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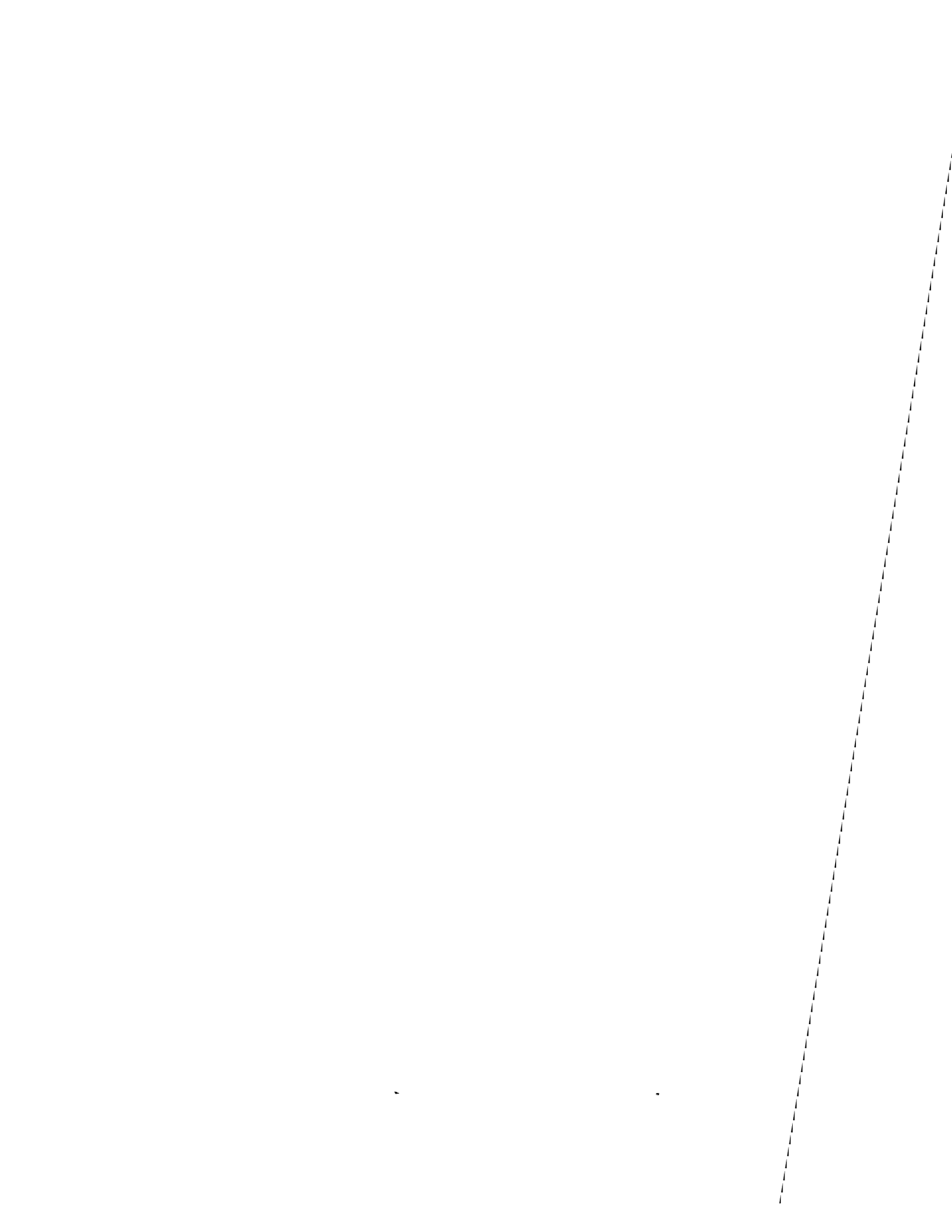

INTERNATIONAL TELECOMMUNICATIONS ALLIANCES AND FOREIGN DIRECT INVESTMENT AS MEANS OF GLOBALIZATION: LEGAL AND REGULATORY RESPONSES TO THE EMERGENCE OF SUPER CARRIERS

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"Quod scripsi sub specie universitatis – sapienti satis"

(" What is written from a universal perspective does not require comments)

- Spinoza, *Ethics*, 2,44 – 5,31

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ABBREVIATIONS AND ACRONYMS

AT&T	AMERICAN TELEPHONE AND TELEGRAPH
BT	BRITISH TELECOM
DT	DUETSCHE TELEKOM
EC	EUROPEAN COMMISSION
FCC	FEDERAL COMMUNICATIONS COMMISSION
FDI	FOREIGN DIRECT INVESTMENT
FT	FRANCE TELECOM
GATS	GENERAL AGREEMENT ON TRADE IN SERVICES
ITAs	INTERNATIONAL TELCOMMUNICATIONS ALLIANCES
ITU	INTERNATIONAL TELECOMMUNICATIONS UNION
JVs	JOINT VENTURES
MNEs	MULTINATIONAL ENTERPRISES
MTFs	MULTINATIONAL TELECOMMUNICATIONS FIRMS
NTT	NIPPON TELEPHONE AND TELEGRAPH
OFTEL	OFFICE OF TELECOMMUNICATIONS
O-L-I	J.H. DUNNING'S CONFIGURATION OF OWNERSHIP-, LOCATION- AND INTERNALIZATION-ADVANTAGES
PTO	PUBLIC TELEPHONE OPERATOR
PSTN	PUBLIC SWITCHED TELECOMMUNICATIONS NETWORK
RBOCs	REGIONAL BELL OPERATING COMPANIES
WTO	WORLD TRADE ORGANIZATION

RÉSUMÉ

Nous assistons depuis peu à l'émergence d'un phénomène qui augmente la vitesse de déréglementation, le libéralisation des échanges et les mutations du droit de la concurrence. Ce phénomène est l'interaction croissante entre les « transporteurs » de télécommunications, qui conduit à la formation d'alliances globales. A l'échelle mondiale, cette interaction s'étend également aux compagnies spécialisées dans l'informatique et la radiodiffusion.

D'ores et déjà, il est possible de prédire que cette soudaine révolution technologique aura pour conséquence probable l'intégration et la convergence progressives des télécommunications avec d'autres segments de l'industrie des communications. Bien que les télécommunications aient récemment fait l'objet d'une certaine déréglementation, leur intégration avec l'informatique et la radiodiffusion engendrera immanquablement des problèmes en matière de réglementation. Cela est surtout dû au fait que les compagnies spécialisées en informatique ne se sont jamais fait imposer de sévères restrictions, contrairement à la radiodiffusion et, dans une certaine mesure, aux télécommunications qui, toutes deux, étaient depuis longtemps soumises à un certain contrôle visant notamment à les rendre conformes aux exigences de « contenu national ».

Les alliances entre les divers acteurs de ce secteur d'activite donc créer un environnement dans lequel une réglementation propre à chaque secteur ne seru plus necessaument solution appropriée dans ce contexte où la tendance est à la convergence. A cet egard, certaines alliances internationales de télécommunications feront l'objet d'une attention particulière. La présente étude passera en revue différents modèles corporatifs, qu'elle situera dans l'évolution historique de l'émergence de nouvelles structures corporatives et de leur traitement en droit.

Elle traitera ensuite de stratégies internationales corporatives dans le but d'identifier les facteurs déterminants, en terme d'investissement direct étranger, qui ont incité les firmes de télécommunications à internationaliser leurs activités. Le but de cette étude est de suggérer un cadre analytique permettant aux législateurs d'aborder cette nouvelle situation qui emerge à un niveau international.

ABSTRACT

An emerging phenomenon, which anticipates deregulation, liberalization of trade, and changes in competition law, is the increasing interaction among telecommunications carriers resulting in the formation of global alliances. These global alliances—on a larger scale—also involve broadcasting and computing companies that have been regulated in a totally different fashion. A likely consequence of this sweeping technological revolution is that telecommunications will gradually integrate and converge with these segments of the communications industry.

As part of this all-service-convergence trend, a number of key international telecommunications alliances (henceforth ITAs) are scrutinized. The thesis begins by canvassing leading business-organization theories that attempt to account for the emergence of ITAs. The first part concludes with the proposal of a multi-causal approach and the description of ITAs as hybrid organizations. The second part of the thesis canvasses legal responses to the emergence of ITAs and evaluates the institutional capacity of existing regulatory mechanisms. The goal of this study is to produce an analytical framework for how this newly globalized industry should be treated by legislators and policy-makers.

INTRODUCTION

The purpose of this thesis is to give an account of the emergence of international telecommunications alliances (ITAs) and to assess legal and regulatory responses. I have adopted a framework of analysis for international telecommunications alliances consisting of three topical pillars: (a) corporate form, (b) explanatory theories, and (c) legal and regulatory implications. I present these three pillars in light of advances in technology, increasing liberalization of trade, new service demands from users, and growth in foreign investment. Telecommunications is here treated as a field in which law, economics, business theory and technologies all interlock.

Thesis and Methodology

The legal and regulatory environment, as well as the organizational structure of corporations have been adapting to the emergence of ITAs, which have induced a number of significant interrelated changes in business practice. Corporate hierarchies, international marketing strategies, and, ultimately, the capacity of domestic regulators to police transactions are all dramatically affected by ITAs. This phenomenon requires a multidisciplinary approach bridging the fields of business law and business organization theory.

I will argue that the changes in the organizational structure of international telecom firms are contingent upon the degree of international regulatory liberalization. Simultaneously, however, international regulatory liberalization hinges upon the evolution of new corporate structures which, in fact, are prerequisite for the emergence of ITAs. In short, there is a feedback mechanism between legal and corporate change, although the principal driver of change is business strategy. Furthermore, it is my hypothesis that the new breed of global telecom alliances provides an excellent example of more widespread

developments in the corporate structure and strategy.[1]

Arguably, this novel organizational specimen, the ITA, appears to be an offspring of repeatedly occurring variations of other globalized corporate structures. Therefore, an important challenge for this thesis is to identify what is distinctive about ITAs. I examine a set of "corporate hybrids" that includes the yet to be fully developed forms of global alliances. An account of hybridization reveals how traditional corporate relations are being altered within the evolving institutional structures that serve global markets.

To identify ITAs as corporate hybrids suggests either that they instantiate an entirely new corporate model for forging global partnerships or that they exemplify an intermediary structure on the organizational continuum ranging from straightforward mergers through full-blown joint ventures to hubs of strategically formulated contractual agreements. I will seek to compare the latter traditional modes of corporate organization with ITAs focusing on two sets of changes in the business environment: (a) growth in technology- and client/demand-driven investment [chapter 2] and (b) deregulatory trends and increasing international competition [chapter 3]. By isolating these dynamics from other changes in the business environment, I will identify key factors that promote the formation of strategic alliances in telecommunications.

Having identified these factors, I will (a) compare the modes of corporate governance structure and partnering strategies of ITAs with those of traditional corporate organizations and (b) assess the legal and business consequences of various ownership and control arrangements within ITAs. However, this study does not purport to explain fully the forces driving the formation of ITAs. Nor

[1] This is not to say that the ITAs are the first global alliances in the realm of organizational corporate structures. They are, however, the most complex ones because they involve service-provision alliances that are different in many aspects from, say, manufacturing alliances. National carriers, which in most cases have been entering international markets from a 'quasi' monopoly position in their local market, have a stronger bargaining power and therefore, much more to offer to their prospective partners. Thus, it seems highly desirable for competitive carriers to form alliances with the non-competitive ones. In a not yet fully liberalized marketplace, such a partnership will out-balance any disparities in partners' bargaining power and afford competitive players a "first entrance" advantage aside from reaping economies of scope and scale.

does it claim to identify an optimal "fit" between the legal and business structures of ITAs, let alone propose a method for reducing the nature of business and the transaction costs through ITA formation.

In the second chapter, I will focus on describing the complexity of ITA architectures [as well as the occasionally intractable inter-company relationships to which they give rise]. I will not attempt to evaluate whether in creating these linkages ITAs are actually achieving an "optimal" organizational and business structure. Nevertheless, the fact that ITAs are arising suggests that they are viewed by managers as an efficient response to change.

Since most of the literature on cross-border partnerships has focused on joint ventures (henceforth JVs), I shall use the models explaining JV strategies to help interpret the new infra-organizational architectures of ITAs. Because through the early 1980s virtually all, and subsequently most international partnerships followed the joint-venture paradigm, ITAs share a number of similarities with JVs, though they also differ significantly.

Summary of Chapters:

Chapter 1 presents a study of ITAs as being representative of diversified corporate structures that were borrowed from traditional patterns of alliance and implemented by telecom companies through both equity and non-equity commitments. The study of these diverse forms of ITAs and their distinct characteristics provide the first "pillar" of the analysis: a taxonomy of inter-firm relationships within which ITAs can be located.

Chapter 2 provides the second pillar of analysis by addressing explanatory theories that help to account for ITAs. The primary focus is the applicability of theories of corporate behavior to the telecommunications industry, with an ancillary examination of some of the major factors governing the emergence of ITAs. From the theoretical literature that accepts JVs as the

model, the most useful theories for understanding ITA formation are:

1. Transaction Cost Economics (Williamson, 1975)
2. Organizational Theory
3. Competitive Advantage Theory (Porter, 1990)

The literature review leads to a discussion of how the phenomenon of ITAs is clearly distinct from other multinational and transnational enterprises. Based on theories of strategic investment, this analysis reveals how specific investment strategies and changes in corporate culture can influence the business decisions of telecom providers to expand into international markets. I will assess investment patterns and branching-out strategies, using the example of leading telecommunications firms. Linking the second chapter's findings on corporate structure with these explanatory theories, I show how telecommunications companies achieve a higher degree of service internationalization by means of ITAs.

Although older explanations of corporate partnerships and strategic investment in the basic telecommunications-services market are still relevant, they must be revised to account for the increasingly prevalent trend of content providers to ally with service providers as both strive to provide seamless global telecommunications service, to offer one-stop-shopping, and to develop global brand names. Therefore, the second chapter investigates how technology- and demand-driven investment strategies lead large telecommunication companies to seek strategic alliances with foreign operators in order to maintain competitive advantage.

Chapter 3 provides the third pillar of the analysis by assessing legal and regulatory responses to the emergence of ITAs. The applicability of antitrust merger control is assessed using recent examples of ITA review in the European Union and the U.S. The chapter focuses on problems arising from the limited

capacity of existing regulatory authorities to address market power generated by ITAs. The analysis culminates in a discussion of the possibility of a transnational competition regime. A critical analysis of this possibility, addressing strong counter-arguments concludes cautiously in favour of such a regime.

PART I FORMS AND CONCEPTUAL CONTEXT OF GLOBAL STRATEGIC ALLIANCES

1. BUSINESS AND LEGAL ASPECTS OF CORPORATE ORGANIZATIONAL RESTRUCTURING IN THE CASE OF INTERNATIONAL TELECOMMUNICATIONS ALLIANCES - MODES OF STRATEGIC COOPERATION

Synopsis: This chapter discusses the results of research into the formation of and corporate forms adopted by international telecommunications alliances (ITAs). The trend toward the formation of ITAs is characterized by a wide range of corporate organizational and legal forms that will be analyzed in this chapter. A typology of corporate forms according to their organizational development is here proposed. This will allow also a treatment of the historical development of "strategic alliances." ITAs are compared with mergers, traditional joint ventures and consortia so as to determine the extent to which these legal forms all coincide. The organizational structure of ITAs is discussed so as to cast light on the global strategies being pursued by telecommunications firms.

Telecommunications is considered a tertiary[2] industrial segment and increasingly includes services in the form of information provision and electronic products. The equipment manufacturing component to telecommunications is, of course, in the nature of a secondary industry. Indeed, this secondary/tertiary combination calls for a cautious approach towards classifying telecommunications as a "typical" service-related sector.

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[2] See UNCTAD, *World Directory of International Investment and Production Statistics 1992* (New York, 1992) (UN Doc. ST/LEG/SER.D/68, Sales No.R.65.V.9). Traditionally, economic activity is classified according to primary, secondary and tertiary sectors. Tertiary industries include construction, transport, trade, real estate, and other services such as telecommunications. My choice of telecommunications for the study of service globalization was dictated by the fact that it has been explicitly classified in the literature as "born global." Tracking global developments in the industry seems to be particularly appropriate. See *e.g.* US Rangan, *Global Competitive Strategy and Multinational Enterprises* (Boston: Harvard Business School Press, 1984) cited to

Furthermore, telecommunications is one industry that cuts across different sectors, as it comprises hardware and software manufacturing, research & development, and implementation of new technologies.[3] This blurring of industrial boundaries has opened new opportunities for telecom carriers to fill niches in worldwide entertainment and information-related businesses. Carriage, content provision, software development, and hardware manufacturing tend to be integrated, albeit with a different degree of "tightness," into increasingly diversified portfolios of strategic competencies displayed by the global super-carriers.[4]

On the one hand, partners in the biggest ITAs, such as *Unisource*, often seek to strike only a looser alliance if a more integrated corporate structure appears to pose a "Trojan horse" threat to their domestic markets.[5] On the other hand, big telecom players may feel the need to bind their "core competencies" together. This ambivalence begins to explain why integration in telecommunications leads to a complex mesh of intra- and inter-firm

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M. Yoshino & US Rangan, *Strategic Alliances: An Entrepreneurial Approach to Globalization* (Boston: Harvard Business School Press, 1995) [hereinafter Yoshino & Rangan].

[3] See S. Chan, ed., *Foreign Direct Investment in a Changing Global Political Economy* (New York: St. Martin's Press, 1995) 3ff [hereinafter Chan].

[4] See R. Carlson, *The Information Superhighway: Strategic Alliances in Telecommunications and Multimedia* (New York: St. Martin's Press, 1996) at 4ff [hereinafter Carlson]. *Compare* R.M. Kanter, *When Giants Learn to Dance: Mastering the Challenge of Strategy, Management and Carriers in the 1990s* (New York: Simon & Schuster, 1989) at 115. See R. Carlson for a discussion of how the need of telephone companies for close cross-organizational cooperation leads them away from their traditional mentality of "public utility" culture. Telecommunications, R. Carlson argues, was a utility industry similar to power, transportation and the postal service. In its early years the industry was mostly a voice service via telephone with some data communications. Rapidly changing technologies and increasing competitive demands have increased the significance of inter-firm cooperation. This trend has also promoted a formation of alliances by cable companies, long distance telephone carriers and entertainment companies. Along these lines, telephone companies are developing entertainment programming by joining with software and equipment suppliers and with entertainment corporations.

[5] For a discussion of the kind of alliance that turns out to be a "Trojan horse" affording competitors easy access into foreign markets, see J. Bleeke & D. Ernest, eds., *Collaborating to Compete. Using Strategic Alliances and Acquisitions in the Global Marketplace* (New York: Wiley & Sons Inc., 1994) at 8ff, [hereinafter *Collaborating*]. See also G. Hamel, C.K. Prahalad & Y.L. Doz, "Collaborate with Your Competitors—and Win" (1989) 1Harvard Business Review 19 at 113ff. However, see *contra* Yoshino & Rangan, *supra* note 2 at 236 for a critique of how the stereotyping of alliances as posing a "Trojan horse" threatens to a recipient market.

relationships. Moreover, the convergence between media technology and telecommunications as well as globalization has necessitated the redefinition of our traditional understanding of corporate structures and organization.[6]

1.1 IMPLICATIONS OF ORGANIZATIONAL EVOLUTION FOR THE CORPORATE STRUCTURING OF INTERNATIONAL TELECOMMUNICATIONS ALLIANCES

In order to situate the global corporate changes under way in telecommunications, it is useful to begin with a sketch of more traditional organizational forms. Not surprisingly, companies in quickly evolving fields such as telecommunications have frequently formed partnerships, mostly in the form of joint ventures.[7] At first, such integration was in fact limited and international joint ventures were not fully diversified.[8] The traditional pattern was that "multinational" corporations consisted of a group of foreign subsidiaries fully

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[6] For a discussion of how the global economy redraws traditional industry paradigms, see J.F. Moore, *The Death of Competition: Leadership and Strategy in the Age of Business Ecosystems* (New York: Harper Collins, 1996) at 13ff [hereinafter Moore]. According to J. Moore, we are now witnessing the dissolution of different industries resulting in the structural transformation of business forms. He argues that there is nothing like "the fixedness of industry structure" and that the new forms of corporate cooperation, such as alliances, defy the traditional notions of vertical and horizontal integration. He maintains that competition is no longer bounded by clearly defined industries; it is rather defined by "networks of organizations stretching across several different industries" which will join in with similar networks, "spread across still other industries." See Yoshino & Rangan, *supra* note 2 [concurring].

[7] See E. Garcia-Canal, "Contractual Form in Domestic and International Strategic Alliances" (1996) 17 Organization Studies 5 at 773 for discussion of the factors that influence the adoption of a contractual form in strategic alliance. According to P. Muchlinski, the choice of a business form of enterprise tends to reflect the market strategy taken by it. The legal form adopted will aim at the most cost-effective accommodation between corporation's business needs and the regulatory requirements to which it is subject. See P. Muchlinski, *Multinational Enterprise and the Law* (Cambridge: Blackwell Publishers, 1995) at 57ff, [hereinafter Muchlinski]. Therefore, there are several significant factors influencing both business and legal form of a corporation:
a) degree of legal freedom as to the choice of legal form
b) foreign ownership restrictions
c) level of control and influence exercised over the host country partner

[8] See *e.g.* G. Jones, *The Evolution of International Business: An Introduction* (New York: Routledge, 1996), for an analysis of "free-standing" firms in telecommunications industry. The argument is that in the postwar era firms had formed alliances and market relationships in place of formerly preferred vertically integrated organizational structures of fully-owned subsidiaries.

dependent on their parent firm. Each of these subsidiaries produced services intended primarily for their local markets. Gradually, these subsidiaries, or affiliates, having expanded beyond national boundaries, evolved into today's coordinated networks of "transnational" corporate activities.[9]

It is noteworthy that network theorists tend to differentiate between internal and external networks.[10] An internal network consists of a network of national subsidiaries of a multinational corporation, whereas an external network comprises links with independent companies originating outside the internal network. An existence of these networks emphasizes the hybrid nature of complex cooperative arrangements that are present at both infra- and inter-firm levels.[11] The internal facet of the corporate network has usually been associated with domestic-based affiliates operating under the mandate from their parent firm binding them to a particular national market. During this so-called "multinational" phase, companies tended to be integrated more vertically than horizontally.[12]

It has been argued that, in the 1980s, both of these governance structures developed simultaneously in response to increasing competition,

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[9] For a discussion of the piecemeal evolution of transnational business organization, see Muchlinski, *supra* note 7 at 8. He describes the process of divisionalization as an intermediate stage in corporate development from a traditional parent company with subsidiaries to one where all operating functions of each of the wholly-owned subsidiaries are performed within one corporate entity. A dispersed structure in which each operating subsidiary had a separate (legal and formal) corporate existence is, thus, replaced by a centralized structure of organization.

[10] *Compare* H.B. Thorelli, "Networks: Between Markets and Hierarchies" (1986) 7 Strategic Management Journal 1, claiming that the respective distinction is, in case of networks, irrelevant. See also J.C. Jarillo, "On Strategic Networks" (1988) 9 Strategic Management Journal at 31 and H.B. Thorelli,"Networks: Between Markets and Hierarchies" (1986) 7 Strategic Management Journal at 37. See further W.W. Powell, "Hybrid Organizational Arrangements: The New Form or Transitional Development (1987) 30 California Management Review 1 at 67 and W.W. Powell, "Neither Market Nor Hierarchy: Network Forms of Organization" (1990) 12 Research in Organizational Behavior at 259.

[11] Complexity refers both to the number of underlying economic relations between alliance participants and to the multiplicity of structural agreements constituting the alliance.

[12] See Muchlinski, *supra* note 7 at 12.

cooperation and inter-firm interaction.[13] In this period, telcos pursued what can be characterized as a multiple-locale strategy. To secure access to the highly profitable "end-consumer" they progressively exported expertise, network upgrading, and systems' management techniques. Systems' management was integrated by introducing host equipment into the national infrastructure in accordance with local technical standards, ensuring end-to-end functionality and satisfying end users. However, in the 1980s services were less complex and, therefore, the functionality was respectively easier to accomplish. Today, such integration across hardware platforms is considered inefficient and non-competitive.[14]

As mentioned earlier, international joint ventures led by multinational firm subsidiaries were initially aimed at serving individual national markets. Early joint-ventures in telecommunications affiliates to respond quickly to the needs of the national markets within which they operated and, consequently, these ventures favored a vertical, hierarchical corporate structure. The need to create permanent organizational structures forced the evolution of multinational telecommunications firms (MTFs). To create a common network infrastructure, many telecom service providers sought to gain access to non-domestic traffic through regional network providers; but restricted by local regulatory burdens, many had to remain linked to their national partners. Joint ventures achieved the greatest organizational uniformity and were the most likely to survive.

Direct participation of the MTF's subsidiaries in national infrastructure allowed them to capitalize on their competitive advantage, viz. "local presence" and ensured almost exclusive control over "end-customers."[15] The need for

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[13] See further Muchlinski, *supra* note 7 at 59 commenting on the 'heterarchical networks' which depict a single innovator capable of establishing multiple strategic alliances. Thus a specific firm may serve as a nexus for a complex web of alliances.

[14] See Carlson, *supra* note 4.

[15] *Ibid.* at 52. In Eastern Europe, for instance, "leapfrog cellular technologies" are seen as a sole means of bypassing outdated land-line systems. It is mostly due to the fact that cost of installing terrestrial lines is prohibitive and not feasible in comparison to cellular network.

control over the "end-customer" stimulated developments in corporate strategy and corporate organization. In the 1980s, large firms tended to form conglomerates whose leaders believed that "diversification strategy" would enable their companies to link related and unrelated sectors to different types of activities (i.e. production of hardware and the resale of services).

This strategy proved inadequate to address unpredicted market developments. The trend by the end of 1980s was to downsize and to focus on more flexible "vertical" integration that would eventually allow management to deal with the problems arising from each subsidiary. Due to the fact that telecom markets were presumed immobile, and therefore inherently local, the telecom companies of the late 1980s were horizontally integrated webs of domestically-based subsidiaries spilling over national boundaries and servicing national and multinational clients. This horizontal mesh eventually led to the birth of new organizational hybrids encompassing both integration modes.[16] These new multi-purpose hybrid firms have increased their international competitiveness through flexible internal organization, cooperation, and focused business investment.

Many business theorists and industrial economists agree that the transition from "multinational" to the "transnational" business corporation is best exemplified by the recent formation of the so-called "networking companies" that manage both their internal (hierarchical) external (horizontal) networks with harmonious, mutual concessions.[17] The proponents of this hypothesis suggest that strategic global telecommunications alliances provide the most striking example of networking companies.[18] Others perceive alliances as intangible and undefinable corporate entities falling in a gray zone between markets and hierarchies.[19] The debate as to whether strategic alliances contribute

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[16] *Ibid.* at 76.

[17] See *e.g.* Yoshino & Rangan, *supra* note 2 referring to networking corporations, and Moore, *supra* note 6 supporting their theory.

[18] See Moore, *supra* note 6 and *Collaborating*, *supra* note 5.

significantly to the business forum is best addressed by detailing the recent history of international firms before drawing conclusive judgments.

Advances in technology, as well as international organizational economic changes, have pushed multinational telecommunications service providers into forming agreements with a variety of network operators so as to be able to offer comprehensive telecommunications services. Unfortunately, there was a lack of uniformity in the formal organization of these operators. Not surprisingly, strategic alliances can be described as big, amorphous entities, ephemerally connected to partners with very different approaches to finding global solutions.[20] As a result, seamless, end-to-end service has been difficult to supply, making these alliances truly unreliable, particularly when they lack clear and direct contact with the local "end-customer."

Weak and unsuccessful alliances were the norm until the early 1990s. Subsequently, however, telecom markets shifted from the model of a single, hierarchically integrated multinational corporation structure to one of a global network of integrated service providers. The emerging organizational form has been characterized by the presence of well-developed, vertically and, more recently, horizontally integrated companies—not the mere "conglomerates of formerly loosely connected service providers."[21] Consequently, the current

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[19] See S. Khemani & L. Waverman, eds., *Global Competition Policy: Modalities of Cooperation* (New York: Routledge, 1996) [hereinafter Khemani & Waverman].

[20] See H.W. de Jong, "Symposium: The Merger Policy Debate Continues: Responses to the Bigness Mystique: The Problem of Mergers" (1989) 9 Journal of International Law and Business 605 [hereinafter Jong].

[21] *Ibid.* at 304. According to H. de Jong, a conglomerate exists when neither merged party competes with the another. They are not potential competitors, nor are they involved in a customer-supplier relationship. Therefore, de Jong argues that it is extremely difficult to show how a conglomerate transaction is likely to injure competition. In my opinion, his approach is too narrow as it does not take into account a situation where parties cooperate with one another in related markets (e.g. telecom services) but compete in unrelated ones such as computing and entertainment.

In fact, recent partnerships/competitors in the same related market, such as long distance telecommunications, raise serious competition implications under domestic laws. For example, the prospective global alliance of GTE, the largest independent local carrier in the US, with STET of Italy would create a conflict of interest. STET has been said to seek alignment with *Unisource* which will link STET with AT&T via AT&T-*Unisource* Services in Europe and

understanding of organizational developments in telecommunications suggests that the latest developments are positive because they secure stable inter-firm partnerships.[22]

Although, stable inter-firm arrangements have been built up by mature, vertically and horizontally integrated multinational companies, such partnerships will always involve a mingling of different corporate structures with separate bureaucratic governance in each of the allying firms.[23] When corporations merge or stitch up an alliance, their diversified, possibly incompatible internal structures are unlikely to transfer to the new corporate organization. When particular hierarchies do not overlap, organizational niches will be created within which the other partners may fit.[24] Therefore, not surprisingly, strategic alliances will represent a mixture of interdependence and integration. In this context only, I suggest, the proposition that they are "loosely connected," "informal" and "ephemeral" is appropriate.

An unusual diversity of approaches and legal architectures are among the most striking characteristics of the present evolution in global telecom partnerships and joint ventures. In several instances, we see telecommunications companies form new types of organizational structures

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WorldPartners elsewhere. Needless to say, GTE has not accepted STET's alliance with AT&T although GTE and AT&T have joined forces to form an alliance with Telefonica of Spain. See "Telecom Markets in 1997" *available in* Westlaw, FED-COM database, File No. 0305011.7 (on file with the Harvard Business Review).

[22] See Nohe, *infra* note 25 for a succinct argument against the common thinking that strategic alliances should overcome their amorphous organizational structure.

[23] See R.W. Smith, "The New Realities of the Communications Marketplace" (1992) 47 Federal Communications Law Journal 2. Telecom markets have been heavily regulated thereby creating a bureaucratic and somewhat stiff corporate structure. Some analysts believe that corporate change and recent organizational developments such as ITAs, are not proof that the telecom industry is moving towards free competition; rather the incumbent carriers are thought to be simply adapting to new market realities.

[24] See Carlson, *supra* note 4 at 51. A micro-partnering strategy, for instance, is commonly undertaken by large corporations that buy out small players and only requires a minimum of capital investment. By allying with large companies, small firms can acquire the resources of an international network and the large company gradually builds up its own network and fills out markets. (See text accompanying note 160 including an analysis of AT&T strategy for developing its network).

reflecting emergent hybrid market/hierarchy architectures and thereby creating "industry-specific corporate models" *(emphasis added)*.[25] Alliance relationships in the telecommunications industry are likely to predominate over the more traditional market-hierarchy dichotomy and are better adapted to overcoming disparities in corporate culture and diverse technical standards.[26] These new corporate hybrids are both a result of the globalization of telecommunications and a catalyst for further change in business strategies and organizational structure.

1.2 STRATEGIC ALLIANCES AS INTERMEDIATE HYBRID ARRANGEMENTS

In broad terms, the organizational behavior literature recognizes three types of corporate organizational structure designed to facilitate collaborative strategies in global telecommunications. I confine my discussion to the following main, easily recognized categories:

1. Horizontally integrated conglomerates, usually in some form of joint ventures, and their global networks.[27] Full-fledged mergers and acquisitions, as instances of complete integration, fall outside the definition of "strategic alliances" (See Figure 1).

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[25] See R. Nohe, "A Different Time, A Different Place: Breaking Up Telephone Companies in the United States and Japan" (1994) 48 Federal Communications Law Journal 2 at 14 [hereinafter Nohe].

[26] See Carlson, *supra* note 4. By continuing to use different technical interfaces and managing incompatible networks, companies inevitably exacerbate the interoperability problem. Interoperability has recently been lifted to the level of system integration to create cross-functional links between a company's elements: such as engineering, management and suppliers. System integration is a prerequisite for strategic alliances in telecommunications. Each partner contributes equipment, management and service-provision capabilities. Thus, the degree of integration depends on the investment made and the commitment to the longevity of alliance. R. Carlson argues that without accepting these burdens, strategic alliances are likely to fail.

Figure 1: Spectrum representing a degree of vertical integration and close interdependence [28]

2. Contractually founded consortia

3. Project-based, non-equity partnerships that are different from JVs, contractual arrangements, and full mergers (acquisitions)

Figure 1 (adapted from P. Lorange and J. Roos) relates strategic alliances to varying degrees of internal formalization and interdependency between the partners by displaying them on a continuous scale ranging from complete integration ("hierarchy") to transactions in an open market setting ("market"). On the left side of the scale, a total consolidation of corporate activities within a wholly-owned organization has the highest degree of integration. Mergers and acquisitions are located on the lower notch of the scale, followed by international joint ventures (i.e. involving joint ownership within a separate unit), and other types of cooperative venture are positioned on an even lower level of the integration scale. At the very far right ("market") end of the continuum, there is no integration and firms are free to exchange goods and services.

P. Lorange and J. Roos describe strategic alliances as "ventures along the scale". However, accepting the supposition—based on Richardson's research in the area of industrial economics—that all corporate hybrids include

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[27] A distinction between international joint ventures (non-subsidiary) and subsidiary joint ventures will be discussed below. (See at p. 32).

[28] P. Lorange & J. Roos, *Strategic Alliances: Formation, Implementation, and Evolution* (Cambridge: Blackwell Business Publishers, 1992) at 4ff [hereinafter Lorange & Roos].

not yet fully developed, intermediate forms of strategic alliance, it would be more accurate to characterize this phenomenon as "further steps along the path towards lower levels of vertical integration."[29] G. Richardson has suggested that cooperative inter-firm relationships between specific industry participants have been established "through the intermediate areas in which there are linkages of traditional connections." [30]

Inter-firm connections have led to the types of complex and interlocking clusters, groups and alliances, that currently permit full, formally developed modes of cooperation.[31] Strategic alliances involve the most formally developed collaborative arrangements, and reflect a hybridization of market and hierarchical modes of governance.[32] The intermediate character of strategic alliances can, I suggest, be specified by determining the extent to which cooperating firms face a polarized choice between equity and non-equity participation (in other words, between "markets" and "hierarchies"): strategic alliances end up somewhere in the mid-range of the spectrum, with arrangements or commitments that involve both of them.[33]

Owing to the increasing hybridization of forms among cooperating firms, strategic alliances currently display an unusual richness and variability in their corporate organizational structure. These corporate forms range from full

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[29] *Ibid.* at 56.

[30] See G. Richardson, "The Organisation of Industry" (1972) 13 Economic Journal 21.

[31] See F.J. Contractor & P. Lorange, "Why Should Firms Cooperate: The Strategy and Economic Basis for Cooperative Ventures" in F.J. Contractor & P. Lorange, eds., *Cooperative Strategies in International Business* (San Francisco: New Lexington Press, 1988).This cooperative paradigm clearly differs from the traditional view of the of the multinational company operating with wholly-owned units in various countries. Thus, recent partnerships involve joint activities of independent companies instead of the traditional pattern of a large "firm" trying to access a market by joining a "local partner" (Heenan & Perlmutter, 1979).

[32] By means of clarification, I would like to underline that there is a difference between a "fully" and "formally developed cooperation mode" and a "not yet fully developed, intermediate form of strategic alliance." The former refers to the developments in cooperative patterns in the inter-company relationships, whereas the latter concerns the actual structure of corporate organization, which is subject to being continually modified.

[33] See Yoshino & Rangan, *supra* note 2 at 82.

consolidation (i.e. mergers and acquisitions) through looser agglomerations such as *ad hoc* pools, to strategic alliances and mixed-form consortia.[34]

Table 1 provides a classification of cooperative arrangements among the telecommunications industry's participants. Distinguishing consolidations, agglomerates and conglomerates from each other, permits organizational researchers to propose various taxonomies of corporate structure and fit strategic alliances into the general forms of collaborative inter-firm arrangements. The two-step conceptual model suggested by P. Lorange and J. Roos provides a method for explaining the nature of these corporate arrangements.

Their model assumes that (1) the goals of alliances are subsidiary to the strategic intent of their parent firms and (2) strategic alliances are nothing more than a tactical or purely instrumental mechanism by which firms are deterministically driven towards a particular end, be it globalization of their business activities or increasing international competitiveness. Their analysis has become a common view concerning the nature of strategic alliances.

Other organization theorists take the view that alliances are ends in themselves and are therefore capable of self-governance.[35] On this view, strategic alliances should not be looked at through the prism of evolutionary

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[34] A definition of strategic alliances, offered by H. de Jong, *supra* note 20, classifies them as "loosely connected conglomerates." Unfortunately, in my judgement, his definition fails to capture the core foundation of inter-company partnership. In fact, any alliance will be doomed by a significant lack of stability and a weak sense of self-preservation if it is only to be a "loosely connected" partnership. Drawing on the underlying, *global logic* of strategic alliances I will use a term "conglomerates" in relation to the genuine-alliance and alliance-like corporate formations that require closer inter-company business relationships similar to those of a merger or takeover. (See Muchlinski, *supra* note 7 for a discussion of business and legal congruence of corporate organizational formations). For less tightly bound partnerships, I will use the term "agglomerations" to indicate the cumulative and ephemeral nature of interrelation among different companies. These distinction follow the definitions in "The New Shorter Oxford English Dictionary," ed. by L. Brown (Oxford: Clarendon Press, 1993, sixth edition): while a "conglomerate" is: (a) "A commercial or industrial cooperation formed by merger or takeover of a number of diverse enterprises, a company with subsidiaries operating in different, unrelated markets" (b) "Distinct parts gathered together in a more or less rounded mass, clustered [...], collected into a coherent or compact body;" on the other hand, an "agglomerate" is "collected into a mass, accumulated in a disorderly, *ad hoc* way."

[35] See *e.g.* Khemani & Waverman, *infra* note 19.

changes solely affecting the cooperative strategies of their parent firms because to do so would reflect only one part of their two-fold nature. This latter view accords with my position that alliances are created not only to implement their parents' ends but also, simultaneously, to catalyze the global corporate strategies that generate those ends.

Table 1: Classification of International Telecommunications Alliances

Business Structure	Consolidations: Takeovers (No new entity)	Agglomerates: Specific purpose cooperative arrangements	Conglomerates: Long-term Strategic Alliances Mixed vertical/horizontal integration or networking	
Corporate Legal Form	Mergers & Acquisitions	Non-equity contractual agreements	Joint Ventures	Contractual agreements: Mixed form equity- or non-equity arrangement
		Ad hoc pools for: a)Joint product development and manufacturing b)Joint marketing, brand name sharing and managerial integration c)Joint service distribution	I. Non-subsidiary 1.Fifty-fifty joint ventures 2.Unequal equity joint ventures a) Minority equity investments[36] b) Equity swaps II. Joint ventures of MTF's subsidiaries but not hierarchically integrated (i.e. "networking alliances")	1.Joint R&D consortia 2.Service provision consortia including links of licensing, joint marketing, management and brand name sharing

[36] See R.N. Osborn & C.C. Baughn, "Forms of Interorganizational Governance for Multinational Alliances" in R. Culpan, ed., *Multinational Strategic Alliances* (Binghampton: The Haworth Press, 1993) at 61 [hereinafter Culpan]. As several researchers have noted, a joint venture is both conceptually and legally different from a minority equity participation investment, in which a firm invests directly into a second company.

Thus, because the purpose of strategic alliances is to facilitate the realization of multiple purposes and tasks, they can be perceived as management tools. They can also be described as new business strategies aimed to enhance competitiveness and as new alternatives to the classical strategies of horizontal/vertical integration and market arrangements. This interpretation of strategic alliances suggests that the utilitarian rationale for creating longer-term inter-firm relationships is the parent firms' need to be able to react swiftly to potentially destabilizing changes in the marketplace.

Notwithstanding this instrumental and utilitarian approach, some alliances were intended by their parent firms to mature into autonomous, *sui generis* structural entities independent of any continued interactions between the parent firms.[37] Consequently, some strategic alliances operate as discrete business forms. A caveat ought to be stipulated, however: since alliances do not have static structures, they should not be portrayed as the final stage of an inevitable, progressive and linear development fostered by the cooperative arrangements of the partnering firms. Rather, alliances should be seen as ever-changing, dynamic entities that evolve into complex, informal, and multi-faceted governance structures. This dynamism is manifested by the increasingly distinctive structural forms and contextual features of strategic alliances and by their becoming less susceptible to their parents' independently pursued strategies.

The possibility of strategic alliances becoming independent is challenged by P. Lorange and J. Roos. They argue that parent firms can only cooperate through strategic alliances if the alliances are developed through the course of continuing inter-company collaboration. Since alliances only arise as tailor-made structures meticulously designed to accommodate the specific factors pertaining to their parents' global ambitions, they are not independent and self-sustainable entities. Therefore, according to P. Lorange and J. Roos, if the parents drift apart and/or their goals diverge or even conflict, an alliance, now bereft of its

[37] See *e.g.* FCC Report, *infra* note 73 on the issue of recent telecom alliances.

parental objective, would inevitably break up.

However, M. Porter questions the necessity of such an alliance's dissolving. He suggests that firms might pursue a generic strategy of alliance as long as collaboration remains a primary target.[38] When firms start to consider more than one cooperative approach in place of an alliance, mutual goals and links are more likely to be diluted and disintegrated (Porter, 1990). Porter's assumption is that firms can pursue different objectives which typically fluctuate as business strategy changes, and still be able to operate cohesively on a cooperative global level—unless, of course, the primary target of global competition changes dramatically in reaction to shifts in business strategy.[39]

As a case in point, one can look at major telecommunication companies, which by increasing the number of successful international alliances are fulfilling the primary target of their global strategy. Although forming an alliance may seem contrary to some particular objectives and specific goals dictated by an internally administered business strategy (e.g. a firm might ally with a partner that is a competitor in some markets), the competitive viability of the emerging

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[38] See M. Porter, "Compete - Do Not Collaborate" *International Business* (20 July 1989). Actually, M. Porter is skeptical about the future of strategic alliances. He has maintained that strategic alliances are destined to fail because they are mere "transitional devices" and as such, they rarely offer a helpful solution to the firms seeking out strategic partners. Alliances, paraphrasing his words, are not able to seize country-specific advantages. Their operation will typically incur significant coordination costs, mainly in terms of reconciling interests and goals of independent partners with ones of their undertaking. M. Porter concludes by saying that alliances are mediocre devices, which do not contribute to the creation of world leadership and may significantly deter the international competitiveness of the firms involved. *Contra* Yoshino & Rangan, *supra* note 2 at 103.

[39] See Khemani & Waverman, *supra* note 19. Nevertheless, the compatibility of business objectives along with mutual trust is the cornerstone of strategic alliances according to the majority of academic writers. In this regard, S. Khemani and L. Waverman have concluded that strategic alliances are collaborative ventures, based on mutual trust, in that they should forge and align mutual interests of the firms involved. See further H. Ergas, *International Alliances in Telecommunications Services* (Washington, D.C.: World Bank Publishing House, 1996) [unpublished] [hereinafter Ergas] defining strategic alliance as partnership which at its pro-competitive core, "is a trading partnership that enhances the effectiveness of the competitive strategies of the participating firms by providing for the mutually beneficial trade of technologies, skills, or products based upon them." Strategic alliance possesses simultaneously these following characteristics: a) the allying firms unite to pursue a set of agreed upon goals but they remain independent after the formation of the alliance, b) the partnering firms share the benefits of the alliance and control over the performance of assigned tasks and, c) the partner firms contribute on a continuing basis in one or more key strategic areas, e.g. technology, marketing etc.

"super carriers" would outweigh the risk. These global carriers are likely to exhibit extensive hybridization of inter-company relationships as the partnering firms, using tactics like cross-licensing agreements or joint ventures, adopt various governance structures often derived from their pre-existing organizations.[40] By concentrating on an examination of the new cooperative archetypes, I will address some configuration opportunities available to the telecom firms involved in pursuing these intricate global patterns of inter-company cooperation.

1.3 CHOOSING THE RIGHT FORM OF INTERORGANIZATIONAL GOVERNANCE FOR STRATEGIC ALLIANCES IN TELECOMMUNICATIONS

In the theoretical literature, strategic alliances are ambiguously defined.[41] All kinds of hybrid inter-firm links, be they mergers, majority-owned ventures, minority equity ventures, or licensing arrangements are lumped together. In their study of strategic alliances, M. Yoshino and U. Rangan argue that the alliance form can range from an arm's-length contract to a joint venture.[42] One group of observers has also termed licensing and cross-licensing agreements as "strategic alliances." Other academic theorists offer an opposite proposition to differentiate the blurred borders between joint ventures and strategic alliances.

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[40] See Ergas, *supra* note 39. The author argues that such an unusual richness of hybrid forms, combined with their distinctive duality, makes them particularly difficult to analyze. It is mostly because a hybrid is simultaneously a single organizational agreement and a product of cooperation of independent corporations.

[41] See Yoshino & Rangan, *supra* note 2 at 5ff. According to them, negative definitions of strategic alliances have been put forward in the business literature of the subject. These definitions just indicate what organizational modalities are not to be thought of as strategic alliances, but fail to offer a positive operational definition of the nature of strategic alliances.

[42] *Compare* Khemani & Waverman, *supra* note 19 at 127. Some of the definitions of strategic alliances cited by S. Khemani and L. Waverman claim that such a relationship is characterized by the commitment of parent firms to jointly pursue a common goal under a long-term, explicit inter-firm collaboration agreement. The collaboration agreement is not based on arm's length or parent-subsidiary relationships. See also Culpan, *supra* note 35 at 33 [concurring].

S. Khemani and L. Waverman, for instance, conclude that joint ventures are a special case of strategic alliances "with a fixed *ex ante* investment and ownership distribution,"[43] meaning by this that joint ventures are a subset of strategic alliances—not, as commonly assumed in much of the literature, that strategic alliances are a form of joint venture.[44] However, this conclusion is valid only when the functional definition of strategic alliances is being considered in direct relation to the business scope of cooperative modes present in an inter-organizational setting.

That definition is not sustainable when one intends to classify strategic alliances from a legal point of view, where the primary focus is on the structural rather than the functional nature of the alliance. Hence, Table 1 categorizes various types of strategic alliances by legal terms. From a legal perspective, inter-organizational hybrids are an empty category, unless they are an outright combination of the equity and non-equity forms—for instance, licensing and joint ventures, which are recognizable under law. Otherwise, they cannot be treated as entities *per se*. In other words, strategic alliances exist in the face of the law only when the inter-company collaborative partnership takes on a legal structure through, for example, licensing and/or allying in a joint venture. In this regard, the capability of law to keep up with the increasing pace of business reconfiguration in the realm of international corporate interactions seems to be substantially insufficient.

Business approaches to the classification of international cooperative structures address alliance formation more widely, because they accommodate various dimensions pertaining to the environmental forces that have stimulated such tremendous growth in the cooperative modes of international partnerships.

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[43] Khemani & Waverman, *supra* note 19 at 128. According to the authors, strategic allianceses, viewed from the perspective of control and ownership, can be classified as either "general," which have "a less defined joint control," and a "special case alliances [...] with a prescribed governance mechanism and decision-making apparatus." Strategic alliances are also distinct from industry associations, because the former do not involve large numbers of competitors as associations do.

These dimensions reflect functional, geographic, strategic and structural facets of recent inter-organizational developments allegedly responsible for the emergence of strategic alliances. These alliances, in business terms, appear to represent a higher evolutionary stage of the advanced cooperative model. Therefore, as many business authors have noted, the legal notion of a joint venture may turn out to be subservient to the more comprehensive mode of strategic alliances captured by the practical business concept, with its terms of operational or functional velocity to respond to changes in corporate organization.

Pragmatically, S. Khemani and L. Waverman (discussed above) consider the joint venture from a business perspective. They define it as being a jointly controlled entity set up by independent firms to accomplish certain tasks. Apparently, under this definition, all alliances in telecommunications involving equity-based corporate relationships would fit their description of a joint venture.[45] Certainly, the governance mechanism of strategic alliances resembles a combination of joint venture and contractual arrangements, which is commonly used for attracting potential partners from beyond the borders of two or more firms.

For my present purposes, however, I will identify as strategic only those alliances that have been set up in the form of joint ventures but that do not involve cooperation based entirely on organizational hierarchy. I submit, therefore, that the proposition put forward by S. Khemani and L. Waverman does not precisely spell out distinctive characteristics that would render strategic alliances categorically different from joint ventures. Their hypothesis maintaining that through a simple examination of structural forms one can classify a joint venture as an instance of the class of strategic alliances, seems to fall short of proper justification.[46] Lacking a definite basis upon which to produce an accurate

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[44] *Ibid* at 129. See also Culpan, *supra* note 35 at 33-34 where B. Borys & D. B. Jemison have classified joint ventures as a special case of strategic alliances.

[45] See Muchlinski, *supra* note 7 at 390.

and succinct operational description of strategic alliances, they are not able to substantiate their presumption of subjectivity of all joint ventures to the strategic alliances.

The confusion of strategic alliances with joint ventures stems from the fact that each is a form of an emerging corporate structure. The fact that they both exhibit a number of common features makes a delineation of their distinctive characteristics problematic. According to M. Yoshino and U. Rangan, for instance, in-house joint ventures, which have been set up for carrying out a specific project, are not to be considered strategic alliances. Such ventures are usually achieved through effecting short-term inter-firm collaborative arrangements involving only partial integration of some business units of the parent companies. In contrast, a strategic alliance, typically an external type of inter-firm relationship, requires establishing an entirely separate operational unit, external to the independent operating firms.

Similarly, according to Yoshino and Rangan's definition, overseas subsidiaries of multinational corporations, even if they are joint ventures, would not count as alliances. These country-specific ventures undertaken for the purpose of entering new geographic markets are well known and have existed for many years. Subsidiary or affiliate-type ventures— arrangements where multinational corporations supply technology, know-how and occasionally financing and local firms provide local legitimacy, market knowledge, contacts, and often management—have been common in telecommunications for many years. These telecom ventures were often considered tactical or reactive responses by the largest operators either to the host-nation government's pressures or to entrenched cultural barriers. Consequently, under these circumstances, the "jointness" of the venture has been a compromise rather than

[46] See Khemani & Waverman, *supra* note 19. The authors have suggested that firms involved in joint ventures have ownership claims to the residual value, and control rights over the use of joint assets. Strategic alliances are, on the other hand, a more flexible form of inter-firm collaboration because the aim is to retain firms' individual capabilities. In this sense, strategic alliances appear as flexible instruments for inter-company cooperation with low set-up and exit

a goal; and therefore, strategic control over the joint venture has been typically vested with the international carrier.[47]

In stark contrast with the approach taken by M. Yoshino and U. Rangan, P. Lorange and J. Roos claim that country–specific and in-house (project-based) JVs ought to be considered true "archetypes" of strategic alliances. Attending to the parents' retrieval of input resources and subsequent distribution of output, these authors suggest that particular JVs are actually strategic alliances because both parent firms commit substantial resources to the venture. The degree of commitment is measured by the extent to which resources are put in and retrieved from the joint venture. Typically, the redistribution only occurs financially.

To remedy this unfortunate downside created in the course of a joint operation by not yet fully committed partners, P. Lorange and J. Roos prescribe another archetype of strategic alliance as an antidote: the formation of a full-fledged JV. Such a venture receives resources from both its partners to establish a long-term partnership with the input resources being retained by the alliance entity itself. Therefore, the authors argue, from the resource commitment perspective, that the comparison of resource input and its subsequent retrieval will yield a genuine basis for distinguishing alliance from non-alliance partnerships. As a result, consortia arrangements are less likely to be categorized as alliances because these collaborative archetypes involve a relatively small resource commitment and the output is typically distributed back to the parties.

Although these archetypes are not to be defined as cooperative alliance strategies, their gradual and continuous evolution may lead to the formation of such a strategy. This supposition, according to P. Lorange and J. Roos, is a cornerstone of the theoretical model explaining strategic alliances. By adopting

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costs. Linked by the sharing of know-how and technology, they should reflect the imember firms' unique characteristics through replication of their organizational structure.

[47] *Ibid. Compare* Lorange & Roos, *supra* note 28.

the resource input/output perspective, the authors have relegated strategic alliances to the role of a means to a particular strategic end, thereby denying their unique character.

Sharing this view, M. Porter maintains that alliances are a means to broaden a firm's scope without over-expansion, achieved by contracting and teaming up with an independent firm to share or perform value activities (Porter, 1990b). The inter-organizational theory, similarly, finds these shared operations of so-called project- and country-based joint ventures inconsistent with a full-blown joint venture, which involves equity arrangements. Other organization theorists argue in the same vein that to determine an appropriate governance structure, partners must assess the need for a mutual acquisition of share holdings in each other's firm to establish a strategic commitment of partners to the alliance.[48]

The literature on the institutionalization of strategic alliances focuses on the structural and operational viability of the emerging corporate hybrid, insisting that the structure of alliances must provide for maximum operational flexibility. Therefore, some firms are actually afraid to lock themselves into an (majority) equity-based alliance if it were possible to retain strategic and operational independence through less-binding (non-equity-based) arrangements. Under certain circumstances, the choice of an arm's-length alliance may be the only appropriate form to sustain the ongoing inter-company interaction—with the option of progressively moving to a different structure as technology and common strategies evolve.

Therefore, because governance structure plays a pivotal role in keeping the inter-company cooperation alive, hybrids have emerged. Given the need for

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[48] See Lorange & Roos, *supra* note 28. The authors argue that strategic alliances do not require establishing a separate unit. I submit that in telecommunications most of the super carriers' alliances have been forged under new names and therefore, unlike intra-firm relationships, required setting up a new organizational structure in a form of a separate alliance. Clearly, the parent firms continue to operate as separate units and typically avoid in-house integration of their partner's systems and functions. *Global One* and *Concert* are both international joint ventures, which involve the creation of separate legal entity with shared equity. Other alliances such as *Unisource* involve also stock swaps, which only refer to the exchange of stocks by the partners.

strategic and operational flexibility of the alliance, firms can favor either arm's length (non-equity) or equity-based arrangements, although usually a combination of both is preferred. Telecom firms setting up collaborative models of inter-firm relations must consider the extended implications of choosing either an equity or a non-equity alliance form: what considerations play the most important role in a particular firm's decision to embark on or, alternatively, forego equity/non-equity involvement in a strategic partnership?[49] What are the contingencies associated with the choice of particular involvement? In addressing these issues, my discussion will center on recognizing and evaluating the advantages and disadvantages of favoring one method of participation in an alliance relationship over others.

1.3.1 NON-EQUITY COOPERATION MODE AS AN OPTION OF STRUCTURAL GOVERNANCE FOR TELECOM COMPANIES

While the number of equity-based JVs is growing rapidly, few published studies address contractual ventures: most authors take an economic perspective, focus on ownership issues and treat all non-equity ventures as simple market transactions.[50] Hence, my goal in this section is to examine whether non-equity based partnerships are strategically significant to telecommunications firms seeking the most efficient governance structure for their alliance partnerships. Despite the fact that these forms are neither the predominant choice of allying firms nor the most eagerly avoided, I will relate the allegedly hybrid nature of alliances to their market-dominated component. It will then be possible to see whether less formal cooperation affects the strategic viability of inter-organizational operation.

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[49] See Yoshino & Rangan, *supra* note 2 at 82.

[50] S.B. Tallman & O. Shenkar, "A Managerial Decision Model of International Cooperative Venture Formation" (1994) 1 Journal of International Business Studies at 45 [hereinafter Tallman & Shenkar].

At this point, I shall make a conceptual assumption that one may look at licensing either as a mechanism used by a firm to service foreign markets, or as both a governance structure and cooperative mode of inter-company partnership. On the former view, licensing provides an alternative mode to export or direct investment in the early stages of the internationalization process by a MTF.[51] On the latter view, licensing permits the establishment of an inter-organizational governance structure of strategic alliances, in which contractual agreements to sell or provide technology and services are wholly or partially market-dominated as a consequence of (1) learning from internationalization experience and/or (2) *ad hoc* changes in a firm's strategic planning.[52]

In general, multinational ventures previously organized their international relations through arm's-length trade, minority investments, and other collaborative forms in order to circumvent investment barriers erected by restrictive regulations aimed at preventing foreign firms from achieving a significant degree of control and influence over strategic industries in the host country.[53] Historically, during the internationalization stage of expansion by

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[51] Internalization and internationalization strategies by multinationals are discussed in greater detail in the next chapter.

[52] See Culpan, *supra* note 35 at 61. For a discussion of the theories dealing with the conceptualization of market and hierarchy mode of the alliances' governance structure (i.e. TCE and O-L-I model), refer to the next chapter. Benefits of internalization versus exploitation of strategic assets by multinationals through licensing have been identified by, for example, P.J. Buckley & M.C. Casson in *The Future of Multinational Enterprise* (London: MacMillan, 1976) [hereinafter Buckley & Casson], and I.R. Markusen in "The Boundaries of Multinational Enterprises and the Theory of International Trade" (1995) Journal of Economic Perspective at 169-89. I.R. Markusen, P.J. Buckley and M.C. Casson agree that benefits of internalization stem from the avoidance of transaction costs associated with arm's length transactions such as licensing. They are also dependent on the level of legal protection of intellectual property in the host country. If the level is high, it will ensure the licensing firm that the amount of control over the use of its technology is equivalent to the control it would have if it undertook the production itself through the affiliate. Another consideration concerning the benefits of internalization is that the external markets for technologies that are in high demand may depreciate their value to firms developing them. Therefore, these "technologies are likely to be of greater value inside the organization responsible for their creation than to outside organization, which means that the organization cannot receive this value by licensing the technologies on the open market." See also WTO, *Trade and FDI: Annual Report on Investment* (Paris: WTO Publications, 1996) [hereinafter WTO Report].

multinational enterprises, contractual cooperation agreements were widespread in the communications industry as a complementary mode to the equity form of international cooperation. Since most telecom providers were nationally controlled and nationally owned, foreign telecom companies would rarely be allowed a majority stake in firms based in the countries with protectionist policies.[54]

Telecom ventures often encountered regulatory limitations because governments quickly recognized that industry's strategic importance and imposed ownership restrictions to protect national security and/or sovereignty.[55] Generally, the threat of foreign control of a nation's high-technology industries, specifically broadcasting and telecommunications, led governments to protect local firms and ensure that these industries could not become defense-vulnerable and therefore incapacitated during a national emergency.[56] To remedy this danger, many host governments insisted that foreign companies form partnerships with local companies in order to set up operations in their

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[53] In this case, the investment usually meant that control over the use of the resources transferred would remain with the foreign investor of assets and intermediate products (such as capital, technology, and access to markets and enterpreneurship).

[54] *Compare* Cable & Wireless Inc., which manages telecom operations in many countries, mostly former British colonies. A discussion of the issues of protectionism in the telecom industry and the blurring of national lines in the provision of telecom services can be found in: S.L. Armstrong, "US-European Telecom Alliances: Global Providers in an Emerging Global Marketplace" (1995) 23 Federal Communications Law Journal 12 [hereinafter Armstrong]. See further J.G. Oh, "Global Strategic Alliances in the Telecommunications Industry" (1996) 20 Telecommunications Policy 9 at 713-20.

[55] For an analysis of the ownership restrictions in Canada's telecom regulation see, for instance, S. Globerman, "Foreign Ownership Restrictions in Telecommunications: A Policy Analysis" in S. Globerman, W.T. Stanbury & T.A. Wilson, eds., *The Future of Telecom Policy in Canada* (Toronto: University of Toronto Press, 1995).

[56] Canada, for example, had an extensive debate about the issues of protectionism during 1970s. See *e.g.* J. Britton & J. Gilmour, *The Weakest Link* (Background Study No 43) (Ottawa: Science Council of Canada, 1978). For discussion of the implementation of the 'screening laws' in Canada, as a consequence of an "open door" approach to foreign investment, see Muchlinski, *supra* note 7 at 197ff. See further P. Morton, "US Renews Fight with Ottawa over Satellite TV" *The Financial Post* (19 July 1997) 5 discussing the issue of breaking down Canada's remaining cultural restrictions in the satellite television and telephone industries. In particular, a postulate from the US was to open Canadian telecommunications market to the US companies by putting an end to the requirement that all Canadian telephone companies make "maximum use" of Canadian telephone lines before routing calls through the US

countries.[57] Joint ventures with local firms were then one of the few ways in which multinational ventures could satisfy a host government's requirements for local majority ownership and control.[58]

Because expanding telecom networks across foreign markets was considered too expensive and regulatory burdens were globally pervasive, telecom providers sought entrance into foreign markets either through the negotiation of accounting rates or, recently, through call-back operators. In various countries, foreign telecom corporations were allowed to undertake only cross-border non-equity ventures, or other quasi-investment and pseudo-participation forms of cooperative involvement.[59] Due to market entry restrictions—mainly restrictive licensing regimes—various types of resale and interconnection agreements had appeared well before ITAs began to emerge in

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[57] See *e.g.* Armstrong, *supra* note 54 for an useful example of "Buy-Operate-Transfer" (BOT) contracts in Thailand.

[58] Muchlinski, *supra* note 7. If one assumes state intervention through protectionist policies, the presence of foreign services in the local market will be visibly reduced. States usually seek this objective by imposing high tariff barriers to trade. Alternatively, a host state may impose requirements that foreign firms enter the local market through the licensing of the local firm or through an equity joint venture with that firm. See also WTO Report, *supra* note 52.

[59] Although the telecommunications industry is characterized by knowledge- and technology-related assets, its strategic character offers an opportunity to competing firms to gain more strategic assets through licensing contracts (and regulation). Due to the fact that the distribution networks of utilities have been natural monopolies, telecom companies were offered an exclusive license to supply them. The regulatory restrictions were very effective entry barriers preserving regional licenses of incumbent carriers. All this has been changing now, however, to the extent that these strategic assets are being steadily eroded as the regulatory restrictions are being lifted. At this point, it may be interesting to take a glimpse into the problem of macroeconomic factors causing erosion of the firm-specific strategic assets. See *e.g.* J. Kay, *infra* note 104 assuming that the deregulation and removal of license exclusivity from the country-incumbent operators are to be considered negative factors altering firm-specific strategic assets. In my judgement, macroeconomic factors such as liberalization of service telecommunications and increasing competition in infrastructure, which may be epitomized by breaking down license monopolies and continuing deregulation, will be then responsible for triggering an effect of growth in telecommunications alliances. See chapter 2, on pp.72-75, below, for a discussion of micro- and macroeconomic factors causing dissipation of the firm's specific (i.e. ownership and location competitive advantages) strategic assets. It is noteworthy that the dissipation effect in telecommunications seems to be stronger than in unregulated industries; two out of three advantages are being altered. Does this mean that the industrial response form telecom firms is stronger than say, from car manufacturers?

foreign markets.[60]

Often, under the terms of these agreements, a foreign telecom company could enjoy only a limited degree of influence over strategic assets. Thus, involuntarily, telecommunications companies have become participants in international networks involving less binding (i.e. predominantly non-equity) transactional relationships such as joint marketing, distribution and consortia.[61] Concession agreements, in general, involved purchasing the right to use an asset for a particular period in order to offer rapid access to new technologies and services.

They depict a narrow interdependence of partners who pool their assets for a limited time to accomplish a narrowly defined purpose.[62] Therefore, lacking strategic and long-term objectives, which are inherent in alliances, such non-equity agreements do not constitute an alliance *per se*.[63] In particular, any licensing- or concession-based collaborative agreement falls beyond the scope of the hybrid alliance definition because typically it does not entail a continuous transfer of technology, products, and skills between partners.[64] Although they may exchange some technology, the partners to the licensing agreement do not

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[60] *Compare* K.R. Propp, "The Eroding Structure of International Telecommunications Regulation: The Challenge of Call-Back Services" (1996) 37 Harvard International Law Journal 2 at 494ff [hereinafter Propp]. See N.J. Nikolopoulos, "Fostering Corporate Networking in the European Union" (1996) 27 CommLaw Conspectus 4 at 41ff [hereinafter Nikolopoulos] for an extensive discussion of resale, lease and international interconnection agreements.

[61] Interesting observations on a relationship between market-dominated transactions and foreign investment restrictions have been made by Culpan, *supra* note 35, and in WTO Report, *supra* note 52. See also H. Hakansson, "Technological Collaboration in Industrial Networks" (1991) European Management Journal 3 at 371-79 and E.J. Contractor, "Ownership Patterns of US Joint Ventures Abroad and Liberalization of Foreign Government Regulations in the 1980s: Evidence from a Benchmark Survey" (1990) 21 Journal of International Business Studies 1 at 55-74.

[62] See Culpan, *supra* note 35, also Khemani & Waverman, *supra* note 19. See further B. Gomes-Casseres, "Computers: Alliances and Industry Evolution" in D.B. Yoffie, ed., *Beyond Free Trade: Firms, Governments, and Global Competition* (Boston: Harvard Business School Press, 1993) at 79-128.

[63] See Yoshino & Rangan, *supra* note 2. *Contra* R.N. Osborn & C.C. Baughn, "Forms of Interorganizational Governance for Multinational Alliances" (1990) 33 Academy of Management Journal 3 at 503-519.

share control over technology-related tasks. Nor do they engage in a reciprocal exchange of their output resources that could lead to the requisite synergies. Most importantly, they do not share a common vision which is, allegedly, a substantial component of any alliance.

Therefore, the licensor receives royalties and revenues with little return on prior R&D expenditures, and the licensee benefits from someone else's product development. As there seems to be a great deal of uncertainty in licensing, the preferred method of servicing foreign markets is direct investment, namely equity arrangements, where control over the technological advantage can be better secured by the investor company. Thus, if the organizational boundaries of both firms are permeable and continuing arm's-length transactions are successfully handled outside the organization, the license agreement might have an improved chance of becoming coupled with an equity structure thereby resulting in the hybrid form of inter-firm collaborative agreements.

According to what some business strategy scholars have noted, such a seemingly uneven evolutionary process owes its intricate patterns of "stop-go" development to operational and structural inflexibility created by excessively detailed contracts.[65] Given that protecting property rights is the primary aim of licensing companies, contracts must ensure that the licensee can be entrusted with the use of unique technology or know–how in a secure manner.[66] In general, telecommunications firms have tended to avoid licensing in the early stages of their internationalization until the technology or other unique asset has been

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[64] See *Collaborating*, *supra* note 5 at 56.

[65] See Muchlinski, *supra* note 7, *Collaborating*, *supra* note 5, and J. Kay, *infra* note 104 for a general discussion of a friction between business "imperative" of operational flexibility of any alliance and its contract- based longevity preserving value.

[66] See Kay, *infra* note 104. According to the author, when a host country lacks a sufficient level of industrial and legal organization there are likely to be only few licensees who may be entrusted with the exploitation of unique technologies. Typically, "even under a strict contractual regime governed by the terms favorable to the licensor," the dissipation of technologies and significant knowledge leakage may occur. See further B. Aitken, G. H. Hanson & A. E. Harrison, *Spillovers, Foreign Investment and Export Behavior* (Working Paper No. 4947) by WTO (Washington, D.C: WTO Publications, 1994) at 1-40, also I.A. Cantwell, *Technological Innovation and Multinational Corporations* (Cambridge: Blackwell Publishers, 1989) and Chan, *supra* note 3.

almost exhausted—exploited to the extent that a potential licensee would not be able to resell the firm-specific asset to third parties.[67] Hence, A. Rugman argues that licensing is an inferior option for multinational companies forming strategic alliances.[68] He observes that licensing poses a significant risk of dissemination of firm-specific assets such as proprietary knowledge, especially in the early stages of R&D advances.

Thus, there will always be some danger that the licensee may compromise the firm's monopoly over a strategic asset. Once its knowledge or technology is dissipated, it becomes impossible for the firm to receive an anticipated return for the use of its internal knowledge. Despite the well-known risk of eroding the value of licensed technologies, licensing/concession agreements are perceived by telecom firms as the most rudimentary form of inter-company cooperation. Typically, a product is ready to be licensed when a service provider incorporates a specific application or technology into a commercial offering. Most carriers currently license domestically grown services at the latest stage of product standardization, including also network management methodologies.[69]

Unisource, for instance, recently set up a separate management company to coordinate the management patterns of its members and, thus, streamline its bidding for global license contracts to establish a unified service delivery platform[70] —allegedly functioning over a certain period only as a strategic planning body for a specific project or contract. Thus, it seems probable that

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[67] A. M. Rugman, "A New Theory of the Multinational Enterprise: Internationalization Versus Internalization" (1980) Columbia Journal of World Business at 24ff.

[68] *Ibid. Compare* F.J. Contractor, *Licensing in International Strategy* (Westport: Quorum Books, 1985) for a discussion of the use of licensing as a part of the internationalization strategy. See Buckley & Casson, *supra* note 52 and WTO Report, *supra* note 52.

[69] H.H. Hecht, "The Art of the Deal," (July 1996) *available in* Westlaw, BUS-COM database, File No. 00987.33 (on file with the Harvard Business Review). One may wonder whether in this case, erosion of knowledge takes place at the time of duplication of so-called "matrix" management methodologies, or earlier that is when the system is being "matrixed" for the first time.

[70] *Ibid.*at 5.

such an integration of management within the *Unisource* consortium may have a considerable impact on the further development of an external rather than an internal form of alliance.

Not surprisingly, carriers and equipment providers often opt instead for joint marketing as a cooperative mode. Indeed, this model has become the *de facto* standard for this type of alliance-based collaboration. Joint marketing involves an agreement in which two or more parties pool their marketing resources and jointly enter a specific technological or vertical segment of telecommunications. Some industry analysts have argued that this strategy rarely enhances revenues for either side, despite very promising profit estimates.[71] Some of the shortcomings associated with joint marketing can be rectified by combining shared marketing and service distribution within a consortium agreement—a technique currently viewed by most of the carriers and equipment providers as a low-cost way to extend their markets.

On the other hand, "consortia" epitomize a group approach to inter-company collaboration by means of amalgamating firms from technology, service, and communications sectors.[72] For instance, the *WorldPartners* consortium is described as a "non-exclusive, co-marketing and co-distribution alliance."[73] Its members are free to form additional alliance arrangements external to it. *WorldPartners* also includes less committed non-equity partners

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[71] See, for instance, the unsuccessful joint marketing approach employed by AT&T for grafting Lotus and Novell into the public network offerings at the New York City Stock Exchange.

[72] See Muchlinski, *supra* note 7 at 85. See further T. Hadden, R. Forbes & R. Simmonds, *Canadian Business Organization Law*, 4th ed. (Toronto: Carswell, 1986). It is important to stress the fact that most ITAs are less integrated but more complex unlike, for example, the other large-scale engineering projects, in the sense that it is typically difficult to identify a central decision-making body. In this respect, T. Hadden has observed that international partnerships are formed as major groupings and structured in a complex manner. They consist in interlocking webs of majority and minority holdings, so that it is hard to assess accurately the profitability and solvency either of the groups as a whole or their parent companies, or to identify those who are formally responsible for their operation. Consequently, these forms of international cooperation may induce a significant decentralization of the managerial function in the future.

[73] See FCC, *Report on Global Telecommunications Alliances* (Washington, D.C.: US Government Printing Office, 1996) [hereinafter FCC Report]. Equity members are AT&T, Singapore Telecom, KDD (Japan), and *Uniworld*. Non-equity members include Telstra OTC (Australia), Korea Telecom, Telecom New Zealand, Hong Kong Telecom, and Unitel (Canada).

and more committed equity partners. According to the distribution agreements, equity members currently have exclusive rights to distribute *WorldPartners'* products in their home countries. In general, these agreements also involve the transfer of intellectual property rights, so that the seller, a particular equity member, can maintain the identity and quality of the product.[74]

Distribution agreements seem, without introducing a transaction cost economics consideration, to offer a useful route to enter foreign markets without necessarily establishing a sales subsidiary in that country. Not surprisingly, other super-carrier consortia follow similar cooperative patterns in an attempt to respond simultaneously to increasingly emerging challenges and developments in important markets.[75] On the other hand, there seems to be enough evidence to argue that telecommunications alliances and consortia are not disposed to address these challenges equally well.

As we have seen in the case of the *WorldPartners* consortium-type alliance, market transactions seem to have a lot more to offer to partners both in terms of flexibility of their governance structure and by providing low-cost solutions to the competence niches in the external organization. However, arm's length transactions may also complicate the coordination of synergies that is needed to promote the long-term productivity of an alliance. Indeed, R. Carlson wisely warns that over-reliance on external contracting, especially in telecommunications, is likely to place critical technologies and the source of core competencies into the partners' hands.[76]

R. Carlson concludes that the "internal" alliances, though they require

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[74] In this regard, it might be interesting to track whether joint distribution agreements employed by large telecom players have any impact on erosion of brand names and free riding on brand labels.

[75] See Yoshino & Rangan, *supra* note 3 who conclude that firms that pursue global competitive strategies in "global" industries will gain primacy. See also M. Porter, ed., *Competition in Global Industries* (Boston: Harvard Business School Press, 1986).

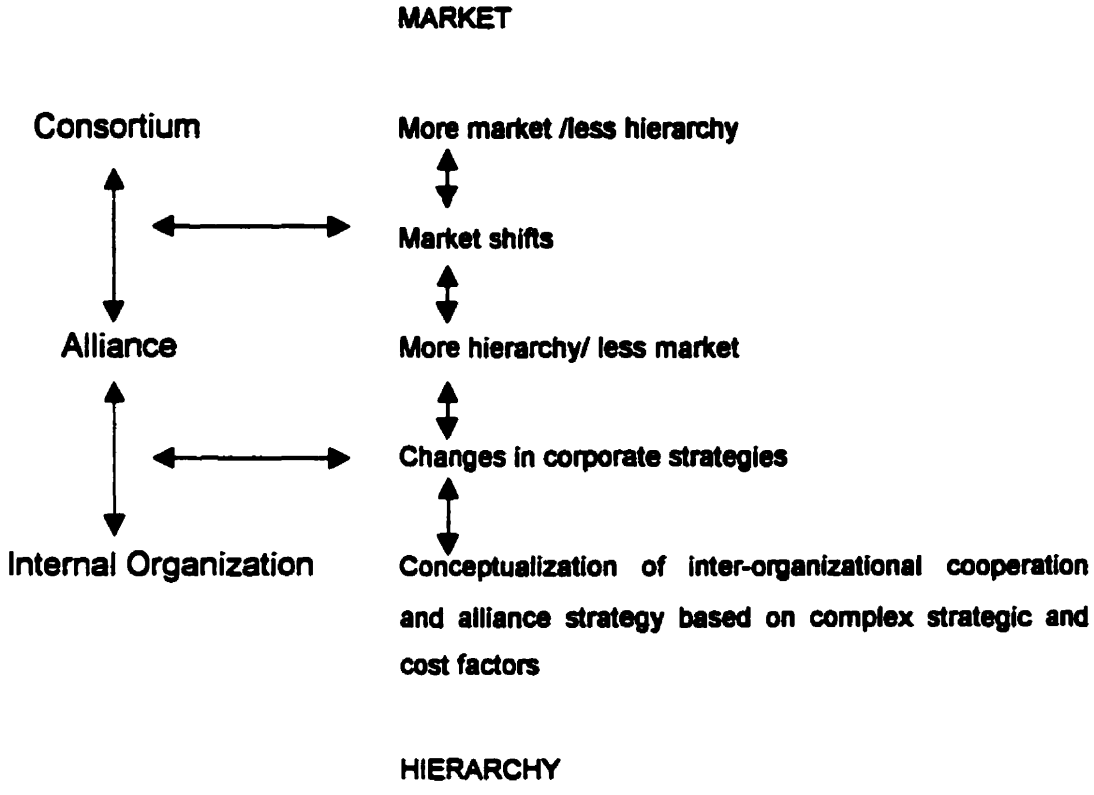
[76] Carlson, *supra* note 5 at 126. See also FCC, *Report and Order on Market Entry and Regulation of Foreign-Affiliated Entities* (Washington D.C.: US Government Printing Office, 1995). For a discussion of the need to increase regulatory scrutiny of non-equity business alliances, see FCC Report, *supra* note 73 at 17.

rigorous attention to start-up, persuasion and follow-through than consortia, promise more complementary developments, closer synergies, and better protection of output innovation and in-house developed technologies.[77] As shown in Figure 2 below, the consortium structure, according to Carlson's conclusion, will be naturally outward-oriented, whereas the purer alliance form will tend to cling to more formal organization.

By contrast, J. Bleeke and D. Ernst observe that the blurred boundaries between alliance, or internal venturing, and consortia, or more market-oriented consortia structures, may be responsible for the emergence of a so-called "structure without structure" form of the inter-company cooperation. Although, according to the authors, the basic building block of most alliances in recent years was the joint venture, the emerging forms of alliance often rely on less formal linkages between firms (Bleeke & Ernst, 1994). These linkages break through organizational barriers of the classical joint venture "as they are often scattered across the globe, with no single theme or focus." Additionally, they require a series of relationships and discrete international ties, and may take the form of interactions that are not rooted in traditional organizational structures.

[77] *Ibid. Compare Collaborating, supra* note 5. J. Bleeke & D. Ernst make the interesting point that in most situations, such an internal alliance is actually not that difficult to consummate. Internal venturing, according to them, involves establishing of consecutive and sequential cross-

Figure 2. Structural model of inter-organizational links of cooperation: "external" consortium vis-à-vis "internal" alliance



1.3.2 STRATEGIC IMPLICATIONS OF OWNERSHIP AND CONTROL LINKS FOR THE EQUITY-BASED ALLIANCE STRUCTURE

In the organizational literature, the level of equity participation has been widely used to identify the nature of the inter-firm cooperation structures. Consequently, the level of ownership and extent of strategic control are essential issues to building and contextually analyze the alliance structures. From a strategic control perspective, striking of an alliance amounts to forging an *entente* that compromises the fundamental interdependence of economic actors

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divisional linkages, usually by way of piggybacking on the existing, or pre-existing favorable relationships between the parent companies.

to facilitate sharing control and, eventually, losing a part of it. The presumption that the telecommunications industry is likely to require a high level of integrated control has led to the establishment of equity—not contractual or market—relations.[78] Therefore, I shall consider equity investment together with the degree of control of strategic assets as determinants of the level a multinational enterprise's involvement with and commitment to the creation of an alliance.

In the past, companies commonly approached international expansion through an inward investment in pursuit of their internationalization strategy by means of establishing equity-based organizations such as joint ventures.[79] The formation of these organizations raised important ownership-related matters concerning financial and strategic (managerial) control. Although these matters were vital for legal and business aspects of multinational joint ventures, in relation to the global strategic alliances (often in the form of "global" joint ventures), they require some additional attention in the current discussion.[80]

According to J. Bleeke and D. Ernst, there was a popular misconception among managers that only total control over a venture would increase the chances of success. Considering the fact that successful joint ventures easily broke up when they developed into an outright contract-based mode of ownership, most have actually emerged as majority equity ventures.[81] Several

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[78] See Culpan, *supra* note 35 concerning the survey on equity and non-equity structure of strategic alliances. According to this survey, in early 1990s JV structure had amounted to 69 per cent of alliances and 31 per cent the remaining non-equity market transactions.

[79] See "Interview with D. Jordan-Smith, Director for Partnerships Alliances and Joint Ventures for AT&T Itsel's Service Division" (31 October 1996) reprinted in 4 Value Added Networks 2. According to D. Jordan-Smith, the joint venture is the 'purest' form of strategic alliances – all of the substantial defining elements are present. Carriers are pooling equity from one or more partners. The organization then enters a specific market with a corresponding web/hub of services and/or products. Cross-ownership creates less fear of dominance and the elements of directly shared risk combined with development tend to render JV a stable, enduring form of strategic alliance.

[80] So-called global joint ventures are also named "new" international joint ventures to underline, perhaps, the recent metamorphosis of their traditional organization in response to the corporate networking, globalization of markets and the emergence of new structures of strategic alliances.

[81] *Collaborating*, *supra* note 5 at 42. See also text accompanying note 82.

business historians have found a deep-rooted belief in the Western business tradition that it is necessary to attain a high level of control in a partnership, if it is to succeed.[82]

Clearly, by establishing the majority stake in a given venture, one of the partners ensures its predominance over brand decision-making and investment strategy. Strategic alliances, however, unlike traditional joint ventures, seem better disposed to promote long-term success without requiring the pressure of majority equity-based leadership.[83] For instance, the business theory of trust assumes that relationships between partners are based on mutual commitment and an effort to build mutual trust; achieving total control should never be their objective. This theory also puts forward an argument that an extreme emphasis on control through equity participation may actually prevent partners from building confidence and joint managerial skills. Equity investment should not then by itself threaten a partner's autonomy, but instead should afford a breathing space to make realization of benefits less painful.

Therefore, in structuring alliances, the issue of financial ownership should be separated from managerial control to optimize operational flexibility. In

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[82] With the advent of strategic alliances, it is difficult to agree unconditionally with this traditional view of ownership and control. For many business analysts, the need for control was always a very important factor explaining the choice of corporate strategy for market entry by multinational enterprises. (*Compare* Bleeke & Ernst, 1994; Muchlinski, 1996 and Culpan, 1993). Thus, the majority interest was considered a must for every successful joint venture because it was believed to stimulate a firm's ability to influence systems, methods, and decisions in the relevant market. However, traditional organizational theory failed to demonstrate that control is always needed to improve a firm's competitive position and maximize the returns on its assets and skills. (In addition, the measure of a firm's success has recently shifted from return on investment (ROI) to return on sale (ROS) considerations, thereby obviating the need for control). Undoubtedly, the measure of control constitutes the basis of a trade-off between risks and returns on the foreign investment, but new alliances are not just about returns on investment. Arguably, greater ownership in the foreign venture does not guarantee efficient and constructive operational control, although it secures a higher level of it.

[83] This assertion is anchored in the critical writings concerning traditional approaches to inter-company relationships, which will be discussed in the next section. As a case in point, one can look at the newly forged telecom alliances, resembling Japanese "group companies" (*keiretsu*), where, notwithstanding lack of regulatory restrictions, equity stake is lower than 1 per cent. This has to do with the fact that partners are equally strong and independent and their alliance keeps both of them interested in each other's welfare without threatening either's autonomy. Also, in a recent reshuffling in the global telecom alliance of *Concert*, caused by the admission of Portugal

contrast to the conventional wisdom that 50-50 ownership renders decision-making difficult, it is postulated that alliances with an even split of financial ownership are actually more likely to succeed than those in which one partner holds a majority ownership interest.[84] When one partner has a majority stake, it tends to dominate decision-making and will put its own interests above those of the joint venture.[85] When ownership is uneven, one partner typically exercises control, sometimes in ways that are in conflict with the minority partner's interest.

Therefore, I argue that the ownership- and control-related issues play an important role in telecommunications alliances, and they are of particular significance to international telecommunications companies seeking cooperative partnerships. In fact, progressively more telecommunications firms are globally integrated operations that opt for complete control of their foreign activities. Overall profit maximization and transaction cost considerations require that foreign ventures fit tightly into the parents' network.[86] For telecom companies, technical dependency and commercial sensitivity of customer information also influence decisions about what sorts of cooperation would help partners to achieve greater interdependency and mutual integrity.

Thus, it seems reasonable to assume that large telecommunications operators will be more likely to prefer an equity-based corporate form of market entry to licensing or brand-name sharing, as these two latter forms may involve a significant knowledge leakage to potential rivals, including technology spillover. Therefore, the legal and business structures chosen by partnering telecom firms likely will be a product of balancing these factors, including the nature of the alliance and the principal characteristics of the relevant legal systems. Allying

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Telecom to the consortium, British Telecom has taken a symbolic stake of one per cent in that company, and MCI has acquired only 0.5 per cent.

[84] *Collaborating*, *supra* note 5 at 28.

[85] *Ibid.*

[86] The high cost of using the national PTO's network has been driving new entrant competitors to integrate their affiliates or to merge, so as to build alternative networks bypassing the anticipated interconnection costs, see See FCC Report, *supra* note 73.

partners should aim to find a legal structure that will offer their alliance the fewest regulatory burdens while permitting maximum operational flexibility.

However, the resulting legal structure often does not correspond to the business and decision-making structure of the undertaking concerned.[87] Indeed, enterprises with only a minority foreign shareholding, in practice, often exercise substantial influence over day-to-day decision making.[88] Thus, a large multinational telecommunication firm (MTF), with even a minority ownership stake in a particular venture, can to exercise operational dominance over its less-developed partners. Due to the national standards or cultural content preferences, such a firm needs only a nominal minority stake to meet the host country restrictions on foreign investment.

To offset and reduce regulatory burdens, especially in states with rigorous restrictions on foreign equity participation, some companies have established a subtle right to exercise substantial financial and organizational control through the so-called "control agreements," which override the fact that the other partner holds a majority ownership in the venture. Several examples of joint ventures, which have been formed in developing countries, involved state-owned operators and telecom firms where the state company had a majority stake but was unable to exercise long-term strategic control.[89] For instance, the

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[87] Muchlinski, *supra* note 7 at 63.

[88] See IMF, *Balance of Payments Manual*, 5th ed. (New York: IMF Press, 1993). Indeed, International Monetary Fund has defined the purpose of FDI in terms of the direct investor's intent to exert a significant degree of influence on the management of the enterprise resident in an economy other than that of investor.

[89] See K. Deepak Data, "International Joint Ventures: A Framework for Analysis" (1988) 14 Journal of General Management 2 at 71 [hereinafter Data]. D. K. Data argues that a host country, if less developed, enters a joint venture with a different set of objectives than the investing firm from more developed country. For the less developed countries, such joint ventures are attractive because they might provide access to technologies and services that would otherwise be very difficult to advance or buy. Not surprisingly, many entrepreneurs in developing countries often see joint ventures with foreign partners as an important mechanism by which they can achieve their competitive objectives. As it is quite apparent from the above statement, the objectives of the parties in a joint venture are often not necessarily congruent and a weaker partner has to compromise. That is also why less developed countries often give up protectionism of domestic ownership for the sake of attracting higher in-flows of foreign funds, transfer of knowledge and expertise. See further Chapter 2, below for a complementary

Ukraine Ministry of Communications has failed to include plans to modernize the country's long-distance regional networks in the *UTEL* joint venture agreement with AT&T, Deutsche Telekom and PTT Telecom Netherlands despite its 51 percent majority stake in the relevant joint venture.[90] Evidently, *de jure* ownership and shareholding may not reflect *de facto* managerial control and influence that the firm has over decision-making in a joint venture involving foreign partners.[91] In this regard, it seems appropriate to discuss (1) some of the consequences of MTFs' adapting joint venture strategies and (2) strategy-related issues relevant to the selection of cooperative methods that affect the governance structure of an ITA.

1.3.3 JOINT VENTURE STRATEGIES: IMPLICATIONS FOR INTERNATIONAL TELECOMMUNICATIONS ALLIANCES

> *"Strategic alliance is just a buzzword used by corporate hipsters for what used to be called joint ventures"*
>
> — M.Y. Yoshino & U.S. Rangan

According to J. Killing, there are three types of joint venture strategies. They correspond to the allying partners' desired levels of management control,

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discussion of joint ventures formed by multinational corporations in a reactive response to government pressures.

[90] In the former socialist states of Eastern Europe, entry and establishment by foreign direct investors has been permitted only through the adoption of a joint venture between the foreign undertaking and a local partner. See Muchlinski, *supra* note 7 at 73.

[91] In this regard, it should be noted that the notion of managerial control may also have pivotal implications for antitrust law. In the case of British Telecom/Banco Santander (BS), which was assessed under the EC Merger Regulation, the partners gave a pre-notification of a set of agreements providing for the transfer of the assets of BS's existing network, Megared, to a new company, BT Telecommunicaciones SA (BTSA). The parties presented the agreement as a "concentrative" joint venture, since both parties would have held a 50 per cent stake in the new company. The interesting fact was, however, that while the parties held an equal number of BTSA's shares, the agreements contained an in-built majority for BT. In addition, BT and BS had an equal number of directors on the board, but BT's director had a casting vote, which usually implies a higher level of managerial control of one partner over the venture. See *British Telecom v. Banco Santander* (No. IV M425) [1994] O.J.E.C. Rep. 235 at 347, (1995) 2 C.M.L.R. 157.

decision-making and influence over the partnership.[92] In the dominant parent strategy, the dominant partner's executive makes virtually all of the venture's strategic and operational decisions, even though the board of directors is composed of executives from each parent.

From the business structure perspective, this strategy is appropriate when a MTF is forced to take a foreign partner solely to satisfy a host government's "national content requirement."[93] The shared management venture is essentially managed by both parents. This form is common in situations where one partner supplies the technological know-how while the other provides knowledge of the local market. In such a venture, both partners typically play an active role in the day-to-day management of the joint business.[94] Finally, the independent joint venture involves an undertaking that is relatively free of management interference from either parent.[95]

While in both business and legal theory, joint ventures often are regarded as independent and autonomous businesses, numerous interdependencies inevitably exist between the joint venture and the respective parent companies. These interdependencies can be defined from either a business or law perspective and pertain to the structural nature of the venture. Thus, in several cases of telecommunications joint ventures, the structural interrelations in the venture are associated with the acquisition of cross-shareholdings in the capital of each partner's company. Often, structural joint venture involves "an important

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[92] J.P. Killing, "How to Make a Global Joint Venture Work" (1982) 3 Harvard Business Review 3 at 120-27.

[93] For the examples of so-called "learning alliances" and other joint ventures that have been formed in developing countries by the national service providers and foreign carriers, see Tallman & Shenkar, *supra* note 50. For a discussion of micro- and macro-economic factors stimulating the formation of international cooperative ventures, see S. Globerman, "Foreign Ownership in Telecommunications. A Policy Perspective" (1993) 19 Telecommunications Policy 1 at 26 and M. Landler, "Year of Intense Activity Looms for Phone Industry, Experts Say" *The New York Times* (2 January 1997) C14 [hereinafter Landler].

[94] As a case in point, one may look at the shared management alliance of *Unisource* partners.

[95] See Data, *supra* note 89.

change in the structure of the business assets of the parties to the agreement."[96] Such a structural change usually occurs because the joint venture takes over or extends the existing business activities of the parent companies or because it undertakes new activities on their behalf.

Indeed, structural joint ventures can also exemplified the various business forms of JVs, namely the dominant parent, shared management and independent venture. Structural joint ventures are characterized by the commitment of substantial financial as well as non-intangible assets such as intellectual property and know-how by the parties involved. Furthermore, the concept of structural joint venture also includes "partial function" ventures that assume one or several specific functions, especially R&D and production, that were formerly internal to the parents' independent business activity, but without providing access to the respective markets.

This concept also covers "full function" joint ventures that are marked by a coordination of independent undertakings among the parties or between them and the joint venture.[97] "Full" and "partial" joint ventures have been recognized as attractive strategic options in the telecommunications industry: *Concert*, the global alliance between BT and MCI, provides a good example of telecom firms that have recognized the strategic relevance of these options.

The potential sophistication of these arrangements is epitomized by *Concert*, which, as a separate structural form, can neither market nor sell its own product line to end customers. It is MCI, which has the exclusive right to sell the *Concert* portfolio of services in the Americas, including the US, while BT is responsible for these activities elsewhere. Such a strategy allows BT and MCI to set their own prices for *Concert* products and services. In addition, they have entered into related independent alliances and joint ventures with local distributors to maximize *Concert*'s global reach. Partners in these related

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[96] See *STET v. Italtel* (No. 333/3), [1990] O.J.E.C Rep. 395 at 402, (1992) 5 C.M.L.R. 27, and *CB v. France Telecom* (No. 264/3) [1994] O.J.E.C. Rep. 1239 at 1246, (1995) 3 C.M.L.R. 186.

[97] Art and Van Liedekerke "EC Competition Law" (1995) Common Market Law Review at 940 [hereinafter Liedekerke].

agreements, however, do not have any direct influence over the development of the *Concert* products.[98]

Another global alliance from the "big three group of super carriers" is *Global One*, which seemingly pursues a similar joint venture strategy to that of *Concert*. Here again, the partners are exclusive distributors of the services produced by the alliance in their respective national markets.[99] The choice of the specific joint venture structures provides evidence that when highly valued technologies or communications systems are involved, it may be appropriate to assume that the alliance, in general, will exhibit in its international networking function at least the major elements of equity-based organizational structures.

Such equity links are present to offset any uncertainty or potential for opportunism that is inherent in so-called arm's length transactions. The *Unisource* consortium, after the secession of Telefonica of Spain from its ranks, has been considering an exchange of equity stakes in an attempt to consolidate its three remaining members. This strategy seems to confirm the common belief that cross-ownership in the form of equity instruments, such as share swaps, can cement the links between allying partners and reduce fears that a single partner will dominate the venture. The cross-shareholding among the *Unisource* members— KPN of the Netherlands, Telia of Sweden and Swiss PTT— is said to address concerns that this loose grouping consortium lacked the level of partner commitment typical of other major alliances.

Yet, the thesis that an equity-based commitment is a cornerstone of successful alliances is being challenged by a sudden shift in the "pro-equity" strategy of *Global One*. This "mega carrier" alliance, which has been seeking to

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[98] It should be noted that had BT has purchased 100 per cent of MCI as had been proposed in the merger agreement, the *Concert* alliance might have looked at as if it were BT's venture, and not a BT-MCI joint undertaking.

[99] See FCC Report, *supra* note 73 at 9ff. It is noteworthy that in case of the *WorldPartners* consortium, the products resulting from the investments made by its equity members become common property of the alliance members. It appears that the return from the investment accrues directly to the individual partners in proportion to their own success in creating value from the *WorldPartners* products. In contrast, the alliances of *Concert* and *Global One* are each

strengthen its presence in the Asia-Pacific region, recently gave up its plan to enter into an equity alliance with a single Asian partner. The original equity plan, which had been a prime strategic consideration, was abandoned in favor of five exclusive non-equity contracts.[100]

Because these multi-purpose shifts in corporate strategies seemingly influence the evolving structures of international telecommunications alliances, it is, I argue, difficult to draw conclusions as to what specific form of inter-company cooperation should be preferred by partnering firms. Notwithstanding the difficulty of identifying the common features of successful organizational architecture for ITAs, equity links are the most prominent components of a workable governance structure.

Surprisingly, those observers, who have supported this conclusion, generally also caution that equity-based alliances may actually suffer from an overly formalized structure.[101] Contractual agreements establishing equity-based partnerships— even at their best— can only reflect an understanding respecting costs, markets and technologies at the moment that the partner companies sign them. When, due to the contingencies, business circumstances change, as they inevitably do in the case of large-size ventures, partners are unlikely to seek compromise; instead they will seek legal enforcement of the extant contract.[102] Consequently, proponents of equity arrangements are less inclined to perceive ITAs solely as a hub of detailed agreements, because their meticulous fulfillment

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structured so that the venture itself produces a revenue stream from specific products and partners then share those revenues in proportion to their equity investment.

[100] See "Global One Changes Asian Plans As NTT Deal Recedes" *Communications Week International* (16 December 1996). Apparently, the alliance strategy of *Global One* is to form partnership with only one of the top three carriers in any country. NTT of Japan, because of its size and prestige, was widely regarded as a single candidate for partnership. On the other hand, the current organizational structure of *Global One* involves equity partners such as FT, DT, Sprint and Telefonica of Spain as well as many non-equity distributors.

[101] See *e.g. Collaborating, supra* note 5 for an extensive discussion of the instances of the alliance failure due to the over-reliance on the agreements establishing partnerships and partners' overbearing enforcement of their terms.

[102] *Ibid.*

may also create distortion and friction between the partners.

Despite the commonly recognized shortcomings of cooperating under pressure from severe contractual obligations, companies still focus predominantly on developing highly detailed contracts. Although I certainly am not suggesting that a well thought-out legal structure should be of secondary concern to the alliance partners, it is now widely admitted that mutual trust, common vision and proportionate risk sharing are the hallmarks of successful partnership. By adhering to these objectives, rather than referring to the terms of the contract in question, companies may establish a strong cooperative spirit and a well-balanced inter-organizational fit. In this respect, the complicated contractual agreements establishing alliances of international carriers, often termed "quasi-hierarchies," have restricted the parent firms' functional and operational viability.[103]

Therefore, it is reasonable to argue that though these arrangements initially have to be grounded in a detailed and substantially lengthy contract that accounts for all anticipated contingencies, they also should provide clear procedures for dispute settlement as well as agreements on value or asset contributions. Such contracts are typically difficult to formulate and usually costly, especially if they are expected to encompass the various complex business and legal circumstances that may be hard to predict at the time of striking the alliance. Although it is not always the case, it is nevertheless common for carrier alliances to fall into a so-called "exclusivity trap."

An exclusive contractual clause can be a double-edged sword. On the one hand, it can reinforce the success of the alliance by defending against the partners seeking better cooperation opportunities outside the partnership. On the other hand, it can undermine the success of the alliance by altering its

[103] See "BT in Broad Review of US$24B MCI Takeover" *The Financial Post* (1 August 1997) 5 and "Pressure Builds on BT to Renegotiate MCI Deal" *The Financial Post* (17 July 1997) 3. Terms of the merger contract between British Telecom and MCI have supposedly included an agreement precluding renegotiations in the event of difficulties by MCI in breaking into the local call market in the US The review of the terms has been instituted by BT just after the

growth and operational flexibility. Although firms must conform to the obligations set forth by a contract, they should use legal enforcement in moderation to avoid jeopardizing the sustainability of the alliance and undermining mutual trust. Lack of trust may be a reason why it is possible for a firm to cooperate wholeheartedly within the alliance when its partner solely relies exclusively on governing its behavior according to the contractual terms.

1.4 CONCLUDING REMARKS AND SUMMARY

In concluding this chapter, it is useful to summarize the issues that have been discussed herein. The discussion of equity and non equity-based arrangements raises questions as to whether market transactions and hierarchies, when combined in hybrid alliance structures, offer more benefits and less disadvantages than *ad hoc* contracts or vertically integrated ventures in non-alliance collaborative partnerships.[104] With respect to this, I have observed that while some writers predicate contract-based alliances, in particular consortia, on the assumption that they represent an intermediate contractual

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announcement of MCI losses on its local phone business was made may be looked at as a case in point.

[104] On the transaction cost economic theory, see generally O.E. Williamson, *Markets and Hierarchies: Analysis of Antitrust Implications* (New York: Free Press, 1975) and O.E. Williamson, "The Economics of Organization: The Transaction Cost Approach" (1981) 87 American Journal of Sociology 22 and for an extensive review of the related reference literature, see O.E. Williamson, *The Mechanisms of Governance* (Oxford: Oxford University Press, 1996) [hereinafter Williamson]. See also J. Kay, *Why Firms Succeed?* (New York: Oxford University Press, 1995) at 152. J. Kay suggests that the business side of "hybrid strategic alliances" may be described in terms of "relational contracts", i.e. those stemming from a continuing relationship between the partners. Such relational contracts are built on implicit business behavior and cannot be enforced legally because the enforcement mechanism is the value of the ongoing relationship between the parties. The "relational contract" school established by I.R. Macneil distinguishes between classical contracting, used for discrete market exchanges, and relational contracting, which applies to long-term arrangements through which parties deal repeatedly. See I.R. Macneil, "Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law" (1978) 72 Northwestern University Law Review 56 and I.R Macneil, "The Many Futures of Contracts" (1974) 47 Southern California Law Review 64. Contracts entered within the the context of a continuing relationship are less subjected to oportunistic breaches because the contracting parties are unlikely to risk the distruction of the future benefits realizable by maintaining the relation. ITAs, therefore, are clearly situated towards the "relational" pole on Macneil's relational/classical spectrum.

form, others are inclined to see them as arrangements that jeopardize the viability and longevity of strategic alliances.

Authors such as R. Culpan and J. Contractor note that a non-equity alliance may be a sustainable alternative to the cooperative mode of a joint venture-based alliance. Others, like R. Carlson, prefer to cast telecommunications alliances as internal ventures reinforced by the cross-divisional development of technologies and systems. I have suggested in this chapter that strategic alliances should appropriately be defined as "networking companies" emerging from intricate patterns of evolving inter-firm partnerships.[105]

I have also looked at strategic alliances through the lens of "organizational hybrids" to expose their distinctive characteristics by identifying their relation to some broadly understood common forms of collaborative arrangements. By incorporating the common dimension of hybrids and other arrangements, I position the governance structure of ITAs *vis-à-vis* strategic alliances and other inter-company collaborative forms. This has allowed me to suggest that, given the body of literature I researched, there is not yet sufficient empirical evidence to support unilaterally one or another of the various descriptions of ITAs.

Instead, it is only possible to identify the commonalties and differences exhibited by traditional and newly emerging corporate governance structures. Nevertheless, it is useful to bring forward some general observations on the corporate structure of ITAs. I synthesize below my main observations on current ITA's structural forms:

1. ITAs encompass a hybrid form of freestanding pro-cooperative inter-company partnership which is spread-out across national boundaries in the form of internationally coordinated corporate networks.
2. ITAs have an intermediate governance structure which is located on the integration/interdependence scale somewhere between markets and

hierarchies.

3. ITAs may be informally/formally structured, loosely/tightly connected, and ephemeral/persistent as long as they do not consist of either *ad hoc* pools or fully internally integrated arrangements.
4. ITAs constitute a *sui generis*, self-governing form of inter-company collaboration employing a subsidiary-like, complementary mechanism used by the partnering firms to achieve strategic aims.
5. Strategic alliances are essentially a virtual governance form—that is "a structure without the structure." They are more structured than JVs, since they are typically made up of multiple focused relationships. However, they are also less structured, because they are not rooted in the traditional JV organizational form.

This synthesis provides a bridge between the first and the second chapter of this thesis. The discussion in the former was focused on the variety and complexity of organizational forms adopted by strategic telecom alliances. It provides a context or background to the theoretical analysis of their conceptual basis, which will be presented in the next chapter. The account of new types of strategic organizational arrangements in the telecommunications industry tested the validity of existing theories respecting alliances and permits a new conceptualization to be considered.

Clearly, these new corporate hybrids challenge the power of existing theories to identify and explain their multiple driving-forces from a mono-causal perspective. Therefore, the second chapter explains why the tentative hypothesis that strategic alliances, those in the telecommunications industry, are transitional corporate forms that raise difficult theoretical and conceptual issues for business strategy and economic scholarship.

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[105] On pp.86-89, below, the reader will find a discussion of the issue of "networking company."

Appendix A:

Empirical Data on International Telecommunications Alliances

Telecommunications Alliances in 1995		
TRANSACTIONS	Total number 2,913	Total value $ 134 billion
Software products and services	29%	21%
Supporting products and services	20%	6%
Telecom services	12%	35%
Hardware	21%	23%
Media and content services	19%	15%

Table 2: Telecommunications Alliances in 1995. (See *Broad View Associates Report* reprinted in *The Financial Times* (1 February 1996) and cited to the FCC Report on Global Alliances)

Table 2 presents the calculated percentage distribution of alliances and partnerships in the telecommunications industry according to the total number and value of transactions across five segments of the industry. The data show that in 1995 the most active sector was software and services. The study carried out by the Broad View Inc., provides additional evidence that a relatively large number of partnerships and joint ventures underlying global alliances were based in Europe and North America (46%), while a large number of operational locations are Central/Eastern Europe and Central/South America.

Table 3 provides indicators of the geographic coverage of the operational locations of partnerships and joint ventures in the telecommunications industry. The multinational corporation indicator is the percentage of an identified group of multinational corporations headquartered in countries where telco has a joint venture or partnership that is providing services.

Geographic Coverage of MTFs' Operations		
	(%) Weighted by Multinational Corporations	(%) Weighted by International Traffic
British Telecom	80	57
Sprint	74	46
AT&T	59	37
MCI	30	27
France Telecom	11	15
Deutsche Telekom	8	12
Telia (Sweden)	4	6
Telefonica (Spain)	3	4
Swiss PTT	2	5
KPN (Netherlands)	2	4
Concert	81	59
Global One	86	65

Table 3: Geographic Coverage of Operations of Major MTFs. (See FCC Report on Global Alliances)[105]

The international traffic coverage indicator is the percentage of outgoing international traffic generated by countries in which the given telco operates. The home market of each company is included in the calculation of covered countries. With respect to the coverage statistics, there is a large gap between the top four individual carriers – AT&T, BT, Sprint and MCI – and the remaining carriers. Such figures suggest that the US international carriers were more

[105] *Ibid.* at 11.

aggressive than other carriers in setting up foreign ventures for international services. However, those numbers will change as foreign carriers become more active in seeking foreign partners. This trend is likely to generate "defensive transactions" by companies from other regions of the world looking for sufficient critical mass to compete internationally.[107]

2. THE IMPACT OF GENERAL AND FIRM-SPECIFIC DRIVERS OF GLOBALIZATION ON INTERNATIONALIZATION AND INVESTMENT STRATEGIES OF THE ITAs

Synopsis: A significant growth in the rate of foreign investment in telecommunications services has prompted faster and greater internationalization of this sector over the past decade, especially among cross-border telecommunications alliances and consortia.[108] *These organizational forms do not conform to classic models of governance and defy the traditional considerations that drive foreign investment decisions. ITAs elude the capacity of existing business theories to present the complex motives underlying a firm's initial approach to international deployment and its consequent expansion strategy. ITAs display new structures and require new theories; however, because they are modeled on old concepts, they are likely to be a breeding ground for the development of hybrid conceptual approaches.*

Therefore, the international expansion of telecommunications companies requires a multi-theoretical framework that recognizes the complex interplay among factors such as global competitiveness, changes in regulatory policies, and technological advances that spill over national boundaries.[109] *Consequently, this chapter proposes principally that existing business, management, and organizational theories fall short of providing a conceptual schema for the new telecommunications paradigm projected by ITAs. This chapter proceeds with a multi-level analysis of the driving factors behind both foreign investment decisions and cooperative strategies that are conducive to the emergence of corporate networks.*

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[107] *Ibid.* at 15.

[108] See T. Levitt, "The Globalization of Markets" (1983) 3 Harvard Business Review 92 at 102 [hereinafter Levitt].

[109] *Compare* Molz, et al., "Industry Dynamics of Cooperative Strategy" in P.W. Beamish & J.P. Killing, eds., *Cooperative Strategies: North American Perspective* (San Francisco: New Lexington Press, 1997) [hereinafter Molz] for a discussion of the "virtual diamond" model of successful competition strategy pursued by an individual firm where success, according to Porter's "national diamond model," would not be expected at the industry level.

Research hypothesis

The globalization of telecommunications services is inexorably linked to the rapidly accelerating dissemination of technology innovations to globally-dispersed markets. Anticipating significant spillovers, telecommunications firms engage in intricate patterns of technology-driven investment and internationalization to ensure global competitiveness. Investment and internationalization strategies involve either equity or non-equity modes of international entry and numerous cooperative arrangements consequently struck by competing firms among themselves.[110]

When relatively simple hierarchical and vertical structures are replaced with complex webs of inter-firm relationships, the communications industry abounds with equity and non-equity links proliferating within corporate networks.[111] Hence, the business organization paradigm for telecommunications firms is now shifting from examples of multi-domestic companies to models of global super carriers. In as much as new networks and technological advances transcend national and industry boundaries, the concepts of territory and sector have begun to break down. Therefore, ITAs, being the most striking example of networking companies, pose a fundamental challenge to the conventional foundations of business organization and regulation, in particular, by necessitating their redefinition. The application of the research hypothesis to the

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[110] Flows of FDI may be distinguished from stocks, which present the total value of the holdings of foreigners. The flows, on the other hand, are the value of new capital introduced over time under the direct investment strategy. (See S. Chan, *supra* note 3 at 216). The aspect of control distinguishes direct investment from portfolio investment, which is simply the establishment of a claim on an asset for earning some return. In practice it is difficult to determine what share of ownership brings with it actual control, even if one could objectively identify the investor's intent to assert or disregard such control. See E.M. Graham & P.R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1989) at 8-9. (N.B.: The idea of interchangeability of ITAs and FDI presumes that only equity-based partnerships represent the pure form of strategic alliance because equity input and consequent investment strategy lie at its very core. See Part I, above, for a discussion of this issue).

[111] The reader may find it useful to refer to the definition of ITAs in the first chapter, where it is maintained that the equity stake is at the core of every strategic alliance but not cooperative ventures such as marketing, distribution, and brand name sharing agreements. See Part I, pp. 45-50, above.

new forms of business organization demonstrates that corporate hybrids are both a product of the globalization of telecommunications and a catalyst for further changes in strategies and organization.

We have seen that the trend toward the formation of ITAs is characterized by a wide range of factors simultaneously stemming from and contributing to the globalization of the telecommunications industry including its services and their providers. This chapter proposes a framework for discussing these factors and isolating the driving forces behind investment decisions in the industry. Investment drivers coincide with corporate strategies; however, the major drivers of industry and individual firm globalization vary across countries and markets.

Several factors have traditionally been proposed in the international business literature as underlying the conceptual link between a firm-specific global strategy and industry-wide drivers of globalization. Those factors are relatively important to both industry and firm-specific globalization occurring in different sectors across different countries. The main factors impacting the globalization processes include liberalization, deregulation and competition.

Impelled by the combination of liberalization, competition and technological innovation, an increase in foreign investment is another contributing factor to the worldwide trend to globalization. It is precisely an interplay of those variables that prompts different firms across different industry sectors to invest in and enter the international arena. The growing rates of foreign investment indicate that the drivers of industry-wide globalization, when combined with firm-specific global strategy levers, provide the basic means for obtaining competitive advantage.

Competitive advantages are driven by markets, resources, and global competitiveness on the one hand and by the interplay of globalization factors on the other. The conjunction of these factors imposes on industries and firms a dynamic process of restructuring and often compels the removal of the various policy barriers segmenting markets for goods and services. Indeed, newly-

minted policies to "deregulate markets" and enhance competition may provide firms from industries such as telecommunications with major competitive advantages.[112]

There is now a consensus among business scholars that the interplay of different sets of comparative advantages determines the investment patterns of globally operating firms.[113] This chapter accords the presence of at least three of these advantages—namely, ownership, location, and internal organization (henceforth O-L-I)—as being particularly conducive to enhancing firm-specific globalization.[114] The examination of these advantages is vital for a better understanding of the broadly conceived capacity of multi-domestic companies to achieve a truly global reach.

The main research question in this chapter is whether the concept of O-L-I configuration is broad enough to fully accommodate the multi-causal motivations of firms to invest abroad: can rationales for foreign investment decisions be derived from the eclectic paradigm theory notwithstanding its inability to accommodate the other factors driving industry globalization? This question apparently is not about whether the economic paradigm theory is capable of explaining the multi-dimensional paradigm shift leading to the emergence of a new telecommunications alliance, but rather about whether a single theory can be applied to increasingly complex business organizations. ITAs challenge the value of existing theories by requiring new concepts with enhanced explanatory potential. The implications of ITAs for the regulation of international telecommunications will be explored in part 2 of the thesis.

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[112] The rationale for the investigation of ITAs in the context of comparative advantages and competitive strategies stems from existing internationalization theories explaining modes of foreign entry preferred by multinational service corporations.

[113] See Levitt, *supra* note 108.

[114] Throughout this chapter, I will use "O-L-I configuration" and "theory of eclectic paradigm" interchangeably. On pp. 72-74, below, the reader will find an overview of this theory.

The rationale for investigation and literature review

It is a shared view among business theorists that the most significant phenomenon in corporate organizations over the last decade has been the dramatic growth in the formation of strategic alliances.[110] Until the 1980s multinational firms typically operated by relying on a system of wholly owned subsidiaries in foreign markets. But, they have increasingly preferred global network arrangements during the 1990s.[116] Although the fragmented data on strategic alliances makes it difficult to generalize about the patterns of collaborative activity, the alliance phenomenon has been looked at from a variety of perspectives.

These studies have ranged from economic explanations such as transaction costs analysis (Williamson 1975 and Hennart, 1990) through ownership and control models (Contractor, 1990; Killing, 1983 and Geringer & Herbert, 1989) to comparative advantage and eclectic paradigm theory (Dunning, 1980 and Porter, 1985). However, to date there has been no comprehensive or unified paradigm theory put forward to explain strategic alliances. Thus, this chapter limits its scope to providing a tentative account of how investment strategies may contribute to the paradigm shift in the telecommunications industry.

The emphasis, therefore, has been put on the logic of international coordination and cooperation among telecommunications carriers through investment. The transition by telcos form the "utility industry" to "global networks" will underpin the second part of the discussion. This chapter will provide illustrations of the ITAs business organization forms described in general terms in the first chapter. Further, the present discussion will focus on firm-specific

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[115] See *e.g.* G.E. Osland & A. Yaprak, *A Process Model on the Formation of Multinational Strategic Alliances* in Culpan, *supra* note 35; B. Gomes-Casseres, "Ownership Structures of Foreign Subsidiaries" (1989), 11 Journal of Economic Behavior and Organization, 25; and V.P. George, "Globalization Through Inter-Firm Cooperation" (1995), 10 International Journal of Technology Management, 35 [hereinafter George].

strategies for identifying partners and creating successful ITAs.

The following account of "environmental variables" such as competition, network economies, and shifts in regulatory policy—which arguably play an important role in deconstructing alliances—permits an examination of ITAs from the perspective of clients, multinational companies, whose rapidly growing demands are another impetus for the growth of ITAs.

Clearly, ITAs require a custom-made conceptual framework distinct from the traditional explanation of every firm's propensity to expand abroad. This framework should be capable of aligning complex corporate strategies to the study of their motivation. Indeed, a review of the motives behind investment strategies may yield more diversified and comprehensive approaches to ITAs.

2.1 THEORIES APPLICABLE TO THE STUDY OF STRATEGIC ALLIANCES

ITAs form inter-organizational networks to improve their competitive advantage through cost minimization while at the same time maintain flexibility. The change in orientation from competition to cooperation in inter-firm relationships is rationalized according to transaction costs economics. While O. Williamson only gives passing attention to hybrid organizations, including ITAs, others (notably J.-F. Hennart, in the case of equity alliances) have applied transaction costs theory to explain the existence of hybrids.[117] A transaction cost theory of hybrid organization must, as J.-F. Hennart explicitly recognizes, account for why firms choose to form a hybrid (i.e. joint governance) as opposed to internalizing (through a merger or acquisition). The principle of minimizing transaction costs is the intellectual link between a theory of the firm and a theory of the market. R. Coase first posed the important institutional question: why are certain transactions executed through markets while others are internalized

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[116] See Carlson, *supra* note 4 and accompanying text.

[117] See J.-F. Hennart, "A Transaction Cost Theory of Equity Joint Ventures" (1988) 9 Strategic Management Journal at 361 [hereinafter Hennart].

within firms?[118]

Organizational hybrids, such as strategic alliances, where two firms retain their identities but subject certain transactions between them to quasi-hierarchical governance structures, are not anticipated by R. Coase in his work. If the existence of strategic alliances is explained by transaction cost differentials, hybrids must be superior to both market exchange and unitary firm alternatives in certain circumstances. What these circumstances are requires a multi-theoretical elaboration.[119]

The transaction costs approach has been significantly enriched by the work of O. Williamson who views contingent "circumstances" as *ex post* opportunism.[120] The unique manifestations of a particular technology and the transfers of services that alliances frequently involve are likely to give rise to a unilateral or bilateral monopoly depending on the bargaining power of each of the allied parties. These factors suggest the existence of market failures.

Market failures, yet another category of contingent circumstances, are associated with informational exchanges (such as technology transfers) and often result from what K. Arrow defines as the "fundamental paradox" of information.[121] Apart from market failures and imperfections theories, hybrids are also explained by the existence of "imperfect competition."[122] All of the theories

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[118] R.H. Coase, "The Nature of the Firm" (1937) 4 Economica at 386 [hereinafter Coase].

[119] For a discussion of a multi-theoretical approach for analyzing hybrids, such as networks and alliances, see J. Attik, "Technology and Distribution as Organizational Elements Within International Strategic Alliances" (1993) 14 University of Pennsylvania Journal of International Business Law at 273.

[120] See Williamson, *supra* note 104.

[121] K. Arrow, "The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Non-market Allocation" in *The Analysis and Evaluation of Public Expenditure*, vol. 1 (Washington, D.C.: U. S. Government Printing Office, 1969) at 47-69.

[122] See generally C. Zeitharni & A.D. Smith, "A Model of Contemporary International Expansion Processes: Evidence from the Regional Bell Operating Companies, 1984-1991" (1995) 18 Journal of Management Inquiry 5 [hereinafter Zeitharni & Smith]. A. Smith argues that a structural market failure arises from the actions of participants in or outside the market to distort the conditions of demand and supply. The other type of market imperfection implies that the market itself is unable to organize transactions or that the behavior of its participants is difficult

explaining hybrids share with transaction costs theory a limited explanatory capacity to address accurately international hybrid organizations, such as telecommunications alliances.

There is now a shared view among economic theorists that alliances should in part be understood as global strategies pursued by multinational enterprises. Acknowledging that ITAs are increasingly visible across industries and countries compels a multi-theoretical approach. Such an approach will combine the classical theory of the firm, market imperfection theory and the theory of "ownership-" and "firm-specific" advantages.

2.1.1 ETIOLOGY OF GLOBAL ALLIANCES

In acknowledging market imperfections, S. Hymer has addressed the question of why certain firms are better able to penetrate foreign markets than the firms located in those markets (Hymer, 1976). The author has addressed—for the first time in contemporary models of trade—the issues of imperfections in the market for cross-border exchange of services. Drawing on the underpinnings of the organizational theory, he has examined the factors that influence foreign investment.

According to his explanation, a foreign firm will enjoy a certain monopolistic advantage over the host-market firm when the latter lacks, using Porter's language, some kind of "competitive" advantage *vis-à-vis* foreign (investing) firm. As a consequence, a firm with exclusive ownership or monopolistic advantage enjoys a temporary economic rent resulting from structural failure in the host-market. In other words, firms invest extra-nationally to gain higher profits from their competitive advantage. To do so, they must organize and integrate their international operations in order to retain control over their advantage and to avoid the uncertainties and high transaction costs of

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to predict.

operating at arm's length in an open market.[123]

Thus, the next step in theoretical development led to the model of internal coordination of activities within the corporate hierarchy. This has become known as the theory of "internalization," which maintains that where a firm encounters high transaction costs due to the uncertainties associated with supplying or

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[123] S. Hymer, *The International Operations of National Firms: A Study of Direct Investment* (Boston, Mass.: MIT Press, 1976) [hereinafter Hymer]. For a discussion of alternatives to Hymer's local market imperfection theory such as "return on investment" (the capitalization-rate hypothesis) or "appropriability considerations" (that is, the desire of large firms to ensure the private appropriation of the returns of public goods such as knowledge), see *e.g.* H.P. Gray, "Macroeconomic Theories of FDI: An Assessment" (1987) 23 Economic Review and S.P. Magee, "Information and The Multinational Corporation: An Appropriability Theory of Direct Foreign Investment" in J.N. Bhagwati, ed., *The New International Economic Order* (Cambridge: MIT Press, 1977). See further G. Mandelker, *Risk and Return: The Case of Merging Firms* (Cambridge: MIT Press, 1974) for a discussion of multi-domestic strategy characterized by firms sharing costs associated with operating in a foreign environment. Costs are further minimized by the fact that investment takes place in neighboring countries where socio-cultural conditions are similar. See also P. Nemetz & S. Christensen, "A Theory of Multiple Interpretations of Multiculturalism in Personal, Societal, and Organizational Setting" (1996) Cultural pluralism in a business world of multinational (*sic!*) corporations assumes multiple and separate cultures coexisting in the same entity. It involves a process in which members of one group (i.e. domestically-based subsidiary) adopt some norms of the other group under the umbrella of multi-nationally-coordinated parent entity. The case of multinational firms shows that different culture subsidiaries often enact behaviors from their alternative culture subsidiaries - some of them are actually bring into life for this very purpose (i.e. "learning alliances").

However, internationalization process and subsequently globalization forces have prompted "Eurocentric" and technology-driven alliances to respond to increasingly common cosmopolitan need- a seamless service provision. The "californiazation of need" (i.e. turning a particular need into a cosmopolitan [global] need), an offshot of intensifying cultural homogenization, defies the idea of universal preservation of particular cultures. The alliances, as hybrid organizations, should, ideally, be aware of different cultural components of their diverse and multiple nature. (Does hybrid organization pose a threat of organizational schizophrenia by precipitating a "mistaken identity" syndrome?). Cultural homogenization, on the other hand, is the creation of integrated entity by once autonomous affiliates through their gradual integration with firms from a local market. In telecommunications context, integration has become a *sine qua non* condition for a foreign affiliate to gain access to profitable local "end-consumers. Through their complex local inter-company links, the MTF's subsidiaries have achieved an end-to-end functionality and become a stark example of a "[culture] melting pot". See N. Glazer & D.P. Moynihan, *Beyond the Melting Pot* (Cambridge: Harvard University Press, 1963). On cultural homogenization, orthodox consumerism theory and californiazation of needs, see K. Ohmae, "The Global Logic of Strategic Alliances" (1989) 4 Harvard Business Review at 143:

> "Whatever their nationality, consumers [...] increasingly receive the same information, seek the same kinds of products. They all want the best products available, at the lowest prices possible. Everyone, in a sense, wants to live- and shop - in California. Economic nationalism flourishes during election campaigns and infects what legislatures do [...]. But when individuals vote with their pocketbooks [...] they leave behind the rhetoric and the mudslinging and the trappings of nationalism."

distributing products through the open market, it could reduce those costs by carrying out such transactions within the firm. By locking these transactions within its bureaucratic hierarchy, the firm "internalizes" its activities.[124] The internalization theory therefore promotes the possibility of alternative patterns of ownership. It assumes that in place of one firm's selling its service through the market to another firm, which then adds value to it, the same firm may coordinate both sets of activities and replace the market for any service transaction in which they were both previously involved.

The market imperfection and internalization theories were complemented by the theory of "location-specific" advantages. Indeed, an adaptation of market imperfection theory to international trade led to the "location-specific" analysis of foreign investment.[125] According to P. Muchlinski, just as different countries enjoy different endowments of productive resources, firms cannot be equally endowed with competitive assets, or with knowledge of foreign markets."[126]

Unlike S. Hymer, R. Vernon has put forward a hypothesis that the efficiency of firms is country-specific and it depends on the country's ability to upgrade human resources and to create new technologies. His concept of the product cycle is not explicitly based on a market imperfection argument. It focuses on location advantage rather than the possible benefits resulting from the failures occurring in the cross-border markets. Other industrial economists have drawn on the work of S. Hymer and R. Vernon to initiate the convergence of their work by acknowledging the role of market imperfections in trade and location dimensions.[127]

Despite this attempted convergence, there has been a significant difference between the orientations of market imperfection theory and of location-specific theory. The proponents of the market imperfection have tended

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[124] See generally Coase, *supra* note 118 and Williamson, *supra* note 104.

[125] See generally P.A. Samuelson, *Foundations of Economic Analysis* (Cambridge: Harvard University Press, 1947).

[126] *Ibid.* at 35.

to view FDI as an aggressive strategy designed by firms to extend their market power, whereas proponents of the location-specific theory have perceived FDI to be a defensive strategy of firms to retain their leading market position. It seems plausible that, in light of such theoretical differences, contemporary business theorists derived the distinction between "strategic" and "opportunistic" alliances from the divergent approaches of the classical thinkers.

According to differing explanations of FDI, alliances could be viewed as either "opportunistic" or "strategic." Adopting the analysis of opportunistic alliances, A. Smith argues that companies operating in an oligopoly have had to expand into new countries to sustain their local oligopoly position. Companies possessing an oligopoly position are more likely to invest abroad than are firms operating in a state of a perfect competition. In general, "a firm invests not because of market power (a market imperfection argument), but rather because the market fails to extract the value of the asset to be exploited."[128]

2.1.2 ECLECTIC PARADIGM AND COMPARATIVE ADVANTAGE THEORY

Given that the theory of foreign direct investment has two poles, it is not surprising to discover that those two poles have been brought together to create a hybrid approach or "eclectic paradigm." J. Dunning maintains that no single theory of the theories plausibly explain the phenomena of investment and cooperation.[129] He argues that two contemporary offshoots "claim to be able to provide a general theory of MNE activity. These are, respectively, the internationalization theory and the eclectic paradigm of foreign direct investment."[130] Internationalization theory is primarily concerned with identifying

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[127] *Ibid.*

[128] See generally Zeithaml & Smith, *supra* note 122.

[129] See J.H Dunning, ***Multinational Enterprise and the Global Economy*** (New York: Addison-Wesley Publishers Ltd., 1993) at 35 [hereinafter Dunning]. In a sense, Dunning's paradigm is an intermediate and hybrid theory because it escapes the preexisting "concept polarization."

the situations in which firms choose to invest abroad and factors pertinent to international cooperation (Dunning, 1995).[131] However, internationalization theory seems too deterministic because by focusing solely on transaction costs, it fails to consider adequately a firm's strategies. J. Dunning, therefore, offers a new paradigm that attempts to unite a macro-economic theory of international trade with a micro-economic theory of the firm.[132] The (ensuing) eclectic paradigm establishes a direct link to the market imperfection theory in assuming that one enterprise possesses certain assets not available to another and that these assets are geographically dispersed.[133] According to M. Porter, whose research on foreign investment has given a new dimension to the eclectic paradigm theory, those strategic assets are measurable "competitive advantages relative to the best worldwide competitors" (Porter, 1990).[134]

M. Porter suggests also that the best measure of international competitive advantage is the presence of (1) substantial exports to a wide range of nations

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[130] *Ibid.* at 56.

[131] Internationalization theory, which has been elaborated further by the Uppsala Business School, seeks to explain how firms engage in foreign activity to exploit actually or acquire certain advantages without actually referring to the relevant location-specific variables. Its focus is generally a firm's international involvement through the gradual acquisition, integration, and use of its knowledge about a foreign market and its successive commitment to the relevant market.

[132] Dunning, *supra* note 128.

[133] *Ibid.* at 45. These are, naturally, ownership-specific advantages because they are assumed to be unique to firms of a particular nationality. Such assets might be specific to a particular location but—depending on the kind of trade that is carried out by the firm—it might be sufficient to have only either O-specific or L-specific advantages. Assuming L-specific consideration for a firm exporting to the developing country, it may not be necessary for that firm to own any O-specific assets in the importing country. It is quite unlike the case of sophisticated markets where highly specialized products or leading-edge technologies are typically demanded. However, if the firm possesses exceptional O- and L- specific advantages, it may opt to enhance their value through a specific pattern of internal coordination— rather than sell them to their competitors.

[134] *Ibid.* M. Porter, unlike J. Dunning has discussed in particular the regulatory issues influencing a firm's international strategy and its domestic competitive position. See generally M. Porter, *supra* note 74 at 38ff and M. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985). See further M. Porter, *Competitive Advantage of Nations* (New York: Free Press, 1990) at 287ff [hereinafter *Advantage*] for a discussion of the concept of "national diamond." M. Porter argues that global advantages depend on a tightly coupled "national diamond" that combines sophisticated home demand, rich supporting and related industries, and vigorous domestic rivalry to enable a firm to dominate internationally

and (2) significant outward foreign investment.[135] The coordination of trade and investment is crucial for a firm to compete and cooperate in international markets. Following M. Porter, other researchers also consider the specific regulatory polices (i.e. regulatory advantages) to analyze comparative advantages of firms in service industries.[136]

For example, ownership restrictions may stimulate foreign investment in other countries having relatively higher incentives for foreign firms to own their value-added facilities rather than licensing or subcontracting to a local producer or provider.[137] In telecommunications, it is usually desirable to possess certain ownership advantages over the constituent telecommunications firms in order to overcome the presence of entry barriers.[138] Government regulations, export/import controls or strategic trade policy are also of much concern to the MNE, especially if it is interested in (outward) market-seeking investment, which may affect its decision whether to enter the market.

In many cases political considerations—or the "encouraging" action of the host government—prompt firms' decisions to engage in strategic investments for the sake of either market exploitation or dominating competing MNEs. A case in

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"without having to rely on foreign and domestic cooperation."

[135] J. Li and S. Guisinger submit that because of the unique features of some service industries, such as location-boundedness and limited tradability, the competitiveness of service industries should be measured on the basis of the relative importance of outward and inward foreign investment. See J. Li & S. Guisinger, "The Globalization of Service Multinationals in the 'Triad' Regions: Japan, Western Europe and North America" (1992) 4 Journal of International Business Studies 7 at 666 [hereinafter Li & Guisinger].

[136] See *e.g.* George, *infra* note 115.

[137] See Dunning, *supra* note 129 at 30.

[138] See especially R. Lipsey & W. Dobson, eds., *Shaping Comparative Advantage: Trade Policy, Industrial Policy and Economic Performance* (Toronto: C.D. Howe Institute, 1987). According to S. Hymer, the existence of exclusive ownership-specific advantages, like property rights, implies a structural market failure when these advantages are sufficient to outweigh the disadvantages an investing firm faces in competing with host country firms. Through investment, the firm has an internationalization incentive advantage to circumvent or exploit market failure because FDI enables it to control the use of property rights transferred to its foreign subsidiary—often to the detriment of host market competitiveness. See also Hymer, *supra* note 123 at 181. I agree with S. Hymer that defensive investments (so-called 'follow my leader' or 'band-wagon') are undertaken when an MNE imitates investment strategies undertaken by the market leaders.

point is the aggressive investment strategy of Northern Telecom (Nortel), the Canadian Telecommunications MNE, which in the late 1980s moved many of its production facilities to the US so that it could win Japanese contracts. At the time, Japan favored the US as a source of telecommunication equipment because of the politically sensitive US-Japan trade gap.[139] Such a strategic investment could be viewed as an aggressive strategy by a firm to advance its market power or to increase market position and efficiency.[140]

This form of strategic investment follows the maxim: "compete, do not collaborate" by keeping the resources and competencies of enterprises largely independent of each other. Therefore, the individual enterprises are best able to advance their economic objectives by competition rather than collaboration.[141] Consequently, many researchers seek to explain the expansion of enterprises in terms of any perceived gains to be derived from in-house vertical and horizontal integration.[142] Others, on the contrary, argue that the "new capitalism" should be described in terms of alliance and collectivism, mostly because the globalization

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[139] See Dunning, *supra* note 129 at 58.

[140] See Hymer, *supra* note 123. At this point, it may be useful to discuss the substitution of Hymer's 'competition within the markets' theory for the new concept of 'competition for the market': that is, concept of franchising and contestable market theory (Demsetz, 1968). However, such a discussion will go far beyond the scope of this thesis. For an extensive analysis of the relevant theories, see Stehmann, *infra* note 253 . *Compare* R. Vernon, "The Product Cycle Hypothesis in a New International Environment" (1979) 41 Oxford Bulletin of Economic and Statistics 6 at 255ff. In his microeconomic firm approach, R. Vernon stresses the propensity of firms to engage in FDI for the sake of cost efficiency rather than the extension of market power. R. Vernon takes a different line in his examination of MNE activity and emphasizes that competitive advantages arise generally from the internationalization of cross-border markets. The Harvard Business School tradition, which is built upon his approach, advances the theory and holds that it is not only location factors (e.g. spatial distribution of resource endowments and markets) that determine global economic activity of the firms.

MNE investment activity is perceived as a strategic response to the anticipated behavior of its competitors. According to the proponents of this "trade/location approach", an MNE engages in a so-called "exchange of threats" defensive investment to invade a foreign MNE's home turf in response to its host market penetration. Although such "behavioral" corporate theory may seem too simplistic to provide a well-grounded and balanced explanation of market globalization in 1990s, it undeniably offers an alternative view on FDI. In particular, it hinges on a defensive rather than aggressive strategy by firms to protect their existing markets. See Hymer, *supra* note 123.

[141] See especially Porter, *supra* note 38.

[142] See Dunning, *supra* note 129 at 463ff on the theory of hierarchical capitalism.

of markets involves both cooperation and competition between the leading wealth-creating agents.[143]

According to J. Dunning, the "new capitalism" challenges the thinking of economists since Adam Smith, who interpreted collaboration among firms as a symptom of structural market failure rather than as a means of reducing natural market failure (Dunning, 1995). This view assumes that one of the motivations prompting the MNE's foreign investment could be to protect or strengthen its market position *vis-à-vis* its major competitor. Firms in oligopolistic industries, such as telecommunications, will compete in each other's territories—pursuing a variety of strategies such as "follow your client," "first mover," and "exchange of threats."[144] Under the latter, telecommunication operators facing competition in their domestic markets are likely to invest in foreign markets to compensate for domestic market share losses.

2.2 EXAMPLES OF OLIGOPOLISTIC INTERDEPENDENCE UNDER THE 'EXCHANGE OF THREATS' STRATEGY

Examples of oligopolistic interdependence between network operators illustrate how regulatory policies can influence an operator's decision to enter a foreign market.[145] An instance, presented by M. Porter, is the case of Ericsson, a Swedish telecom supplier that has never been insulated from competition in the national market. Consequently, the company was forced to seek export sales aggressively. Unlike Ericsson, Hasler, a comparable Swiss company with significant technological capabilities, was protected as a state monopoly. The state monopoly protection escalated the costs of telecom services and

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[143] *Ibid.*

[144] The interaction between the leading competitors in the services sector has been analyzed recently by Li & Guisinger, *supra* note 135 at 678ff.

[145] See text accompanying note 59.

eventually hampered Hasler's competitiveness. Due to these conflicting regulatory policies, Ericsson is today a leading telecom supplier whereas Hasler is not internationally known.[146]

This case clearly illustrates how the ability of a telecommunications company to engage in strategic investment may *inter alia* depend on the country-specific characteristics of regulatory regimes. If, for example, a government policy is hostile to foreign ownership and its telecommunications industry functions as a state-owned monopoly, the "exchange of threats" strategy is unlikely to be pondered.[147] Therefore, a similar degree of market openness and actual competition in respective markets is indispensable for a reciprocal implementation of "compensatory" investment.

Similarly, the history of British Telecom (BT) illustrates how by allowing interconnection, a public telecommunications operator can expect "reciprocal concessions" from other countries having open markets.[148] Under such a "reciprocal concession," BT has successfully entered the Swedish market, where the provision of services, including basic network operation, has been open to competition—very much like the British telecom market.[149] Not surprisingly, Telia of Sweden, when awarded a license for international calls in the UK, established a switch in London in order to retaliate against BT's having entered the Swedish market. Hence, Telia has been able to compensate for "national" losses resulting from the entry of BT into the Swedish market because it can compete with BT in both markets. (BT, on another front, has intensified its engagements in the US

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[146] *Ibid.*

[147] See *Advantage*, *supra* note 134.

[148] See K. Bernard, "New Global Network Arrangements " (1994) 18 Telecommunications Policy 5 at 393 [hereinafter Bernard]. See generally the commentary on the *Concert* alliance, Part II, below, p.112, note 249. BT (UK), an owner of Syncordia and BT Tymnet, is the 100 per cent owner of MCI. BT has recently been reported to have expressed an interest in acquiring a minority stake in STET, the Italian state-holding company for telecommunications provision.

[149] See *Advantage*, *supra* note 134.

through its strategic alliance with MCI).[150]

In light of the most recent strategic alliances such as *Concert, Global One* and *WorldPartners*, it may be useful to consider what other influences compel corporations to opt for foreign investment.[151] A common view holds that service firms make investments primarily in the highly developed, culturally similar areas of the world.[152] Changes in national regulatory regimes and increasing competition have become important reasons for telecommunication companies to seek to protect and strengthen their present international position regardless of host market culture. Thus, one may be surprised that telecommunications partnerships are typically formed by firms from the Triad countries. These countries have large markets, highly developed and clustered industries as well as stable political situations.[153] They are likely to become primary targets for investing multinationals. Consequently, when one firm invests abroad, its competitors often do the same even at the risk of aggravating excess capacity in a particular market.

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[150] C. Graack, "Telecom Operators in the European Union" (1996) 20 Telecommunications Policy 5 at 346ff [hereinafter Graack]. Relevantly, MCI had considered an independent global strategy over cooperation. At the international level, however, the company was said to recognize BT's long-term potential, which would give MCI almost instant access to various world markets. Consequently, MCI has decided to form a joint venture with BT that would depend mostly on BT's 'service velocity' capabilities and considerations of future risk-sharing. ['Service velocity' refers to the quickness with which a firm works out customer-driven solutions and develops synergies with other companies in response to changing market demands]. See C. McLachlan, "Blurring Boundaries: Joint Ventures Link Countries, Technologies. Economic and Legal Realities Help to Spur an Alternative to Mergers" (1994) 17 The National Law Journal 2 at A2 [hereinafter McLachlan].

[151] See Zeithaml & Smith, *infra* note 122 at 4 for a very useful literature review on internal and external motivations for FDI in light of the new globalization theories. See also *Advantage*, *supra* note 134 for a discussion of the importance of network organization for the competitiveness of a firm and given region or country. The conceptual substitution of internationalization for globalization is consistent with a widely recognized understanding of the organization of firms, often referred to as "clusters" or "networks." Globalization thereby denotes growing synergies of partnering firms and their national economies by means of strategic alliances, foreign investment, and international trade.

[152] See especially S. Agarwal & S.N. Ramaswami, "Choice of Foreign Entry Mode: Impact of Ownership, Locations and Internalization Factors" (1993) 1 Journal of International Business Studies 2 at 5ff [Entry Mode].

As multinational enterprises expand their global presence, suppliers of services such as telecom firms often follow in their wake, sometimes at the explicit request of the client firm. This trend in FDI brings about self-perpetuating paths of corporate growth. The global expansion of telecom firms helps to reduce the costs of operating a global company. Just as a multinational enterprise serves as a conduit for further trade and investment, super-carriers reduce informational barriers between countries.[154]

2.2.1 THE "FIRST MOVER" STRATEGY: THE ROLE OF CHOICE OF PARTNER AND FAVORABLE PAST ASSOCIATION IN THE FORMATION OF LEARNING ALLIANCES

The investment-decision process and the consequent formation of an alliance have been said to depend on the choice of partner and size compatibility among partnering operators. The compatibility-of-size factor makes it clear why smaller carriers must cooperate to compete successfully with large global players such as AT&T. For instance, the cooperation between AT&T and *Unisource* seems to be a more stable and successful arrangement than would be possible with a collection of cooperative ventures between AT&T and each single member of *Unisource*.[155]

Although many researchers seem to agree that small- to medium-size operators are now able to compete with MTFs in international markets through their strategic partnerships with other small service providers, it should not be assumed that the role of large firms is diminishing. In fact, the respective studies suggest that any restructuring of the activity of large firms reflects their

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[153] McLachlan, *supra* note 150.

[154] See "A World of Opportunities: Linkage Between Multinational Enterprises and Telecom Firms" *The Banker* (22 August 1997).

[155] See Entry Mode, *supra* note 152.

preferences for replacing hierarchical/horizontal structures with alliance relationships.[156] There is increasingly more evidence suggesting that small companies partnering in international alliances often fill the niches of large networks. They are likely to owe their prosperity to large firms that supply critical assets, such as a new technology, knowledge and management solutions.

This situation is especially evident among so-called learning alliances created by joining large telecom firms from developed countries with small companies from developing countries. For the large operators, the reasons to participate in learning alliances include opportunities for reciprocal benefits, such as the minimization of undesirable "spillover effects." The large operator is also likely to consider its favorable past association with the prospective partner when entering new markets.

Thus, AT&T formed the UTEL joint venture with PTT Telecom Netherlands, DBT of Germany, and the Ukraine Ministry of Communications in light of past favorable associations. It was crucial to this alliance that AT&T had cooperated successfully with the Netherlands and Germany for more than sixty years in providing international long-distance services between Europe and the United States.[157] In forming the UTEL joint venture, the partners were able to set up a relatively high market-entry barrier for other entrants. Because of the long-established German and Dutch involvement in the Ukrainian telecommunications industry, prospective competitors cannot offer either comparable market knowledge or equally attractive business opportunities.

Similarly, AT&T has recently formed another joint venture (again with the German partner) to manufacture fiber optic cable primarily for the Ukrainian telecommunications market. AT&T's concentration on Eastern European markets reflects its global strategy to anticipate and foster long-term opportunities for gaining greater competitive advantage. Such advantage has already been

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[156] J. H. Dunning, "Re-appraising the Eclectic Paradigm in an Age of Alliance Capitalism" (1995) 3 Journal of International Business Studies 10 at 462 ff.

[157] See *e.g.* B. Ziegler, "Who's Afraid of AT&T?" *Business Week* (14 June 1993) at 32 [hereinafter Ziegler]

generated by its positive, prior undertakings with its Western European partners.

By pursuing the "first mover" strategy, AT&T has successfully targeted the Ukrainian telecommunications market's great potential for local manufacturing and service provision. Consistently, AT&T is also expanding its presence in Eastern Europe by forming new joint ventures in the Czech Republic and Russia, enhancing the company's competitive advantage *vis-à-vis* its global competitors. AT&T's expansion into Eastern and Central European markets has been positively influenced by regulatory comparative advantages such as the privatization of state monopolies and an increasing liberalization of trade.[158]

The relative lack of restrictions on foreign ownership in services and the increasing international competitiveness of other service providers in its home country have prompted AT&T to serve local and foreign customers through the host market. Its early venturing abroad and long-established presence in other regions have increasingly impelled host markets to adopt AT&T's systems as local standards.[159] Such expansion indicates that in the subsequent phase of the internationalization process the significance of cultural distance between home and host country diminishes.[160]

Thus, the direct investment strategy by AT&T has been to address the local market better by offering customized services. Clearly, these advantages could be created because of the AT&T's earlier incumbency and its dominant position in the Czech market, which now yields AT&T economic rents that will

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[158] For an extensive literature review of privatization of state-owned monopolies in Eastern and Central Europe, see R. Molz & E.Gedajlovic, "Transitional Economies, Corporate Theory and Privatization" (1992) 2 International Comparative Management 7 at 155.

[159] Ziegler, *supra* note 157. In its initial start-up phase, AT&T formed several joint ventures across Eastern and Central Europe; for instance, a new alliance, called AT&T Prague s.r.o., with the Prague telecommunications company, Tesla a.s. By strengthening its business presence in the Czech Republic, which dates back to 1928, when transatlantic telecommunications was established between New York and Prague, AT&T has managed to sustain its competitive advantage towards other home-country competitors, namely Bell and Ameritech which are also active in the region. Bell Atlantic, for example, has partnered with US West, Czech and Slovak PTTs in Eurotel, to operate cellular and public switched packet data networks in the Czech Republic and Slovakia.

[160] See Entry Mode, *supra* note 152 at 8.

persist long into the future.[161] Indeed, the creation and preservation of economic rents seems a plausible rationale for the very recent extended investment in the telecommunications market of the Czech Republic by "first-movers" such as AT&T.

Consequently, AT&T has increased its international competitiveness in its home country by keeping its main competitors such as Bell Companies, Sprint, and MCI at a distance from its 'target markets' of Eastern Europe. According to A. Smith, Regional Bell Operating Companies (RBOCs) have a distinct geographic orientation and are quite unlikely to compete fiercely with AT&T in Eastern and Central European markets (Smith & Zeithaml, 1995). Like AT&T, RBOCs have based their geographic orientation on their early successes or partnering relationships.[162] However, they are rather reluctant to enter Russia or Central Europe despite the tremendous opportunities for long-term returns on risks in that region. Indeed, RBOCs are, as demonstrated by their pattern of investment, mainly interested in business opportunities in big, successful and fully developed economies that are inherently international, such as Italy and New Zealand.[163]

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[161] *Ibid.*

[162] See Bernard, *supra* note 148 at 359.

[163] See generally US Department of Commerce, International Trade Administration, Office of Service Industries, *Future of International Telecommunications Trade Issues* (Study Paper No. 2) *available in* LEXIS, Nexis Library, FCT File (on file with the Columbia Law Review) and Landler, *supra* note 93. Bell Atlantic, for instance, has formed a joint venture company—Infostarda S.p.A—with Olivetti to offer telecommunications services to business customers in Italy. The joint venture capitalizes on Bell Atlantic's partnering with Telecom Corporation of New Zealand, STET of Italy, and Omnitel Pronto Italia. It was designed to address the internationally corporate sector that requires highly advanced services, which are provided by the convergence of computing, telecommunications, and media technologies. Meanwhile, though AT&T's international competitiveness is increasing rapidly, its prospects for domestic expansion have been dampened by its recently completed corporate downsizing and by its spinning off Lucent Technologies, NCR and AT&T NSI. Notwithstanding the so-called "lean organization" trend towards corporate downsizing, the telecommunications industry is undoubtedly one with the highest level of consolidation. According to business analysts, this active "strategic realignment" stems from the necessity to find alternative ways to reduce transaction costs—accomplished through new alliances or investment in related businesses. The "strategic realignment strategy" has brought about a significant wave of consolidation that began in 1996 with large deals in the US telecommunications sector. These were principally the proposed $21.3 billion merger of the Bell Atlantic Corporation with the Nynex Corporation and the acquisition of MCI Communications

2.2.2 THE EMERGENCE OF STRATEGIC ALLIANCE UNDER THE "FOLLOW YOUR CLIENT" STRATEGY

The early joint venturing of service multinationals was motivated by the goal of following home (country) client firms, namely, multinational corporations. This client-driven strategy arose because the service firms began to supply the foreign affiliates of MNEs directly with services they had previously supplied to their parent companies. However, regulatory frameworks may favor national monopolies—to the detriment of competition—especially when the incumbent operator is still state-owned or foreign capital participation is not welcomed. Often, incumbent operators in markets not exposed to intensive competition are also forced to expand internationally—primarily because newcomers, even if few, are more likely to concentrate on highly profitable segments, such as business telecommunications.

It is undeniable that large multinational corporations have become the main recipients of highly sophisticated services that can only be offered by international telecommunications alliances.[164] Since those services require an increasing integration of telecommunications systems on a global scale, only ITAs will be able to provide them and consequently will dominate. This is because these "super telcos," unlike national PTOs, are global in scope and well-prepared to offer new services often tailor-made to the specific needs of business consumers.[165]

However, this so-called "client-driven" investment strategy of telecom companies is insufficient to explain on its own the complex motives for forming ITAs. Yet, it plays an important role in our understanding of intricate patterns of

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by British Telecom—valued at $21.27 billion–which was ultimately superseded by *WorldCom.*

[164] See R. Crandall, *Telecom Mergers and Joint Ventures in an Era of Liberalization* (Working Paper No. 2) (Washington, D.C.: Institute for International Economics, 1996).

[165] See US Office of Technology Assessment, *Transformation of Global Telecommunications* (Washington, D.C.: US Government Printing Office, 1997) discussing the new concept of "super telco" providers.

response mechanisms bearing on the emergence of telecommunications alliance. The view that global carriers arose simply as a response to demands from multinationals, like any view of a complex phenomenon, is partial. Nevertheless, many see its logic and importance in anticipating the demand-driven and thereby dynamic character of the telecommunications industry.

An increasing demand for multinational enterprises and their intensifying activities all over the world has stimulated competition among telecommunications operators and directed a sweeping flow of FDI into the telecommunications-related industries.[166] Business customers, especially multinationals operating across national frontiers, require one-stop-shopping services and 'seamless' global communications. A need for these services stems from the operational and strategic capabilities of multinational corporations to transfer their economic activities from one country to another.

Such a transfer is typically contingent upon the realization of any prospective advantages that ensue from the relative differences in, for example, telecommunications policies between the countries. On the other hand, the needs to comply with various regulatory schemes and to settle accounts in various currencies have led many corporations to seek one-stop-shopping. Besides, national operators—unlike independent telecom providers—are often restricted to national boundaries.

Hence, cooperating with other network operators is the only way for such restricted operators to offer services that will be tailor-made to the needs of such profitable customers as multinational companies. The existence of multinationals entails that in order to maintain their competitive advantages, both independent

[166] According to the UNCTAD, *The World Investment Report* (New York, 1995) at 12 (UN Doc. E/673-TD/B/ C.6/341 Sales No.E.95.VII.1), by the early 1990s there were 37,000 transnational corporations in the world with the total stock of FDI exceeding $ 4 trillion in 1995. Transnational capital is, of course, highly concentrated both geographically, by sector and in terms of the share of foreign assets controlled by the largest firms. The *Report* also states that there are 2,000 top multinational corporations, which inevitably become the business target for multinational telecommunications companies offering 'seamless' communications. According to the *Report*, the size for the market for such 'seamless' services is estimated to grow to US $25 billion by the

and incumbent operators must gain access to the home markets for such advanced buyers.[167] Since many multinationals use a variety of telecommunications services from different countries daily, wireless service provision could seemingly alleviate the problem of differential services that are often incompatible, varying widely in their technical characteristics from country to country.

Therefore, there is a pressing need for achieving a seamless interconnectivity that would provide those companies with compatible and fully integrated services.[168] For this reason, telecom operators are likely to press for trade liberalization and deregulation.[169] Thus, it is important to recognize the comprehensive role of telecommunications policy in ensuring the global accessibility and availability of those services to all classes of consumers.[170]

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year 2000.

[167] See *Advantage*, *supra* note 134. With respect to this, M. Porter cites the example of NEC (Japan), which embarked on "a long and frustrating process of gaining access to the US market," in a long-term strategy to establish a presence in the US market.

[168] See A. Cane, "Shake-Ups Reshuffles As Operators Get Ready For The Fray," *The Financial Times* (18 June 1997) 1. According to A. Cane, the world market for advanced seamless services is estimated to total from $3 to $4.5 billion in a couple of years. With the communications market estimated to reach a total of $550 billion in the near future—and international services to reach about $50 billion—the advent of free trade in this sector would be a huge economic advantage to telcos and consumers.

[169] See I. Angus, "The Role of Telecommunications in Business Strategy" in M.F. Estabrooks & R.H. Lamarche, eds., *Telecommunications: A Strategic Perspective on Regional, Economic and Business Development* (Ottawa: Canadian Institute for Research on Regional Development, 1987) [hereinafter Estabrooks & Lamarche].

[170] See ITU, Press Release ANEC/7, "Is the Networked Economy Truly Global?" (21 May 1997) *available in* LEXIS, Nexis Library, BUS-COM File for the argument that multinationals are not the only customers for the network that will constitute the networked economy. From a universal service standpoint, information technologies should create a telecommunications network based on the widest possible level of participation and access to basic services. The concept of a global networked economy was developed by the Canadian writer M. McLuhan in his 1962 book "The Gutenberg Galaxy," which involves the notion of instantaneous communication and erosion of geographical space through the use of new telecommunications technologies. In this regard, ITU Director-General, R. Ruggiero points out that the word "global" has several meanings. The concept of global network implies the capacity to carry all kinds of information and, at the same time, the ability to access from all locations around the world.

2.3 THE CONCEPT OF A NETWORK COMPANY

In his three-part analysis of the consequences of telecommunications liberalization, E. Noam argues that both media convergence and international promotion of interconnection agreements encourage competition. Simultaneously, lower transaction costs stimulate the creation of new types of carriers and delivery systems.[171] Interestingly, E. Noam also observes that these latent forces are gradually driving common carriers in the US to disintegrate. He associates these forces with the emergence of private networks built by systems integrators and broadband services. The broadband services, however, are being offered by the converging 'content' and 'carriage' operators. The emergence of global networks seems to have a parallel effect on PTOs in the international context.

It has been said that the development of these networks and their gradual integration with the 'system of networks' is at least partially attributable to the phenomenon of ITAs. The need for integrating national and international networks necessitates global carriage because only superior system integration capabilities could eventually lead to the "matrix of the 'network of networks' that will envelop us electronically."[172] According to Noam's vision, however, such an

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[171] See generally G.O. Robinson, "The New Video Competition: Dances with Regulators" (1997) 19 Columbia Law Review 27 for a description of the telephone-cable connection in light of the new telecommunications law; and H. A. Shelanski, "The Bending Line Between Conventional 'Broadcast' and Wireless 'Carriage' " (1997) 19 Columbia Law Review 27 at 1049. See also E. M. Noam, "Beyond Liberalization II: The Impending Doom of Common Carriage" (1994) 18 Telecommunications Policy 6 at 435 for the argument that these forces have undermined the institution of common carriage. See further E. Noam, "Will Universal Service and Common Carriage Survive the Telecommunications Act of 1996?" (1997) 19 Columbia Law Review 27 at 969 for a depiction of interconnection rights as a substitute for common carriage and viability of the mixed—common/private—carriage system. For a business analysis of synergies between mobile phone companies and cable TV operators, see F. Koelsch, *The Infomedia Revolution: How It Is Changing Our World and Your Life* (Toronto: McGraw Revson, 1995) at 140ff.

[172] See generally E. M. Noam, "Beyond Liberalization: From the Network of Networks to the System of Systems" (1994) 18 Telecommunications Policy 4 at 286 [hereinafter Noam]. See further B. Petrazzini, *Global Telecom Talks: A Trillion Dollar Deal* (Washington, D.C.: Institute for International Economics, 1996) [hereinafter Petrazzini]. According to the author, the Internet is actually an example of a network of networks:

"[T]here are now a large number of local-use networks centered on 'servers', computers

integration will take place only among the various pieces and elements of physical networks and their segments. The culmination of such integration will be the creation of a higher level 'system of systems' such as the Internet. It may actually be useful to test whether establishing "internal hybridization" will appeal to ITAs seeking out non-carriage partners. If so, would this hybridization within the carriers themselves involve locking up small and independent providers in the incumbent network so that a new "networking company" would emerge?[173]

The authors who argue that global competition pushes firms to adopt complex global strategies—strategies that combine low transaction cost and different techniques of product differentiation—have also promoted the idea of "corporate networking." M. Yoshino, for example, points out that the corporate network used to be related to the notion of global coordination of the web of international subsidiaries, often autonomous and reluctant to relinquish their control over the key-business areas in the name of internally unified strategy.[174] Since most multinationals have reconfigured and built subsidiaries, which now strive for independence, the task would be to integrate them into a coherent global network that will consist of internal and external facets.

The internal network would then capitalize on organizational innovations to cover core businesses, through the mechanism of internal hybridization, and the external network would stimulate global competitiveness by attracting new

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managed by an Internet service establishment. Some are nationally subsidized, designed for researchers and universities to use; others are commercial and charge usage fees accordingly. These myriad networks interact through the standardized Internet Protocols (IP). The "backbone" of the Internet is now made up of dedicated broadband telecom lines linking switches around the world. Management of the Internet is amorphous, consisting of concerned parties informally gathered to deal with issues as they arise."

This model of the Internet described by B. Petrazzini almost entirely corresponds with the future model of telecommunications proposed by E. Noam. Moreover, the amorphous character of the Internet, its non-regulation and *ad hoc* international coordination involving parties interested in finding common solutions to issues as they emerge, make this network of networks a case for proponents of national policies and regulatory agencies rather than supra-national regulation. (See Part II, below, for a discussion of this issue).

[173] See Part I, above, for a comment on AT&T's "traffic locking" strategy, see text accompanying note 160.

[174] See Yoshino & Rangan, *supra* note 2 at 65.

partners. This two-faceted alliance structure underpins the concept of a global strategy for corporate networking by hinging its strategic logic on the assumption that competitive advantages, which have traditionally been gained through international development, must be, in addition, secured through the external networks.[175] It is now a common view that a capability to achieve greater organizational efficiency is linked to a firm's choice of strategic approach for coordinating interdependencies between internal and external facets. Therefore, to illustrate how significant it is for a firm to enhance competitive advantages I will discuss alternative models of coordination strategies actually pursued by three different telecom companies that anticipate the enhancement of existing internal/external network interdependencies.

2.3.1 STRATEGIC CHOICES OF NETWORK COORDINATION: THE CASES OF THREE TELECOM COMPANIES

Building on the interdependencies between the external and internal facets of its network, a firm is well-situated to develop and consequently sustain the types of organizational capabilities necessary for managing system interdependencies across international boundaries. For telecommunications companies, these interdependencies involve the integration and coordination of system elements. These processes reflect the dual nature of a telecommunications network: providing service and equipment.[176]

According to M. Fransman, there are two types of network activities—

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[175] See Molz, *supra* note 109 for a discussion of cooperative strategies in the dominant and peripheral games. The authors concur that the construct of networks is difficult to fit within the basic paradigm of competitive strategy.

[176] M. Fransman, "AT&T, BT and NTT: A Comparison of Vision, Strategy and Competence" (1994) 18 Telecommunications Policy 2 at 138 [hereinafter Fransman]. Prior to the span-off of Lucent, AT&T was both: a major manufacturer of telecommunications equipment and a network operator at the same time. Hence, to conceive of AT&T as a true representative of the service providers would be inappropriate. The existence of two complementary sets of activities reflects a market verticality problem.

namely, services provision (i.e. running/improving) and manufacturing of network elements—that require suppliers.[177] Although both types are inter-related technically and conceptually, it is valid to consider them separately. The ability to manufacture telecommunications equipment has often been seen as largely irrelevant to being competitive in the provision of services.[178] Several telecommunications companies have already spun off their hardware R&D laboratories under the intensifying pressures from managers bent on enforcing a cost-reducing, "lean organization" mode of corporate governance.

Therefore, some companies have chosen not to manufacture equipment but rather acquire it in the open market. For instance, British Telecom (BT), steered away from various joint research and development projects in the field of convergence between communications and computing technology, and decided not to produce and supply computers and computer services. Rather than computer (hardware) manufacturing, it has put more emphasis on customer satisfaction and the provision of services to especially large multinational companies.

However, giving up on some ownership advantages, such as having proprietary technologies of (hardware) manufacturing, has proved to be unfortunate in light of some of BT's alliances.[179] For example, the investment in Mitel Corp., the Canadian telecommunications equipment manufacturer in which BT owned a 51 per cent stake, did not work out well because of the change in BT's strategy. A shift in corporate vision followed by a reconfiguration of comparative advantage has directed BT towards a greater service specialization and R&D in software and system engineering. BT managers believed that increased software capacities might directly and strongly affect BT's competitive

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[177] *Ibid.*

[178] See especially Y.L. Doz, *Government Control and Multinational Strategic Management: Power Systems and Telecommunications Equipment* (New York: Praeger Press, 1979). *Compare Advantage*, *supra* note 134 describing a complete set of value-added business activities ranging from product design and manufacturing through operation to service.

[179] Fransman, *supra* note 176 at 151.

advantage in over-all service provision.

Unlike BT, AT&T has developed a wide range of internal competencies in software, transmission and computing devices for provision of highly specialized and more comprehensive services. By setting its strategic goals on increasing competitiveness through "in-house" vertical integration, AT&T has significantly enhanced its ownership advantages.[180] This positioning has also been achieved through increasing network competencies. Hence, the company was able to compete successfully in other service-related markets (i.e. computing, hardware, and related software) and strengthen its network management at the same time.[181]

Such widespread investment in all service-related areas has resulted in significant competence spillovers so that AT&T is now able to build complex, networked information systems that surpass those offered by other computer manufacturers, long-distance companies and phone-switch makers—making it a leader in combining communications networks, computing, switching, and network operating.[182] According to M. Porter, large scale investment by AT&T and the fact that communications in the US is privately-owned stimulated investment and innovation and continuous integration (Porter, 1990). S. Globerman has pointed out that—regulatory comparative advantage notwithstanding—the relationship between a firm's capacity to innovate, its size,

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[180] *Ibid.* By not committing as much resources to innovation as AT&T and NTT, British Telecom opted for arm's-length relationships with a potentially large number of suppliers. Thus, BT has avoided equipment manufacturing and cost-escalating R&D so as to benefit from the constant existence of a strong group of suppliers on the market who compete among themselves. However, such a simple coordination through the market mechanism may lead to opportunistic behavior on the part of the ad hoc suppliers who, in anticipation of more systematic returns R&D investment, may value long-term orders over periodic ones.

[181] See *Advantage*, *supra* note 134.

[182] AT&T and NCR, for instance, have jointly set up the computer network for after-hours trading at the New York Mercantile Exchange. See "Innovation Key Consideration in Telecommunications Company" *BNA Corporate Counsel Daily* (12 July 1994) 2 on how converging technologies stimulate knowledge-enhancement in firms such as AT&T.

and its vertical integration may be assumed from the fact that firms in the telecommunications industry have long enjoyed distinct comparative advantages closely related to their innovation processes.[183] Although this assumption may seem consistent with "the recent general findings in the industrial organization literature," as S. Globerman argues, there is still little evidence to support it.[184]

Until its most recent corporate restructuring–splitting service provision from equipment manufacturing, AT&T was been said to have sustained its centralized and comprehensive network expansion (i.e. both service provision and equipment manufacturing) for the purpose of "empire-building."[185] Thus, in addition to technology-based advantages, it appears that there can be certain organization-like features within the firm-specific context that essentially bear on the prospect of alliance formation. As proprietary technology is the subject of a strategic alliance, so the form of an alliance's organizational architecture is the product of the structural elements and factors contributed by each firm. The organizational design of the network will have an essential bearing on the ongoing, functional role of the alliance.

Therefore, if a firm is engaging in vertical coordination of its internal network and horizontal coordination of its external network, hybrid organization of future alliances is likely to prevail. However, hybrid organization may turn out to be asymmetric when the external facet of the network has not been developed sufficiently to permit international strategic alliances. For instance, Nippon

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[183] See S. Globerman, ed., "Economic Factors in Telecommunications Policy," in *Telecommunications Policy and Regulation: The Impact of Competition and Technological Change* (Ottawa: The Institute for Research on Public Policy, 1986) at 19ff. The evidence of that kind of relationship is discussed in the Restrictive Trade Practices Commission Inquiry into a vertical link between Bell Canada and Northern Telecom, see *ibid.* at 20-22.

[184] *Ibid.*

[185] See *ibid.* at 30 for a discussion of how telephone companies create separate subsidiaries to enhance their competitive advantages. See also J. Atik, "Technology and Distribution as Organizational Elements within International Organizational Alliances" (1993) 14 University of Pennsylvania Journal of Business Law 4 at 247, pointing out that the structure of the firm is usually indicative of its ability to form and sustain an alliance, but that its proprietary technology yields inconclusive predictions about the control of assets, distribution of control, and responsibilities, etc.

Telephone and Telegraph (NTT) has sustained a wide range of domestic suppliers to manufacture and jointly develop equipment and services, without engaging in international investment.

NTT, a state monopoly, through a close collaboration with domestic producers (i.e. development partners), has succeeded in ensuring an exclusive domestic supply for its business through a heavy investment in R&D.[186] Thus, NTT has been able to avail itself of product innovations much earlier than outside manufacturers. However, NTT's experience of joint R&D with a stable group of national suppliers did not go hand in hand with international experience.[187]

By relying too heavily on enhancing internal competencies, the company failed to develop a substantial internationalization strategy.[188] By contrast, AT&T has taken advantage of its network management, operational flexibility, and international experience to respond to the differences in country-specific consumer demands. The multinational character of AT&T has also been enhanced by the strategic designation of international markets to be exploited by the numerous partners of AT&T's alliances.[189] Therefore, AT&T has coordinated the complementary facets of its network by exploiting the synergies between

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[186] Although some critics, among them M. Porter, argue that by guaranteeing a home market to domestic equipment manufacturers, those manufacturers will be insufficiently flexible to enter national markets. See *Advantage*, *supra* note 134.

[187] See "Realignment and NTT Joint Ventures" *Telecom Finance* (3 March 1997). NTT's competence coordination has been based on close cooperation with domestic suppliers. This strategy has prevented it from taking on any other form of network coordination for lack of involvement in global telecommunications services. NTT has recently agreed to its own break-up, reversing more than a decade of resistance to the privatization proposal plan. Under the agreement reached by NTT and the Ministry of Posts and Telecommunications, NTT will be split up into two regional local-phone carriers and one long-distance company. The agreement calls for the establishment of an NTT holding company, which will own the shares of the newly created companies. In return for submitting to the break-up plan, NTT will be able to enter into ITAs involving equity swaps. The deal will then allow NTT to offer new services and form global partnerships.

[188] See M. Gerlach, *Alliance Capitalism* (Los Angeles: University of California Press, 1992) for a discussion of the relationship between the inward investment restrictions in Japan and internationalization patterns of Japanese multinationals.

[189] See Carlson, *supra* note 4 at 38 for the argument that it is common for larger established

them.[190] The different patterns of network coordination examined indicate that a firm's integration mode (i.e. vertical, horizontal, or both) will have a profound impact on its choice of a global investment strategy. The recent international mergers and alliances formed by such firms as BT and AT&T suggest that strategic flexibility is sustainable when the internal organization of a firm is separated from "a packet of capabilities [maintained] in international activities."[191]

This vast structure of subordinate, criss-crossing networks suggests that corporations prize them as a highly viable means of addressing strategic issues. Because of their effectiveness and risk-reduction, these arrangements are less costly than myriad spot transactions and/or major resource commitments that are typically associated with internalization. Internationalization may be preferred within corporate hierarchy, but if costly, may be questionable or even undesirable from a public-interest point of view. There have been numerous cases of production cartels in which companies either pursued total vertical integration or formed networks that were illegal due to their interference with the open market and equal entrepreneurial opportunity.[192]

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firms to enter multiple alliances in order to access a range of new technologies.

[190] *Ibid.* Because AT&T serves as a nexus for a complex web of alliances, it may be linked through a common alliance partner and, thus, risk the unauthorized diffusion of technological advantages. Therefore, NTT appears to be better-positioned to minimize the dissemination of knowledge and technological advantages through its "closed-end" organization. Nevertheless, there will still be a possibility of commercially sensitive knowledge "leaking" to the other competing suppliers, especially when they are involved in similar kinds of cooperative research and development.

[191] See A.D. Smith & C. Zeithaml, "Garbage Cans and Advancing Hypercompetition: The Creation and Exploitation of New Capabilities and Strategic Flexibility in Two Regional Bell Operating Companies" (1996) 7 Organization Science 4 at 388.

[192] See *e.g.* J. Boissevain, *Friends of Friends: Networks, Manipulators and Coalitions* (Oxford: Blackwell, 1974) for cases in which networking partners have discriminated unduly against outside suppliers as well as created certain vertical exclusionary restraints between outside manufacturers and dealers [hereinafter Boissevain].

2.3.2 COMPETITION AND NETWORKS: PRACTICAL IMPLICATIONS

It was proposed in the previous section that the integration of networks and the emergence of such new organizational structures as alliances may actually bring about anti-competitive outcomes. These could be in the form of excessive network integration and growing cartel-type arrangements between global telecommunications providers.[193] The "cartel-type" ITAs will result in the recreation of *de facto* monopolies with high levels of concentration among weakly competing firms. Thus, there might be a situation in which a strategic choice of network organization would put a new entrant at a significant disadvantage compared with the incumbent firms.[194] Clearly, by definition any network will have some exclusionary effect.

For example, unilateral, or vertical, network coordination provides a strong stimulus for excessive pricing, cross-subsidization, and exclusion of the outside firms.[195] By contrast, network hybridization or 'internal hermaphrodization' of wire-line and wireless carriers fosters competition by avoiding duplication of incumbent infrastructure and excessive carriage capacity.[196] Because there are niches and discontinuities in the telecommunications network, the exploitation of these niches is a remedy against the cartel-type integration of networks that otherwise might conceivably

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[193] See definitions of "network alliance" and "networking company" in Carlson, *supra* note 4 at 56.

[194] Network characteristics have traditionally been depicted in terms of inherent network economies. The attributes of network externalities negate the applicability of either potential entry or contestable market theory. Potential entry will be meaningful if the new entrant can realize all inherent network economies when the minimum efficient market share is not greater than 50 percent (Landser-Posner Index). A low rate of return on investment is another negative network externality and may significantly impede the financial viability of a new entrant. An extensive analysis of network externalities is outside the scope of this thesis, however, see R. Mansell, *The New Telecommunications: A Political Economy of Network Evolution* (London: Sage Publications, 1993) and P.G. Rosput, "The Limits to Deregulation of Entry and Expansion of the US Gas Pipeline Industry" (1993) 4 Utilities Policy 3 and M.A. Spence, "Contestable Markets and the Theory of Industry Structure" (1990) 21 Journal of Economic and Management Science 8.

[195] See Boissevain, *supra* note 192.

[196] See Noam, *supra* note 172.

occur. It should come as no surprise, therefore, that the liberalization of markets and the establishment of strategic alliances may actually be the main forces aligning price with costs structures.[197]

From a consumer welfare maximization point of view, the change of paradigms in the telecommunications industry should clearly translate into lower costs for telecom services.[198] In the case of private wireless telecom providers, consumers can now buy the bandwidth capacity they need for a given connection at continuously declining transmission costs.[199] This shift towards bandwidth pricing stems from the long anticipated, competition-induced decline in the provision of services by the entrenched public utility infrastructure and the increase in the private service provision.[200]

Since multinational companies demand new communications services that will allow them to send varying amounts of information per second down the transmission line, bandwidth pricing becomes essential for cost-minimization.[201]

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[197] For a discussion of market and public policy failures and their effects on consumers' welfare in the context of telecommunications service provision, see J.M. Griffin, "The Welfare Implications of Externalities and Price Elasticities for Telecommunications Pricing" (1989) 64 Review of Economics and Statistics 1.

[198] For an extensive discussion of obstacles to the attainment of network economies, see *e.g.* W. Sichel & D.L. Alexander, eds., *Networks, Infrastructure and the New Task for Regulators* (Michigan: University of Michigan Press, 1996) [hereinafter *Networks*].

[199] *Ibid.* at 16.

[200] It is beyond the scope of this thesis to discuss in great detail all the issues related to optimal pricing in telecommunications. However, the reader may find it useful to refer to the following sources: G. Faulhaber, "Optimal New-Product Pricing in Regulated Industries" (1989) 1 Journal of Regulatory Economics 4; and G. Brock, "Pricing, Predation and Entry Barriers in Regulated Industries" in D.S. Evans, ed., *Breaking Up Bell: Essays on Industrial Organization and Regulation* (Amsterdam: Kluwer Publishing, 1983) who comments on the non-sustainability of a natural monopoly in telecommunications—such as commodity-based, subsidy-free price structures, or barriers to entry and exit as inducing deviations from optimal-pricing rules (i.e. Ramsey rule). On pricing rules such as marginal cost pricing [involving considerations of traffic/or distance insensitivity of costs of telecommunications provision] and usage-insensitive access charging, see also B.M. Mitchell & I. Vogelsang, "Theory of Telecommunications Pricing" in G. Muskesn & J. Gruppelaar, eds., *Global Telecommunications Networks: Pricing Consideration* (Dordrecht: Kluwer Publishing, 1988). See also F. Cairncross, *The Death of Distance: How the Communications Will Change Our Lives* (Boston: Harvard Business School Press, 1997).

[201] See especially J. Bond, "Telecommunications is Dead, Long Life Networking" (Address to the World Bank Group on Public Policy for the Private Sector, 17 February 1995) [unpublished].

However, the prospect of bandwidth pricing for custom-tailored services challenges existing policies and incumbent operators, which naturally lag behind in responding to them. As competition in domestic markets becomes the norm, these consumers will seek operators that can offer packaged services on a global scale. It would appear that a shift from the existing operators to ITAs capable of offering highly sophisticated solutions and state-of-the-art communications is irreversible. At the same time, it is the rapidly growing demand for such services that explains the trend among telecom operators to enter into global alliances.

According to some business analysts, the telecommunications industry should be prepared to stimulate this demand for novel services in the future. Like the international airline industry, the telecom industry requires significant investment in networks and in the provision of new services.[202] Empirical study in the US and UK determined that controlling costs and continuing market growth may not be sufficient to maintain a high profit margin in the telecommunications sector. In the US and the UK the growth in demand for new and advanced telecommunications was slower than expected. The data seem to sustain an argument that new advanced services are beginning to compete with, and substitute for, the existing services rather than creating new demand.[203]

Therefore, there is a need to stimulate the demand for new services either

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Paging, for instance, requires narrow bandwidth (i.e. a small amount information per second), while new multimedia services (e.g. teleconferencing) require considerably more bandwidth because the transmission of video sends much more information down the line than does the transmission of sound alone. Unfortunately, most telecom operators do not offer choices in bandwidth: customers get a standard telephone line, accommodating 64 kilobits per second (kbps) in Europe and 56 kbps in the US.

[202] It is beyond the ambit of this thesis to examine in great detail the similarities between the airline and telecommunications industries. It is sufficient to point out to the interesting analysis of parallel types of strategic alliances in those industries: ITU, "Telecommunications: Comparison with the Airline Industry" in *World Telecommunications Development Report* (Geneva: ITU, 1996) See further G.W. Douglass & J.C. Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy* (Washington, D.C.: Brookings Institute, 1974), I. McIntyre, *Dogfight: The Transatlantic Battle over Airbus* (London: Praeger, 1992) and Muchlinski, *supra* note 7.

[203] See ITU, *Preparing for the Coming Profit Squeeze* (Position Paper No. 47) by T. Kelly (Geneva: ITU, 1995) for an analysis of falling revenues in the UK and US fixed-line market.

through price reduction and opening up new markets or through investment in new infrastructure to facilitate the development of new services. T. Kelly argues that there is no substitute for investment and that current windfall profits should be re-invested in the network. However, he cautions against the idea of building a national information structure as being supply-pushed rather than demand-led growth.[204]

Therefore, efficient privately owned PTOs are likely to focus their attention on the most profitable segments of the market—namely, corporate consumers—and to neglect the less lucrative market segments. Such a focus on large business customers is actually quite natural since large buyers have the leverage to extract price and service concessions from telecom carriers. The result of such bargaining is likely to drive down the prices paid by multinationals and raise the prices paid by all other classes of customers.

The consequences of this type of behavior are asymmetric allocations and cost differences that networks will concede to large corporate users. This seems to be borne out in the case of global telecommunications, where network investment appears to be driven by increased demand from the large users, notably multinationals. Thus, as compared with their share of demand, the basic service users are compelled to pay disproportionately for both exploiting the old and building a new infrastructure.[205]

In this regard, H.M. Trebing argues that a strong, bargaining power on the part of multinationals is not likely to be eroded. The unbundling of the infrastructure, he argues, will actually strengthen their power in the oligopolistic setting of international telecommunications prices. In practice, large buyers have been keen proponents of deregulation in telecommunications.[206] Furthermore,

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[204] *Ibid.*

[205] See H.M. Trebing, "Introduction to Part 2: Analyzing Public Utilities as Infrastructure in a Holistic Setting - the New Challenge for Public Policy" in *Networks*, *supra* note 198, for an analysis of public utilities and network infrastructures as interdependent relationships between infrastructure investment, strategic behavior of user groups, and network economies.

[206] The lag between practice and policy in wireless telephony is actually the epitome of the

telecommunications companies have moved rapidly, in part to service their multinational clients, into "unregulated markets" such as computing and into "deregulated markets" such as foreign service provision.[207]

In addition to pressures created by the needs of multinationals, national markets are being fragmented into a variety of niche markets that are best-suited to the new operators' core businesses specialization. In this newly "networked industry," the dominance of the telecom operators over their traditional markets is eroding dramatically. The growing trend towards creating ITAs may stem from the desire of former monopoly players to recreate at the international level "oligarchies" similar to those operating in their domestic markets. In that is the case, the underlying market forces in the industry are likely to be obviated.[208]

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yawning gap between industry realities and government regulation. When AT&T acquired McCaw Cellular Communications, a merger valued at $66 billion as of its 1992 announcement, it threatened regulators with the possibility of recreating a national and end-to-end network much like the one existing prior to AT&T's divestiture. It would have promised full-service telecommunications based on wireless local exchanges and presented AT&T with an opportunity to rebuild its full-service network grounded in wireless telephony. However, with the advent of the 1996 Telecommunications Act, AT&T may resurrect the previous strategy of "emporium building". See J. Chen, "The Legal Process and Political Economy of Telecommunications Reform" (1997) 19 Columbia Law Review 27 at 840.

[207] *Ibid.* By 1993, the nine largest US telephone carriers (excluding AT&T and MCI) had 265 investment programs in 52 foreign countries while 20 large gas and electric companies had only 73 programs in 32 countries.

[208] See R. Pitofsky, "A Framework for Antitrust Analysis of Joint Ventures" (1985) 54 Antitrust Law Journal 37 at 898 for an argument that the suppression of potential competition is the principal anti-competitive concern in alliances.

PART 2 LEGAL AND REGULATORY RESPONSES TO THE GLOBALIZATION OF SERVICES AND EMERGENCE OF GLOBAL CARRIERS

INTRODUCTION

International institutions and traditional economic organizations (i.e. firms) are at the centre of attention for practitioners and scholars who are investigating the reformulation of inter-organizational linkages.[209] A comparative study of conflicting trends in international relations and law provides an opportunity to reflect on the development of international governance structures and to evaluate strategies for cooperation between states. Current discussions of globalization often project optimism about growing global unity and prospects for a new world order based on a strengthened and integrated framework of international institutions. Although change factors associated with globalization have created an awareness of the need for new forms of international cooperation and a system of global governance, it is misleading to think that global economic trends are eliminating the political structures of national states.

Together with globalization, there has been a countervailing trend towards fragmentation because of continuing awareness of diversity and the realization that states pursue independent goals. The dynamics of change and interdependency suggest an intensifying relationship of the contradictory cross-currents in law and economics. A central dilemma of neo-liberalism is that the pressures to further develop international economic integration run against the belief that the primary political unit remains the sovereign nation-state.

Although the neo-liberal process of economic cooperation has focused primarily on the organization of global trade within the WTO, the proliferation of

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[209] We have already seen older international institutions such as GATT being transformed into new ones like WTO and that WTO has been transformed from an IGO (international governmental) organization to a hybrid INGO (i.e. the hybrid is formed by both governmental and nongovernmental members). For an elucidation of this argument, see P.M. Nichols, "Realism, Liberalism, Values, and the World Trade Organization" (1996) 17 University of

international regulatory networks in fact does little to remedy the "legitimacy deficit" of international institutions. In this context, it is not surprising that there is now broad cross-disciplinary debate over the state-market dyad at national, regional and global level. The tension between globalization and fragmentation of markets and states has created pressure for changes in institutional theory.

3.1 MACROSCOPIC THEORIES OF HYBRID INSTITUTIONALIZATION

Questions of how to conceptualize relations among independent nation states and social as well as economic institutions have become a common concern of contemporary scholars. In particular, "bipolar" approaches to international relations, institutions and law have been increasingly challenged by the construction of complex networks of institutional arrangements. Arguably, only complex theories are capable of addressing adequately institutional networks, forged by the direct interaction of various types of actors; states, interest groups, transnational organizations etc. The dominant paradigm in both international law and international relations was state-centered, i.e. positivism in international law and "realism" in international relations.

"Realism" views states as the primary actors in international politics and treats all states as autonomous and self-interested. While realism and its adjunct, cooperation theory, have greatly improved our understanding of relations among states, they do not provide an adequate account of the myriad transnational and national institutions. Critiques of realism within international relations theory have gone through successive phases: transnational politics, pluralism, and neo-liberal institutionalism. In particular, according to neo-liberal institutionalism, nations are not considered the ultimate actors on the international stage. This theory attempts to understand states' interests with

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Pennsylvania Journal of International Economic Law 851 at 7. For a useful literature review of the comparison and taxonomy of international organizations, see *ibid.*

reference to the institutions that connect to them.[210]

Underpinning the complex and multi-layered network of international bodies is the debate over the way traditional economic and social interactions are regulated.[211] Neo-liberal institutionalist analyses of those interactions have been providing an agenda for how to relax hegemonic assumptions in the older theoretical models. The "middle range" analyses accommodate a wide spectrum of theoretical possibilities and recognize that contemporary international relations cannot be understood in all circumstances by relying solely on centralized or decentralized models.[212]

G. Teubner in his essay on "The 'State' of Private Networks" argues that pluralism and more recent "neocorporatist" models may be helpful in revising traditional accounts of institutional configurations.[213] He concludes that it is important progressively to move towards a richer institutional theory to exploit complementary features between international relations and legal theory as well as transaction cost economics and cooperative strategies.[214] In this context, D. Kennedy & C. Tennant identify "a dramatic increase [...] in the volume of scholarly work that aims to rethink the foundations of international law to respond to recent trends in political, social and economic theory". Thus, they announce the emergence of "New Stream" hybrid theories that will take a variety

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[210] See D. Kennedy & C. Tennant, "New Approaches to International Law: A Bibliography" (1994) 35 Harvard International Law Journal 417.

[211] See J.R. Reidenberg, "Governing Networks and Rule-Making in Cyberspace" (1996) 45 Emory Law Journal 911.

[212] For the argument that the "anarchy-hierarchy" dichotomy should be eplaced with a more nuanced view of hybrid governance in international relations since the traditional rigid dichotomy obscures a great variety of institutional relations. See H. Milner, "The Assumption of Anarchy in International Relations" (1991) 17 Review of International Studies 67. H. Milner argues that since international institutional relations are multi-purpose, the simple anarchy-hierarchy dichotomy draws on a standard (Weberian) definition of the state, as possessing a monopoly on legitimate coercion, which produces a misleading understanding of institutions more generally. *Compare* C. Pinder & L. Moore, eds, *Middle Range Theory and the Study of Organizations* (Boston: Harvard University Press, 1980).

[213] G. Teubner, "The 'State' of Private Networks: The Emerging Legal Regime of Polycorporatism in Germany" (1993) Brigham Young University Law Review at 553.

of approaches and import concepts from a variety of disciplines. Hybrid theories do not constitute a single, cohesive argument; they afford an opportunity for open-system analysis of international institutional governance. In relying on a "network of theories" they offer a pluralistic perspective on relations between international institutions and multiple other organizations.

In particular, P. Taylor offers a "macroscopic" open system of analysis when explicating theories underpinning the complex web of links between international organizations. He divides explanations of international organizations into three groups: 1 - "adjustment theories", which explain the responses of national governments to changes in the global environment; 2 - "integration theory", which anticipates a reformulation of the traditional state-oriented system of international relations; and 3 - "constitutional theories", which go beyond the state system and look toward new methods of ordering the world into a unified whole. Taylor's taxonomy does not end with these broad divisions.[215] Within adjustment theories, Taylor identifies different styles of intergovernmental cooperation in international organization: 1 - coordination; 2 - cooperation; 3 - harmonization; 4 - association and 5 - supra-nationalism. Taylor's work illustrates the tremendous variety of forms among international organizations. Most importantly, it provides a fluid interface for rather than impermeable barrier between theories that only appear to be remotely related.

Drawing on transaction costs theory, one could roughly describe a "market" for international regulation because states, like individuals, can contract towards efficient outcomes.[216] However, taking account of opportunistic behavior

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[214] *Ibid.*

[215] P. Taylor, "A Conceptual Typology of International Organization" in A.J.R. Groom & P. Taylor, eds, *Frameworks for International Cooperation* (New York: Wiley & Sons Inc., 1990) at 12.

[216] The parallel to the Coase-Williamson theory is that firms internalize costly transactions whereas low cost transactions are left to the market between firms. Market pressures ensure that the pattern of transaction costs is efficient; equivalent pressures may not exist in other, that is international, institutional settings. See S.N.S. Cheung, "Economic Organization and Transaction Costs" in J. Satwell, ed, *The New Palgrave: A Dictionary of Economics*, vol. 2 (New York: Groves Dictionaries, 1987) at 56 and D.C. North, "Institutions and a Transaction-Cost Theory of Exchange" in J. Alt & K. Shepsle, eds, *Perspectives on Positive Political Economy* (Cambridge:

by states, international institutions may be inefficient because they are designed to achieve simultaneously differing goals. The existence of simultaneous alternative goals distinguishes institutions from firms; whereas firms increase efficiency by lowering transaction costs, some institutions, by raising transaction costs, increase their bargaining power.[217] This is particularly clear when institutions serve purposes of power and control rather than efficiency. Where one set of actors creates an institutional arrangement designed to maintain control over another, the outcome looks inefficient from the perspective of those being controlled but efficient from a perspective of those who control.[218]

Power and control issues have a special salience in the international setting. The concern is that states will forego cooperative arrangements out of fear that benefits will be distributed unequally because the international institutions are controlled by a small number of powerful states. This so-called "security dilemma" is the international version of Rousseau's stag hunt where, although universal cooperation is the best outcome for all, fear that other might not cooperate leads to the tragic outcome that no state cooperates.[219] As the security dilemma illustrates so well, mutual expectations of non-cooperation becomes an inefficient outcome due to the subsequent development of the state

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Cambridge University Press, 1990). See also K. Waltz, *Theory of International Politics* (Reading: Addison-Wesley, 1979). What remains unanswered is whether "transactions" at the international level are indeed low cost. Given the sheer size of international relations, efficiency considerations are likely, *prima facie*, to instigate cooperation among international institutions. Whether a two-party cooperation model can be routinely transferred to n-actor situations at the international forum remains problematic.

[217] See J. Fearon, *Cooperation and Bargaining Under Anarchy* (Chicago: University of Chicago Press, 1994) for the sophisticated argument and that cooperation problems are predominantly bargaining problems.

[218] See B. Yarbrough & R. Yarbrough, *Cooperation and Governance in International Trade* (Princeton, NJ: Princeton University Press, 1992) at 130 and G.J. Stigler, "The Theory of Economic Regulation" (1971) 2 Bell Journal of Economics and Management Science 21 who argues that antitrust law has the same intent *vis-à-vis* oligopolists.

[219] It is noteworthy that the "security dilemma" in the field of international institutional cooperation is parallel to the "compete – do not collaborate" model of non-cooperation among firms. For a balanced discussion of why cooperation literature has overemphasized efficiency gains and under-appreciated the extent to which realization of conflicting goals impedes cooperation, see

sovereignty system.[220]

Cooperation is therefore difficult but not impossible. International cooperation faces the inevitable challenge of how to bring together self-interested and composite nation states within the formalized international framework such as the WTO. Unfortunately, according to the classical "atomization paradigm," institutions rarely do operate as envisioned by their founders.[221] In particular, they often lack authority at the international level. This

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S.D. Krasner, "Global Communications and National Power: Life on the Pareto Frontier" (1991) 3 World Politics 41 at 336.

[220] This is more apparent in the international security regime where cooperative efforts have been in general less successful than in the economic realm. See J.H. Jackson, "Reflections on International Economic Law" *available in* LEXIS, Nexis Library, File UPAJIEL 851.

[221] For the discussion of "atomization paradigm", see A.A. Berle & G.C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932). Dissociation of wealth and decision-making from shareholders (owners) is inherent in agency theory. Owners become the passive actors to the advantage of active managers who dominate the internal organization of the firm. This restructuring leads to the "atomization" paradigm of large corporations, which depends on gradual dilussion of shareholders' power to control managers, who, in principle, are accountable to them under the agency theory. In the Berle-Mean's era shareholders were mostly individuals and even today, intermediaries rarely own more than 1 per cent of the individual stock of a large firm. Due to the atomization of shareholding, an active shareholder cannot capture the full benefit from monitoring managers. To exercise his/her ownership right, the shareholder should become involved, study the enterprise, or sit on the board of directors, thereby taking on the risk of enhanced liability. But any corporate gain from shareholder involvement is to be divided among all shareholders, making fragmented shareholders rationally forego involvement.

Due to atomization and an unwieldy ownership structure, there are agency costs to bear. First of all, managers, the agents of shareholders, make errors, but the cost of correcting them (i.e. monitoring costs) often exceed the loss incurred due to these errors. To offset these costs as well as bonding costs, there will be an increase in residuum costs - thus an equilibrium seems unattainable. Therefore, some agency theorists finally concluded that rôle of shareholders was to bear, not to shape corporate decisions. However, the 1980s takeover wave proved that managers who deviated too much from shareholders' interests faced hostile takeovers. Alternatively, some takeovers were explicable as agency costs themselves, created by errant managers seeking to expand their empire. These agency costs of overexpansion would also be reduced by a second takeover wave that would break-up inefficient empires. See A.L. Clapses, "Blinded by the Light: Antitrust Analysis of Computer Industry" (1993) 61 Antitrust Law Journal 15 at 899 for a discussion of alliances as techniques of 'empire-building'. The phenomenon of large firms that survived the takeover turmoil is similar to Darwinian evolution, because these firms managed to balance the problems of managerial control, risk-bearing and capital demands. Those organizations have adapted the technique of empire building through, for instance, complex governance structures such as multidivisional firms. However, the cultures of divisions and headquarters did not always mesh, leading to cultural clashes and quests for autonomy preservation. If one were to identify the preservation of autonomy with maintenance of control over an alliance, alliances would pose the following paradox:

might suggest that states can solve their cooperation problems on their own without any significant organization among them. Under the anti-institutionalization approach, international institutions have no significant role in promoting cooperation unless they are personified with the state. On the other hand, no matter how passive international organizations are portrayed to be, they do continue to be created.[222]

This poses an interesting theoretical conundrum for the current analysis of international organizations.[223] International cooperation strategies may actually accommodate a wide spectrum of possibilities that recognizes that cooperation requires neither hierarchical, formalized institutions with full enforcement capacities nor purely informal relationships. One may imagine the "cooperation spectrum" ranging from "self-enforcing agreements and decentralized cooperation without institutions" (under a "cooperation under anarchy" model), or perhaps, "market" exchange model through hybrid organizations to a higher level of institutional consolidation.[224]

The "market" model of cooperation is difficult to maintain in the context of

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"A real alliance comprises the fundamental independence of economic actors, and managers don't like that. After all, for them, management has come to mean total control. Alliances mean sharing control. The one precludes the other". See Yoshino & Rangan, *supra* note 2.

[222] S. Gilbert & P. Strebel, "Strategies to Outpace the Competition" (1987) 4 Journal of Business Strategy at 28 argue that both firms and states are global competitors striving constantly to create new strategic groups such as international alliances and international institutions.

[223] D. Snidal, "Political Economy and International Institutions" (1996) 16 International Review of Law and Economics 121 [hereinafter Snidal].

[224] See "Coordination and Collaboration: Regimes in an Anarchic World" in S.D. Krasner, ed., *International Regimes* (Ithaca: Cornell University Press, 1983) and "Understanding the Problem of International Cooperation" in D. Baldwin, ed., *Neorealism and Neoliberalism: The Contemporary Debate* (New York: Columbia University Press, 1993). See further K. Oye, ed., *Cooperation Under Anarchy* (Princeton: Princeton University Press, 1986) and S. D. Krasner, ed., "Coordination and Collaboration: Regimes in an Anarchic World" in *International Regimes* (Ithaca: Cornell University Press, 1990). For a critique of the "cooperation under anarchy", see H. Milner, "The Assumption of Anarchy in International Relations Theory" (1991) 17 Review of International Studies 6 at 37-69. The ideal of anarchy as an institution-free environment, like the Hobbesian state of nature, does not transfer perfectly to an international setting where the international system and states themselves are socially, politically and economically constructed. Therefore, the international system is likely to be decentralized - states have not yet adopted

international politics, misperceptions and conflicting interests.[225] Cooperation under anarchy is a stark example of inefficient autarky.[226] On the other hand, centralized cooperation is also far from being a perfect solution to the ever-changing environment of domestic politics. Therefore, a plausible model of cooperation strategy should bring together complex and diverse organizational modes as well as governance mechanisms and cooperative strategies.[227]

A hybrid can do it all; it is simultaneously a multi-purpose and multifaceted inter-organizational agreements and a single product of independent organizations.[228] In my view, the attainment of such hybrid

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Hobbes' solution of constructing common international government in contrast to hierarchic domestic politics.

[225] On the neoclassical political economy strand of the "new institutionalism" developed in the transaction costs theory of the firm, see Snidal, *supra* note 223 and Williamson, *supra* note 104.

[226] There is a striking parallel here between a firm and a country. Trade theorists argue that autarky at the level of a nation could be expected to lead to a progressive loss of international competitiveness. Similarly, firm-level autarky leads to the progressive loss of competitiveness as resources are misdirected, key investments fail to be made and core competitive advantages are compromised. In an era of global competition, superior competitive performance is achieved when firms combine country-based, government-based and firm-based advantages. See D.B. Yoffie, ed., *Beyond Free Trade: Firms, Governments and Global Competition* (Boston: Harvard Business School Press, 1993). It is difficult for a firm to acquire such a diverse set of advantages by itself. As global competition intensifies, no firm or state can function as an island of self-sufficiency or attain strategic autarky.

[227] It is important to draw a distinction between organization modes of the hierarchies and price system of the contractual agreements and governance structures viz. economic institutions (firms and markets). See J.F. Hennart, "Explaining the Swollen Middle: Why Most Transactions Are a Mix of 'Market' and 'Hierarchy' " (1993) 4 Organization Science 4 at 529. This distinction does not ensue from the transaction costs economics (TCE) as it neglects the attributes (i.e. methods of organizing) of governance structures in which hierarchies are attributes of a firm and contructual agreements are attributes of markets). Markets are institutions that predominantly use the [contract] price method of organization and they reward agents on the basis of their output. Firms predominantly rely on hierarchies where rewards are based on behavior, that is input. Markets and firms are institutions which use one or both methods to organize economic activities. A complete theory of economic institutions, according to J.-F. Hennart, should simultaneously consider the costs of organizing transactions in markets and those of effecting transactions within the firm (e.g. management costs). This argument is only valid when one assumes that management costs are not included in total transaction costs.

[228] This thesis draws on comparative institutional model built upon studies in organization theory, transaction cost economics (Williamson, 1975) property rights theory (Demsetz, 1989), agency theory (Berle & Means, 1937), general systems theory (Boulding, 1956) and comparative advantage theory (Coase, 1935, Dunning, 1980 and Porter, 1985) to examine multiple interactions, interdependencies and complex organizational and institutional forms (i.e. every institution has been organized in a manner consistent with a particular method).

arrangements would integrate political considerations that are inherently about allocation of coercive powers and enforcement and economic ones such as efficiency, cooperation and competition within the international framework. As multinational corporations and ITAs increasingly transcend state boundaries the exercise of powers by different states with respect to, for example, mergers, inevitably overlaps and intersects.

Yet, strategic alliances undermine state authorities' powers resulting from the separation of the public sphere of politics from the private sphere of market relations. This interaction creates both a competitive tension between states, which seek to preserve their national interests, and pressure towards the imposition, or harmonization of the substantive rules and regulation. In particular, the WTO has made attempts to strengthen the linkages between political and economic issues by coordinating trade and competition law in relation to transnational economic activities.

Research hypothesis

In the previous chapters, I have examined the typology of ITAs, discussed their market strategy as well as investment patterns, and elaborated what the existence of ITAs specifically implies for business organization theory and corporate strategy, including foreign investment as well as network dynamics. Those "business" implications must now be linked with "legal" responses to the establishment of ITAs as found in competition law and regulatory policies. A conceptual relationship between both sets of exigencies bridges the previous (business) part with the present (legal) part of the thesis by referring to the emergence of hybrid-type institutional arrangements within the framework of international organizations. The second part of the thesis is based upon the premise that those regulatory policies and competition laws being applied to global telecommunications alliances are derived from traditional concepts of national jurisdiction and natural monopoly regulatory policies. On the one hand,

no domestic competition authority itself, even if as influential as the US Department of Justice or the European Commission, has jurisdiction to address all the market implications of ITAs. On the other hand, the WTO, while having the international predominance, lacks those legal tools to assess market power of ITAs that are available under the domestic competition law regimes. Does the gap in WTO institutional capacity, exposed by the relation between competition law and trade regulation, require reform of the WTO framework? Currently, Article 9 of the GATS makes only general reference to the possibility that anti-competitive behavior could have trade distorting consequences. It simply provides that Member States can initiate consultation concerning the control of such behavior. The GATS does not purport to establish a transnational code of conduct governing anti-competitive behavior, it simply intends to facilitate the coordination of domestic antitrust review.

To date, policy-making bodies and international organizations have been searching for appropriate regulatory strategies to tackle and channel global mergers and alliances. Most national and regional attempts to define new rules for the review of ITAs – such as EU competition law and the US antitrust law – highlight slowly disintegrating exclusive national jurisdictions and increasingly porous sector barriers. With new global mergers and alliances, however, these national and substantive boundaries that formed the sovereignty paradigm and clear industry definition for regulatory authority and policy decision-making will dissolve rapidly. Thus, the question about how to implement competition law instruments to ensure that new global telecommunications alliances will not distort the competitiveness of a marketplace may gain international importance.

In the following chapter, I will examine how by reflecting on global networks, the European Commission (EC) in a number of its landmark decisions, namely *Concert* and *Global One,* has demonstrated that balancing political and economic trade-offs with competition law concerns is a necessary element for the provision of global telecommunications. These decisions illustrate how regulation and competition law both make an attempt to consistently keep pace

with globalization of telecom markets. The main proposition of this section is that the case of global carriers presents the most salient example of how the ITAs investment strategies and hybrid organization forms reorient traditional system of cooperation among antitrust agencies.

Thus the question arises as to whether the old monopolies that are being replaced by new transnational operators require transnational institutional framework to assess their implications for markets, trade and competition law. Indeed, such a transnational framework may itself be a hybrid form resulting from the institutionalization of various concerns and multi-layered disciplines that come into play upon the "globalization" of conflicting national interests. In the previous discussion I have put forward a proposition that the business viability of alliances depends, largely, on harmonious cooperation among partners. Likewise, supranational framework should provide for a harmonious but informal cooperation among competition law authorities rather than a "highest-common-denominator" outcome in the development of uniform substantive standards of competition law, trade and regulatory policies.

3.1 THE EC AND FCC EXAMINATION OF RECENT ALLIANCES AND MERGERS IN TELECOMMUNICATIONS

Synopsis: The complexity of inter-firm arrangements and the globalization of multinational firms from the telecom industry—utterly reinforced by the convergence of carriage and content—have posed perplexing questions for regulatory authorities and antitrust agencies.[229] *In answering some of these questions, the US Federal*

[229] See M. Styliadou, "Applying EC Competition Law to Alliances in the Telecommunications Sector" (1997) 21 Telecommunications Policy 1 at 47ff [hereinafter EC Competition]. Following the author's reasoning, from a competition law standpoint, one can divide ITAs into two main categories, the first of which has two sub-categories:
1) **Carrier/content provider alliances** – these alliances permit telecom operators from one country to benefit from the forthcoming liberalization of the voice telephony and telecommunications infrastructure in another country.
a) **infrastructure alliances** - with this model, telecom operators have normally opted for a domestic partner, capable of providing to the venture a strong financial basis along with the

Communications Commission (FCC) and the EC, in their recent decisions regarding global alliances, have weighed important industrial policy considerations against the straightforward enforcement of antitrust laws. These decisions constitute guideposts for scholarly debate about whether the competitive benefits of ITAs outweigh their alleged harm to competition.

There are at least three multinational fora that have strongly promoted coordination and cooperation between telecom regulatory authorities. The EC, International Telecommunications Union (ITU) and WTO have made remarkable efforts to establish a comprehensive framework of laws and policies pertaining to broadly conceived telecommunications issues. In particular, their efforts have been aimed towards developing quasi-formal cooperation among competition policy authorities so as to facilitate an antitrust cooperation and common approach to strategic alliances, which have not yet been addressed effectively by the traditional national antitrust systems.[230] Furthermore, in the absence of

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existing network and clientele (i.e. bank) or an existing infrastructure (i.e. energy companies).
b) **content alliances** – these so-called "multimedia alliances" are intended to allow telecom operators to benefit from the market opportunities created by new technologies and the convergence between telecommunications, media and computing industry.
2) **Alliances of telecom carriers** – the main objective of these so-called "global carriers" alliances is the provision of advanced telecommunications services to corporate clients. Arguably, the global carriers seem to attract the most competition by luring prospective participants into the most profitable segment of the telecommunications market. Seemingly, in the course of this chapter, I will limit my analysis to alliances of telecom carriers since this category has attracted the most consideration from the EC Commission and under EU Competition Law.

[230] There is arguably an insufficient basis on which to judge the significance of strategic alliances to competition law and regulatory policy. This problem is related to the lack of precise registration procedures that confounds antitrust and competition law authorities. In general, alliances, unlike co-marketing and R&D joint ventures, need not be announced; there is no registrar of them, nor is notification to antitrust authorities needed in general. By contrast, in the United States R&D joint ventures can be registered with the FTC; if viewed as pro-competitive, these joint ventures may be shielded from damages in any private antitrust law suit launched against them. Canada exempts R&D agreements (Section 45(3) (e) of the Competition Act) unless an undue lessening of competition arises. The Canadian provision applies to both R&D and other types of joint venture activities such as joint production and marketing ventures, which are excluded from the exemption in the US. See generally Canada, Bureau of Competition Policy, *Guidelines on Strategic Alliances* (Ottawa: Bureau of Competition Policy, 1995). See further H.I. Wetston, *The Treatment of Cooperative R&D Activities Under the Competition Act* (Ottawa: Committee on Science and Technology of the Canadian Manufacturers' Association, 1988) for the argument that the Canadian R&D joint venture provision is broader than the protection afforded by the joint venture legislation in the US under the National Cooperative

such cooperation, domestic competition laws may prove inadequate to deal with inter-jurisdictional conflicts.[231] Thus, national policy-makers and competition authorities may find themselves constrained by their weak jurisdictional grip on entities that spill over borders. One may ask whether the international trade regime of the WTO should be extended so as to incorporate basic competition law norms and prevent system-wide friction.

Such frictions are exacerbated by the difficulties that governments have in adjusting to the pace and magnitude of change in the telecommunications industry. For example, multinational telecommunications mergers operate in various and conflicting jurisdictional contexts and require multiple applications and approval procedures. This complexity has revealed gaping holes in the *ad hoc* system for coordinating and implementing national policies. Collective regulatory efforts for adjudicating disputes resulting from the operation of ITAs are likely to surface in the near future.[232]

3.1.1 IMPLICATIONS OF MULTIPLE JURISDICTIONS FOR THE EMERGING ITAs

Because ITAs involve the coordination of complex economic activity across national boundaries, there are multiple, and often competing, legal regimes in play. No one regime fully controls an ITA's relationships because more than one domestic legal system can assert potential authority over the alliance.[233] Multiple jurisdictions create possibilities for substantive conflicts of

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Production Act of 1984.

[231] See e.g. H. Ungerer, "European Policies and Regulation" (1992) 12 Telecommunications Policy 5 at 713 for the in-depth analysis of the major objectives of the EU liberalization program and the separation of regulatory and operational functions at national and international levels.

[232] ITU, *Telecommunications Policies and Strategies* (Study Paper No. MPG-03) by ITU (Geneva: Centre for Telecommunications Development, 1997).

laws, as the rival legal systems will often provide for different and strategically competing results.

A conflict of laws involves two or more legal systems vying to operate. An equally troublesome scenario is indifference on the part of the various national legal systems concerning the resolution of controversies and filling of gaps. This latter situation may be simply the result of the inability of a domestic regime to characterize a transnational organization; an ITA, with its multiple participants of differing nationalities, is arguably even more "state-less" than is the multinational enterprise.[234] Furthermore, an alliance, while in some sense a unitary organization, is not formed by a single organizational instrument such as a corporate charter or partnership agreement authorized under a particular domestic legal regime. Indeed, the various "business agreements" entered into by the parties to the ITA, may well be governed by a variety of domestic laws and, thus, implicate multiple jurisdictions in the ITA dispute settlement.[235] Finally, disputes may be generated by the excessive willingness of a national authority to give effect to specific legal obligations where the foreign party cannot be said to have elected to interpret those obligations according to the source legal system.

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[233] See Khemani & Waverman, *supra* note 19. See further M.P. Broberg, " Merger Control in the European Community" (1996) 7 World Competition 2 at 9ff. [hereinafter Broberg]. Parties to an international merger may typically face the possibility of multiple reviews and challenges posed by any antitrust authority acting alone to block the merger even if it may produce benefits in the other jurisdiction.

[234] See J.H. Harwood II, W.T. Lake & D.M. Sohn, "Competition in International Telecommunications Services" (1995) 19 Columbia Law Review 27 at 874ff [hereinafter Competition].

[235] For instance, MCI and BT had to refer their merger at the national level to the British and American governments and, in addition, at the supranational level to the European Commission.

3.1.2 MULTILATERAL AND BILATERAL PROCESS OF APPROVING INTERNATIONAL TELECOMMUNICATIONS ALLIANCES

There is little consensus as to whether the formation of ITAs is an anti-competitive tactic on the part of incumbent operators. It is may be argued on the contrary that alliances should be encouraged as pro-competitive because they are "a means for the foreign firms to enter the other countries' telecommunications markets."[236] However, even completely freeing up entry into all domestic telecommunications markets is not certain to ensure that normal competitive forces will come to the fore. The ensuing market structure will require some underpinning regulatory framework, even if it is not complex *ex ante* regulation. In the case of the EU, where such a regulatory framework is provided by the rules of the Treaty of Rome, competition policy is becoming a foundation for telecommunications regulation. The EU experience provides framework for assessing the issues carried by and the mechanisms needed to address ITAs. The EC has already dealt with a number of cases involving ITAs and mergers that have presented challenges for competition policy at the European level.[237] Arguably, the EU has conducted a unique experiment in operating an integrated competition law and policy that provides lessons at the global level.

European telecommunications markets are, in general, characterized by the presence of large PTOs enjoying a significant degree of market dominance. Ensuring that these PTOs do not abuse dominant position is thus a central task of the competition authorities in the EU. It is important to detail the actual practice of the EU competition authorities regarding ITAs.

It has been said that the competition articles of the Treaty of Rome have put into place an *ex ante* regulatory regime. In applying these articles to ITAs,

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[236] See Atik, *supra* note 185 at 292.

[237] There are two conflicting views on the competitive effects of ITAs. See Petrazzini, *supra* note 172 for a discussion of whether new global alliances might lead to the formation of cartels and eventually impede competition.

the European Commission has become "a regulator of regulators" by extending its powers over the telecom providers from outside the EU. Although the Commission applies Article 85 exemptions and Article 86 *ex post,* the pre-notification of transactions under the Merger Regulation dispositions, is applied *ex ante* to assess the competitiveness of ITAs. [238]

It is well known that Article 85(1) of the Treaty of Rome prohibits agreements or practices that appreciably affect trade between Member States and have as their object or effect the prevention, restriction, or distortion of competition within the Common Market.[239] Article 85(2) renders such prohibited agreements void. Article 85(3) provides that an exemption can be granted to any agreement or practice that is found to be, broadly speaking, in the public interest—meaning that it satisfies two positive and two negative requirements.

In applying the conditions of Article 85 (3) EC, the Commission enjoys a relatively wide margin of discretion since the exemption conditions are broadly drafted. In particular, the first two conditions for exemption—namely, that agreements must contribute to promoting technical or economic progress while allowing consumers a fair share of the resulting benefit, leave the Commission

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[238] See See P. Holmes, J. Kempton & F. McGowan, "International Competition Policy and Telecommunications: Lessons from the EU and WTO" (1996) 20 Telecommunications Policy 10 at 755 [hereinafter Holmes]. The Commission directives under Article 90 (another of the Treaty's competition rules) require that after 1998 all telecommunications services and infrastructure markets will be open to competition. Article 90 states that public undertakings such as PTOs, or undertakings given special or exclusive rights by the Member States, should not be exempt from the competition rules of the EC Treaty. Article 90 (3) gives the Commission the authority to issue directives ensuring that such undertakings adhere to the competition rules. The consequence of this is that regulation is not replaced by the market alone, but by competition law controlling any market asymmetries that may induce anti-competitive behavior. This shift in emphasis from *ex ante* regulation to an *ex post* reliance on competition law is likely to become apparent, as liberalization is fully introduced in the EU market.

[239] *Treaty Establishing European Economic Union,* 25 March 1957, 298 U.N.T.S. 3, art. 85(3) [hereinafter *EEC Treaty*]. Article 86, on the other hand, prohibits abuses of a dominant position. There is no provision for an exemption from that prohibition. Apparently, the EC invoked Article 86 much more rarely than Article 85. See generally Ch.W. Bellamy & G.D. Child, *Common Market Law of Competition,* 3rd ed. (New York: Macmillan, 1987) and D.Wyatt & A. Dashwood, *The Substantive Law of EEC,* 2d ed. (Sydney: Law Book, 1987). See also D.W. Hayter, "Scapegoat for the Trade Deficit: Does EEC Antitrust Treatment of Joint Ventures Place the United States at a Competitive Disadvantage?" (1995) 16 Hastings International & Comparative Law Review 5 at 393ff [hereinafter Hayter].

sufficient flexibility to achieve the objectives of the EU competition policy. The two last conditions for exemption ensure that an appropriate balance is struck between the restrictions on competition and the benefits accruing to the consumers from the agreements to be exempted.[240]

When the Commission deals with the notified joint venture under the Merger Regulation, or Article 85 EC, its common practice is to distinguish between "concentrative" and "cooperative" joint ventures.[241] Unlike concentrative joint ventures (JVs) which, in principle, are examined under the Merger Control Regulation, cooperative joint ventures have to be assessed essentially under Article 85 EC. Transactions, which do not fall under the EC Merger Regulation, may be subjected to national competition regulation, or ultimately to EC jurisdictions under Article 85 of the Treaty. [242]

It has been standard practice to find that the mere formation of a cooperative JV constitutes a technical infringement of Article 85. This is simply because the JV partners are actual or potential competitors and their joint undertaking is likely to restrict competition between the parents. The broad interpretation of the concept of "potential" competition brings virtually any JV within the scope of Article 85(1).

However, the Commission has over time taken a more "nuanced" approach to the issue of potential competition, especially as concerns cooperative JVs of a structural nature.[243] Structural JVs comprise "all forms of

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[240] Besides the indispensability requirement, the other condition is that the agreements must not result in the elimination of competition in respect to a substantial part of the products in question.

[241] It is noteworthy that under the US antitrust law the distinction between "concentrative" and "cooperative" joint ventures does not exist. See *e.g.* H. Satzky, "New EEC Antitrust Regime for Joint Ventures" (1990) 18 International Business Lawyer 3 at 518 [hereinafter Satzky].

[242] *EEC Treaty*, *supra* note 239 and EC, *Council Regulation No 4064/89 of 21 December 1989 on the control of concentrations between undertakings*, O.J. Legislation (1989) No L395 at 1 [hereinafter *Merger Regulation*].

[243] See EC, *Commission Guidelines No 175/83 on the application of the EEC competition rules to the telecommunications sector*, O.J. Information and Notices (1989) No C286 at 4 [hereinafter *Guidelines*]. Section IV of the Notice provides a list of categories of agreements which the Commission believes fall within the scope of application of Article 85 (1). For the purpose of this paper it is sufficient to mention that the second category in the *Guidelines* comprises agreements

cooperation entailing major changes in the structures of the parties to the agreement."[244] However, the precise scope of the notion "structural JV" remains unclear—primarily because if an agreement creates a new undertaking that performs all the functions of an autonomous corporation, it is difficult to see why it should be handled and assessed differently from any other concentration. This is so particularly if the undertaking is not intended to restrict competition between the partners themselves and their respective venture. A restriction may result from the emerging structure of the partnering arrangement or from its anticipated impact on the market position of the allied partners.

Although DT and FT as well as Sprint were indeed potential competitors for the provision of certain customized packages of telecommunications services, the Commission, in assessing the structure of the *Global One* alliance, has found that the venture is structural and cooperative in nature.[245] The *Global One* alliance, as has been emphasized, would entail major changes in the

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concerning the provision of non-reserved services and terminal equipment, including agreements between PTOs, agreements between PTOs and other service providers, agreements between non-PTO service providers, and research and development. According to the *Guidelines*, not only do joint ventures between telecom services providers fall within the scope of Article 85, but even an agreement on the exchange of information, if it extends also to competition sensitive information, could raise serious issues under the relevant Article. However, in light of the "relaxed attitude," adopted by the Commission under the Bangemann Report, the exchange of competition-sensitive information under such joint venture agreements as *Atlas* and *Global One*, which clearly involve significant transfers of all kinds confidential information, has to be treated with a leniency in an era of emerging global telecommunications markets. For the critical approach to the *Guidelines*, see *e.g.* N. Emiliou, "Treading a Slippery Slope: The Commission's Original Legislative Powers" (1992) 23 European Law Review 5 at 308.

[244] For a discussion of the European rules on assessing the competitiveness of structural joint ventures, see EC, *The Commission Annual Report on Competition Policy* (Luxembourg: EC, 1992) at 32.

[245] In response to such newly created international ventures as *Concert* (formerly *Newco*), *Unisource* and *WorldPartners*, the France Telecom (henceforth FT) and Deutsche Telekom (henceforth DT) decided to form a strategic alliance under the name of *Phoenix*. In a defensive reaction to these new alliances, the joint venture between DT, FT and Swiss PTT, named *Eunetcom BV*, was established in 1992. Following was another alliance under the name of *Phoenix*, which replaced the *Eunetcom* joint venture. Soon after, France Telecom and Deutsche Telekom AG formed a joint venture with Sprint Corporation, to be called *Global One* in place of *Phoenix*. See FCC, *AT&T Petition before the FCC in the Matter of Sprint Corporation* (Washington, D.C.: FCC, 1995) [hereinafter *AT&T Petition*] and "Germany to Allow Strong Competition for Telecoms" *The Financial Times* (27 March 1995).

corporate structures of DT and FT and, therefore, their investment in Sprint came under scrutiny.[246] The task of the Commission was to determine whether the relevant investment increased the influence and shared interest that the alliance members had with one another to the point of significantly accentuating the risk of lessening competition.

This market structure consideration has been further weighed with an *ex ante* assessment of shifts in the market position of the parent companies in their respective countries upon the formation of the alliance. From a commercial standpoint, *Global One* was initially considered a mere cross-Atlantic telecommunications line concentrating traffic between Germany, France, and the US. In *Global One*'s final form, upon negotiation with the Commission, DT's, FT's and Sprint's own service offerings could compete directly with the service offerings to be provided by the alliance, especially as customers were more likely to prefer domestic to international telecommunications services.

The same pro-competition reasons were also adduced in support of the requirement that *Global One* partners' directly develop their own activities through subsidiaries and international licenses to offer more comprehensive services to their home country customers. Thus, the *Global One* joint venture could eventually become an instrument for developing global strategies by DT and FT—"undertakings with very limited presence outside their respective home countries"—and by Sprint, whose international undertakings were equally limited for lack of strong regional partners.[247] Although this joint venture has been said to limit competition in the relevant markets, DT and FT's investment in Sprint has finally been cleared and hence Article 85(1) considered inapplicable to the agreements for the sale and/or purchase of shares.[248]

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[246] EC, *Commission Decision of 17 July 1996 relating to a proceeding under Article 85 of the EC Treaty and Article 53 of the EEA Agreement (Case No IV/35.617 - PHOENIX/Global One)*, O.J. Legislation (1996) No L 239/57 at 1 [hereinafter *Global One*].

[247] *Ibid.* at 33.

[248] *Ibid.* at 52-54. Apart from assessing the legality of cross-equity swaps, the Commission was concerned with the application of Article 85(1) EEC Treaty and 53(1) EEA to the contractual

Similarly, in the case of *Concert* alliance, the Commission has concluded that the BT investment in MCI is not caught in the net of Article 85, whereas the creation of the *Concert* joint venture technically is, because BT and MCI are potential competitors with each other and their relevant joint venture.[249] Prior to the incorporation of *Concert*, the parent companies were actually direct competitors—at least for obtaining contracts for similar sets of services. However, the Commission has observed that neither BT nor MCI provided "real one-stop-shopping, end-to-end services to customers' premises located outside the national borders."[250] The *Concert* alliance has thus been commended by the European Commission for "implementing trans-European networks that will allow Europe's major corporations to choose from international telecommunications services of a quality that is currently only available nationally or locally."[251]

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exclusive distribution agreements between the operators. It has been concluded that the creation of *Global One* did fall under the relevant Articles; so did the contractual provision regarding the appointment of DT and FT as exclusive distributors in France and Germany respectively. According to the parties, however, the exclusive distribution clause was meant to reflect DT, FT and Sprint's commitment to ensure *Global One*'s steady funding and credibility. Arguably, its market reputation would have been jeopardized if the members of the alliance had used other global service providers in their respective markets.

[249] EC, *Commission Decision of 27 July 1994 relating to a proceeding pursuant to Article 85 of the EC Treaty and Article 53 of the EEA Agreement (Case IV/34.857 - BT-MCI)*, O.J. Legislation (1994) No L223/44 at 4 [hereinafter *Concert*]. This alliance offers global connectivity of services to corporate clients allowing them to benefit from the advantages of seamless cross-border services through *Atlas* in Europe and through *Concert* worldwide. See also I. S. Forrester & Ch. Norall, "Competition Law" (1995) 13 World Competition 2 at 448ff. It should be noted that despite the liberalized telecommunications market in the United Kingdom, the British government has maintained a duopoly on international facilities-based services. Currently, only BT or Mercury (a C&W owned company) can provide international services on their own cables. Other providers, including AT&T, must lease international facilities from these two companies and not use their own facilities to carry the international traffic. The British government has recently signaled its intention to fully deregulate this market and allow foreign providers to apply for international facilities license. See A.L. Thimm, *America's Stake in European Telecommunications Policy* (Westport: Quorum Books, 1995) at 191.

[250] *Ibid.* at 12.

[251] *Ibid.* at 34-37.

3.1.2.1 COMPETITION POLICY CONSIDERATION IN THE *GLOBAL ONE* AND *CONCERT* DECISIONS

In a sense, both decisions - *Concert* and *Global One* - illustrate how the Commission considers exemption conditions to distinguish global services goals animating these joint ventures from limitations on domestic competition. Those limitations are implicit in the operators' structure and stem from the "not-yet-fully-liberalized environment" in which they function. Therefore, the Bangemann Report has emphasized that the application of competition rules should reflect the reality of the emerging global telecommunications markets and change in traditional models of regulation.[252] Admittedly, by offering a wide range of services, global alliances increasingly challenge the traditional model of separate arrangements with other individual providers.[253] Thus, ITAs would bypass international accounting and settlement processes, the system by which the carrier in the country where the call originated compensates the carrier in the destination country. This system has widely been blamed for keeping the price of international telecommunications services artificially high: global alliances could over time lead to a reduction in rates charged to the consumers of these

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[252] See The Bangemann Group, *Europe and the Global Information Society* (Brussels: EC, 1994) [hereinafter Bangemann Report]. The Bangemann Report includes guidelines for the European Community's policy towards telecommunications, which are gradually updated and supplemented through the Commission's decisional practice of assessing the anti-competitive behaviors in the telecom sector under Articles 85 and 86. See *e.g.* Liedekerke, *supra* note 96 at 957.

[253] See generally O. Stehmann, *Network Competition for European Communications* (New York: Oxford University Press, 1995) [hereinafter Stehmann] for a succinct account of how ITAs contribute to the development of a strategy of network competition in the European Union. He points to the advantages, which may arise if network competition is based on a supra-national perspective. He also points out one significant difference between telecommunications networks and electric and gas networks. For telecommunications, he argues, new technologies have caused a proliferation of alternative delivery systems. Though these systems may be based on a variety of wireless, landline, and satellite technologies, alternative delivery systems are by no means always close substitutes for one another. Rather, these systems appear to have a strong complementary relationship based on comparative advantage in terms of cost, reliability, and quality of service. The problem is how to ensure that consumers can combine or choose between different delivery systems in a fashion that best satisfies their needs. To offer choice in a network of networks and still minimize transaction costs will involve inter-network coordination at a level that far surpasses current interconnection and unbundling agreements.

services.

If the super carriers are the first step towards progressive dismantling of the current accounting and settlement systems, other PTOs are likely to follow global providers in establishing relationships in order to offer end-to-end services. Thus, the emergence of ITAs, far from being anti-competitive, may serve to disrupt the traditional bilateral monopoly relationship between various national PTOs that underpins the international accounting and settlement system.[254] In this regard, there is a growing recognition that the efficient and innovative supply of international telecom services requires that national telecommunications policies no longer focus on purely national concerns such as protecting the national carrier through the imposition of discriminatory interconnection fees.[255]

At the same time, competition forces in liberalized markets may confront telecom regulators with the problem of how to deregulate without jeopardizing the viability of the incumbent public telecommunications operator.[256] The erosion of structure of traditional international telecommunications regulation makes national regulators increasingly aware of the fact that the provision of services is no longer guaranteed by the existing bilateral arrangements between PTOs.[257]

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[254] See J.I. Klein, "The Internationalization of Antitrust: Bilateral and Multilateral Responses" (Address to the European University Conference on Competition, 13 June 1997) [unpublished] [hereinafter Klein].

[255] See Bangemann Report, *supra* note 232.

[256] It has been argued that established PTOs should be given a chance to defend their national position by rationally responding to the competitive challenges of the European Common Market and the emerging global market. According to this approach, national government should make an attempt to preserve the incumbent PTO's position while permitting a degree of privatization and liberalization conducive to striking alliances with other operators. In European countries, the influence of EC competition policy is decisive, but the sheer size of the public PTOs in Germany and France entails a variety of domestic approaches to foreign investment. The focus on FDI in these countries will likely be to ensure access to other markets and to reposition the national PTO as a global carrier. See EU, News Release 96/753, "Telecommunications: European Union Parliament Endorses Telecom Measures on Competition, Trans-European Networks" *BNA Management Briefing* (2 February 1996) *available in* Westlaw, BMB database, File No. 0010. See further A. Perrucci & M. Cimatoribus, "Competition, Convergence and Asymmetry in Telecommunications Regulation" (1997) 21 Telecommunications Policy 6 at 493.

Since each national PTO prices its portion of the network separately and bills separately for multiple sets of services, different technical features of each of the networks will come into conflict. Therefore, it is not surprising that by forming telecommunications alliances and mergers the national operators are striving to achieve interface interoperability, to synchronize systems, and to coordinate networks. Clearly, the important task for telecom regulators is to assure that these new partnerships will not undermine the general pro-competitive objective of liberalized markets without imposing undue restrictions on the emerging ITAs.

Thus, the Commission has been more inclined to support super carriers, rather than to focus on their anti-competitive effect.[258] In principle, the EC applies an antitrust test to ITAs so as to prevent implementation of inter-company collusive agreements. Yet, it underwrites those arrangements among carriers that seek to preserve and enhance their competitive advantage and avoiding dependence on a local PTO for serving international customers.

The Commission does so by identifying, in part, what are the consumer welfare gains that will be achieved proved through ITAs; the antitrust review then becomes a source of seeking concession for partners to the ITA. The nominal compliance of the partnering carriers with the EU competition law is the *prima facie* reason for review. By approving both *Global One* and *Concert* the EU Commission has made sure that they will compete with each other in European and American markets. The *Global One* venture created competition for BT and MCI's existing alliance (i.e. *Concert)*, especially because both alliances have a

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[257] Satzky, *supra* note 241 and Hayter, *infra* note 239 for an account of challenges offered by global telecom alliances to national competition policies.

[258] See EC, *Commission Decission of 15 December 1994 relating to a proceeding pursuant to Article 85 of the EC Treaty and Article 53 of the EEA Agreement (Case IV/34.768 - International Private Satellite Partners)*, O.J. Legislation (1994) No L354/75 at 55 [hereinafter *IPSP*].

[259] The *Concert* alliance showed that investment in a US carrier offers an efficient way of servicing multinational companies. Sprint's highest turnover has been generated in France and Germany and thus its *Global One* partnership with FT and DT is not surprising. Furthermore, FT and DT will certainly capitalize on Sprint's participation in *Global One* because of the latter

similar target consumers - the large multinational corporations.[259]

Three general principles may be derived from the Commission decisions on ITAs. Firstly, The EC Guidelines on the application of the competition rules to the telecommunications sector provide that both geographic and service markets may evolve and therefore may require periodic reassessment of strategic alliances by the Commission.[260]

Secondly, when reviewing ITAs, the Commission attempts to take a commercially realistic view of the notion of "actual and potential" competition.[261] A commercially realistic approach to "actual and potential" competition may lead to the conclusion that one part of the notified transaction merits negative clearance while another is eligible for an exemption. This could happen, for example, when a strategic alliance is active in different markets, only some of which present actual or potential competitive overlap between the participating undertakings.[262]

Thirdly, the exemption requirements set out in Article 85(3) must not afford the possibility to eliminate competition in respect of a substantial part of the service in question. Therefore, the Commission gives special attention to foreclosing effects, especially where agreements involve the use of bottleneck facilities, such as satellite capacity. Potential anti-competitive effects may,

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significant turnover produced in Member States, such as the Netherlands and the UK, where the FT and DT's joint venture *Eunetcom B.V.* has less presence and lower performance.

[260] In *Concert* and *Global One*, for example, where the Commission granted an exemption for a period of 7 years, the relevant market was described as the emerging market for value-added and enhanced services to large multinational corporations, "extended enterprises and other intensive users".

[261] *Compare* EC, *Commission Decision of 23 December 1992 relating to a proceeding pursuant to Article 85 of the EEC Treaty (Case IV/32.745 - Astra)*, O.J. Legislation (1993) No L20/23 in which the Commission considered that the foreclosure effects of the agreement (resulting, in particular, from the actual and potential restrictions with regard to the up-link services and transponder capacity) could not be outweighed by the benefits which ensued from the economic progress in the provision of the satellite television services and improved distribution. (Note: "up-link" involves the facility for beaming telecommunications signals to a satellite).

[262] See Holmes, *supra* note 218.

however, be controlled through the imposition in the exemption decision of behavioral undertakings such as an obligation to give third parties access to certain facilities.[283] The third party considerations are particularly important in the merger control procedure and to decisions under the EU Merger Control Regulation or US Antitrust Law have been challenged by the third parties so far.[284]

3.1.2.2 APPLICATION OF MERGER REGULATION AND ARTICLE 85 OF THE EC TREATY TO THE "CONCENTRATIVE" JOINT VENTURES OF TELECOM PROVIDERS

The Merger Regulation, in general, provides the Commission with a mechanism to determine whether the concentration would create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the Common Market or its substantial part.[285] In assessing the compatibility of the pre-notified transaction with the Common

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[283] See *e.g.* Stehmann, *supra* note 253.

[284] In response to BT's proposed purchase of 100 percent of MCI, AT&T argued that the UK market is not as open as claimed. AT&T's operations in the UK can only be provided on an indirect-access basis, which is inferior to the equal access available to foreign carriers in the US. Additionally, bilateral agreement between AT&T and BT provides for separate phone bills - one from AT&T and one from BT - being sent to AT&T' customers. Under those circumstances, the FCC was expected to apply its effective competitive opportunity test and delay the merger conclusion beyond end-1997. The Commission, however, has considered that despite BT's overwhelming dominance of the UK telephone market it is rather unlikely that it could to subsidize MCI in the local network.

Additionally, the FCC required the UK government to lift current restrictions, which limit individual investors to 15 per cent ownership of BT. It would have had to decide whether *Concert* should be regulated as a dominant carrier on the US-UK international route. It is noteworthy that Deutsche Telekom (DT) is involved in another partnership with Sprint, namely APC, which is a digital mobile service provider in the Washington D.C. area. DT's cellular subsidiary acquired 51 percent of APC; Sprint Spectrum owns the other 49 percent. Although BT-MCI merger raised regulatory issues in the US, the alliance has actually resulted in the cross-border takeover of Sprint by Deutsche Telekom and France Telecom - each of them owns 10 percent of the former. The merger of MCI and BT would have yielded lower prices but also threatened the stability of other competitors in the domestic and international phone business by eroding the system of artificially inflated rates between the United States and Europe.

Market, the Commission has an exclusive jurisdiction over the concentration once it comes within the scope of the Regulation.[266] The whole Merger Regulation system is exclusively concerned with the structure of the undertaking intended to operate in the Common Market.

Subsequently, anti-competitive behavior of undertakings in the marketplace is dealt with under Articles 85 and 86 of the EC Treaty. This provides a very strong argument that the Commission may only impose structural conditions on undertakings under the Regulation, whereas behavioral conditions may only be imposed upon the application of relevant Articles. However, behavioral conditions have been imposed on some "concentrative" joint ventures that were reviewed by the Commission under the Regulation and Articles 85 and 86 of the EC Treaty.

In particular, in the telecom sector the Commission has analyzed the impact of "concentrative" joint ventures on competition drawing on Articles 85 and 86 EC, which - after the introduction of the Regulation - were considered no longer applicable to concentrations.[267]The main decisions regarding application of Article 85 and 86 of the EC Treaty Regulation concern telecom alliances:

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[265] See *Merger Regulation, supra* note 242 at 2.

[266] For the interesting theoretical debate concerning the "classic" distinction between the competition's promotion and its safeguards, see D. Cassutta & G.M. Grillo, *Concorrenza Monopolio e Regolamentazione* (Bologna: MULINO II, 1989) at 61. The authors argue that this distinction begs the very delicate question (outside the purview of this thesis) concerning the division and balance among the powers of the institutions entrusted with telecom regulation, i.e. sector specific regulation and antitrust authorities.

[267] *See Europemballage and Continental Can Co. v. Commission* (No. 6/72), [1973] C.J.E.C. Rep. 453 at 651, (1973) 45 E.C.R. 215 and *B.A.T. and R.J. Reynolds v. Commission* (No. 142/84 and 156/84), [1987] C.J.E.C. Rep. 390 at 553, (1987) 89 E.C.R. 187. *Compare* Liedekerke, *supra* note 96 at 939. The author argues that after the landmark decision against British Telecom in 1982 there has, in fact, been no formal prohibition resulting from the application of Articles 85 and 86 of the EC Treaty to the merging telecom operators. See also EC, *Commission Decision of 10 December 1982 relating to a proceeding pursuant to Article 85 of the EEC Treaty (Case IV/27.335 - British Telecommunications)*, O.J. Legislation (1982) No L360/36. For several years, Articles 85 and 86 of the EC Treaty were construed to be inapplicable to concentrations. The consequence of this interpretation was that only national competition authorities could examine concentrations. As time passed, the Commission became increasingly aware of competition problems, which concentrations may create, and it therefore began examining the possibility of applying the Articles to concentrations. The turning point was reached when, in two judgements, the European Court of Justice held that Articles 85 and 86 were applicable to concentrations.

Concert and *Global One*. The antitrust test of the Merger Regulation was applied to *MSG Media GmbH* and *Nordic Satellite Distribution*, which were intended to provide digital pay TV services. Interestingly, both transactions were prohibited by the Commission.[268]

In all of these cases, the Commission has taken a strikingly different approach to the undertakings examined under Articles 85 and 86 and those examined under the Merger Regulation. In the first case, the Commission has appeared rather lenient - all undertakings have eventually been cleared - whereas in the second it has adopted a more rigorous attitude. Are the rules laid down by Articles 85 and 86 and the Merger Regulation much different or it is simply a sign of inconsistency? The answer to both questions is in fact negative.

Despite their important differences, both telecom and pay-TV alliances

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[268] See EC, *Commission Decision of 2 March 1996 relating to a proceeding pursuant to Article 85 of the EC Treaty (Case 96/177/EC - Nordic Satellite Distribution)*, O.J. Legislation (1996) No L53/20 at 2 and EC, *Commission Decision of 9 November 1994 relating to a proceeding pursuant to Article 85 of the EC Treaty and Article 53 of the EEA Agreement (Case IV/87.469 - MSG Media GmbH)*, O.J. Legislation (1994) No L364/1 at 48. In the second case, the European Commission blocked the creation of a joint venture (MSG) between Bertelsmann (the German media group), L. Kirch (the leading German supplier of TV programming) and Deutsche Telekom (the German PTO controls the majority of German CTV networks). This decision shows that the assessment of concentrations in developing markets focuses on the issue of whether the operation is likely to result in the creation of a durable dominant position in the relevant market. In such a case, the Commission naturally focuses on barriers to entry, which the concentrations may erect.

In MSG, the Commission found that the partners to the JV were the only enterprises which might have decided independently to install an infrastructure for digital pay-TV and to provide the corresponding services. Furthermore, in view of the respective strengths of the partners in MSG in relation to the provision of technical and administrative services for pay-TV, the accumulating of those strengths in MSG would probably have deterred any competing supplier of the relevant services from entering the market for such services in Germany. Consequently, the setting-up of the joint venture would have given MSG a durable dominant position in the market for technical and administrative. In addition, since two of the partners have preferential access to the programming software, their involvement in MSG would have given them a durable position in the downstream market in Germany.

This decision illustrates the continued tension between the role of competition as an instrument for achieving industrial policy objectives and as a separate and genuine objective in itself. While the Commission is prepared to accept restrictions on competition which contribute to the implementation of the industrial policy objectives, this favorable attitude changes where the restrictive arrangements result in the elimination of competition. In this respect, the MSG Media Service decision reflects the principle underlying the implementation of competition policy of the EC. One may wonder, however, whether - notwithstanding the provisions of the Merger Control Regulation - the Commission should take a different approach where the concentration results in the creation of a dominant position that is clearly the sole means of effectively achieving technical and economic progress. See Broberg, *supra* note 233 at 9 for the in-depth analysis of

have presented strong elements of vertical ("concentrative") integration, in particular in relation to their parents' operations. In telecom alliances, the parents are the providers of the telecom infrastructure and a series of services indispensable for the operations of the venture or of any other entity operating in the same market with it. In the pay-TV alliance, the parents were leading program producers in Germany, and, as a result of their venture, Deutsche Telekom would have benefited from a privileged access to their programs. Therefore potential competitors to Deutsche Telekom would have been deterred from entering the market if the most popular program producers were allied with their major competitor.[269]

The apparent difference in the treatment of vertical integration in these two types of cases may be partially justified by the different nature of the market involved. The growth potential of the telecom market is likely to attract big players who have the means and the knowledge to deal with anti-competitive behavior. Yet, the more limited growth potential in the pay-TV market is likely to deter potential competitors from fighting against anti-competitive practices.

The extent to which the Commission was correct in its assessment of the alliances is difficult to judge, since it mainly depends on whether the markets will evolve as predicted. It is therefore debatable whether all the potential problems arising out of the vertical relationship between the telecom ventures and their parents will be adequately addressed through regulatory measures.[270] These measures may prove inadequate if a global carrier's international activity has been coupled with asymmetric liberalization of the national market, in which case domestic market power may be extended internationally.[271]

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the EC Merger Regulation.

[269] See EC Competition, *supra* note 229.

[270] *Ibid.*

[271] As I have indicated above, firms from oligopolistic industries usually have a 'first mover' advantage (e.g. AT&T in Eastern and Central Europe) resulting sometimes in a so-called 'market leverage' effect, for they often use standards and technological advantages to lock in customers' networks and exclude others. With an advantage this sort, there is the real prospect of a foreign-

Viewing communications as one big market raises antitrust questions concerning cooperation between competitors in international and national markets.[272] One may argue that communications constitutes many well-defined markets, in which case an alliance between local and international provider will benefit local consumers.[273] However, it is still be unclear whether the related companies will combine and really compete, or combine in a manner to block or slow competition.[274]

In general, predicting a future market structure embodying local and international dimensions is hardly feasible when there are so many imponderables, such as conflicting regulations and laws. Indeed, the Merger

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owned PTO with a near monopoly in one or several host economies engaging in subsidized competition in either international or domestic markets. This exact situation arose with the proposed BT-MCI merger after which the FCC expressed its concerns as to the possibility of MCI cross-subsidizing its domestic losses from the profits that it would generate in Europe. See in particular S.M. Gorinson & M.L. Stern, "Much of the Transactional Activity Following the Telecom Act of 1996 Flows From the Elimination of Entry Barriers and Outmoded Regulations" (1997) 19 The National Law Journal 24 at A3 [hereinafter Gorinson & Stern] for a discussion of the implications of the 1996 Telecommunications Act and growing competition in the local loop.

[272] See J. R. Loftis III, "ABA' 96 Antitrust: FTC Staff Report Addresses Global Competition Issues" (1997) 18 The National Law Journal 49 at 11 [hereinafter Loftis].

[273] See M. Lavelle, "The Great Telecom War Commences" (1996) 18 The National Law Journal 30 at 8 for a critique of the decision by the US Justice Department and the FTC, which failed to prevent a joint venture between two Bell Companies. According to the critics, both companies were allowed to enter the "telecommunications market" understood "too broadly". *Compare* H. N. Janisch, "At last! A New Canadian Telecommunications Act" (1993) 12 Telecommunications Policy 26 at 691 taking account of massive trans-border alliances and the respective judicial and regulatory activities in the light of "regulatory forbearance" issue. See further S. Globerman, T. H. Oum & W. T. Stanbury, "Competition in Public Long-Distance Telephone Markets in Canada" (1993) 12 Telecommunications Policy 26 at 297.

[274] See Practicing Law Institute, *The 14th Annual Institute on Telecommunications: Telecommunications Future* (Panel Discussion Paper No. G4-3978) by D.J. Cornell & R.E. Wiley (New York: Columbia University, December 1996) *available in* LEXIS, Nexis Library, FCT File (on file with the Columbia Law Review) for a discussion of the 1996 Telecommunications Act's impact on industry structure with respect to consolidation and diversification trends in national and international market. For example, since the Telecommunications Act of 1996 was signed, MCI has been planning to form a joint venture with AT&T to build expensive local phone networks in the US. This would permit both companies not to rely on Regional Bell Companies for access to the established local calling networks which were opened to competition in 1996. Such a joint venture between two fierce marketplace rivals illustrates the ambiguity and incapacity of regulatory measures to ensure sufficient safeguards for emerging liberalized markets. While it is true that AT&T and MCI might be competing vigorously in long distance, neither is much of a presence in the local market, which has been dominated by the Bell Companies.

Regulation itself grew out of differences in policies and institutions prevailing among the EU member states. It therefore represents a compromise between German demands for an independent rule-based regime, a public interest approach favored by the UK, and industrial policy considerations opted for by countries such as France.[275]

Consequently, the "antitrust test" set out in the Merger Regulation includes factors that do not relate purely to competition. Since antitrust practice has shifted over the years from *per se* intervention towards policies based "rules of reason", it is now considered appropriate, in some circumstances to allow various forms of collaboration. Collaboration may reduce transaction costs, strengthen competition and improve efficiency. However, approval is often justified by the Common Market's political agenda. Consequently, it is most difficult to assert that the single thread in the Commission' s application of the competition law is the extraction of efficiency gains from ITAs through regulatory intervention.

For example, allowing big PTOs to merge could necessitate relinquishing potential benefits arising from the existence of several incumbents in the European market. There is a danger that instead of exploiting the presence of a many PTOs to generate fierce competition, the European market could become dominated by an oversized carrier. Indeed alliances between PTOs, such as FT and DT, could serve to cover up geographical markets. Certainly, a merger between big PTOs would imply a retrograde step. Rivals would be kept out of their domestic markets and their enhanced home-market position could be used to dominate other markets. Whether a merger between big PTOs is detrimental to competition depends on whether the relevant yardstick is the global or the European market.

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[275] See R.W. Crandall & K. Flamm, eds., ***Changing the Rules: Technological Change, International Competition and Regulation in Telecommunications*** (Washington, D.C.: Brookings Institute, 1989) at 205 [hereinafter ***International Competition***].

3.1.2.3. THE FCC APPROVAL OF GLOBAL TELECOMMUNICATIONS ALLIANCES

The current wave of telecommunications reform is by no means limited to the European market. However, the international trend towards increased competition owes a great deal to the efforts of the European Commission. Since the Commission urges the internationalization of national telecom markets of the EU Member States, other carriers press for opportunities to provide national and international services in these markets. Specifically, the U.S. multinational telecommunications users and providers have been seeking access to the network and services of foreign telecom operators and the right to offer "value-added" services outside the US.

Therefore, during the last decade, the FCC strove to increase competition in international telecommunications services and to provide business opportunities for new entrants into the US international telecom market - MCI and Sprint. Both providers formed strategic alliances with the European PTOs. However, when the first alliance - *Concert* - was proposed, Sprint urged the FCC to condition approval of the deal on a showing of adequate market access for US carriers in the United Kingdom. It was suggested that a possible effect of the *Concert* joint venture on competition in international telecommunications could be that BT would use its market power in the UK to favor MCI over other US carriers.

Sprint and AT&T particularly articulated such concerns after the proposed merger between BT and MCI was announced. Specifically, AT&T urged the FCC to secure its liberalization goals by requiring BT to prove that the merger would increase competition in the American telecommunications market and that equal access to market exists in the UK.[276] It is unclear to what extent the February

[276] See *AT&T Petition, supra* note 245 at 7. Section 310(b)(4) of the Communications Act of 1934 limited indirect foreign ownership of such licensees to 25 percent, unless that limitation was found not to be in the public interest by the FCC. The offer in question complied with the relevant section because in November 1995 the FCC enacted a regulation saying that it would waive the indirect limitation in certain circumstances, namely when it is advised that there are trade

1997 WTO agreement on basic telecommunications and the fact that the US pledged to allow unlimited indirect investment in the US telecommunications carriers after 1998 caused the FCC to put pressure on BT not to provide any special concessions to MCI in the provision of basic telecommunications services. Nonetheless, with this major competitive safeguard in place, the FCC approved the merger (See Figure 4).

FCC approval of the merger between BT and MCI was a significant step in the direction of a bilateral approach to encouraging liberalization in foreign markets. However, some argue that the FCC international telecom benchmarks were too aggressive. For example, applying the ECO test (i.e. "effective competitive opportunity test") as a means of broader public interest analysis may be conceived of as unilateral imposition of rules on international services that does not fall within the agency's jurisdiction. On the other hand, the FCC has argued that the opening of foreign markets is one of the goals of the test, which aims primarily at protecting US consumers from providers who could use their foreign affiliations to impair competition in the market for US international services.

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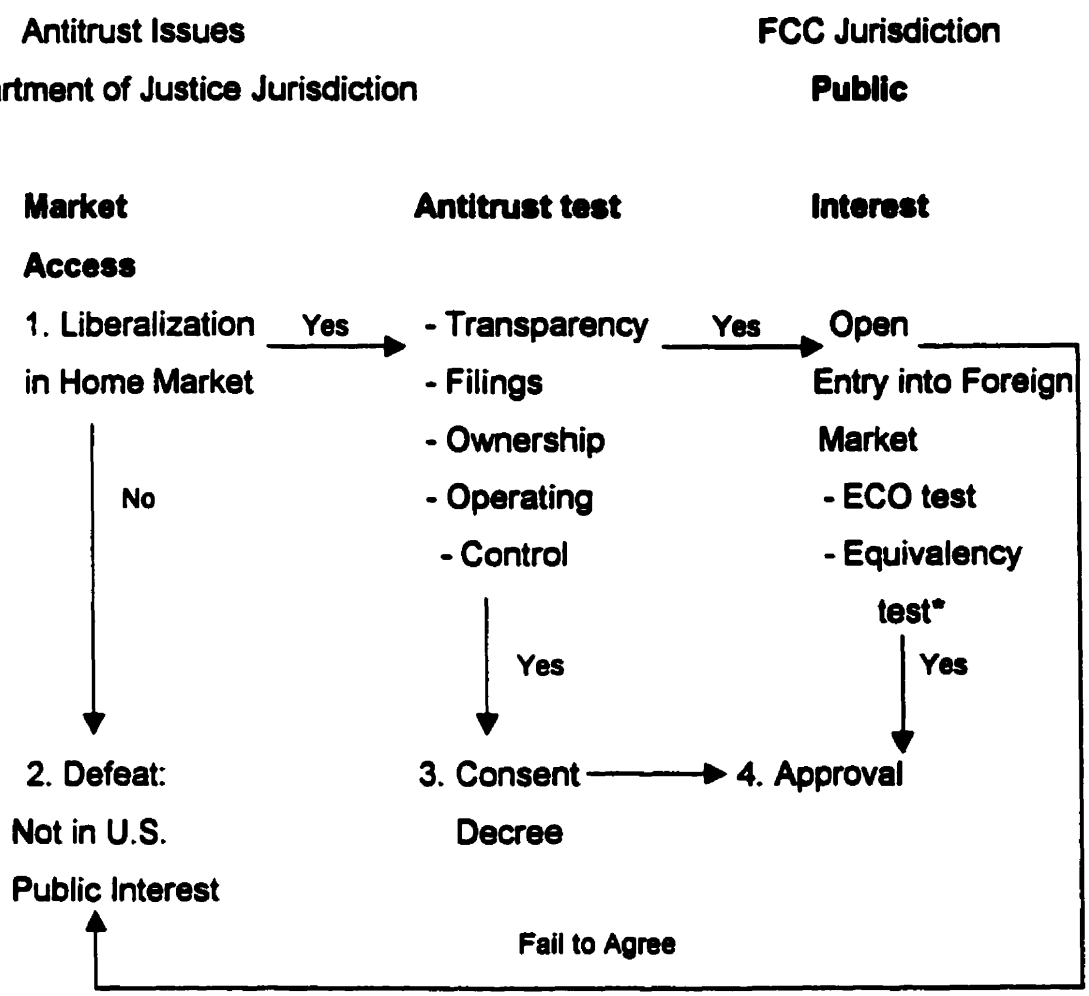
policies that would mandate such a waiver. However, more problematic were the restrictions placed by the Communications Act on the ownership of wireless licenses by a foreign government or its "representative," presumably a state-owned or controlled PTO. Section 310(a) flatly prohibited a foreign government or its representative from holding any wireless license, directly or indirectly. This limitation was not subjected to a waiver from the FCC. Thus, that the status of France Telecom and Deutsche Telekom, when they entered the US through their partnership with Sprint, was at least unclear. Upon the formation of *Global One*, DT and FT were

Figure 4: BT-MCI model for the FCC approval of global telecommunications alliances.[277]



Similar considerations prevailed in the case of *Global One*, which agreed to a consent decree with the Department of Justice's Antitrust Division. The FCC applied the ECO test to the venture and found that France and Germany did not

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wholly owned by their respective governments, and even after their partial privatization their status would remain vague.

[277] R. Gaster & E.R Olbeter, eds., *Bit by Bit: Building a Transatlantic Partnership for the Information Age* (Amonk: M.E. Sharpe, 1996) at 45.

offer effective competitive opportunities to US carriers.[278] However, the FCC concluded that in light of the substantial commitments by French and German governments to liberalize their telecom sectors, the approval of *Global One* would be granted - conditioned on continued progress towards liberalization in these countries.

Indeed, both France and Germany must implement the European Union Directive requiring liberalization of basic telecommunications services by January 1, 1998. In addition, both countries have made commitments in connection with the WTO agreement on basic telecommunications, but they did not undertake these obligations until well after the FCC decision. It is therefore not certain whether the FCC has indeed used its power as leverage to prod individual countries to open up their markets.

However, even without exploiting bilateral pressure tactics, the United States could achieve much the same result through aggressive application of competition policy. For example, the United States could create indirect pressure for market opening abroad by blocking entry of carriers with closed markets, on the ground that such entry would present a risk of anti-competitive conduct. Yet, as the telecom markets are currently opening many national operators imitate the 'going global' strategy pursued by private telecommunications companies, which are generally more flexible in forming international alliances. As the market for international telecommunications services grows incrementally more competitive, market forces - not regulators - will play an increasing role in shaping the evolution of the industry's structure.

In particular, efforts to form global super carriers through mergers and

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[278] See *United States* v. *Sprint Co.*, Civ. No. 95-134 US Dist. (D.D.C.1996) *available in* LEXIS, Nexis Library, File No. 13757. See also "French Law Foreshadows E.U. Directives on Interconnection" *Telecom Finance* (13 September 1996). It is unclear whether the conclusion of the WTO negotiations on basic telecommunications will have an impact on the FCC's implemenation of its order regarding *Global One*. Starting in 1998, it will be inconsistent with the US commitments for the FCC to impose conditions that discriminate among carriers based on their nationalities. On the other hand, the FCC still will be able to impose conditions to safeguard competition in the US international telecommunications market. The FCC could conclude that, without continued progress towards liberalization in France and Germany, allowing *Global One* to offer service between those countries and the US could undermine competition on those routes.

alliances have created and will continue to create powerful new players who promise to drive much of the sector's future development. Surely, cooperation within an alliance leads to expanding trade in services as well as to improving efficiency in other sectors. However, it may also result in international cartel arrangements and anti-competitive restraints inhibiting competition. Therefore, managing their dual implications becomes the key issue for regulatory authorities and national legislators.

3.2 THE IMPACT OF A GROWING CONVERGENCE OF GOALS OF THE EU AND WTO - INTERNATIONAL ANTITRUST COOPERATION IN THE CASES OF ITAs

Besides raising some intricate problems for competition laws, international alliances are inherently related to the evolving complex issues around national or supra-national regulatory policies on market access and around the international treatment of foreign investment. Countries have to decide whether and, if so, on what conditions foreign carriers should enter their markets. Will these super carriers pose a threat to competition or to newly liberalized monopolies? There is a real danger that ITAs will give rise to a global oligopoly and that interface between competition law and trade and merit further consideration in the WTO framework.

To address these issues, I will seek to identify how existing relations and interdependencies between national regulators and the international trade regime apply to ITAs. In doing so, I will attempt to describe an emerging policy framework spanning domestic, regional and international regulatory institutions. In particular, I will comment on the creation of a working group to begin development of a trade and competition agenda at the WTO.

EU and WTO Members have raised several important questions regarding the interrelationships among networks, competition, technological

change, and optimal regulatory policy.[279] These questions highlight significant market access problem encountered in many countries, the solution to which lies first, in the application of domestic competition law, and second, in the negotiation in the WTO of multilateral competition rules against anti-competitive behavior.[280] The WTO has given its working group the task of studying issues relating to the interaction between trade and competition policy and is seeking to identify multilateral disciplines that may merit inclusion within the WTO framework.[281]

However, several countries, including the US, have favored a cautious approach to the WTO role in the area of international antitrust enforcement – notwithstanding the direct link between such a role and the traditional trade-liberalization agenda of WTO. Two broad phenomena amount for the interest in the intersection of trade and competition policy: first, an increasingly globalized economy, spurred largely by technological advances; and second, the successive reductions of government-imposed barriers to trade resulting from the various GATT rounds.

The ongoing process of globalization plainly has important consequences for trade issues, but also has great significance for international competition law.

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[279] See H. Ungerer, *Determining the New Regulatory Challenges for Competitive Telecommunications Markets in the International Telecommunity* (Study Paper No.14/11) by EC (Seoul: International Telcommunications Summit, 1997) [hereinafter *Competitive Challenges*]

[280] *Ibid.* at 39. The author has emphasized that the opening of closed markets for basic telecommunications to national and international competition by virtue of the WTO agreement will result in international telecommunications services, spurring investment all over the world. FDI, as an instrument of an MNEs' international activities, often forms part of the global strategies of carriers to build up global networks that will expeditiously cater to the business needs of multinational corporations. Therefore, market access for firms providing advanced telecommunications services is an essential condition for successfully developing all national economies and trading internationally.

These concerns have been recognized by the community of nations under the auspices of WTO, which made telecommunications subject to the emerging rules of the multilateral trading system. However, after the successful conclusion of trade negotiations on the provision of telecommunications services much remains to be done to ensure that both business and non-corporate customers together reap the full benefits of improvements in technical efficiency. Technological and market forces are changing the telecommunications industry from a special status or natural monopoly industry into a "normal industry," which is now seen as the modern trade route.

In particular, growing number of transnational telecom alliances and mergers has led, as we have seen, to pre-merger review of the same transaction by several different countries' competition authorities. International market-access cases concerning anti-competitive horizontal and vertical restraints are designed to prevent foreign competitors from entering domestic markets on a level playing field have also assumed dominance.[282]

An international antitrust agenda cannot neglect either merger review or restraints on market access and must also address cartel behavior. On the other hand, a reasonable trade regime need only deal with the market-access issues With that recognition in mind, one should underline what specific problems are that have brought ITAs to the fore within the WTO multilateral agreement on basic telecommunications. Linked trade and competition concerns have prompted current efforts to develop a multilateral regime. The review of proposed ITAs illustrates how antitrust agencies have worked with their counterparts in other countries.

As a practical matter, transnational mergers are not being dramatically inhibited by the requirement to submit to multiple domestic reviews and, at least on an informal level, the various enforcement agencies are already engaged in significant cooperation. This cooperation is likely to increase over time and also likely to lead to more formalized antitrust enforcement agreements – initially on a bilateral, and then perhaps, on a multilateral basis. Moreover, merging firms that are subject to multiple reviews can facilitate coordination and cooperation among the various national competition agencies by authorizing them to share otherwise confidential information.[283]

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[281] *Ibid.* at 42.

[282] EC, *Competition Policy in the New Trade Order: Strengthening International Cooperation and Rules* (Brussels: EC Publications, 1996) at 84.

[283] For example, the US Congress, recognizing the critical importance of multi-agency cooperation, gave the Antitrust Division of the Department of Justice the explicit authority to negotiate bilateral antitrust cooperation agreements under the International Enforcement Assistance Act of 1994. These agreements allow US antitrust agencies to exchange evidence on a reciprocal basis with foreign antitrust agencies, for use in antitrust enforcement and to assist in

These considerations notwithstanding, there may well be additional ways to make the multi-agency review process more efficient and less burdensome. In pursuit of this agenda, the OECD's Competition Law and Policy Committee has recently proposed an initiative to work towards a recommendation urging the adoption of bilateral agreements directed at cartel activity.[284] This recommendation has been said to reflect the "positive comity" approach that was given emphasis in the 1995 cooperation agreement between the US and the European Union.[285]

This approach increases the pressures throughout the world to allow competition authorities to conduct effective investigation and, in the absence of a treaty, the ability to overcome the limits of jurisdictional reach to gather evidence on another country's territory. Furthermore, positive comity may enhance the likelihood that the review processes governing transnational (telecom) mergers and alliances will diffuse international trade and investment tensions. The impetus for multi-agency cooperation will add a measure of consistency in the trade, investment and competition law areas and is likely to grow over time.

In parallel with this necessary exercise of traditional comity, the European Commission has stressed the need to rebalance the traditional bilateral relations

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gathering evidence located in the US for the other country. At the same time, however, confidential information is protected. For a discussion of the mutual legal assistance treaty between US and Canada on the prosecution of global cartels, see Klein, *supra* note 254.

[284] *ibid.* at 15.

[285] EC, *Agreement between the Commission of the European Community and the Government of the United States regarding application of their competition laws*, O.J.Legislation (1995) No L218 at 47-50 [hereinafter *Agreement*] and WTO, *1996 Raport of the Ministerial Conference on Competition Policy* (Washington, D.C.: WTO General Council Publications, 1996) *available at* http://usdoj-icu/css/mlb. It should be noted that the "alert sytem" created much by the cooperation agreement between the US and EU has been applied, for instance, to the *Concert* alliance. Under this system each party has notified its partner about the merger "far enough in advance [...] to enable the other Party's view to be taken into account before the final decision is adopted". This exchange of information is the clearest obligation stemming from the agreement; provisions on cooperation and coordination of enforcement activities also exist in all cases of mutual interest. This model may therefore become a blueprint for establishing contacts between the agencies, assisted by the officials in charge of international relations, at the outset

with the US. One aspect of such a rebalancing that has been discussed by the WTO Working Group on Competition concerns the view of the EU national governments that US antitrust exercise excessive extraterritorial jurisdiction and are overly interventionist. It has been stressed, for example, that in the cases of the transatlantic alliances in the telecom sector, the territorial reach of the US antitrust law gave rise to much contention on the part of some of EU governments.[286]

The EC has admitted that in practice the impact of extraterritorial jurisdiction is rather limited although "the Community has never formally claimed a territorial jurisdiction as extensive as the one claimed by the U.S."[287] Indeed, nothing precludes the so-called "requesting authority" that chooses to defer or suspend the extraterritorial reach of its enforcement activities, from later initiating or reinstating such activities. However, the Commission has pointed out that in the course of reviewing telecom alliances, US antitrust authorities have never suspended their antitrust enforcement powers.

Indeed, the Antitrust Division of the Department of Justice has, in conjunction with the FCC, been tempted to apply antitrust rules for trade purposes in situations where ITAs are harmful to US trade but have no effect on

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of merger, in order to exchange views and, when appropriate, to coordiante the proposed merger enforcement activities.

[286] See C. Rakovsky, *The Commission's Cooperation with Third Countries in the Field of Competition* (Working Paper No.18/09) by EC (Brussels: FIW Conference Papers, 1997) [hereinafter Rakovsky]. See also FTC, *1996 Report on the Antitrust Enforcement Guidelines for the International Operations* (Washington, D.C.: FTC, 1996) for a discussion of the controversial efforts at the WTO to reach agreement on multilateral competition policy.

[287] *Ibid.* at 15. It should be noted that EU member states objected to the Commission's having negotiated the agreement on the antitrust cooperation between the EU and US without the prior authority of the Council of the Ministers. This objection was upheld by the European Court of Justice. See *French Republic v. Commission* (No.327/91), [1991] C.J.E.C.Rep. 239 at 56, (1992) 28 E.C.R. 8. This institutional objection was overcome by the *Agreement* being concluded on the behalf of the Community. See *Agreement, supra* note 285. In its decision, the European Court of Justice emphasized the limitation of the Commission's powers to negotiate the scope of the agreement. In particular, the Court was concerned with the confidentiality of information divulged to the Commission and made the exchange of such information with US agencies difficult. In particular, once the Commission has initiated a proceeding under the Merger Control it cannot defer to the US antititrust agency even if the agency is deemed to have a stronger interest in case.

the U.S. market or consumers. Consequently, in the case of *Global One* the impact of the alliance on the U.S. international telecommunications trade was overshadowed by the FCC concerns that both France and Germany would have to offer effective opportunities to US carriers for the approval to be concluded.[288] This is all to say that in the WTO open trade system, the international telecommunications will ultimately have to be governed according to universal commitments to the adoption and enforcement of competition laws and cooperation in antitrust enforcement.

In this regard, a question arises as to whether authorities should aim towards full harmonization of national policies or simply provide a viable forum for efficient exchange of information and coordination of multilateral regulatory investigation, such as a joint review process and the setting up joint screening standards. Given that the postulate of full harmonization seems to be rather far-fetched, the more realistic approach will herald an intensified cooperation among the competition authorities of the countries from which the investing companies largely originate. The WTO is a rule-based regulatory regime that depends heavily on the strict application of neutral legal and economic principles. Competition rules are often of this character.

It is therefore necessary to ensure that economic efficiency considerations will not supersede the functioning of a transnational competition regime that parallels the ITAs transnational framework should aim to further supranational, multi-purpose cooperation among regulatory authorities rather than simply to facilitate the "clearance" of ITAs. On the other hand, even among the relatively like-minded states of the European Union, it took seventeen years to agree on the Merger Control Regulation. A WTO competition policy debate would have to balance many diverse national interests, with the possibility of

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[288] See also EC, Press Release COM (97) 504, "Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the implementation of the telecommunications regulatory package", commenting on the evaluation of antitrust enforcement issues in the case of *Global One* made by the German Monopolies Commission.

positions shifting in response to trade-offs in other trade negotiations related to services, intellectual property, or of the myriad fields currently covered by the WTO.

That is why, perhaps, some WTO Members have supported efforts to achieve a "minimum" set of competition principles or to identify common substantive standards rather than attempting to set "maximum" standards.[289] Competition policy, moreover, is often very fact-sensitive and governments are usually reluctant to turn over to a WTO body the kinds of confidential business information typically required for a proper competition analysis in particular cases. This problem, along with the lack of consistent dispute settlement, highlights the difference between international competition law regime, currently emerging through cooperation in antitrust enforcement, and other areas covered by WTO.

3.3 THE INTERRELATION BETWEEN ITAS, INVESTMENT AND COMPETITION LAW

Notwithstanding the assumption that by developing competition rules within the WTO, the multilateral harmonized approach to ITAs would go beyond the trade liberalization concerns, the further harmonization of national regulations conforms with the letter of the WTO telecom agreements. The hybrid nature of ITA governance structures seems to entail that in order to track their evolution and competition effects, competition authorities will have to abandon of the exclusive reliance upon domestic policy and go about enacting a new enforcement "interface" or "platform", which itself takes on a hybrid structure.[290]

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[289] *Ibid.*

[290] See generally M. Fredebeul-Krein & A. Freytag, "Telecommunications and WTO Discipline: An Assessment of the WTO Agreement on Telecommunications Services" (1997) 21 Telecommunications Policy 6 at 477ff. The key problem of the new international telecom regime is how to deal with competition between firms and countries in the area of international telecom

This platform will then permit legal regulatory institutions to adapt their guidelines to which ITAs should be regulated as a new type of actor dominating contemporarily the ever-changing scene of global telecommunications.

The growth of technology- and customer-driven FDI is manifesting itself in a wide range of global organizational forms including strategic alliances and consortia. This increase in FDI generally fuels a greater proliferation of networks of inter-firm relationships. As we have seen in the previous discussion, the growth innovation- and demand-driven FDI and strategic alliances among multinational corporations are likely to cause frictions between existing national policies and new organizational corporate forms.[291]

These conflicts may naturally arise between foreign investment and competition laws within the traditional structure of supranational institutional cooperation. The purpose of this section is to investigate the impact of inter-firm partnerships – including ITAs, and mergers – on the competition law and foreign

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services. This inevitably involves an increasing level of international activity in terms of FDI inflow through strategic alliances, cooperative ventures, and—most of all—mergers and acquisitions of large carriers facilitated by opening up of countries through privatization and liberalization. However, when it comes to foreign investment, most states have remained mercantilist and protectionist, essentially because they have believed that unregulated foreign direct investment could lead to the erosion of ownership of their resources and production. While many states have sought to attract foreign capital using various incentives (i.e. allowances and tax holidays), they have feared being dominated by foreign capital.

Capital-importing states have carefully regulated foreign investment. Typically, foreign investors have been kept out of many sectors, such as telecommunications, which investors often saw as the most lucrative.The argument often put forward to support protectionism with respect to FDI holds that since telecom MNEs do not have any national loyalties in service production and delivery, their increasing presence in the domestic marketplace can ultimately undermine the cultural basis of a host-country. Hence, it has been argued that in the past different countries imposed conditions on FDI as part of preventive strategy aimed at controlling restrictive business practices by multinationals. It should be noted that the WTO now covers FDI in services by virtue of GATS, which includes the provision of services through a commercial presence of telecom operator in another country. This means that the WTO's Dispute-Settlement Understanding covers investment disputes and provides the possibility of trade sanctions for violation of investment obligations. In this respect J. deAnne points out that this makes the WTO the international organization for regulating multinationals through the dispute-settlement procedure. It may also be interesting to test whether the WTO could regulate the ITA's disputes. See J.deAnne, *International Direct Investment: Strengthening the Policy Regime* (New York: Routledge, 1995) at 39.

[291] OECD, *The Changing Role of Telecommunications in the Economy: Globalisation and its Impact on National Telecommunications Policy* (Working Paper No: 79) by OECD (Paris: OECD, 1995).

investment interplay: what is the nature of the relationship between domestic and subnational competition law and FDI? Is there a case for coordinating procedural and substantive rules of competition law and FDI at a higher level? To address these questions, I will discuss the conceptual consequences for FDI of interactions between competition law and regulation of international telecommunications services.

Furthermore, the linkages between international telecommunications alliances, FDI, international trade and competition law should be clearly identified so as to establish what mechanism is driving the increasing inter-relatedness of these phenomena.[292] However, this thesis will limit its focus to the more modest goal of seeking to give an account of how contemporary developments in global telecommunications can be situated in the context of the conceptual issues relating to the intersection of trade, investment and competition law.[293] More specifically, I will give an account of the main regulatory and policy implications of ITAs.

Accordingly, I will attempt to describe how the globalization of telecom firms and telecom services induces differences and regulatory shortfalls at the national and international levels. The increase of noticeable policy mismatches is revealed by the incompatibility between substantive competition norms and the degree of enforcement at both levels. At the international level, alliances can be assessed from a multi-aspect perspective, whereas at the international level, they are assessed in light of specific competition reforms and related economic

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[292] See See T. Watts, "Telecommunications Policy, Productivity, and Strategies of Multinational Corporations" in Estabrooks & Lamarche, *supra* note 169 at 203. FDI along with trade has been considered one of the two chief engines for territorial expansion of firms. The investment was usually made outside the home country of the investing company, but inside its organizational infrastructure or within the same economic entity (i.e. a so-called intra-firm FDI).

[293] On the increasing inter-relatedness between those three policies in the context of telecommunications, see *e.g.* WTO, *Economic Globalization Increases Impact of National Competition on International Trade* (Position Paper No. 68-C) by WTO (Rome: WTO, 1995) [hereinafter *Economic Globalization*]. See further ITU, *World Telecommunications Report: Trade in Telecommunications* (Geneva: ITU Publications, 1997) [hereinafter ITU Indicators]. *Ibid.* for a draft of multilateral, intergovernmental agreement within which operators will negotiate bilateral, operating agreements, based on accounting rates.

considerations. A recurrent theme in the literature on international policy in this area is that integrated considerations of investment law, regulatory policies and antitrust principles is a *sine qua non* condition for a comprehensive analysis of the multi-dimensional consequences of globalization.[294]

One issue is how increasing trade globalization is intertwined with a FDI growth in a way that renders complementary these two forms of international expansion by multinational corporations. Telecom companies have often perceived international trade and FDI as substitutable or analogous ways of servicing foreign markets. However, many tend to see FDI, as opposed to trade, as the "primary motor of globalization" – the force that propels the ongoing integration of the world economy.[295]

Because it facilitates trade opportunities, FDI functions as the most effective mechanism for the diffusion of know-how, spread of capital and growth in production. While FDI is governed by investment policy, its growth also puts pressure on domestic regimes - such as the rules covering trade in telecom services, barriers to entry and foreign ownership restrictions. For this reason, direct investment and trade policies are inextricably linked.[296]

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[294] For a discussion of the relationship between competition policy, wider economic policy objectives and other determinants of economic growth, such as globalization, international trade and deregulation, see I. Carand, *Competition Policy as a Dimension of Economic Policy: A Comparative Perspective* (Occasional Paper No.7) by IC (Ottawa: Industry Canada Publications, 1995) [hereinafter Industry Canada]. See further E. Olbert, "From Monopoly to Competitive Markets" in R. Gaster & E.R Olbeter, eds., *Bit by Bit: Building a Transatlantic Partnership for the Information Age* (Amonk: M.E.Sharpe, 1996) [hereinafter From Monopoly] and Stehmann, *supra* note 253 for the comparison of national and international competition policy issues related to foreign investment in telecommunications.

[295] See WTO, Press Release TRA/7/95, "Next Challenge for WTO Governments is Liberalization of Trade in Telecommunications" *available at* http://www.wto.org/trade/public. In his speech, R. Ruggiero has put emphasis on the role of globalization and liberalization of services in telecommunications. Both should be equally present in the 'two-tier' global information society to allow telecom providers to reach out for rural and business customers. Modern technologies, according to the Director General, require global approaches because they abolish national boundaries as they bypass the existing networks, rendering national monopolies obsolete. Therefore, the rules on competition should be global because only a multilateral system will give those rules legal security and political legitimacy.

[296] See OECD, *Globalization and Linkages: Macro-Structural Challenges and Opportunities* (Working Paper No.181) by P. Richardson (Washington, D.C.: OECD, 1997) for a discussion of

The existence of these policy issues demonstrates the need for the promotion and protection of investment through multilateral investment treaties. The proliferation of multilateral treaties will obviate the need for negotiating on a country-to-country basis. In the absence of binding multilateral rules constraining national policies towards FDI, the development of trading blocks such as NAFTA, APEC, the EU can be viewed as a means for stimulating multilateral cooperation on trade and investment issues. In the field of telecommunications, multilateral institutional cooperation is of great importance because substantial and procedural rules on market entry, investment thresholds and accounting rate systems are entirely dependent upon non-discriminatory and equal treatment and by all signatories.

Faced with the growing importance of strategic investment, many countries have recognized a need to overcome institutional obstacles that could slow the pace of globalization. Yet, some view multilateral institutional agreements that lay down common standards for national FDI rules in telecommunications as threats to sovereignty and national requirements.[297] Despite such national concerns, a consortium of nations has agreed to discuss the subject of greater cooperation within the WTO framework and the development of common procedural standards.[298]

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the relationship between economies and companies pursuing "linkage-intensive" development strategy and how they integrate into the global economy.

[297] See *Economic Globalization*, *infra* note 293 for a discussion of the changing concept of autonomous nation states. "The phrase 'no man is an island' can increasingly be applied to nations, as interdependency, globalization and the integrated global economy affect us all. The fact that telecommunications is now seen as a tradable commodity – rather than a state-provided service has led to even greater erosion of sovereignty." See Letter of Dr Pekka Tarjanne, Secretary-General, International Telecommunication Union to the Telecom Regulators in Holsingor, Denmark (23 January 1996). See also ITU Indicators, *supra* note 293.

[298] See World Trade Policy Review Body, WTPRB Press Release 17/96, "Canada's Domestic and External Reforms Create Stronger Base for Economic Expansion" (11 November 1996), and WTPRB, WTPRB Press Release G/73/95, "Review of Canada's TPRB's Evaluation" *available at* http://www.wto.org/prb.index for the interesting observation of Canada's "gradual manner of competition" and continuing attempts to balance internal pressures in a federal system with the aims for broader regional integration and multilateral liberalization. See further R. J. Daniels & R. Morck, *Canadian Corporate Policy Options* (Calgary: University of Alberta Press, 1996) for an analysis of how the combined effects of globalization have forced a rapid rationalization of the

Multilateral agreements and joint procedures are sought either for reasons of economic efficiency or to promote "convergence" between national law and policies. Multilateral agreements can facilitate trade by reducing transaction costs and time-consuming administrative procedures. Several reasons exist for seeking greater coordination between national and international regulation. With increasing interdependence between nations, domestic regulation alone is no longer sufficient to address complex global phenomena, such as international telecommunications alliances. Furthermore, it is not be possible for a set of loosely coordinated national systems to provide effective and timely regulation. Nor is an umbrella of international regime alone capable of addressing local or regional market discontinuities.

The emergence of ITAs has demonstrated that the scope for individual countries, acting alone, is becoming significantly limited. Not surprisingly, the regulators, subjected to various and often conflicting pressures, are going through a period of transition during which they are seeking jointly to develop more comprehensive solutions applicable to international and national problems. Just as there has been a convergence between the telecommunications, entertainment, broadcasting and information technology industries, so too there has to be a convergence between regulators and regulatory regimes and coordination of the work of international institutions.[299]

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economy. Access to the global markets means that the government itself has to become a competitive business in the new global economy. The state should focus on framework policy. That is to say, governments should concentrate on providing the legal and institutional environment in which markets and firms will prosper. Indeed, M. Porter has observed that government should be a "pusher and challenger." *Compare* World Trade Policy Review Body, WTPRB Press Release G/56/96, "Open Markets - Domestic and Worldwide - Remain the Key to US Economic Growth" *available at* http://www.wto.org/prb.index.

[299] See *e.g.* P. Tarjanne, *The Changing Relationships Between National and International Regulations* (Helsingor: ITU Center for Tele-Information, 1996) for a discussion of the shift in international regulation from the one-way relationship with national regulators to a subtle set of multi-way intersections between them.

3.3.1 THE CAPACITY OF PRE-EXISTING REGULATORY REGIMES TO REGULATE TELECOMMUNICATIONS IN TRANSITION: SHOULD THERE BE A CONVERGENCE BETWEEN REGULATORY SYSTEMS?

The introduction of competition into the telecommunications markets has meant that national regulators can no longer regulate in isolation from their counterparts in other countries.[300] Historically, telecommunications providers have only been subjected to the regulation of carriage. Regulating content is perhaps the most complicated regulatory problem that international organizations will have to face in the coming years.

Content regulation must balance the desirability of protecting against social harm and against the value maintaining other principles, such as freedom of speech, access to information, and diversity of opinion.[301] Nevertheless, in the future, different kinds of international telecommunications services will be provided through alternative routes receiving increased attention from "closed national" policies.[302] There will be a growing overlap between regulation of content and carriage, in part because telephone companies and cable TV operators have already begun to provide services previously supplied by only one of them.

Furthermore, the ability to substitute services across subsections or market segments, particularly between cable TV, telecommunications, broadcasting and the Internet, also creates pressures to coordinate regulation across these communications sectors. The most critical issues emerging in telecommunications concern promotion of competition, negotiating multilateral interconnection agreements, designing revenue settlements and the like.

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[300] See Gorinson & Stern, *supra* note 271 commenting on the regulatory coordination between OFTEL and FCC in the case of the *Concert* alliance.

[301] See ITU, *The Future Trend of Telecommunications Services and the Right to Communicate* (Geneva: ITU, 1997) *available at* http://www.itu.int/publications.

[302] *Ibid.* at 45.

Although the implementation of pro-competitive policies in telecommunications is sector-specific (or in some cases, specific to network industries), in many important ways these policies themselves essentially induce competition between sectors.

The pressure for some measure of regulatory convergence seems to be an outcome not only of changes in technology and market structures but also of the increasingly significant role of international agreements on telecommunications regulation. The recent EU and WTO initiatives, although not comprehensive, are important steps in bringing national approaches to the regulatory policies together.[303] Undoubtedly, the high level of insularity or compartmentalization that has been predominant at the national and international levels, as well as the industrial level, is likely to be eroded rapidly.

At present, the convergence between the segments complicates the job of regulating each sector but also reduces the scope for discretionary decisions. Hence, the traditional clear segmentation of the market enables regulators to treat different categories of service providers differently – especially in the case of mobile telephone prices, which were typically unregulated, while fixed telephone prices were controlled. The sweeping wave of service convergence – reflected in the increasing substitutability of mobile and fixed services – has eased the way for consumers to bypass high priced international telephone services by using private networks.[304] The pending introduction of global personal mobile satellite services creates further pressures to reduce differential regulatory treatment and to push prices closer to costs. Thus, the regulatory agenda has shifted from minimizing the price of subscribing to local telephone service to managing multiple issues related to competition, entry and pricing. By

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[303] See WTO, *What the Transformation of Telecom Markets Means for Regulation?* (Public Policy Papers No. RT/9/98) by S. Smith (New York: Public Policy Centre, 1997) [hereinafter Smith]. According to the author, the Negotiating Group on Basic Telecommunications has been one of the first multilateral efforts to deal explicitly with substantive aspects of competition policy. Although limited to telecommunications, this "major achievement" has paved the way for future multilateral disciplines and a limited international harmonization.

[304] See *Networks, supra* note 198 at 282.

authorizing rate rebalancing (whereby prices are moved closer to costs by reducing prices for international services and increasing them for local and network access service) economic rents and cross-subsidies are reduced.[305]

Furthermore, the progressive incompatibility between the industry's market structure, on the one hand and pricing methods on the other, points to the demise of natural monopoly. Traditionally, in the conventional copper wire local loop, the marginal cost of adding a new subscriber declined no matter how many existing subscribers there were. Therefore, the telecommunications sector – or at least its local loop – was considered to be a natural monopoly.

In a traditional network, 70 to 85 percent of the cost of a call, even an international one, relates to the low-technology short-distance copper-to-the phone link. Wireless, cable and other technologies are now challenging the conventional local loop based on wire-line technology and buried copper. Wireless linking, in many cases, is already cheaper per new subscriber than the wire-line link. Yet, switching directly to a wireless network would face regulators with complex issues of how to redistribute subsidies for local service that previously went automatically to wire-line telephone companies.[306]

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[305] See Smith, *supra* note 303 at 24.

[306] See K. Marron, "Phone Companies Battle Over Playing Field" *The Globe and Mail* (2 September 1997) C4 quoting Dean Proctor, Vice-President of Regulatory Affairs for Microcell Telecommunications Inc. of Montreal, who, on the issue of subsidies, said that the telephone companies are likely to argue that the wireless operators are not direct competitors in the local market and therefore should not get a share of the subsidies. The postulate of equal treatment of wire-line and wireless operators by denying the latter subsidies "is not competition," Mr. Proctor said. "It's cloning. If you compete with them, you have to build an identical network based on the type of architecture they had 120 years ago. Nobody would do that." On the other hand, in response to that argument, Robert Farmer, Vice-President, Regulatory, at Stentor Resources Centre Inc, claims that "you can picture four providers of local service providing four different services to a house and each receiving a subsidy. Does that make sense?"

Nevertheless, it seems desirable to have several competing providers of local service. It may be quite feasible without really raising the network's cost, considering that wireless cost curves show, in general, that size no longer brings a real cost advantage. The implications, besides the increasing "competition for subsidies," are profound: the best way to deliver service to customers would no longer be through a utility but through competing providers of local telecom services. Furthermore, telecom regulation with respect to local subsidies would then focus on the structure of the sector, recognizing benefits from wireless and mobile and translating them into new subsidy-distribution guidelines. Such new rules could provide so as much competition as possible, facilitating the shift from monopoly to a more competitive local market.

Forging local competition involves elaborating a system through which specific telephone extensions are re-addressed so as to permit subscribers to keep the same number when they choose to change to another service provider (i.e. the "number portability" problem). Technological progress and innovation is rapidly eroding the ability to sustain old practices based on monopolistic behavior and state control aimed to protect national markets for local providers. Call-back systems, virtual private networks and the Internet, together with the growing promise of modern satellite communications, are multiplying opportunities for bypassing telecom monopolies. At the same time, the increasing information-sensitivity of transnational corporations and the dramatic reductions in the cost of communications create additional incentives for customers to explore bypass alternatives.[307]

3.3.2 THE FUTURE OF ITA REGULATION: IS A SUPRA-NATIONAL SYSTEM MORE APPROPRIATE THAN A MULTI-DOMESTIC ONE?

> *"The world of telecommunications needs more policy experimentation and less harmonization"*
>
> *- E. M. Noam & A. Singhal*

The fact that telecommunications networks are becoming more and more global, actually requires establishment of national telecommunications policies. The legal environment facing the telecommunications industry is critical to its domestic and international alliances because it governs how companies compete with one another. Hence, a set of legal ground rules is needed under which alliances among the world's largest PTOs will compete to provide better domestic products and international end-to-end services. As corporations seek to exploit new global possibilities for outsourcing, they may find that the range of

[307] See K. Propp, "The Eroding Structure of International Telecommunications Regulation: The

choices and the uncertain regulatory environment makes planning a corporate communications strategy difficult.

The business operations of super-carrier alliances, once approved by the US and European authorities, will then depend largely on how they are regulated by individual nations' regulators.[308] Therefore, one should expect that domestic markets would be most inclined towards liberalizing telecommunications. In this regard, E. Noam and A. Singhal argue that the liberalization of telecommunications at the national level will then transform the international system of telecommunications and lead to the emergence of global telecommunications networks and alliances. However, such a "global" infrastructure nevertheless requires an appropriate regulatory structure governing the new supra-national telecom carrier. For the time being, the intricacy of policy issues associated with supra-national carriers is being approached unilaterally by national policy and sub-national regulation.

There are indeed conceptually difficult problems, which *prima facie* require at least some kind of uniform regulatory framework at the international level. Without some degree of uniformity the negative effects of asymmetric policies may reinforce restrictive local regime, permit discriminatory treatment, and unduly extend the market power of a protected carrier. The major threat to free, accessible and affordable global telecommunications is the obligation on carriers to conform to the content policies imposed by restrictive countries.

However, because national content policies are – not surprisingly – hard to maintain in an international setting, a worldwide harmonization of content policy is unlikely and undesirable due to divergent national views.[309] For this

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Challenge of Call-Back Services" (1996) 37 Harvard International Law Journal 2 at 494.

[308] See E. M. Noam & A. Singhal, "Supra-National Regulation for Supra-National Telecommunications Carriers" (1996) 20 Telecommunications Policy 10 at 769ff [hereinafter Noam & Singhal] for a very interesting argument, *contra* to the widely promoted vision of future international telecommunications being subject to some supra-national regulatory order. The authors suggest that a better approach for the foreseeable future should be to "encourage more national experimentation and to focus less on international policy coordination" (emphasis added).

reason, E. Noam and A. Singhal argue that there may be no need for a formal coordination between two given countries and that a unilateral optimum can be reached by unilateral actions and reactions aiming at creating new opportunities for the new information age rather than maximizing harmonization.[310] Therefore any problem that emerges could be solved on an *ad hoc* basis.[311] Such an *ad hoc* or case-by-case approach to complex policy goals would seem to presume the existence of nationally elaborated mechanisms that permit policy coordination. Indeed, the history of multilateral antitrust cooperation is marked by creation of insufficient measures to prevent, for example, international cartels aimed to prop up national monopoly arrangements.

Any new supra-national regulatory system is likely to police alliances of incumbent telecommunications operators, because as we have seen such alliance may be driven by considerations not necessarily related to the development and opening telecommunications infrastructure. However, elaborate consolidation through supra-national arrangements, would likely result in inter-jurisdictional struggles over international problems, such as the regulated provision of international telecom services.

Accordingly, E. Noam and A. Sighal conclude: "[i]ronically, for a world full

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[309] See A.E. Lehmann, "The Canadian Exemption Clause and the Fight to Maintain an Identity" (1997) 23 Syracuse Journal of International Law & Communications 187 at 77ff.

[310] *Ibid.* at 78. It should be noted that despite the fundamental impact of the US on further coordination of regulatory policies and antitrust law enforcement, its own policy decision-making process remains wedded to traditional paradigms of distinct legal fields and territorial borders. Under the US system, no single government organization is in a position to assess the redefinition of traditional regulatory borders. Multiple federal agencies, including the State Department, the United States Trade Representative, the FCC, FCT and the Commerce Department's National Telecommunications and Information Administration, each have narrow and overlapping claims to various aspects of telecommunications law and policy. Regulators then compete with one another for jurisdictional power. Thus, the US approach to regulation, with its preference for narrowly targeted law and philosophy of limited state power may be contrasted with the EU approach which also anchors regulation in territorial and substantive jurisdictional areas, but tends to favor proactive government intervention. These differing approaches demonstrate a set of difficulties arising from the problems governments have in coping with the speed and magnitude of change in the telecom industry.

[311] See Khemani & Waverman, *supra* note 19 at 147. The similar view was expressed by S. Khemani and L Waverman in relation to the legal treatment of strategic alliances: they should receive a case-by-case consideration based on a 'rule of reason' approach.

of conflict, telecommunications is probably the one sector with an excess of policy collaboration and with a compulsion to protect."[312] The future of telecommunications regulation seems to involve a certain adjustment process in the absence of full coordination. Traditional policy goals will be pursued and achieved individually by each country.[313] Multilateral jurisdictional efforts, which are 'outcome determinative', will with each single arrangement reduce flexibility in policy. However, pressured by national telecommunications providers and other market players, many countries' regulatory authorities may block market entry if all telecommunications issues are left for the domestic regulators to decide.

Competition authorities, as creatures of the nation state, are generally answerable to the political authorities of their respective countries so their priorities reflect national politics. In this regard, D. Neven & P. Seabright argue that it is unrealistic to expect national competition authorities to be entirely objective and impartial. The fact that there are likely to be "strategic" regulatory decisions having transborder effects will distort competition policy in the global context.[314] This is mostly because harmonization of competition law, trade and

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[312] See Noam & Singhal, *supra* note 308.

[313] See E.M. Noam, "Beyond Liberalization III: Reforming Universal Service" (1994) 18 Telecommunications Policy 9 at 702 for the proposition of creating a 'mixed system' of telecommunications regulation under which the US jurisdictional issues would be settled at the intermediate level between an entirely state-based and total national uniformity system.

> "At the one extreme if the system is entirely state based it would be difficult to regulate carriers efficiently because each state would have to calculate its own transmission path revenue by shifting revenues and costs either in real or accounting terms according to which state offers a lower rate. The result would be a 'race to the bottom' by states to attract telecommunications carriers, and inefficient operations by carriers chasing the lowest rate. To the other extreme, total national uniformity, would abandon a history of federalism and regional diversity."

Although E. M. Noam does not suggest straightforwardly that the new telecommunications carriers should be subjected to the "mixed system" of regulatory policies, he nevertheless predicts that ITAs are much likely to behave in the same fashion as common carriers would under the entirely nation-based system. See E. M. Noam & A. Singhal, *supra* note 308 at 772. See also Figure 5, below, on p. 153 for the "mixed" model of the hybrid structure of regulatory collaboration.

[314] See D. Neven & P. Seabright, "Trade Liberalization and the Coordination of Competition Policy" in L. Waverman & W. S. Comanor, eds., *Competition Policy in the Global Economy: Modalities for Cooperation* (New York: Routledge, 1997). A given ITAs activity may be subject to

investment is a politically charged matter, since the nation states will have to give up at least a part of their asserted prerogative of sovereignty to make the "common rule" viable.

Therefore many governments prefer to talk about coordinating convergence and system compatibility rather than fully-fledged harmonization. This becomes then a matter of international coordination system in which laws and policies are brought together by relieving tensions among them. Thus, on matters of substantive importance such as competition law, WTO Members may not have a multilateral agreement but for other matters, such as antitrust enforcement and adjudication, there will be right mechanisms to bring national laws together.[315]

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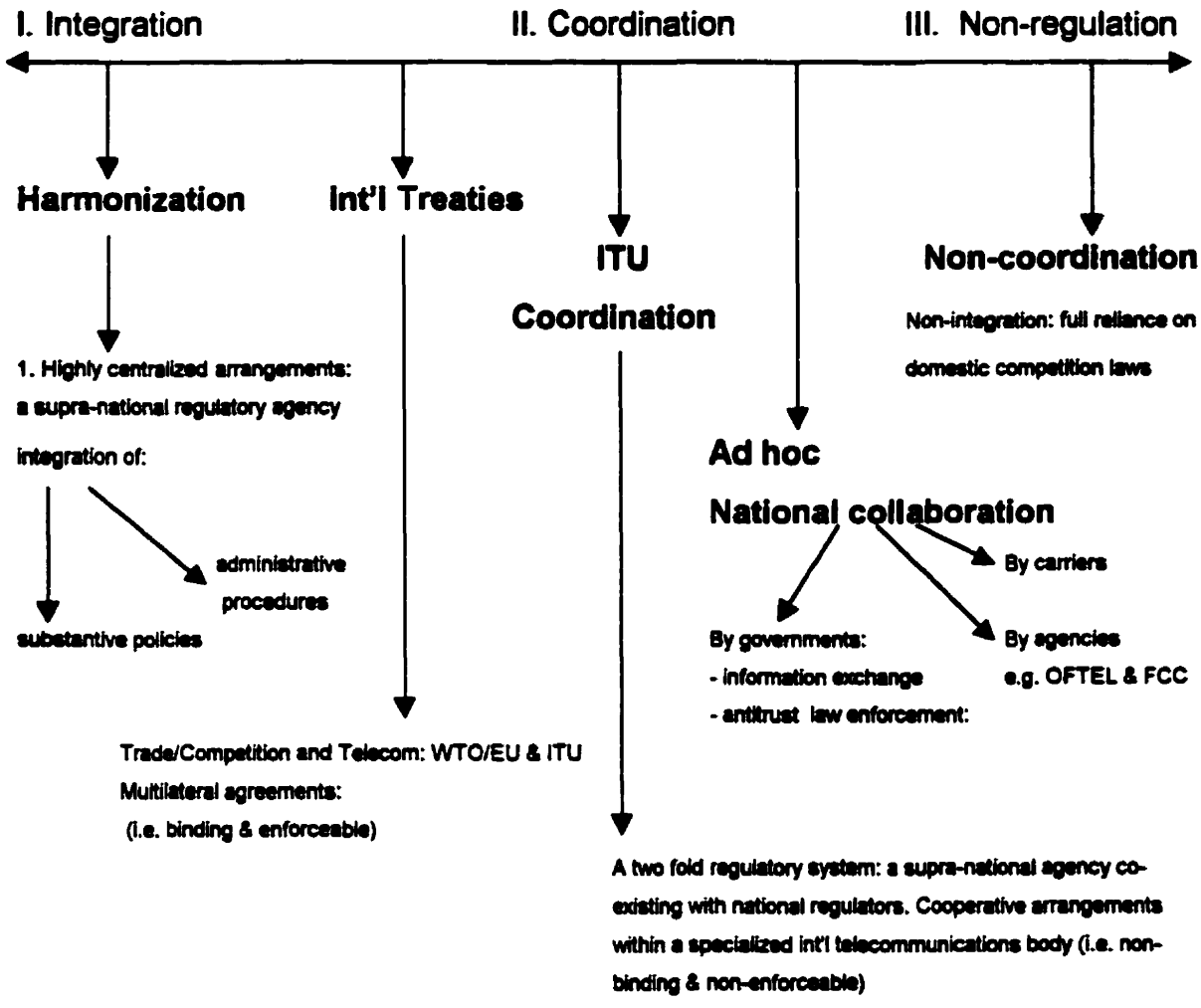
differing rules simultaneously, such as trademark or antitrust regimes, because its activity transcends the borders of a single nation. This in itself creates conflict – the temptations to apply national standards and laws extraterritorially further compounds the legal uncertainty. For example, United States has extended patent law to restrict foreign activities that were heretofore legal where conducted. On the other hand, Data Protection Directive of the European Union requires *ex ante* evaluation of foreign data processing standards, see P. Schwartz, "European Data Protection Law and Restrictions on International Data Flows" (1996) 80 Iowa Law Review 471 at 56.

[315] See W.A. Cann, "Internationalizing Our Views Toward Recoupment and Market Power: Attacking the Antidumping/Antitrust Dichotomy Through WTO-Consistent Welfare Theory" (1996) 17 University of Pennsylvenia Journal of International Economic Law 127, S.P. Croley & J.H. Jackson, "WTO Dispute Procedures: Standard of Review and Deference to National Governments" (1996) 90 American Journal of International Law 19 and C. Cocuzza & A. Farabasco, "The World Trade Organization: New Legal Order for World Trade" (1996) 16 Michigan Journal of International Law 34. It may be noteworthy that ITAs were not explicitly on the WTO basic telecommunications negotiation agenda. However most participants made commitments to pro-competitive principles, – such as the establishment of independent regulators, adoption of competitive safeguards and regulatory measures to ensure interconnection. The discussion of ITAs tended to cluster around two extreme positions. C. Cocuzza & A. Farabasco argue that some governments have been enthusiastic about including ITAs – "as a means of delivering swift liberalization and globalization of participating markets" – in the negotiation agenda, others have been more skeptical and pointed out that the multilateral trade regime "is being overtaken by the sector-specific regulatory issues and the velocity of technological change in the industry".

Figure 5. Hybrid structure of regulatory collaboration



3.4 SUMMARY

By way of summary this chapter, it should be stressed that the problem is not only whether hybrid governance structure of ITAs entails the development hybrid legal institutions. It is also to identify categories of legal issues that are emerging as a result of intermediate corporate arrangements. The areas where law seems to be most clearly affected by the new forms of inter-firm cooperation include:

1) Contract law[316]
2) Business Associations
3) International Trade
4) Competition Law
5) Foreign Investment Law
6) Telecommunications Law[317]

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[316] See M. Conrod, "Knowledge-Based Economy Will Encourage Long-Term Agreements: Technology Will Change the Nature of Contracts" The Lawyers Weekly (25 October 1996) arguing that there is a paradigm shift in the nature of high technology industries from commodity to a service. The telecommunications industry is moving away from a manufacturing-based organization with hardware and software and turning to a knowledge-based one. The convergence of telecommunications, content and computers requires a different approach to contracting, in the form of "co-development agreements, joint ventures and strategic alliances and will then give rise to other legal considerations such as joint and several liability". (On relational contract and international strategic alliances, see note 104).

[317] Beyond the disintegration of territorial borders, global telecommunications networks formed by ITAs undermine clear distinctions and borders in substantive law. For example, telecommunications law has been distinct from financial services law, and intellectual property has been distinct from privacy law. Likewise, the borders of protection within any particular field were usually well defined – a "common carrier" had a set of regulations quite independent from those of a "cable" provider or broadcaster. The new strategic alliances obscures these substantive borders – the new technological abilities of a telephone companies to offer "video" dial tone and a cable company to propose voice telephony undercut the well-defined borders of communications law.

Because strategic alliances, as noted in the previous discussion, resemble joint ventures and contracting, their emergence is likely to impact business and contract law directly. Trade, competition law and foreign investment, I argue, should be viewed as inter-linked in the treatment of ITAs so as to minimize the significant constraints created by isolated domestic policies and jurisdictions. One of the reasons why internationally coordinated competition laws come into conflict with the objectives of particular national policies is that an increasing number of firms is deciding to invest abroad and to ally.

The intricate interplay between foreign investments, competition policy and the business of international communications casts little light on how to achieve greater coordination of regulatory regimes without restructuring national autonomy. An intermediate solution might be to construct hybrid regulatory framework (i.e. a multi-regulatory interface) in an attempt to pool domestic jurisdictional regime to accommodate global alliances (see figure 5 above). Such a hybrid regime enabled by the liberalization of trade and telecommunications policies would facilitate cooperation among regulatory agencies acting in pursuit of domestic policy obligations and at the same time within the multilateral framework.

3.5 CONCLUDING REMARKS

This thesis about international telecommunications alliances has brought together two sets of inquiry with a view to showing how one illuminates the other. The first line of inquiry has to do with the ITA as a corporate form. Why do these global actors take on an intermediate form between markets and hierarchies? What precisely is the nature of the "hybrid" governance structure they display? Is this hybrid merely and unstable traditional form of organization tending towards merger on the one hand and dissolution into separate entities on the other? Or is the ITA in fact a new form of business organization unto itself, explained by the need to create clusters of networks in order to respond to the multiplicity of contexts characteristic of global markets? This thesis has defended the hypothesis that the answer to this last question is affirmative.

The second line of inquiry has to do with the institutional structure of transnational regulation. Given the emergence of ITAs and given their complex network organization, what is the appropriate response of domestic and international regimes, each of which has limited capacity, to police anti-competitive conduct and abuse of dominant position? Can it be said that we face is an unhappy choice between global harmonized rules on the one hand or fragmented domestic extra-territorial enforcement of rules on the other? Or is there an emerging hybrid structure to international legal institutions, also based on networks of relationships that can adapt to the nature of the phenomena to be regulated? Again, this thesis has defended the hypothesis that the answer to the last question is affirmative.

One would expect to find a symbiotic relationship between regulatory regimes and the actors these regimes aim to channel. This thesis has attempted to pave the way toward a "hybrid" approach to legal institutions that can meet

the hybrid structure of international market actors. In so far as the turn-of-the-century orientation toward international governance is based on open trade and liberalized markets, it becomes crucial to ensure that regulatory mechanisms put in place by the global regime do in fact correspond to the nature actors in contemporary transnational markets.

This is all the more significant when it comes to assessing the legal environment within which the infrastructure of the so-called "global information economy" is to operate. ITAs have become the most significant legal actors assembling and operating the global telecommunications infrastructure. This thesis has attempted to identify possible pathways of change and adaptation of the international trade regime, investment policy and antitrust law by pointing toward the creation of hybrid regulatory institution.

The subject of hybrid structures overarches markets and legal institutions and gives rise to a rich, if complex, research agenda. This thesis has begun the task of drawing out a "multi-theoretical" methodology relying upon business organization theory, transaction costs economics, the theory of regimes in international relations as well as legal pluralism. The principal methodological postulate applied in this thesis has been that studying of complex phenomena requires the use of multi-layered and varied set of theoretical tools. It is to be hoped that the reader has found this elaborate methodology more illuminating than daunting.

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