



## The Telmex Dispute at the WTO: Competition Makes a Backdoor Entry

– Sonali Singh\*

The settlement of disputes on competition cases at the World Trade Organisation (WTO) has long been thought implausible. However, lately, a WTO Dispute Settlement Panel has found that Mexico has not done enough to prevent anti-competitive practices in its market that impede the entry of foreign competitors. Though cases on competition have come up before the WTO earlier, it decided its first competition case only in this case at issue.

This case is based upon WTO rules agreed in 1997 to help open telecommunications markets. The rules in the WTO 'Reference Paper on Pro-competitive Regulatory Principles' are quite basic, obliging signatories merely to enact 'appropriate measures' to prevent 'major suppliers' from engaging in 'anti-competitive practices'.

The US-Mexico case is the first, and so far the only case of the dispute resolution on telecommunications services. That this dispute became the first to undergo the formal WTO dispute settlement mechanism was largely due to the economic significance of the trade concerned. The specific details of any case are unique, but this case stands out from the rest, inasmuch as the findings may have further implications.

### Background

On April 17, 2002, the Dispute Settlement Body of the WTO established a panel of three members, wherein the parties to the dispute agreed to have standard terms of reference. On August 26, 2002, the Director General composed a panel of three members with Ernst-Ulrich Petersmann as the chairman.

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.<sup>1</sup>

The panel submitted its interim report to the parties on November 21, 2003, followed by the final report on March 12, 2004.

### What Was the Dispute About?

In the mid-1990s, the US telecoms service provider Sprint partnered with Mexico's largest supplier of telecoms services, Telmex, to provide long-distance services between the two countries. Others like AT&T, MCI, etc. had to settle for deals and hence, could not benefit from Telmex's considerably large network. The resultant complaint before the WTO, at the US initiative, demanded

that the Mexican government should see to it that Telmex provides to these US firms with non-discriminatory access in accordance with the WTO Reference Paper on Telecoms<sup>2</sup>. Within a few months, the Mexican telecoms regulator Cofetel issued a set of regulations to Telmex, which ordered the latter to provide all foreign long-distance operators with access to its network, at reasonable costs. Not satisfied with this, the US, at the initiative of AT&T, referred this matter to the WTO's Dispute Settlement Body.

### The Allegations on Telmex

In February 2002, the US requested a WTO panel to address restrictions imposed by Mexico on international telecommunications services between the two countries. The US alleged that Mexico had failed to open its cross border telecommunications market as mandated by the General Agreement on Trade in Services (GATS) on the grounds that Mexico has:

- Not ensured that US carriers connect their calls to Mexico at reasonable rates, terms and conditions;
- Not ensured that US firms have reasonable and non-discriminatory access to and use of Mexico's telecom network;
- Not provided uniform treatment to US-owned commercial agencies;

- Not prevented Mexico's dominant carrier from engaging in anti-competitive practices;
- The access rates were not cost oriented. The US alleged that Mexico (Cofetel) has provided a single, dominant company with a government mandate to set excessive rates for international calls;
- Effectively set up a cartel of telecoms operators with Telmex as the ring leader;
- Overcharging US rivals; and
- Inhibiting foreign entry.

The US alleged that this was a state-authorized cartel benefiting Sprint and Telmex and harming their American rivals. The panel did not deny the US its complaint. Instead, it found a way of creating a WTO cartel ban using the principles in the Reference Paper on telecoms.

### **The Reference Paper**

Many governments recognised towards the end of the General Agreement on Tariffs and Trade (GATT) negotiations – liberalising trade in goods and services – that traditional trade laws were not enough to ensure that their markets became and remained competitive. More specifically with regard to the telecoms sector, the trade negotiators provided in the reference paper that WTO members should be required to ensure that their large incumbents provide sufficient entry points on satisfactory terms.

The approach in the Reference Paper followed some principles of competition and regulation for participants to consider binding in their basic telecommunications commitments, to protect and promote competition by requiring that, appropriate measures be maintained in order to ensure the elimination of anti-competitive practices.

57 WTO members, including the US, Mexico and the European Union (EU), committed themselves to the Reference Paper, which establishes disciplines on competition safeguards in the telecoms sector. Such safeguards include interconnection guarantees, transparent licensing, independence of regulators from telecoms operators, and fair allocation of resources such as frequencies, numbers, and rights of way. Telmex was providing these services in compliance with Mexico's international long distance (ILD) rules.

### **Findings of the Panel on Key Issues<sup>3</sup>**

The panel submitted its interim report to the parties on November 21, 2003, followed by the final report on March 12, 2004. The WTO panel made detailed findings on market definition, explained what constitutes a 'major supplier', and expanded the definition of 'anti-competitive practices'. The WTO panel filled in the gaps, on the following issues:

#### ***Telmex: A Major Supplier***

As per the Reference Paper, a major supplier is one that has the ability to materially affect the terms of participation in the relevant market for telecommunications services, as a result of control over essential facilities, or use of its position in the market. Telmex was then the largest carrier of outgoing calls for all markets.

Therefore, the panel found that Telmex was a 'major supplier' within the meaning of Mexico's Reference Paper, with respect to the service at issue. The finding is based on the ability of Telmex to affect the terms of participation through use of its position in the relevant market.

The panel found that Mexico had a special obligation to control such a 'major supplier' to ensure that it did not engage in anti-competitive practices. Telmex along with all the other Mexican gateway operators constituted a 'major supplier'.

#### ***The Relevant Market***

Applying the basic principles of US antitrust law and Mexican competition law, which define relevant market in terms of demand substitution<sup>4</sup>, the US argued that, the relevant market in this case was the termination of voice telephony, facsimile and circuit-switched data transmission services supplied cross border from the US to Mexico. Mexico however disagreed with this, contending that US calls terminating in the country could not be a separate market as, "Telmex completes international calls on a shared-revenue basis, under a traditional accounting rate regime, and the relevant market would have to include two-way traffic".

The panel had little doubt accepting the market definition submitted by the US. It expressly approved the American notion of demand substitution. Accordingly, the WTO panel found the 'relevant market' to be the termination in Mexico of calls from the US.

#### ***Telmex Enjoyed Market Power***

A firm has market power if it has the ability to profitably maintain prices above competitive levels for a significant period of time, which includes the ability to maintain prices well above costs, and protection against a rival's entry or expansion.

The US quoted the findings by Mexico's competition authority; that Telmex had substantial power in international services markets based on a market share of 74 percent in the international traffic, control of nearly 75 percent of international gateway capacity, and a right to set prices because of its large market share. However, the panel based its decisions purely on the empowering regulations, ruling that:

"Since, Telmex was legally required to negotiate settlement rates for the entire market for the termination of the

services at issue from the US, it had patently met the definitional requirement in Mexico's Reference Paper that it had the ability to materially affect the terms of participation, particularly with regard to price".

### ***Anti-competitive Practices***

The panel began by noting that the term 'anti-competitive practices' is not defined in Mexico's Reference Paper. Instead, it offers a non-exhaustive list of examples of anti-competitive practices, which include cross-subsidisation, using information obtained from competitors with anti-competitive results, and not making available, technical information about essential facilities to other service suppliers on a timely basis.

However, the panel turned to guides that other WTO panels have referred to in the past. Looking at the dictionary meanings of 'competition' and 'practices', the word 'anti-competition' in its relevant economic sense has been defined as 'tending to reduce or discourage competition'. The panel found that the meaning of 'anti-competitive practices' in some international instruments, particularly, Article 46 of the 1948 Havana Charter, which recognises 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 cartels and various other forms of collusive behavior is likewise emphasised in the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.

With the focus clearly on monopolistic conduct by a dominant incumbent, the panel found that the object and purpose of the Reference Paper commitments made by the members supports the conclusion that the term 'anti-competitive practices', in addition to the examples mentioned, includes market sharing agreements by suppliers, which on a national or international level, are generally discouraged or disallowed.

### ***Actions Required by a Member's Law can be 'Anti-competitive'***

On the subject, whether actions required by a member's law are anti-competitive, Mexico, US, and the European Communities put various arguments forward. The US argued that Telmex was operating a horizontal price fixing cartel, and such a practice could certainly not be taken to promote competition. With regard to this, the panel applied the principles of public international law, setting aside the state action doctrine. It held that international commitments made under the GATS for the purpose of preventing suppliers from engaging in, or continuing anti-competitive practices, are designed to limit the regulatory powers of the WTO members.

### **Box 1: WTO's Decision on Telmex: Fundamental Flaws Inherent?**

**According to Philip Marsden, noted trade and competition expert, the Telmex decision points to certain fundamental flaws in the WTO system, as stated below:**

- ◆ Panels are asked to interpret and clarify provisions about which they have little expertise. While they can call on experts to help them, most are reticent to do so.
- ◆ Panels are bound by the Dispute Settlement Undertaking, which prohibits them from adding to or diminishing the rights and obligations in the agreements, so that they do not upset the 'security and predictability' of the multilateral trading system.
- ◆ The panels' take to what they think is the safest route, turning to dictionaries to define key words. These are often terms of art, about which there is much debate.
- ◆ The panel report stated clearly that its findings apply solely to the specific case of Mexico brought before it.
- ◆ Although the parties claimed not to be satisfied with all aspects of the panels' findings, neither party elected to take the panel decision to the WTO Appellate Body. As a result, the WTO's Dispute Settlement Body adopted the panel report, by consensus.
- ◆ Some believe that the panel had been exceedingly weak in terms of economic and competition analysis of the matter at issue.
- ◆ The panel adopted a wide interpretation of what constitutes anti-competitive practices. It ruled that a cartel is a type of practice against which appropriate preventive measures should be maintained, although this is not explicitly mentioned in the reference paper.

*Source: Marsden (2004)*

Therefore, the panel concluded that acts required by governments could be 'anti-competitive practices' and can be prohibited by WTO rules.

The panel held that Mexico had violated its obligations under the Reference Paper by failing to contain 'anti-competitive practices' by a 'major supplier'. Subject to appeal, Mexico must bring its measures in conformity with WTO law by significantly revising or eliminating its current system.

### **The WTO Ruling**

This is the first ruling of a WTO dispute settlement panel based primarily on services and it proves that the GATS can be used to break open a public services monopoly.

The panel agreed with the US that the Mexican government failed to ensure that Telmex provided interconnection on cost-oriented terms to foreign service

suppliers as required under section 2.2 of the Reference Paper, and that, it provided Telmex with the monopoly power to negotiate the interconnection rate that foreign basic telecoms service suppliers must pay to their Mexican counterparts to connect their telephone calls in Mexico, in violation of section 1.1 of the Reference Paper<sup>5</sup>.

Whether Mexico was right or not, it deserved better than it actually got from the WTO. Some experts have found some fundamental flaws in the way the case has been handled (see Box 1). Some also expressed surprise with the fact that the WTO panel found it prudent to look at the United Nations Conference on Trade and Development (UNCTAD) Set and even the aborted Havana Charter for guidance, while completely ignoring the Mexican plea that the domestic players were allowed to coalesce to combat the predatory behaviour of the US giant.

The lesson learnt from the dispute is that, the dispute settlement bodies cannot responsibly tackle the problems of anti-competitive practices in a satisfactory manner. The panel had to grapple with the complex issue of private agreements and hybrid government-private arrangements as the new barriers to a liberalised marketplace, in a vacuum where international competition rules do not exist. The stretching of judicial creation runs the risk of undermining the legitimacy and integrity of the WTO.<sup>6</sup>

Mexico was not happy with the WTO ruling for obvious reasons. However, even the US was unhappy as the panel sided with Mexico regarding International Simple Resale (ISR) (use of leased lines to carry cross-border calls), since Mexico had not undertaken commitments on cross-border market provision of non-facilities based services. Nevertheless, instead of going for an appeal, they reached an agreement in early June 2004 to resolve their ongoing WTO dispute over international communication services. The agreement implements recommendations included in the WTO Panel report released on April 2, 2004 (see Box 2).

### Possible Implications

The United States Trade Representative, (USTR), an arm of the executive branch of the US government brought this issue before the WTO at the instance of AT&T and MCI. The USTR is responsible for the US international trade policy, at unilateral, bilateral, or multilateral levels. It may be noted that governments, and not companies have access to the dispute settlement mechanism of the WTO. A supplier has to convince its government to file a

### Box 2: The US-Mexico Agreement on Telmex

#### The Main Features of the Agreement Notified to the WTO Dispute Settlement Body are:

- ◆ Mexico will remove the provisions in its Law relating to the proportional return system, uniform tariff system, and the requirement that, the carrier with the greatest proportion of outgoing traffic to a country negotiate the settlement rate on behalf of all the Mexican carriers for that country. Both countries believe that the elimination of these provisions will allow the competitive commercial negotiations of international settlement rates.
- ◆ Mexico will allow the introduction of resale-based international telecommunications services in Mexico by 2005, in a manner consistent with Mexican law.
- ◆ The US recognises that Mexico will continue to restrict ISR to prevent the unauthorised carriage of telecommunications traffic.

*Source: WTO (2004)*

complaint even before the first formal consultative step takes place in the WTO framework.

Around this time, other telecommunications related disputes between WTO members had been under discussion for long, and one or two had nearly come to the WTO before being settled through purely bilateral channels. Moreover, disputes can be resolved through bilateral efforts, without resorting to formal WTO procedures, which are costly in terms of human resources and expert advice. Well-tried practices of private sector dispute resolution offer alternatives for dealing with conflicts between operating companies among developing countries.

Among other things, the USTR annually reviews the operation and effectiveness of the US telecommunications trade agreements pursuant to section 1337 of the Omnibus Trade and Competitiveness Act of 1988. As may be expected, the views of the USTR tend to reflect those of large American corporations. The purpose of the review is to determine whether any act, policy, or practice of a foreign country that has entered into a telecommunications-related agreement with the US is:

- Not in compliance with the terms of the agreement; or
- Otherwise denies, within the context of the agreement, mutually advantageous market opportunities to telecommunications products and services of US firms in that country.

Its review is based on public comments filed by interested parties. (See Box 3)

### Box 3: Summary of Findings from the USTR Annual Review, 2005

- Unjustifiably high fixed-to-mobile termination rates (the cost of interconnecting calls to wireless networks);
- Lack of reasonable access to leased lines and submarine cable capacity (including pricing and provisioning times); and
- Lack of an independent regulator to adequately address issues of effective market access in a number of countries.

Source: [http://www.ustr.gov/Trade\\_Sectors/Services/Telecom/Section\\_1377/Section\\_Index.html](http://www.ustr.gov/Trade_Sectors/Services/Telecom/Section_1377/Section_Index.html)

The USTR concluded that these issues raised concerns regarding practices in trade partners' telecommunications markets. As per the US perception, there are several other countries engaged in anti-competitive activities in various sectors of the economy, particularly with regard to the telecoms services. Australia, Germany, France, China, New Zealand, Singapore, and Switzerland are some other countries not adequately addressing the problems of excessive pricing, and lengthy provisioning time for the supply of leased lines to competitive suppliers of telecoms services. Among the major economies with high rates and no

regulatory intervention, Switzerland stands out. Given the fact that Switzerland's rates are among the highest in the region, a more active response by the regulator to address this issue appears warranted.

In fact, even India was cited for inadequately ensuring access to submarine cable capacity (See Box 4). These complaints relate to obligations undertaken in the GATS Telecommunications Annex requiring that WTO members, where they have specific service commitments, ensure that access to and use of public telecommunications networks and services, including leased lines, be provided on reasonable and non-discriminatory terms and conditions.

Finally, some commentators identified country-specific problems, including concerns that Mexico and South Africa have been slow in implementing WTO commitments specific to certain sectors. The Panel's findings clarify certain aspects of the GATS that are significant beyond the telecommunications sector such as electricity, transport services, and postal and courier services.

### Conclusion

Undertaking the GATS obligations has broad domestic policy implications. The GATS schedules are legally binding and enforceable treaty obligations. The Mexico case illustrates that undertaking and implementing the Reference Paper needs to be given considerable thought and effort, which seems to have been lacking in this case.

### Box 4: USTR's Allegations about the Indian Telecoms System

In the year 2004, the office of the USTR, received formal complaints regarding a longstanding problem in India; of its tolerance of actions by its dominant international carrier, Videsh Sanchar Nigam Ltd (VSNL), limiting the access to and use of submarine cable capacity it controls through its cable landing station. This raised concerns about India's compliance with its WTO obligations to ensure reasonable and non-discriminatory access to and use of its public telecommunications network. Given the rapidly growing demand for international bandwidth in India, to serve foreign and domestic telecommunications and other businesses, tolerating such restrictive practices hurts a broad range of domestic and international consumer and business interests.

Under the threat of regulatory intervention, VSNL has reportedly agreed to activate some of the

circuits under the dispute, freeing up capacity to meet some of the demand. However, in the absence of clear rules (e.g., on pricing and provisioning), ensuring a reasonable and non-discriminatory access to submarine cable capacity on a long-term basis remains problematic. VSNL has no incentive to allow competitors, (whose cable terminates at VSNL's landing station) to freely activate and market that capacity in India, when it could keep prices (and the market share) for its own services higher by limiting competitors' access to additional capacity.

Though no action has been taken against VSNL, USTR will continue to closely monitor this situation and encourage The Telecom Regulatory Authority of India (TRAI), India's telecoms regulator, to introduce long-term rules to prevent similar disputes from arising in future.

Source: [http://www.ustr.gov/Trade\\_Sectors/Services/Telecom/Section\\_1377/Section\\_Index.html](http://www.ustr.gov/Trade_Sectors/Services/Telecom/Section_1377/Section_Index.html)

The Reference Paper is a key element of the WTO framework for telecommunications services. While it leaves up to each member country the translation of guidelines into specific measures, the principles are quite clear, powerful, and ultimately, enforceable.

Multinational telecommunications companies take GATS seriously. They are well-informed of the rights and benefits to which the GATS entitle them. This case suggests that suppliers are likely to increasingly use GATS commitments to secure markets and pursue GATS benefits. Many developing countries indeed, undertake the GATS commitments in the hope of attracting foreign investment from such companies. Once having committed, however, countries will find it increasingly difficult to renege on their promises.

So, it is fair to say that problems like this one are not specific to the US or Mexico alone. Various other countries have been witnessing the same, but since a dispute of this nature went as high to the WTO, trepidation of such a repetition remains.

The decision of the WTO on the Telmex dispute really speaks for itself. Many weaknesses in reasoning and inadequate competition analysis have been identified. The WTO's legislative arm could offer more guidance on the objects and intended application of the competition provisions in the Reference Paper, but that is not likely to happen any time soon, and would also not help correct the dangerous precedent that the Telmex case sets.

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## Endnotes

- 1 Whenever a dispute arises between two parties, a third party whose interest (similar interest) is affected or is likely to be affected by the decision/judgement has a right to intervene or participate in the proceedings.
- 2 For the Reference Paper visit: [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/tel23\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm)
- 3 This section is based on WTO (2004) and Marsden (2004)
- 4 According to demand substitution, the substitution effect is the change in quantity demanded that results because any change in the price of a good is also a change relative to the prices of other goods that might act as substitutes.
- 5 "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"
- 6 Lee Kathy Y (2005) "The WTO Dispute Settlement and Anti-Competitive Practices: Lessons Learnt From Trade Disputes" The University of Oxford Centre for Competition Law and Policy Working Paper (L) 10/05 ([www.competition-law.ox.ac.uk/lawvle/users/ezrachia/CCLP%20L%2010-05.pdf](http://www.competition-law.ox.ac.uk/lawvle/users/ezrachia/CCLP%20L%2010-05.pdf))

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