission, a dispute needs to be settled within a time-period shorter than that provided for under the procedure described above, the Commission itself may settle the said dispute.

## Auditor

**Rule 34.** Subject to a favorable opinion by the Commission, the Committee shall hire an Auditor. The Auditor shall have a recognized reputation in the area of accounting and auditing in the telecommunications field.

The Auditor may not be a firm that is financially controlled by the long-distance service licensees represented on the Committee or by the partners or shareholders of the said licensees.

**Rule 35.** The Auditor shall have the following responsibilities, *inter alia*:

I. To recommend on a monthly basis, subject to consultation with the Committee and to the approval of the Commission, for each registered international gateway, and in accordance with available data on traffic, the percentages for the distribution of international incoming traffic to the various long-distance service licensees and of outgoing traffic to the various foreign operators. The percentage recommendations shall take into account call duration, time of day, type, and destination, as well as optimal routing of traffic;

II. To ensure that each international gateway operator applies its approved percentage;

III. To recommend, subject to consultation with the Committee and to the approval of the Commission, the accounting methodology to be applied to settlements with foreign operators, and to ensure that each international gateway operator applies the approved methodology;

IV. To define, subject to consultation with the Committee and the approval of the Commission, the information systems and formats to be used to transmit the information needed to implement and operate the proportionate return and uniform settlement rate systems;

V. To ensure that revenue from international traffic is distributed among long-distance service licensees and foreign operators in accordance with the uniform settlement rate and proportionate return systems;

VI. To inform the Committee and the Commission of any irregularities detected in the implementation of the said systems that affect the supply of international long-distance services;

VII. To reconcile the monthly information furnished to the Commission for that purpose by the international gateway operators with respect to the rights and duties arising from the calculation of proportionate returns, based on the methodology established in these Rules. This information shall be duly reported and confirmed by the external auditor of each international gateway operator; and

VIII. To fulfil other responsibilities that the Commission deems necessary for the full observance of these Rules.

**Rule 36.** The cost of hiring the Auditor shall be shared by all long-distance service licensees participating in the Committee, starting on the date each joins the Committee. The costs shall be shared in accordance with a formula specified by the Committee and approved by the Commission that assigns a portion of the total cost of operating the system to each licensee on the basis of the activities that generate the said costs. For this purpose, each licensee's share of the total amount of

international traffic and the number of international gateways operated by each licensee shall be taken into account, *inter alia*.

In the case of special audits of international gateway operators conducted on instructions from the Commission and arising from a dispute between international gateway operators or as the consequence of an irregularity detected by the Auditor, the costs shall be paid by the international gateway operator found liable for the irregularity or else by the operator(s) that requested the action that gave rise to the special audit if the claim of irregularity is found to be without merit.

### **Percentages**

**Rule 37.** The Committee shall determine the percentages for each international gateway operator applicable to the month following the month during which the traffic was originated and shall make such determination within the first 15 calendar days of the month following the month during which the traffic was originated, on the basis of the information furnished by the international gateway operators in accordance with Rule 42 of these Rules. Where the Committee fails to arrive at a recommendation by consensus within the aforementioned period, the Auditor shall have an additional several calendar days in which to recommend the percentages to be applied.

As of the first calendar day of the calendar month following the recommendation of the Committee or Auditor, as applicable, international gateway operators shall adjust the percentages by which international incoming and outgoing traffic is to be distributed.

**Rule 38.** In calculating the percentages to which the above Rule refers, all settlements for the types of traffic indicated in Rule 8(IV), except for country-direct services and services provided via international non-geographical reversed-charge (800) numbers, shall be taken into account.

In the case of collect-call traffic, for the calculation of the percentages applicable to international outgoing traffic, settlements for collect-call traffic originated abroad and terminated within Mexican territory shall be excluded. In calculating the percentages for international incoming traffic, settlements for collect-call traffic originated within Mexican territory and terminated abroad shall be excluded.

**Rule 39.** Traffic sent to a country with which Mexico does not share a border may be routed either directly or through an intermediate country. For the purposes of calculating the percentage arrangement in the latter case, the traffic in question shall be counted as if it were traffic destined for the intermediate country.

**Rule 40.** The proportionate return system established in these Rules may not be modified prior to the third anniversary of its entry into effect.

Notwithstanding the foregoing, after reviewing the competition and reciprocity conditions in effect for the operation of Mexico's telecommunications services with other countries, as well as the trends in international references for interconnection rates and settlement rates for Mexico's traffic with its principal trading partners and the growth and development of telecommunications markets in Mexico, the Commission may decide to modify the proportionate return system established in these Rules prior to the above-mentioned third anniversary.

### **Information**

**Rule 41.** Within the 15 calendar days following the end of each calendar month, and for each of the international gateways, the international gateway operators shall make the following information, *inter alia*, available to the Committee and the Commission:

- I. Incoming and outgoing traffic volume in minutes;
- II. Total revenue from incoming and outgoing calls; and
- III. Any other information that the Commission considers necessary and that Rule 8 indicates must be made available.

**Rule 42.** Within ten calendar days following the end of each calendar month, and for each of the international gateways, the international gateway operators shall make available to the Committee information on the settlement income and settlement payments for the calendar month in question that have been received from or made to their foreign correspondents.

**Rule 43.** International gateway operators shall establish the control mechanisms necessary to demonstrate the authenticity of the information they make available to the Committee and Commission, in accordance with criteria to be established by the Auditor.

**Rule 44.** Under the terms of Article 71 of the Law, the Ministry may penalize international gateway operators that commit any irregularity relating to the implementation or operation of the uniform settlement rate or proportionate return systems or that furnish false information concerning the operation of international gateways.

#### **Transitional Provisions**

**First.** These Rules shall enter into effect on the day following their publication in the *Diario Oficial de la Federación*.

**Second.** As of 1 January 1997, long-distance service licensees may carry international switched circuit traffic in accordance with the provisions of these Rules.

**Third.** International gateway operators that have not carried international traffic prior to the date of the entry into effect of these Rules may begin sharing in the distribution of international incoming traffic as of 1 January 1997.

**Fourth.** Within 15 days of the enactment of these Rules, the Commission shall make available to long-distance service licensees the settlement rates applicable to international traffic going out to or coming in from the various countries with which any long-distance service licensee has international interconnection agreements.

**Fifth.** Long-distance service licensees that have, prior to the date of enactment of these Rules, concluded interconnection agreements with foreign operators or entities of an international nature that carry traffic between Mexican territory and foreign countries, must file those agreements, as well as the settlement rates in effect, with the Commission so that they may be recorded in the Public Telecommunications Register. The licensee to which this provision refers shall have 15 calendar days from the entry into effect of these Rules to file these agreements and rates. The terms of the said agreements shall not contravene the provisions of these Rules.

**Sixth.** The Committee shall hire the Auditor responsible for auditing the uniform settlement rate and proportionate return systems within 15 calendar days of the entry into effect of these Rules. Where the Committee fails to hire the Auditor within that period of time, the Commission shall appoint an Auditor and shall determine the terms under which it shall be hired by the Committee.

**Seventh.** International gateway operators providing services during the month of January 1997, shall, for the first time, make available to the Committee and Commission the information to which Rules 41 and 42 refer, within the first 15 working days of February 1997. For international gateways that are not in operation during the month of January 1997, the said 15-day period shall begin on the first day of the calendar month immediately following the date on which the said international gateway commences operations.

**Eighth.** Prior to 14 February 1997, and on the basis of the information which the international gateway operators make available to the Committee under Transitional Provision Seven above, the Auditor shall establish the percentages applicable to the distribution of international incoming and outgoing traffic for the month of March 1997. These percentages shall be determined by the Auditor on the basis of information concerning international outgoing traffic generated during the month of January. For international gateways that are not in operation during the month of January 1997, the percentages shall be determined based on information concerning the calendar month following the commencement of operations of the said international gateway.

Mexico, D.F., 4 December 1996. Carlos Casasús López Hermosa, Chairman of the Federal Telecommunications Commission. Initialled.

Wednesday, 11 December 1996.

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