



## The WTO *Telmex* Case – Implications for Vietnam

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In the dispute settlement system of the World Trade Organisation (WTO), there have been certain cases allegedly related to anticompetitive practices that impeded market access. The Mexico *Telmex* Case was, however, the first and so far the only competition case, derived from a claimed violation of the WTO competition provisions.

This briefing paper introduces WTO competition-related dispute settlements as background to analyse the Mexico *Telmex* Case and attempts to capture the potential implications of the WTO Panel's decision on Vietnam.

It argues that the regulations together with anticompetitive practices in Vietnam's telecommunication industry are inconsistent with the WTO law. If such regulations are not repealed or amended, then Vietnam might face a risk of becoming another WTO Member going into the Dispute Settlement Body (DSB).

### The WTO Dispute Settlement System

Disputes between Members of the WTO concerning their rights and obligations under the WTO agreements can be settled pursuant to the Understanding on Rules and Procedures Governing the Settlement of Disputes – called the Dispute Settlement Understanding (DSU). This dispute settlement mechanism plays a central role in clarifying and enforcing the WTO law, with a view to easing international trade.

However, until November 2006, out of the 352 disputes in the WTO dispute settlement system, there have indeed been only a few derived from and/or related to competition considerations, such as *Japan-Film*, *US-1916 Act*, *Argentina-Hide and Leather*, and especially Mexico *Telmex* Case.

### The Mexico *Telmex* Case

Prior to 1997, *Telmex*, the largest supplier of basic telecom services in Mexico supplied long-distance and international telecommunication services on a monopoly basis. Since 1997, Mexico had authorised multiple carriers to provide international services. At the time of the dispute, 27 carriers provided long-distance services in Mexico, of which 11 were international gateway operators, i.e. long-distance service licencees authorised by the Federal Telecommunications Commission (FTC) to operate a switching exchange as international gateway carrying incoming international calls and outgoing ones.

According to Mexico's Rules for the Supply of International Long-Distance Services (ILD Rules), all international gateway operators applied the same uniform settlement rate<sup>1</sup> to each ILD call, regardless of which

operator directed the call. The Mexican operator with the greatest market share of outgoing long-distance calls for each country was given the power to unilaterally negotiate the settlement rate with that country (it was always *Telmex*). Also, the ILD Rules stipulated a proportionate return system which required incoming calls from a foreign country to be distributed among Mexican operators in proportion to each operator's share of outgoing calls to that country.

The US telecommunication providers, AT&T and MCI, petitioned the US Trade Representative that they were overcharged and prevented from entering the Mexican market due to the price cartel led by *Telmex*.<sup>2</sup> The US then complained to the DSB. Basing itself on Mexico's Schedule of Specific Commitments, which incorporated the Reference Paper and the Annex on Telecommunications, the US raised three claims:

- Mexico's ILD Rules failed to ensure that *Telmex* provided interconnection to US basic telecommunication suppliers on a cross-border basis with cost-oriented, reasonable rates, terms and conditions. This was inconsistent with Mexico's obligations under Sections 2.1 and 2.2 of the Reference Paper and a violation of WTO pro-competitive provision;
- Mexico did not maintain measures preventing *Telmex* from engaging in anticompetitive practices. This was inconsistent with its obligations under Section 1.1 of the Reference Paper and a violation of WTO mandatory provisions preventing anticompetitive practices; and
- Mexico failed to ensure US basic telecommunication suppliers reasonable and non-discriminatory access, and use of public telecommunication services. This was

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inconsistent with its obligations under Sections 5(a) and (b) of the Annex on Telecommunications (Mexico's violation of WTO pro-competitive provision).

### **Did Mexico Fulfill its Commitments under Sec 2?**

In principle obligations under the Reference Paper related to interconnection applied to international calls terminating at the border. The Panel thus considered whether Mexico had fulfilled its commitment to provide interconnection with a major supplier at cost-oriented rates on two grounds namely: (i) whether *Telmex* was a major supplier; and (ii) whether *Telmex* provided interconnection with cost-based rates and reasonable terms and conditions.

The Reference Paper defines a major supplier as a supplier, which (i) has the ability to materially affect the terms of participation having regard to price and supply, (ii) in the relevant market for basic telecommunication services, and (iii) as a result of control over essential facilities or use of its position in the market. Applying the demand substitution test, the Panel found the relevant market to be the termination of calls in Mexico from the US.

Relating to *Telmex*'s ability to materially affect market power, by other than the use of competition factors, the Panel based itself purely on the empowering regulation. It held that because *Telmex* was legally required to negotiate settlement rates for the entire market for termination of calls from the US, it had the ability to materially affect the terms of participation, particularly with regard to price. Regarding the third requirement of the Reference Paper to determine a major supplier, the Panel merely stated that "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".

With regard to cost-oriented interconnection rates, the Panel first looked at the general meaning of the word to determine the cost-oriented rates. It then examined its special meaning for the telecommunication industry. Drawing upon International Telecommunication Union (ITU) recommendations, as well as the increasing and widespread use of the long run average incremental cost methodology among the WTO Members including Mexico, the Panel confirmed that the term 'cost-oriented' means cost incurred in providing the service. Besides, it took into account the transparent, reasonable, economically feasible, and sufficiently unbundled requirements in Section 2.2(b) of Mexico's Reference Paper. It then rejected Mexico's argument that rates should also include "the state of a WTO Member's telecommunication industry; the coverage and quality of its telecommunication network; and the return on investment," because all these were not relevant to determine a proper cost-oriented rate.

Because Mexico did not offer comments on the specific methods of evaluating costs and settlement charges presented by the US, nor taking up the Panel's invitation to submit its own calculations, the Panel, in accordance with the Article 11 of the DSU, examined the methods presented by the US. The Panel compared the *Telmex* negotiated interconnection rates with: (i) domestic prices in Mexico for the same network components (77 percent above); (ii) grey market rates for a variety of international

calls to Mexico (22 to 323 percent above); and (iii) termination rates on other international calls (48 percent to 667 percent above). Next, it examined the proportionate return procedures and financial compensation agreements among Mexican operators. The Panel thus held that *Telmex* interconnection rates were not cost-oriented. Mexico had, consequently, failed to fulfill its commitments under Section 2.2(b) of the Reference Paper.

### **Did Mexico Meet its Commitments under Sec 1?**

Regarding anticompetitive practices, Section 1.2 of the Reference Paper lists three anticompetitive practices. The anticompetitive practices... *shall include in particular*: (i) engaging in anticompetitive cross-subsidisation; (ii) using information obtained from competitors with anticompetitive results; and (iii) not making technical information about essential facilities and commercially relevant information available to other services suppliers on a timely basis. The Panel held that the definition of 'a major supplier' and the requirement in Section 1.1 of the Reference Paper to prevent a major supplier from engaging in or continuing anticompetitive practices also suggested that horizontal co-ordination of suppliers could be relevant.

The Panel considered the meaning of anticompetitive practices in the failed 1948 Havana Charter for an International Trade Organisation, the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of RBPs, the Organisation for Economic Cooperation and Development (OECD) Council Recommendation Concerning Effective Action Against Hardcore Cartels, the work of the WTO Working Group on the Interaction between Trade and Competition Policy, as well as the purpose of the Reference Paper, and then concluded that "the term 'anticompetitive practices', in addition to the examples mentioned in Section 1.2, includes horizontal price-fixing and market-sharing agreements by suppliers which are generally discouraged or disallowed".

Another issue raised was whether practices required under a Member's law could be anticompetitive. Article 27 of the Vienna Convention on the Law of Treaties states that "a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty", and the Appellate Body in the *US-Gasoline* case admitted that WTO law was not "to be read in clinical isolation from public international law".

Accordingly, the Panel found that the uniform settlement rate system, which was required by ILD Rules, negotiated by *Telmex* and applied by Mexico's all international gateway operators, had effects equivalent to those of a price-fixing cartel; and the proportionate return system, together with financial compensation agreements negotiated between Mexico's international gateway operators (led by *Telmex*), instead of actually transferring the excess call attempts among themselves, was similar to a market sharing agreement between suppliers.

Consequently, the practices of *Telmex* as a major supplier required by these two systems under the ILD Rules – the uniform settlement rate system and the proportionate return system – were anticompetitive practices within the meaning of Section 1 of Mexico's Reference Paper.

## Did Mexico Meet its Obligation under Sec 5 of GATT?

The Panel, on the basis of interconnection rates concluded that such rates were inconsistent with the provision of access to and use of public telecommunication transfer networks and services on reasonable terms and conditions. Mexico had, therefore, failed to meet its obligation under Section 5 (a) of the Annex on Telecommunications.

Relating to the issue of commercial presence in Mexico, the Panel found that Mexico made a commitment to allow commercial agencies through their own commercial presence to supply the services at issue, without any geographical or routing restriction. The establishment of commercial agencies was, however, subject to a permit requirement that could not be fulfilled because Mexico has not enacted the corresponding enabling regulations yet. US commercial agencies, who were thus prevented from establishing themselves in Mexico, were effectively denied access and use of the available private leased circuits.

Even if commercial agencies had been permitted to establish themselves in Mexico, they would have been prevented by the ILD Rules from interconnecting any private leased circuits to foreign public telecommunications transport networks and services. Accordingly, the Panel held that even though Mexico had violated commitment by effectively denying foreign suppliers permission to establish commercial agencies in Mexico, thus failing to ensure them access to private leased circuits and interconnection with public telecommunication networks and services as required by Section 5(b) of the Annex on Telecommunications.

## Implications for Vietnam

Vietnam applied for WTO membership on January 4, 1995 and signed its WTO Accession Protocol on December 7, 2006. According to its Schedule of Specific Commitments in Services, Vietnam commits to open its telecommunication services market, especially, it undertakes the obligations in the Reference Paper.

When Vietnam was not yet a WTO Member, the country signed the Bilateral Trade Agreement (BTA) with the US, based on the WTO principles and rules, and came into force in December 2001. According to Annexes F and G of the BTA, the WTO GATS Annex on Telecommunications (with the exception of Section 6 and 7) and Reference Paper are incorporated into the BTA. Under the BTA, Vietnam has promulgated many laws and regulations, which are consistent with WTO law. They include:

- The Ordinance No 43/2002/PL-UBTVQH10 dated May 25, 2002, on Posts and Telecommunications;
- The Decree No 160/2004/ND-CP dated September 03, 2004, setting forth detailed regulations on telecommunications for implementing the Ordinance on Posts and Telecommunications;
- The Ordinance No 40/2002/PL-UBTVQH10 dated May 10, 2002, on Price;
- The Prime Minister's Decision No 217/2003/QD-TTg dated October 27, 2003, on management of posts and telecommunications prices; and
- The Law No 27/2004/QH11 dated December 03, 2004, on Competition.

Thanks to the government's pro-competitive policy, new telecommunication service suppliers, such as Viettel, EVN Telecom, Saigon Postel, Hanoi Telecom, and Vishipel have joined the market. However, the state-owned VNPT is still the dominant player in the telecommunication industry. Complaints from both foreign and domestic suppliers have recently been raised. In a survey made by the US-Vietnam Trade Council on implementation of the BTA, US companies contended that Vietnam has not done enough in implementing its obligations under the BTA relating to the competition provisions, in particular:

- The international interconnection rates,<sup>4</sup> which Vietnam's major supplier, VNPT, charges US suppliers remain well above cost and that this is inconsistent with Section 2 of the Reference Paper.
- The cost of leased lines is high, particularly in the light of lower regional benchmarks, and which fails to ensure that foreign service suppliers can access and use leased lines on reasonable and non-discriminatory terms and conditions as stipulated in Section 5 of the Annex on Telecommunications.
- The independence of the regulator is not assured. US suppliers are concerned that Vietnam's Ministry of Posts and Telematics is not truly separate from VNPT, which can be contrary to Section 5 of the Reference Paper.

Regarding international interconnection rates, the Decision No 29/2005/QD-BBCVT of Minister of Posts and Telematics dated August 25, 2005, stipulated that target floor rate, i.e. minimum rate for international incoming interconnection rates via both Public Switched Telecommunications (PSTN) and Voice over Internet Protocol (VoIP) was 17 US cents/minute, and Vietnam's international telecommunication service suppliers were authorised to proactively negotiate rates with foreign suppliers provided that such rates were not lower than the target floor one. If any international telecommunication service supplier could receive incoming calls in an amount exceeding the distributed quota, it would have to pay additional interconnection rates for excess calls, which would resemble fines. However, if the aggregate of the incoming calls exceeded the total amount of quotas distributed, the excess amount was distributed to VNPT.

Although the Panel in the Mexico *Telmex* case admitted that the term 'anticompetitive practices' in the Reference Paper may be interpreted differently by different WTO Members from a competition perspective, the practices of VNPT together with those of Vietnam's other international incoming call service suppliers under the Decision No 29/2005/QD-BBCVT, have been anticompetitive practices like the practices of *Telmex* and Mexico's other international gateway operators under the uniform settlement rate and proportionate return systems of Mexico's ILD Rules.

On January 17, 2006, the Decision No 04/2006/QD-BBCVT was enacted to repeal the Decision No 29/2005/QD-BBCVT. According to this new decision, Vietnam's international incoming call service suppliers must notify the Ministry of Posts and Telematics of their floor rates which replaces the target floor rate previously stipulated. Further, if the quarterly amount of international incoming calls received by one supplier exceeds 39 percent of the

total amount of all international incoming calls in the corresponding quarter, that supplier must pay a fine of 17 US cents/minute for the excess amount to Vietnam Universal Telecommunications Service Fund.

At first glance, it is obvious that this new decision, in the context of the oligopoly in Vietnam's international telecommunication service supply does not change the competition in international incoming call market. Such regulations may ensure that the international interconnection rates that Vietnam's suppliers negotiate with and charge foreign suppliers will not be lower than 17 US cents/minute. Thus, they implicitly help Vietnamese suppliers to continue, and engage in a price cartel in international incoming call service, in which VNPT is the price-maker. As a result, high international incoming interconnection rates in Vietnam are maintained.

In practice, the rate to make a phone call from US to Vietnam is offered at around 10.4 US cents/minute, whereas Vietnam's target floor for international incoming interconnection rates (or fine for excess calls) is 17 US cents/minute (63 percent above). Since 1999, around 50 cases, in which violators transferred international incoming calls to Vietnam without interconnection with Vietnam's gateway operators, have been detected; and an estimated 20 percent of international incoming calls to Vietnam were made without interconnection with Vietnam's gateway operators.

Despite strong criticism against high international interconnection rates, there are also proponents, who argue that such high rates are used to fund investment in Vietnam's telecommunication infrastructure and universal telecommunication services. Such arguments are similar to ones that were used to criticise the Panel's analysis of cost-oriented rates in the Mexico *Telmex* case. For example, Mexico had the right to subsidise the cost of building and operating the public switched telecommunication network by higher international connection rates. It was noted that the only source of funding for achieving universal service was the revenue earned by *Telmex*, which alone was responsible for an obligation to serve the carrier of last resort. Contrary to such contention, the Panel did not disallow 'non-traffic-sensitive costs' or other 'common or sunk costs' in cost elements.

Accordingly, as in the Mexico *Telmex* case, Vietnam, to some extent, has not maintained appropriate measures for

the purpose of preventing suppliers, who alone or together, are a major supplier from engaging in or continuing with anticompetitive practices. This is also supported by the fact that many domestic suppliers have had concerns about the anticompetitive practices of VNPT in the domestic telecommunication market, which may violate not only the Ordinance on Posts and Telecommunications but also the Law on Competition.

Many unsettled disputes between Viettel and VNPT, or EVN Telecom and VNPT, from 2004 to 2006, related to interconnection. In all the cases, Viettel (or EVN Telecom) complained of VNPT's interconnection refusal, and/or VNPT's applying technical measures to hinder Viettel's (EVN Telecom's) services, which exemplify these concerns. Consequently, if these issues are not properly settled, US or other WTO Members after Vietnam's accession to the WTO may claim that Vietnam violates Section 5 of the Annex on Telecommunications.

## Conclusion

Studying and drawing lessons from the specific WTO dispute settlement cases are very necessary for Vietnam. From a competition perspective, in comparison to the Mexico *Telmex* it can be said that the Decision No 29/2005/QD-BBCVT, or even the recently enacted Decision No 04/2006/QD-BBCVT – together with other anticompetitive practices in Vietnam's telecommunication industry – are inconsistent with the WTO Reference Paper and Annex on Telecommunications. If these regulations are not repealed or amended, Vietnam will face a risk of having other WTO Members complain to the DSB in its WTO post accession period. It can also be deduced from the Mexico *Telmex* case that a lack of implementing rules and regulations cannot be used as an excuse to delay the effectiveness of market access commitments undertaken in the WTO Member's schedule.

The Panel in the Mexico *Telmex* case shows that domestic competition laws by themselves, without proper enforcement, are not appropriate measures for preventing anticompetitive practices. Vietnam should, therefore, firmly enforce its Law on Competition as well as other relevant regulatory provisions in order to establish free competition in the telecommunication industry and ensure compliance with the competition provisions in the Reference Paper and Annex on Telecommunications.

## Endnotes

- 1 A settlement rate is the rate which an international gateway operator charges a foreign operator for receiving a phone call from a foreign country, or a foreign operator charges an international gateway operator for receiving a phone call originating in Mexican territory to a foreign country.
- 2 The meaning of international interconnection rate is similar to one of incoming settlement rate in the Mexico *Telmex* case.
- 3 There are two ways to send phone calls, i.e. PSTN, and VoIP. PSTN is the classical telephony network. VoIP describes the process of sending phone calls over the Internet instead of directly through the PSTN.
- 4 Under the Official Letter No 1683/BBCVT-KHTC dated August 25, 2005, regarding international incoming calls via PSTN, VNPT, Viettel and VPT were permitted to receive 12 million minutes/month, 5 million minutes/month and 4.5 million minutes/month; distributed quotas for VoIP international incoming calls depended on suppliers' development of direct internet access points (POP).

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