



**A FRAMEWORK FOR IMPLEMENTING
THE WORLD TRADE ORGANIZATION
GENERAL AGREEMENT ON TRADE IN SERVICES
REFERENCE PAPER**

This document was prepared by a number of United States Telephone Association ("USTA") member local exchange companies to achieve a workable framework for implementing the General Agreement on Trade in Services Reference Paper.

ABOUT USTA

The mission of the United States Telephone Association is to promote the general welfare of the telephone industry, to collect and disseminate information relevant to the industry, and to provide a forum for the discussion and resolution of issues of mutual concern to our member companies.

In its 100th year, USTA is the largest network of local exchange carriers and telecommunication companies with more than 1,200 members worldwide.

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A FRAMEWORK FOR IMPLEMENTING THE GATS REFERENCE PAPER

Overview

Purpose

The World Trade Organization's (WTO's) Reference Paper on the General Agreement on Trade in Services (GATS) sets forth the definitions and principles on the regulatory framework for basic telecommunications services and the role and scope of the regulator. The Reference Paper did not bind nations to adopt the specifics of any country's regulatory structure. Rather, it committed them to creating an open regime to encourage the international flow of investment, to create a regulatory environment which would treat all players fairly, and to ensure that any social obligations are fairly distributed but flexible in their implementation approach.

The purpose of this paper is to provide additional clarification and assist countries in implementing the Reference Paper in a globally consistent manner. These implementation guidelines were developed by a large segment of the United States Telephone Association's (USTA's) local exchange member companies based on their experiences in the increasingly competitive telecommunications industry of the United States.

Contents

The Introduction provides the context for the paper and defines the role of the regulator. To be effective, the regulator must be independent; must safeguard competition; must foster a proper investment climate; must ensure seamless, any-to-any communications for users; and must ensure fulfillment of any social obligations.

Definitions are provided for these terms: users; essential facilities; and major suppliers.

Competitive Safeguard compliance procedures are required and the regulator should have the authority to ensure

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compliance. In addition, proprietary information must be protected, and technical and relevant commercial information must be disclosed to other suppliers as needed and on a timely basis.

Interconnection - It is essential for effective competition to ensure that customer access to long distance and other service providers is provided by the incumbent under non-discriminatory terms and conditions. This includes non-discriminatory technical standards and specifications, rates, quality, and end user access. Interconnection must be provisioned in a timely manner. The market should be allowed to set rates and regulatory intervention should be restricted to those situations when market forces are inadequate. A series of conditions are outlined to serve as guidelines if such intervention is required.

The paper also addresses the need for public availability of the procedures for interconnection negotiations; for transparency of interconnection arrangements; and for swift resolution of disputes by an independent arbiter.

Any Universal Service funding mechanism should be explicit, competitively neutral, and targeted to those who otherwise could not afford service.

License Approval or Denial should be accomplished through a process that is open to the public.

The Regulator must be independent from the incumbent and from short-term political considerations.

Allocation and Use of Scarce Resources, including frequency allocation, numbering, and rights of way, must be open and non-discriminatory.

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Introduction

The acceptance of the Reference Paper (in whole or in substantial part) by 65 World Trade Organization (“WTO”) member countries on February 15, 1997 has rightly been recognized as one of the most significant aspects of the landmark WTO agreement which extended the General Agreement on Trade in Services (“GATS”) to include basic telecommunications services. Its near-universal acceptance by the WTO member countries making market access commitments in the negotiations evidences the widespread recognition:

- that telecommunications competition in the long run is in the best interests of nations seeking to benefit from advances in communications and computing technology, and...
- that such commitments have little value unless competition between entrants and incumbents is based on principles of fair competition.

The definitions and principles on the regulatory framework for basic telecommunications services set forth in the Reference Paper also reflect a global consensus that simply lowering legal entry barriers to new foreign or domestic investors and total reliance on market forces are inadequate to make the transition to a workably competitive telecommunications sector. Experience from many nations demonstrates that an independent regulator is needed to ensure fair and transparent regulatory treatment of incumbents and new competitors to maximize societal benefits.

Different nations have taken different paths toward the goal of a competitive telecommunications sector. The purpose of the GATS agreement is not to force nations into one model or another, but rather to insure that, whichever path toward telecommunications competition is chosen by a nation, the regulatory structure should ensure that competitors achieve maximum benefits from a fair and open

playing field for all, and that, even in a competitive environment, the ability of citizens to communicate with each other is not impaired. To be successful, the following principles

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should govern the role and scope of an effective regulator:

- The regulator must be independent: Because the regulator must be a conflict resolver in the public interest, it cannot have either the appearance or the reality of a conflict of interest. Independence from the incumbent operator is part of this.
- The regulator must safeguard competition where it exists, and ensure a smooth and fair transition to competition where efficient competition is in the public interest, but does not yet exist. A key requirement for competition is the ability of market entrants to interconnect with an incumbent supplier on fair terms.
- The regulator must ensure seamless, any-to-any communications for users, regardless of the service provider or technology being employed.
- The regulator should ensure fulfillment of any social obligations in a competitively neutral way.

Above all, regulators should understand that the decisions they make send signals to investors. Pricing decisions affect opportunity assessments, and interconnection negotiations can be either accelerated or delayed by regulators. Regulators affect the investment climate by their effect on the level of risk and uncertainty.

Finally, there is no reason for regulation in a market that is completely open, has established principles of interconnection, and has a functional dispute resolution process. Competition, not perfect regulation, is the goal.

The Reference Paper of the GATS agreement did not bind nations to adopt the specifics of the US regulatory structure or of any other country's regulatory structure. Rather, it committed them to creating an open regime to encourage the international flow of investment, to create a regulatory environment which would treat all players fairly, and to ensure that any social obligations are fairly distributed but flexible in their implementation approach. The test of this is not in the form which regulatory structures take, but in the substance of what they do.

The Reference Paper establishes definitions and principles for these key requirements. The purpose of this paper is to provide additional clarification in order to assist in their global application in a consistent manner. This memorandum provides a section-by-section explanation of the Reference Paper, with each section of the Reference Paper printed in bold italicized text.

Definitions

Users mean service consumers and service suppliers.

Essential facilities mean facilities of a public telecommunications transport network or service that

- (a) are exclusively or predominately 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.**

Users: The inclusion of service suppliers as users recognizes that they are customers of network operators from which they buy transport and other telecommunications services. These types of users either resell, add value through the provision of processing or other capabilities, or create new services in combination with their own facilities.

Essential Facilities: Under US law, the essential facilities doctrine addresses a particular type of "refusal to deal" in violation of the Sherman Antitrust Act's prohibition on monopolization or attempts to monopolize. The doctrine applies when a firm (or group of firms acting as a consortium) possesses market power over a particular asset or scarce resource, access to which is imperative if efficient competitors are to engage in competition on the merits in a downstream (e.g., retail) market.

To be essential, the resource must be not just helpful, but necessary to survival of efficient competitors that can improve the competitive process in a

downstream market. Essential facilities have been defined in a number of ways by the courts and in the legal literature. For example, in *MCI v AT&T* (MCI v AT&T 708F.2nd 1081 at 1132), the

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court determined that a plaintiff must prove:

1. control of the essential facility by a monopolist.
2. a competitor's inability to practically or reasonably duplicate the essential facility.
3. the denial of the use of the facility to a competitor.
4. the feasibility of providing the facility.

Another possible definition of essential facility, compiled from several court rulings, would require that:

1. the entrant cannot operate effectively without the resource; and
2. an alternative to the desired facility is not available and the facility cannot be practically or reasonably duplicated.

Major Suppliers: Major suppliers are those entities which are in a position to exercise market power in a relevant market, either as a result of their control of essential facilities, or as shown by their ability to raise price and restrict output in a relevant market. Market shares, by themselves, are not the sole determining factor of whether a firm possesses market power, and other factors such as demand and supply elasticities, conditions of entry, existence of competition and effective regulation, and other market conditions, must be examined to define a relevant market and determine whether a particular firm can exercise market power.

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 anticompetitive practices referred to above shall include in particular:

- (a) engaging in anticompetitive cross-subsidization.

Preventing Anticompetitive Cross-Subsidization: Cross-subsidization requires that one service is sold at a price well above cost in order to support the pricing

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of a second service below cost. There are two areas of concern around cross subsidies. One involves increasing the prices of products and services to customers of monopoly services while lowering prices for competitive services below cost. Merely lowering the prices of competitive services while raising prices of less competitive services does not constitute anticompetitive behavior. This can be a way of retaining revenue neutrality as rates are realigned between long distance and local services to more closely reflect underlying costs. It can also take a geographic dimension between contested urban markets and less contested or uncontested rural markets. But there must be monopoly power present for anticompetitive cross-subsidy to be sustained.

A variety of tools have been used to address the issue of cross-subsidization. In the case of service offerings, both structural and accounting separation have been used. In the case of geographic cross-subsidy, many nations have retained a requirement of geographic rate averaging for "major suppliers." Whichever approach is chosen, compliance procedures are required, and this means that the regulator should have the authority to compel the provision of data as it deems necessary, and to conduct periodic audits.

(b) using information obtained from competitors with anti-competitive results.

Protecting Proprietary Information: Every operator should be required to treat as proprietary all information obtained from other operators as a result of the necessary sharing of information needed to achieve interconnection. Protection should be afforded to all information, such as competitors' business and marketing plans, trunking configurations, peak usage, network architecture, and equipment types, obtained through the provision of facilities to unaffiliated operators.

c) not making available to other service suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide service.

The Timely Disclosure of Technical and Commercial Information: Major suppliers are required to make timely disclosure of the technical and other relevant commercial information that other suppliers need to provide services. For example, all information affecting the provisioning of interconnection and numbering arrangements should be made available in sufficient

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detail and with sufficient lead time to allow adequate time to complete any required network modifications.

2. Interconnection

2.1 This section applies 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, where specific commitments are undertaken.

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 favorable than that provided for [the major supplier's] own like services or for the like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;

Non-Discriminatory Terms and Conditions for Interconnection at any Technically Feasible Point in the Network: In most countries, absent alternative local network suppliers of call origination services, the major supplier controls ubiquitous network infrastructure and is the primary means by which providers of long distance and other services will be accessed by end users. Ensuring that customer access to long distance and other service providers is provided by the incumbent under non-discriminatory terms and conditions is essential to ensure full and fair competition.

The obligation of major suppliers to allow other suppliers to interconnect "at any technically feasible point in the network" means that interconnection pertains to facilities required to permit another carrier to connect to the incumbent's network. "Technical feasibility" should also take into account efficiency concerns, so that competitive rivals cannot raise an incumbent supplier's costs by insisting on difficult (but feasible) interconnection arrangements at noncompensatory rates.

Non-Discriminatory Technical Standards and Specifications :

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The technical ability to interconnect under non-discriminatory terms and conditions requires interoperability among networks implemented through published, standardized, open interfaces which make available the same functionality to the traffic of the entrant as to the traffic of the major supplier.

Non-Discriminatory Rates: Rates charged for interconnection for all similarly situated operators should be the same, including the major supplier's affiliates and subsidiaries. Similarly, the principle of non-discrimination requires that the same rates apply to all equivalent interconnection arrangements irrespective of the type of service that the interconnecting operator offers or the nature of the interconnecting operator.

Non-Discriminatory Quality: The quality of interconnection should conform with all the conditions of technical/operational quality and reliability established by standards bodies, including routing and peak load capacity as would be provided by the major supplier to its own traffic, unless specific variations are mutually agreed.

Non-Discriminatory End-User Access: Allowing users of one supplier to communicate seamlessly with users of another supplier requires that numbering and dialing procedures be managed on a non-discriminatory basis. Numbering arrangements must allow all existing or potential users to seamlessly communicate with other users regardless of the identity or technology used by their local supplier or intermediate suppliers.

(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 service to be provided; and

The Timely Provision of Interconnection: Major suppliers have the opportunity to delay the provision of interconnection to other suppliers, which can significantly inhibit the development of competition. To avoid this, a strict timetable should be established for the progress of negotiations.

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Cost-Oriented Rates: In rate-setting, the regulatory principle should be to let the market set rates to the maximum extent possible, and restrict regulatory intervention to those situations when market forces are inadequate. When competition is initially made possible in a telecommunications market (e.g., the local exchange market), regulation should provide neither entrants nor the major supplier any net advantage on an on-going basis. Further, when competitive forces effectively constrain the prices, regulation of those prices is no longer useful and should be curtailed or eliminated.

As long as the following conditions are met, the major suppliers should be free to establish rate structures that correspond to cost causation principles and market conditions (e.g., consumer demand, competition) without further regulatory encumbrances on prices:

1. Regulation should result in prices that are subsidy-free; are non-predatory, but not in a way that impedes the legitimate competitive responses of the firms operating in the market; are not unreasonably discriminatory; and that are sustainable in the marketplace by recognizing competitive pressures, cost conditions, consumer preferences, and other determinants of sustainable prices.

2. Regulation should prevent monopoly pricing of services that are vested in the public interest, and for which a telecommunications carrier would have significant market power in the absence of regulation. Wholesale and retail customers without alternatives to such services should be protected from unreasonably high rates for these services.

3. In markets in which there is competitive entry in some geographic segments of the market, but not all, two principles should apply: the prevention of monopoly pricing in market segments for which there are no substitutes to a service that is vested in the public interest; and pricing freedom leading to competitive parity, in terms of regulatory requirements, for the firms operating in those market segments where alternatives exist.

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4. Pricing rules should be designed to foster the competitive process itself, not to advantage or disadvantage any group of competitors. Pricing rules should allow flexibility. They should allow the legitimate competitive responses of existing carriers in markets where competitive entry occurs. Pricing flexibility is an important component of the competitive process, and by its existence, fosters entry by efficient firms equipped to compete with existing carriers on price and other product, quality, or market characteristics.

5. The pricing of retail services that are optional, but for which there are few or no substitutes should be given wide latitude in pricing. In this case, the market itself should reasonably be expected to police the exercise of market power, and there is little or no need for regulation of the upper limits of prices of such services.

6. The pricing of wholesale inputs should be based on pricing rules which provide the correct pricing signals to prospective entrants and which ensure that efficient entry and investment in infrastructure are encouraged properly. This can be achieved using a pricing rule such as the well-known Efficient Component Pricing Rule (ECPR), which considers all direct unit costs as well as opportunity cost (the cost of foregone alternatives), or modifications thereof. Any pricing rule should result in full cost recovery.

Unbundling: The term unbundling can be associated with the pricing of a network as well as the disaggregation of a network into separate elements. The pricing aspect refers to a requirement that the firm establish separate prices for components of upstream services, rather than offering only one bundled price for the total service, thereby making the unbundled components available to firms with which they compete in downstream markets. This removes the burden of purchasing unneeded or redundant features. It also protects against the risk of anticompetitive "tie in" sales. The second aspect refers to making specific components of a

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network available, which would allow a user to recombine these network elements as needed to offer a service. Finally, unbundling does not preclude the firm from also offering bundled service packages, or from engaging in joint marketing efforts.

(c) Upon request, at points in addition to the network termination points offered to the majority of interconnectors, subject to charges that reflect the cost of construction of necessary additional facilities.

Any customized interconnection which is directed by regulators or negotiated by the parties should be charged at rates which fully compensate the interconnectors for the costs involved.

2.3 Public availability of the procedures for interconnection negotiations.

The procedures applicable for interconnection to a major supplier will be made publicly available.

The Public Availability of Interconnection Procedures: The process by which interconnection agreements are reached must be clearly specified so that all parties know their rights and responsibilities in establishing interconnection. This includes time frames to reach agreements, response times for information requests, arbitration rules, and appeal procedures.

Governments are advised to consider the use of industry workshops, conducted under the auspices of the independent regulator, to establish a standard industry-wide approach to technical and commercial terms for interconnection. Such workshops have proven successful in individual states in the United States, as well as in the United Kingdom.

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.

The public availability of all prices, terms and conditions for interconnection to the networks and services of the major supplier promotes non-discriminatory treatment. However, proprietary information provided in the course of arriving at

interconnection agreements should receive a particularly high degree of protection against unauthorized disclosure, with strong associated penalties.

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 time period which has been made publicly known, before an independent domestic body, which may be a regulatory body as referred to in paragraph 5 below, 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.

Recourse to Dispute Settlement: Swift resolution of disputes by an independent arbiter are essential to ensure that a new entrant is not held hostage to unreasonable delays in interconnection by the incumbent.

The Need for an Independent Regulator: Especially in nations where courts do not have a customary or timely means of dispute settlement, an independent regulatory body is essential. The regulator should be authorized to collect data, intervene at its own initiative, and have defined responsibilities to act in the best interest of consumers and competition. It should also be empowered to impose sanctions where appropriate, and after due process, recommend the revocation of licenses. The regulator's role should be well defined with explicit restrictions on the extent of its authority so that competition, not regulation, controls the market.

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 anticompetitive 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.

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The most effective policies for ensuring that social obligations are met are those which drive down the costs of providing service. The forces of competition, by encouraging operators to adopt new wireline and wireless technologies, are a significant positive factor. Other policy tools include the use of incentive regulation such as price caps (which serve the dual purpose of encouraging cost reductions by the established operator as well as protecting against transitional abuse of market power).

Any universal service obligation should cover only the shortfall between: (1) what a targeted user or group of users can afford to pay to maintain the policy goals of universal service subscribership; and (2) the rates for services subject to universal service support that would have to be charged to cover costs and provide contribution to overhead for the firm providing service.

Any universal service funding mechanism should be competitively neutral, affording no competitive advantage to any service provider; should be targeted towards those who otherwise could not afford to subscribe to telephone service; and encourage the efficient provision of services. No universal service funding mechanism should exhibit biases in either paying into the fund or drawing from it.

Mechanisms to provide universal service that are sustainable in a monopoly environment are not suitable in a competitive environment. In particular, implicit support mechanisms to fund universal service should not be established. Existing implicit mechanisms should be phased out through a rebalancing program. All universal service obligations should be funded through explicit mechanisms.

4. Public availability of licensing criteria

Where a license 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 license and***
- (b) the terms and conditions of individual licenses.***

The reasons for the denial of a license will be made known to the applicant upon request.

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In order to guard against arbitrary issuance or denial of licenses, an open process is required, including publication of all the criteria to be considered in the licensing decision, the evaluation process itself, and the period of time required to reach a decision. The approval or denial of a license should be accompanied by a written, public decision with a statement of the reasons for the choice of successful applicants, as well as reasons for denial of license applications.

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions and the procedures used by regulators shall be impartial with respect to all market participants.

An Independent Regulator: Because the regulator must be a conflict resolver in the public interest, it is critical that there be neither the reality nor the appearance of a conflict of interest. While independence from the incumbent is clearly needed to avoid conflicts of interest with a major player in the market, independence from government is less obvious.

Clearly, any regulatory body will be a governmental organization. Its legal status will differ depending on the different national legal and constitutional structures. But what is needed in every case is clear authority and associated enforcement powers so that the principles of open access and unbiased decisions should not be unduly compromised by short-term political considerations. A clear set of stable and defined responsibilities and procedures should be established, which serves as a standard for policy and procedures. If this exists, it is less material whether the regulatory body sits under a Ministry (e.g. as in India) or is an independent body (e.g. as in the US or UK.).

Ensuring economic investment signals: Despite the requirement of the reference paper that there be impartiality among operators, the actions taken by regulators inevitably provide entry signals to investors, and therefore should be taken with this in mind. For example, if prices are kept artificially low in a particular market, entry will not be attractive to firms,

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and investment will not occur there. Instead, investment will be aimed at more lucrative markets or be directed into other countries. Similarly, a price set for an input such as interconnection will define incentives for efficient investment in infrastructure. Correct prices for essential inputs encourage efficient entrants, discourage inefficient ones, and provide the correct pricing signals for investment incentives. Overly high prices for inputs discourage even efficient entrants and dampen proper incentives to invest in infrastructure. Unduly low prices for inputs encourage entry by firms that will not invest in their own facilities, and crowd out demand that could be met by firms that have incentives to invest in infrastructure.

6. Allocation and use of scarce resources

Any procedure 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.

Frequency allocation: The right to use spectrum for public or private services should be granted under the same open process as any other license.

Numbering: The numbering system is a critical part of the ability of users to "find and be found." If this ability is impaired, the overriding public interest in a seamless "any-to-any" network will be sacrificed. Numbering resources should be administered in a fair and non-discriminatory manner with numbering policies developed by a neutral body whose composition includes representatives from all segments of the telecommunications industry.

Rights of way: In most cases, when national telephone operators built their systems, they did so as a government agency. This gave them access to public and private land on terms and conditions that private operators would not normally obtain. But the inability of new entrants to get access to tower sites, public way-leaves and footpaths, building access, and poles can be a major impediment to competition. Regulators must take steps to ensure that these legacies of government monopoly do

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not prevent the deployment of new networks by giving all licensed operators non-discriminatory access to public rights of way.

Control over private rights of way which satisfy the criteria to be designated an "essential facility" should not be allowed to become a barrier to new competition. New suppliers should be assured fair access to rights of way controlled by major suppliers at reasonable terms and conditions. And access to private property for the development of new rights of way should be obtained through private negotiation.