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MEXICAN TELECOMMUNICATIONS:

***A STUDY OF PRIVATIZATION OF THE STATE MONOPOLY
AND OPENING OF THE MARKET TO COMPETITION***

BY

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of the requirements of the degree of Masters of Laws (LL.M.)

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ABSTRACT

A little over 10 years ago the Mexican government privatized *Teléfonos de México*, S.A. (Telmex), the telecommunications monopoly that had dominated the market since 1948 and had become a government-owned company in 1976. This thesis focuses on the company's privatization and on the regulatory framework that resulted, analyzing the achievement of the objectives set with the purpose of liberalizing the market and opening it to competition and foreign investors.

The main issues addressed are the regulatory framework of Mexican telecommunications, the players involved, interconnection of their networks, foreign investment in Mexican telecommunications, licensing of radio frequencies, rate regulation, universal service obligations, and the international scenario in liberalization of trade in telecommunication services and the relating international instruments, insofar as they relate to the Mexican experience.

RÉSUMÉ

Il y a de cela un peu plus de dix ans, le gouvernement mexicain a privatisé Teléfonos de México, S.A. (Telmex), le monopole des télécommunications qui dominait le marché depuis 1948, et qui était devenu propriété de l'État depuis 1976. Le présent mémoire s'intéresse particulièrement au processus de privatisation de la compagnie, ainsi qu'au cadre réglementaire qui en a résulté, analysant l'atteinte des objectifs fixés en vue de libéraliser le marché et de le rendre accessible à la concurrence et aux investisseurs étrangers

Les thèmes abordés ici sont le cadre réglementaire des télécommunications mexicaines, les intervenants concernés, l'interconnexion de leurs réseaux, l'investissement étranger dans les télécommunications mexicaines, l'autorisation des fréquences radio, le contrôle des tarifs, l'obligation de service universel, et le contexte international de libéralisation du commerce dans les services de télécommunication, dans la mesure où il concerne l'expérience du Mexique.

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INTRODUCTION

The mid-eighties were a crucial time for Mexico, which was overwhelmed by economic and political turmoil. Mr. Carlos Salinas de Gortari was elected President in 1988, and with him came political and economic reforms. The markets were to be deregulated and liberalized to open Mexico to international trade of goods and services, and to foreign capital. One of the main markets was certainly telecommunications service.

As a developing economy and neighbor to one of the most powerful countries in the world, Mexico, in need of economic and political progress, was under great pressure to open its markets to global trade in goods and services. As a result, steps were taken towards deregulation and liberalization from within the country. In the international context, Mexico expressed its commitment by becoming party to the General Agreements on Tariffs and Trade (GATT),¹ and by entering into negotiations towards the implementation of the North American Free Trade Agreement (NAFTA).²

Mexico privatized *Teléfonos de México, S.A.* (Telmex), its state-owned telecommunications monopoly, in the late eighties. In so doing, Mexico committed itself to

¹ See *General Agreement on Tariffs and Trade*, October 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S.194; *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, April 15, 1994, Legal Instruments-Results of the Uruguay Round vol. 1 (1994), [hereinafter *GATT*].

² See *North American Free Trade Agreement* (1993), Dec. 17, 1992, 107 Stat. 2057.

creating a suitable environment for the gradual entering of competitors in numerous areas of telecommunications.

From a domestic perspective the decision to privatize Telmex came at just the right moment. After more than 40 years of monopolistic operation the situation was depressing. Technology was outdated and service provision was slow and sometimes even absent. Consumers felt abused and deceived as service worsened every day and prices rose continuously. Yet, Telmex was one of the most profitable companies in the world; but this was not reflected in its services or its technology.³

This thesis addressed the privatization process of Telmex, as well as the liberalization of the telecommunications market in Mexico. The purpose is to analyze the particularities of the privatization and the evolution of the liberalization of the market in order to pinpoint the accomplishments and flaws, learn from past experiences and even propose alternate solutions.

Chapter One of this thesis provides a general background and serves as an introduction to Mexican telecommunications. It approaches the aspects such as the first licenses, foreign investment in early Mexican telecommunications, installation of the first wire networks, the first interconnection disputes and the introduction of long distance service. The incorporation of Telmex into the governmental structure is also addressed, and

³ See A.L. Ruelas, "México y Estados Unidos en la Revolución Mundial de las Telecomunicaciones, Universidad Autónoma de Sinaloa and Universidad Nacional Autónoma de México" (1996) Online, <http://www.lnic.utexas.edu/la/mexico/telecom/index.html> (date accessed: May 4, 2000).

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HISTORICAL BACKGROUND

I. Early Mexican Telecommunications

The first telephone lines were laid in Mexico in the late 1800s, by small companies and persons to whom licenses were granted. One such company, *Alfredo Westrup y Compañía*, entered into an agreement with the government of Mexico City to connect the police headquarters of the City with the offices of the General Prosecutor and the Secretary of State. In 1881, three years after installation commenced, the first private networks were in place. That same year American M.L. Greenwood was given a license to install a public service network in Mexico City. The following year *Compañía Telefónica Mexicana* (CTM) was incorporated as a subsidiary of the United States of America ("US") based Western Electric Telephone Company, becoming the first Mexican telecommunications company.⁵

In 1888 Mexico's first telephone directory, which included information on more than 800 subscribers, was compiled, and three years later Mexico City, Guadalajara, Puebla, Mérida, Monterrey and Veracruz all had telephone service.⁶ In 1892 and 1893 CTM expanded through the acquisition of other companies operating in Mexico and started providing telephone service to major cities throughout Mexico.⁷

⁵ See Alestra, "Telecomunicaciones en México" (1997) Online Alestra, S.A. de C.V., http://www.alestra.com.mx/alestra/frames/f1_telecom.html (date accessed: May 4, 2000).

⁶ See *ibid.*

In 1904 the US International Telephone and Telegraph Company (ITT) took over CTM, while in 1905 the Swedish company L.M. Ericsson (Ericsson) received a transferred concession to provide telephone services in Mexico City and surrounding areas. That same year CTM changed its name to *Compañía Telefónica y Telegráfica Mexicana* (CTTM). CTTM and Ericsson became the key Mexican telephone service providers, dominating the Mexican market.⁸

Aggressive competition between Ericsson and CTTM began. In the 1920s long distance service became an important issue. Ericsson started providing long distance service in 1926, and in 1927 CTTM began providing long distance service to the US and Canada. By the next year service was being provided to Europe.⁹ The competition between CTTM and Ericsson intensified. They were both developing their own networks but there was a problem; these networks were not interconnected, and therefore a CTTM user could not communicate with an Ericsson user and vice-versa. Finally in 1941 CTTM and Ericsson interconnected their lines throughout Mexico, except for Mexico City, which was Mexico's main market.¹⁰

In 1947 Ericsson and CTTM merged to create *Teléfonos de México, S.A.* (Telmex), adopting the corporate regime of a Mexican company with predominantly foreign capital. Finally in 1948, now as a single company, Telmex began to interconnect lines in Mexico.

⁷ See Teléfonos de México, "La Historia: Teléfonos de México, extracts from Historia de la Telefonía en México 1878-1991" (1999) Online Telmex, <http://www.telmex.com.mx/tel2.html> & <http://www.telmex.com.mx/tel3.html> (date accessed: February 10, 2000) [hereinafter "Historia de la Telefonía"].

⁸ See Ruelas, *supra* note 3.

⁹ See Alestra, *supra* note 5.

In 1958 a group of Mexican investors purchased the majority of Telmex's shares and took control of the company.¹¹ Telmex operated with a majority of Mexican private investors until 1972, when the government became the majority stockholder. In 1976 Telmex was incorporated into the governmental sector.¹² As a government-owned company Telmex continued to provide local and long distance services exclusively until 1990, the year in which the re-privatization and opening to competition process began.

II. Regulatory Background

Beginning in 1940 the law regulating all communications matters, including telecommunications, land, air, maritime and postal communications, was the *Ley de Vías Generales de Comunicación*¹³ (LVGC). One of the main objectives of the LVGC was to regulate aspects that before the 1940s had been exposed to irregularities, mostly due to the lack of surveillance and regulation. Such aspects included interconnection and the granting and transfer of concessions and permits.

The LVGC gave all related powers essentially to the *Secretaría de Comunicaciones y Transportes*¹⁴ (SCT). Among other matters the SCT was entitled to:

¹⁰ See Ruelas, *supra* note 3.

¹¹ See "Historia de la Telefonía", *supra* note 7.

¹² See Alestra, *supra* note 5.

¹³ See *Ley de Vías Generales de Comunicación*, (*Diario Oficial de la Federación* (DOF) February 19, 1940), which is Spanish for General Communications Ways Law. DOF stands for Federation's Official Gazette.

¹⁴ *Secretaría de Comunicaciones y Transportes* is Spanish for Communications and Transport Ministry. The SCT is a governmental ministry that depends directly on the executive branch of the Mexican Governmental Organization.

- construct, improve, conserve and exploit all means of communication;
- inspect and police compliance with the applicable laws;
- grant, interpret and enforce concessions obligations;
- enter into contracts with the federal government;
- modify and revoke concessions or agreements;
- grant or revoke permits;
- expropriate property as required;
- approve, revise and modify tariffs, schedules, distance tables, and generally all documents related to the exploitation; and
- verify compliance with the LVGC as well as sanctioning.

When the State began to purchase Telmex's stock an unhealthy relationship between the SCT and Telmex started to develop, since the authority was getting closer to the operator and functions and faculties began to combine into the same managerial and regulatory structure. This situation worsened throughout the years until the time when Telmex was controlled completely by the SCT. In other words the State became the operator of Telmex and thus also became the regulator and regulated in the telecommunications sector. This situation and the consequences thereof would represent the main challenge to be overcome 20 years later.

A few months before the privatization of Telmex the situation in a nutshell was: one regulation, the LVGC; one regulator, supervisor, inspector and judge, the SCT; and one service provider, Telmex, which was fully operated and controlled indirectly by the SCT.

There was a big void in Mexican telecommunications laws and regulations. The LVGC dated from 1940 and was not fit for a new telecommunications approach and policy; moreover, it did not include a specific regulation for the telecommunications sector.

This situation did not seem to bother the authorities too much; after all, Telmex had been operating under the LVGC when it was a State monopoly, and it could still benefit from that unclear situation even as a private monopoly. However at the same time, in the early 90s, Mexico was involved in the process of negotiations for NAFTA, which provides for the liberalization of the telecommunications sector. Obviously the US and Canada would want things done in an orderly and transparent fashion, which would also suit the needs and interests of their potential investors. Since neither Canada nor the US would enter into the agreement without some certainty on the foregoing, Mexico passed the *Reglamento de Telecomunicaciones*¹⁵ (RT). The RT served a double purpose; on one hand its purpose in view of NAFTA, since it showed the US and Canada that Mexico wanted to improve the situation, and on the other hand it gave the privatization of Telmex regulatory support. Among other matters the RT provided for:

- definitions of types of communications, networks and services;
- objectives of regulation of establishment, installation, maintenance, operation and exploitation of telecommunication networks and the services provided thereby;
- regulation of participation, rights and obligations of the players involved in such regulation and exploitation;
- the attributions of the SCT to issue policies and development of the sector programs;

- the attributions of the SCT to grant concessions and permits;
- the reservation of telegraphic, radiotelegraphic and satellite sectors to the State and State-owned companies;
- the classification and definition of basic and additional telecommunications services;
- concessions to be granted for up to 50 years, which may be extended in case the conditions of the concession were met;
- the liberalization of the market of telecommunications equipment; and
- the prohibition of cross-subsidization and monopolistic behaviors.

Since the RT was passed two months prior to the privatization, it was criticized as being issued only in order to give the privatization regulatory support. Moreover the RT and the Modification to the Concession Title of 1976 (which will be defined and explained below) had numerous identical provisions. To add to the controversy, key areas within the telecommunications sector already operating were left unregulated, and the issuing of a law addressing cellular radiotelephony, satellites, satellite television and database networks had to wait.

¹⁵ See *Reglamento de Telecomunicaciones* (DOF October 29, 1990), which is Spanish for Telecommunications Regulation.

CHAPTER TWO
TOWARDS PRIVATIZATION

I. Basic Concepts

A. Why Privatize?

Privatization necessarily implies the existence of a government-owned company. The transition from being government-owned to privately-owned may come as a result of different motivations, their common denominator being an economic rationale. For example, a State may decide to privatize a public company in order to: (i) raise revenue for the State; (ii) raise investment capital for the industry or company being privatized; (iii) reduce government's role in the economy; (iv) promote wider share ownership; (v) increase efficiency of the industry; (vi) introduce competition to the particular market; (vii) expose the company to market discipline; and/or (viii) comply with international treaty obligations or follow foreign trends.¹⁶ Generally, every case will include a combination of a few of the foregoing.

Even though the term privatization implies the existence of a government-owned company, it does not necessarily mean that that company represents a monopoly. Often

public and private companies in the same business coexist in a same market. However when there is a government-owned monopoly, the situation is more complicated.

The existence of a monopoly, regardless of the service or product, already represents a problem for consumers. In a nutshell, we can identify two main issues that often arise from monopolistic activity: (i) over-pricing and (ii) under production or provision of the service. As simple as these may sound, the manifestation may be of diverse forms, whether due to direct high pricing, insufficient service, delays in service, abuses incurred by taking advantage of the position of exclusive provider, etc. The problem becomes more acute when the monopoly is in government hands, since the government can more easily evade consumer protection laws and surveillance. Often government monopolies have been used as an instrument of control of opposing forces or groups. For example, in Mexico governmental censorship was accomplished through the control of paper for the press, which was a government monopoly;¹⁷ whenever a newspaper published information or criticisms that attacked the government, directly or indirectly, the government would cut the supply of paper to the particular newspaper company. Similar abuses can be identified throughout the history of Mexican monopolies, whether involving telecommunications, electricity, oil, paper, etc.¹⁸

¹⁶ See UNCTAD, Sectoral Analysis. Telecommunications, Comparative Experiences with Privatization. Policy Insights and Lessons Learned (Geneva: United Nations, 1995) at 156 [*hereinafter* UNCTAD].

¹⁷ See C. Monsiváis, "La Censura en México, Topodrilo" (Spring 1988) 1 Universidad Autónoma Metropolitana Iztapalapa, Online Universidad Autónoma Metropolitana Iztapalapa, http://www.iztapalapa.uam.mx/iztapala.www/topodrilo/01/td01_09.htm (date accessed: May 4, 2000).

B. Methods of Privatization

The method of privatization to be used depends on the case and the nature of the company being privatized. Although this study does not presume to determine the ideal form of privatization, the most common methods include: (i) outsourcing, where the government contracts with a private organization to provide a service; (ii) management contracts, where the operation of a company is transferred by contract to another company (private); (iii) public-private competition, where private and public enterprises are allowed to participate in a market; (iv) franchising, where private companies are given the exclusive right to provide services construed to determined geographical areas; (v) vouchers, where the government pays for the service, but individuals are given redeemable certificates to purchase the service on the open market; (vi) commercialization, where the government stops providing a service and lets the private sector assume the function; (vii) asset sale or long-term lease, where the government sells or enters into long-term leases for company assets, thus turning physical capital into financial capital; (viii) direct sale or partial sale of the entire company to the public; (ix) sale of the company to another company or consortiums; (x) deregulation; and (xi) removal of subsidies.¹⁹

II. Conditions Motivating the Privatization

¹⁹ See L. Rubio, "Privatización: Falsa Disyuntiva" (June 1999) Online Nexos, http://www.nexos.com.mx/internos/junio99/privatizacion_falsa_disyuntiva.htm (date accessed: May 4, 2000).

Two separate issues can be identified as the main motivators of the privatization of Telmex; on one hand the international trend and movement towards telecommunications liberalization and on the other a combination of economic and political circumstances from inside Mexico.

A. International Influence

When the privatization of Telmex was proposed, changes in the telecommunications sector were ongoing in the international context, mainly in developed economies.²⁰ The US had broken up Bell and AT&T into “baby” regional companies, the British had privatized British Telecom, and the Japanese had implemented changes favoring the deregulation of telecommunications.

As a result of recently entering into the GATT²¹ agreements and negotiations toward a free trade agreement with the US and Canada, Mexico adopted a new economic development strategy based on economic deregulation and commercial opening. Moreover international trends and policies in telecommunications spearheaded by industrialized countries and organizations like the International Telecommunications Union (ITU) and the

¹⁹ See Reason Public Policy Institute, “Types and Techniques of Privatization”, Online Reason Public Policy Institute, <http://www.rppi.org> & Online Privatization Center, <http://www.privatization.org>. For further literature on privatization issues, see the mentioned web sites (date accessed: May 4, 2000).

²⁰ See A. Jiménez, “Telescopio: *Reestructuración del sector telecomunicaciones: *Fracaso político: *Renuncia a la mexicana” (May 1998) 32 Media Comunicación, 400.

²¹ See GATT, *supra* note 1.

World Bank, together with the negotiations on trade of services of the GATT's Uruguay Round, greatly influenced Mexico's decision to privatize its State monopoly.

With the international trend towards liberalization and deregulation came the weakening concept of *natural monopoly*. Governments conveniently benefited from this concept, for they were the proprietors of the companies and their profits. However the growth of technology has been accompanied by significant industrial and technological changes that challenge the concept of natural monopoly.²² Everyday new technologies are developed that make services faster, easier, cheaper, etc. This applies not only to customers but to providers too. Although the concept of *natural monopoly* could have been justified during the times of wire technology, nowadays it is almost at the point of being obsolete.²³ As technology evolves and becomes more affordable it is no longer justifiable to say that since the area is so specialized and expensive to develop it should be controlled solely by the state. Today it is evident that private corporations can provide even better telecommunications services than can the State.

B. Domestic Conditions

²² See C. Casasús López Hermosa, *Telecommunications In Mexico: Evolving Regulatory Framework*, Comisión Federal de Telecomunicaciones (Speech at Merrill Lynch, Hotel Presidente Intercontinental, Mexico City, December 3, 1997).

²³ See Foro Nacional de la Concertación, "Documento para la concertación sobre el futuro de las Telecomunicaciones en Costa Rica", Presidencia de la República de Costa Rica (1998), Online Casa Presidencial del Gobierno de Costa Rica, <http://www.casapres.go.cr/concerta/telecom.htm> (date accessed: May 4, 2000).

At the beginning of the restructuring process domestic conditions were important for privatization. Mexico had been going through one of its worst economic crises, although it reached its most severe levels during 1982, with the problems accumulating from a long time before. The foreign debt of approximately US \$7 billion had almost doubled by 1974. By 1979, when it reached its worst level, the debt had exceeded US \$80 billion.²⁴

Concerning telecommunications services and infrastructure, conditions were no better. There was little money and a high devaluation of the Mexican peso; moreover equipment had to be purchased from outside of Mexico since it was not domestically manufactured. Telmex's foreign debt was increasing every year. In December 1980 Telmex's debt reached 43% of its total assets. During 1981 Telmex increased its foreign debt by an additional 25.3%, and particularly its debt with the US grew to a staggering 98%. At the end of 1982 Mr. Andrés Caso Lombardo, head Minister of the SCT at that time, informed the public that the demand for telecommunications services had exceeded the capacity of the industry. By 1986 Telmex's total debt had doubled that of the end of 1980.²⁵

Regarding investment in the telecommunications industry the conditions were the same. The investment was 12.6% less than anticipated. The number of installed telephones was 17.2% less than the goal set, while the number of long distance circuits was 40% less than expected.²⁶

²⁴ See Banco de México, "Información Económica", Banco de México, Online Banco de México, http://www.banxico.org.mx/public_html/inveco/infecon/sinfo.html (date accessed: May 4, 2000).

²⁵ See Ruelas, *supra* note 3.

²⁶ See *ibid.*

Because Telmex was a government-owned company the public never knew the real situation. However in 1989, when Telmex was preparing for its privatization, Mexican telecommunications authorities began to disclose the facts. The SCT issued in 1989 a development plan entitled *Programa de Modernización de las Telecomunicaciones*²⁷ in which the infamous situation of Mexican telecommunications was described.

From 1972 to 1988 Telmex increased its coverage from 1.1 million lines to 4.4 million, which represented only 18% of the Mexican homes with telephone penetration at 6 lines per every 100 persons.²⁸ Although most highly urbanized areas did have telephone service, it was slow and inefficient. In rural communities the situation was depressing; of the approximately 15,000 rural communities with a population of between 500 and 2,500 people only 5,000 had telephone service. This did not mean that a town had telephone service for all, most or even a minority of its inhabitants, but generally meant that the town had one telephone for its entire population. Even in Mexico's most highly populated and important cities, the waiting time to get a line installed was 4 to 5 years.²⁹ The public felt strongly deceived as prices increased often for local and long distance services, and as charges for so-called "ghost phone calls"³⁰ appeared on their bills.³¹

²⁷ *Programa de Modernización de las Telecomunicaciones* is Spanish for Telecommunications Modernization Program.

²⁸ See A.A. Pisciotto, *Telecommunications in Mexico: A Market In Transition* (Chicago: CCH Inc., 1997), Online Kellydrye, <http://www.kelleydrye.com/tc111397.htm> (date accessed: May 4, 2000).

²⁹ See Comisión Federal de Telecomunicaciones, *Primer Informe Anual 1996-1997* (September 1, 1997) Online COFETEL, http://www.cft.gob.mx/huml/9_publica/6_primer%20informe/info02.html (date accessed: May 4, 2000), [hereinafter *First Annual Report 1996-1997*].

³⁰ Ghost phone calls, long distance calls never made, were charged by Telmex to the customers' telephone bills. Those people who tried to take the matter to court or refused to pay for the unmade phone calls had their telephone service suspended.

Together with the long waiting periods to have a line connected, charges soared between US \$600 and US \$1,100 for the connection. The telephone excise tax was arbitrarily set and was one of the highest in the world.³² There was a daily average of 67,000 telephones out of service and one million unattended service requests.

According to Mr. Caso Lombardo, the inefficient service was in part due to a lack of good equipment, since 20% of the telephone lines in Mexico were obsolete and had to be replaced. In addition, Mexico unfortunately depended on foreign technology providers; 95% of its equipment was supplied from outside Mexico. ITT's equipment represented 65% of the Mexican telecommunications market and Ericsson's 35%.³³ This was due to the fact that Mexico invested very little in technology research and development. For example, in 1987 Mexico invested between US \$8 million and US \$ 12 million annually in research and technology development, whereas in other countries, *companies* would invest between US \$500 million and US \$2.5 billion annually.³⁴

Telmex was unable to develop the technological infrastructure that Mexico required. The demand for reliable and efficient service was high and the response to that demand was very poor. Mexico's telecommunications infrastructure even became a barrier to commercial, economic and social development. During its last years as a public company Telmex was at

³¹ See E. Fernández Armendáriz, "Los Viejos y Nuevos Pecados de Telmex" *El Diario* (December 8, 1998), Online *El Diario*, <http://www.diario.com.mx/dch/1298/08/opinion/op4.html> (date accessed: December 10, 2000).

³² See Operations Evaluation Department, *Privatization and Deregulation in Mexico*, World Bank (November 1995), No. 97, Online World Bank, <http://wbln0018.worldbank.org/oed/oeddoclib.nsf/44b2db891b40bcdc85256808006a000f/02ba59e41714b982852567f5005d8a07?OpenDocument> (date accessed: May 4, 2000), [hereinafter OED World Bank].

³³ See "Historia de la Telefonía", *supra* note 7.

the peak of being a corrupt, inefficient, highly leveraged and bureaucratized enterprise. If Mexico was convinced of modernizing its telecommunications sector, privatizing Telmex was the first and most important step towards this goal.

³⁴ See Ruelas, *supra* note 3.

CHAPTER THREE

THE PRIVATIZATION OF TELMEX

I. Political and Regulatory Framework for Privatization

As mentioned in the previous Chapter, Mexico adopted a liberalizing and market opening policy. In 1985 more than 2,000 import duties were eliminated; in 1986 Mexico became a party to the GATT Agreements.³⁵ Mexico was going through the beginning of an important transition process, from being a highly protectionist economy to a liberalized market for the free flow of goods and services. Accordingly old models had to be adapted and renewed, especially with regard to bureaucratized legal provisions, which were inefficient and gave too much discretionary power to governmental authorities.

An important change made by the administration of Mr. Miguel de la Madrid Hurtado,³⁶ who had inherited decades of bad presidential administrations and economic crises, came at the beginning of his term. Articles 25, 26 and 27 of the *Constitución Política de Los Estados Unidos Mexicanos*³⁷ (Mexican Constitution) were amended. These articles

³⁵ See Secretaría de Comercio y Fomento Industrial, *Mexico's International Trade Relations: Challenges and Opportunities* (Mexico: Secretaría de Comercio y Fomento Industrial, 1990) at 10.

³⁶ President of the United Mexican States from December 1982 until December 1988.

³⁷ See *Constitución Política de los Estados Unidos Mexicanos* (1917) [hereinafter *Mexican Constitution*], which is the Political Constitution of the United Mexican States.

elaborated those economic areas where participation corresponded to the State.³⁸ Prior to the amendment, the Constitution gave high discretionary power to the government, providing that it could impose any modalities to property, as dictated by public interest; public interest being a concept also determined by the government. After the amendment, the articles provided that the government could only reserve for itself the authority to dictate policy statements promoting economic development activities.

The liberalization process was more straightforward during the term of Mr. Carlos Salinas de Gortari.³⁹ Together with the change in the presidency came numerous changes in the state ministries and in state policies accordingly. At the beginning of his presidential term Mr. Salinas de Gortari gave the *Secretaría de Comercio y Fomento Industrial*⁴⁰ (SECOFI) a mandate to deregulate the economy.⁴¹ The SECOFI, led by Mr. Jaime Serra Puche, implemented an ambitious program named *Programa para Revisar el Marco Regulatorio de la Actividad Económica Nacional*⁴² whose purpose was to identify each and every statute or regulation impeding the adequate development of Mexican economic productivity. Within the areas included in the revision and further deregulation program were electronics and the transfer of technology.⁴³ Accordingly changes were made to numerous statutes and

³⁸ For more information concerning the modifications to Articles 25, 26 and 27 of the Constitution, see Biblioteca del Congreso, Reformas a la Constitución desde 1917, Biblioteca del H. Congreso de la Unión, H. Cámara de Diputados, Online Cámara de Diputados, <http://www.cddhcu.gob.mx/leyinfo/refcns/> (date accessed: May 4, 2000).

³⁹ President of the United Mexican States from December 1988 to December 1994.

⁴⁰ *Secretaría de Comercio y Fomento Industrial* is Spanish for Ministry of Commerce and Industrial Development. SECOFI is a centralized governmental ministry that depends directly on the executive branch of the Mexican Governmental Organization.

⁴¹ See P. Morici, *Trade Talks with Mexico: A Time for Realism* (Washington DC: National Planning Association, 1991) at 27.

⁴² See *Programa para Revisar el Marco Regulatorio de la Actividad Económica Nacional* (DOF March 3, 1989), which is Spanish for Legal Framework of the National Economic Activity Revision Program.

⁴³ See Morici, *supra* note 41.

regulations, the most significant here being those concerning foreign investment and privatization. Mexico was eager for money and economic and industrial development, and there was little money inside Mexico. Therefore foreign direct investment had to be permitted, specifically projects having 100% foreign investment, including those concerning computers and high technology.⁴⁴ In 1989 and 1993 more opening in foreign investment laws and regulations was adopted, and further projects were opened to 100% foreign investment. Others in which little or no investment was permitted opened to different percentages, and up to 49% in areas previously reserved for the Mexican government or Mexican nationals.⁴⁵

The market opening and deregulation process resulted in a privatization policy too. Certain government companies were to disappear and accordingly the subsidies they received were to be eliminated. Today more than 75% of over 1,200 government companies have been sold, including *Aeroméxico*, *Mexicana de Aviación*, banks and Telmex, among others.⁴⁶ Yet there are two big state monopolies left, *Petróleos Mexicanos* (PEMEX) and *Comisión Federal de Electricidad*.

SECOFI implemented another program, *Programa de Modernización Industrial y del Comercio Exterior*,⁴⁷ whose main objective was to simplify statutes and regulations in order to create a clear legal framework for investors. An important element of the program was

⁴⁴ See *ibid.*

⁴⁵ See *Ley de Inversión Extranjera* (DOF December 27, 1993) [hereinafter *LIE*], which is Spanish for the Foreign Investment Law.

⁴⁶ See Morici, *supra* note 41 at 29.

⁴⁷ See *Programa de Modernización Industrial y del Comercio Exterior* (DOF January 23, 1990), which is Spanish for Industrial and Foreign Trade Modernization Program.

modifying those regulations and statutes granting excessive discretionary power to Mexican authorities. Heavily motivated by negotiations with the US and Canada in connection with the future entering of NAFTA, this program was the first step in a series of amendments of Mexican statutes and regulations. Among others acts, the *Ley de Inversión Extranjera* (LIE), the *Ley Federal de Competencia Económica* (LFCE)⁴⁸ and the *Ley de Comercio Exterior* (LCE)⁴⁹ were issued. These acts concerning foreign investment, competition and antidumping laws were an essential part of the NAFTA negotiations, since they represented the US's and Canada's main concerns with regard to the Mexican market. Together with specific directives on antidumping, competition and other subjects, the program also provided for the deregulation and modernization of telecommunications. The government adopted programs for strategic changes in areas concerning telecommunications, mainly focused on the modernization of infrastructure, international trade in services and equipment, competition and simplification of related regulations.

During the same time the SCT issued the *Programa de Trabajo del Sector Comunicaciones y Transportes*⁵⁰ which set important policy guidelines to direct the deregulation and modernization of the communications sector. The main policy aims were:

- (i) to deregulate and modernize regulations;
- (ii) to promote competition in the telecommunications sector;
- (iii) to improve services and promote additional services;

⁴⁸ See *Ley Federal de Competencia Económica* (DOF December 24, 1992), which is Spanish for Federal Competition Law.

⁴⁹ See *Ley de Comercio Exterior* (DOF July 27, 1993), which is Spanish for Foreign Trade Law.

⁵⁰ See *Programa de Trabajo del Sector Comunicaciones y Transportes* (DOF January 23, 1989) [hereinafter *Work Plan for the Communications and Transportation Sector*], which is Spanish for Work Plan for the Communications and Transportation Sector.

- (iv) to expand the service coverage in the urban areas and to the rural areas; and
- (v) to increase technological research and development.⁵¹

On May 31, 1989 Mr. Carlos Salinas de Gortari announced in a speech to the Mexican population given on the day of the presentation of his *Plan Nacional de Desarrollo 1989 - 1994*.⁵²

An essential aspect of the creation and operation of economic infrastructure is telecommunications. In order to support all areas of the national development, an important telecommunications modernization is required. Telecommunications services must diversify, improve their quality, widen their coverage in the urban areas and extend to rural areas. The tariffs for the diverse services shall not be significantly different from those applicable in the countries with which Mexico competes in the international market.

The essential modernization and expansion of communications will require great investments, which shall be financed with private party's participation; the purpose is not to distract tax resources which can satisfy the demands of the health, education and housing sectors, and the adequate development of the rest of the infrastructure. The State shall be in charge of the regulation and surveillance of the telecommunications sector, and shall promote its development, by means of a new regulatory framework that takes into account the technological change of the past years. The regulation will give the proper legal safety to the participants in the sector.

The expansion of the basic telephone services shall be promoted with the objective of substantially increasing the number of telephone lines. The telephone service shall

⁵¹ For further literature in connection hereto, see *National Development Plan 1989-1994*, *infra* note 51; *Work Plan for the Communications and Transportation Sector*, *ibid*.

⁵² See *Plan Nacional de Desarrollo 1989-1994* (DOF May 31, 1989) [hereinafter *National Development Plan 1989-1994*], which is Spanish for National Development Plan. It is issued by the President of the United Mexican States and outlines the development strategies for the different ministries and their functions during the President's term in office.

increase its efficiency and modernize its systems in order for it to become a true link between Mexicans and to the outside.

The technological change nowadays permits the competition in telecommunications services. Multiple enterprises will be able to develop the services of commuted data transmission, informatics, cellular telephony and more. In such sense, consumers will be able to choose between companies that will compete in the sale and maintenance of terminal equipment. The regulation of these services will promote competition and avoid the rising of monopolistic practices.

The new cellular telephony concessions will be subject to auction, in an open and transparent way that guarantees the best offer of services and economic remuneration for the State. Priority shall be given to the integral benefit of the satellites system, facilitating the installation and operation of land private party operated stations. The microwave net will be modernized and fiber optic links will be established.⁵³

In accordance herewith, the main challenges that the government had set for the telecommunications sector in Mexico were: (i) accelerating the deployment of basic infrastructure; (ii) introducing new services and advanced technology; (iii) developing the telecommunications market by opening to private investment; and (iv) changing the role of the government to a regulator and promoter of privately-owned companies.⁵⁴

With the implementation of certain measures, opening and deregulation of the telecommunications market began to take effect. The commerce of terminal equipment was liberalized in 1988; this was important because the commerce of terminal equipment was previously reserved for Telmex. Further in 1989 the *Reglamento de la Ley para Promover la*

⁵³ *Ibid.*

⁵⁴ See J. Lozano Alarcón, *Developments in the Mexican Telecommunications Market* (Washington, DC: Comisión Federal de Telecomunicaciones, 1999).

Inversión Mexicana y Regular la Inversión Extranjera (RLPIMRIE)⁵⁵ permitted complete foreign investment in equipment manufacturing companies.⁵⁶

An essential step was to separate functions within the legal framework, since the traditional model did not have a clear separation between the functions of the operator of the service and the regulator. All matters concerning regulations, surveillance and control of telecommunications were given to the *Dirección de Políticas y Normas de Comunicación*⁵⁷ (DPNC), which was an office of the SCT, whereas the provision of the telecommunication services reserved to the state by law⁵⁸ were given to *Telecomunicaciones de México* (Telecomm). Telecomm was created by a presidential decree in 1989⁵⁹ as a government organism, independent and autonomous from the government, with its own assets and independent budget.⁶⁰

The market began opening to competition first for cellular services. In 1989 the SCT issued an official invitation all parties interested in licenses for the operation of mobile telephony with cellular technology in all Mexico, divided into 8 geographical regions. The licenses granted were effective for 20 years, and according to the LIE and regulatory laws, foreign investment in participating companies could reach up to 49% of the total stock.

⁵⁵ See *Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera* (DOF May 16, 1989) [hereinafter *RLPIMRIE*], which is Spanish for Regulation to the Law for the Promotion of Mexican Investment and the Regulation of Foreign Investment.

⁵⁶ See *LIE*, *supra* note 45, art. 5; *RLPIMRIE*, *ibid.*, art. 5.

⁵⁷ *Dirección de Políticas y Normas de Comunicación* is Spanish for Policy and Communications Norms Directorship.

⁵⁸ See *LFT*, *infra* note 91, art. 9.

⁵⁹ See DOF November 17, 1989.

⁶⁰ Although it is independent from the government, the link is evident and inevitable. However, Telecomm's highest organ is the Board of Directors, which is integrated by Mexico's Ministers of Finance, Communications and Transportation, State, Foreign Affairs and Commerce and Industrial Development, in an effort to have all

II. The Re-privatization of Telmex

The government intended to realize key goals as a result of the privatization, namely: (i) to develop the public network efficiently and improve the quality of service; (ii) to establish the basis for healthy competition; (iii) to eliminate cross-subsidies between services; and (iv) to foster productivity gains in order to reduce rates for consumers.⁶¹

Once the decision to re-privatize Telmex was made, four important conditions were established by the government for the privatization: (i) the government should maintain the regulation, surveillance and policing of the sector; (ii) the majority of Telmex's capital stock should be held by Mexican individuals; (iii) telephone service and coverage should improve rapidly; and (iv) scientific and technological research in the sector should be promoted.⁶²

In September 1989 at a reunion of the Telephone Operators Union, Mr. Carlos Salinas de Gortari announced the re-privatization of Telmex. He explained that during the time that Telmex had operated as an enterprise incorporated into the federal government's administration, it had never had sufficient resources to expand the Mexican telecommunications system.⁶³ The government began preparing the way for the final steps of the privatization process. The excise tax was abolished and local and long distance telephone

the related parties included in decision making, not just the Minister of Communications and Transportation, as was the case before.

⁶¹ See Lozano Alarcón, *supra* note 54.

⁶² See *First Annual Report 1996-1997*, *supra* note 29.

rates were re-balanced.⁶⁴ Thereafter the Concession Title once given to Telmex was modified, since it had been issued on an exclusive basis, and Telmex's stock sold.

A. Labor Transition from a State-owned Company to a Private Company

In any privatization the transition that employees of the company go through must be considered. There are two sides to this process. On one hand management has to change its mentality from being a company with a public service goal to being a revenue-oriented company. On the other hand, the whole labor status of employees may change as a result of the sale of the company, and they will certainly want their conditions to be better or at least the same. In a company the size of Telmex (more than 48,000 employees), employees play an essential role that can certainly determine the success of the process. Thus, workers of the state-owned company might be protected under a collective agreement or out of a collective agreement under another regime, which they would want to ensure. Moreover, they may also want to keep at least the same pension funds and benefits provided by the State-owned company. In a nutshell, they would want their jobs, wages, plans, and conditions to be at least respected and if possible improved.

The *Sindicato de Telefonistas de la República Mexicana*⁶⁵ (STRM) played an essential role in the privatization of Telmex. From the late seventies through 1987 the relationship was

⁶³ See Ruelas, *supra* note 3.

⁶⁴ See OED World Bank, *supra* note 32.

⁶⁵ *Sindicato de Telefonistas de la República Mexicana* is Spanish for Mexican Telephony Workers Labor Union.

tainted by numerous strikes.⁶⁶ It is important to underscore that the STRM grouped together 41,521 of the 49,000 Telmex employees. When the idea of privatizing was announced, the STRM immediately announced its strong opposition; however, by 1988 the STRM formulated a new collective labor agreement, accepting all the conditions proposed by Telmex. In March 1989 the STRM again expressed its strong opposition to the privatization, then in July it announced it would leave the decision to the President, and by September 1989 the STRM announced its support of the privatization of Telmex.⁶⁷ During the same period Telmex was also reorganized in order to simplify internal procedures and to eventually cut the costs of day-to-day management.⁶⁸

By the time of the privatization the power of the STRM had been substantially lessened. Top management at Telmex and high governmental telecommunications officials agreed with the privatization, especially since most of them were connected with the ruling party and loyal followers of the government line.⁶⁹ In any case, offering long-term loans to top management to allow them to purchase 1.4% of Telmex's stock reduced any possible resistance.⁷⁰

The rest of the employees of the company (over 48,000) were also taken into account. After the government modified Telmex's Concession Title, it contained the obligation to respect the terms of the agreements of all Telmex's employees, which meant

⁶⁶ From 1976 to 1987 the STRM provoked more than 5 strikes. The main complaint was the limits on wages imposed by the government. See Ruelas, *supra* note 3.

⁶⁷ See B.A. Petrazzini, *The Political Economy of Telecommunications Reform in Developing Countries: Privatization and Liberalization in Comparative Perspective* (Connecticut: Praeger, 1995) at 115.

⁶⁸ See Ruelas, *supra* note 3.

⁶⁹ See Petrazzini, *supra* note 67 at 116.

respecting pensions and benefits agreed to under their recently signed collective agreement.⁷¹ Moreover, an important incentive was given to the STRM, since employees were given the opportunity to purchase 4.4% of the company's stock, thereby participating in the profits of the company through a package of stock options. This scheme of profit sharing through employee share-ownership, widely used in these types of government restructurings, is based on the assumption that employees who share in the profits generated by their company also share an interest in the success of the business.⁷²

B. Telmex's Concession Title of 1976

After Telmex was incorporated into the governmental sector in 1976 it was granted an exclusive Concession Title, which provided:⁷³

- Telmex is licensed to construct, operate and exploit a public service telephony network solely and exclusively in all Mexico.
- The term of the concession is for 30 years, counted from that date in 1976.
- The concession includes local telephony across Mexico, and national and international long distance.
- Tight surveillance by the SCT and numerous activities first has to be approved by the SCT. For example, all equipment used for the network had to be approved by the SCT, as well as all projects, all property sales and even discarding old equipment. Moreover the

⁷⁰ See *ibid.*

⁷¹ See *Modification to Concession Title*, *infra* note 74, background VII.

⁷² See K. Newman, *The Selling of British Telecom* (London: Holt, Reinhart & Winston, 1986) at 150.

title provided that all equipment, networks, circuits and accessories had to be connected to those of the SCT.

The title also provided general guidelines and policies for expansion and modernization, which were not satisfactorily met, as explained in the preceding section. A matter of another study would be to determine whether the Concession Title should have been revoked, under Articles 34, 35, 36 and 37 of the Concession Title of 1976 and Article 14 of the LVGC.

C. Modification of Telmex's Concession Title of 1976⁷⁴

Before proceeding to sell the stock of the company, the Concession Title of 1976 had to be modified in order to meet all the expectations and conditions set by the government in connection with the privatization of Telmex. The modifications were set out in general terms and directed at key areas and policies that had to be regulated and overseen as a result of the privatization:⁷⁵

- Telmex is granted a license to construct, operate, maintain and exploit a public service telephony network⁷⁶ in Mexico.

⁷³ See *Concession Title of 1976* (DOF March 31, 1976).

⁷⁴ See *Modification to Concession Title of Teléfonos de México, S.A. de C.V.* (DOF December 10, 1990) [hereinafter *Modification to Concession Title*].

⁷⁵ See *ibid.*

⁷⁶ According to the same title, the construction, operation, maintenance and exploitation of a telephony network includes: (i) local telephony; (ii) national and international long distance; (iii) transfer of voice, sound,

- The concession shall be in full force for 50 years, counted from the date of the original granting of the concession (March 10, 1976).
- The area granted shall be all the national territory, with the exception of the area granted to *Teléfonos del Noroeste, S.A. de C.V.*⁷⁷
- The SCT shall have the right to appoint one director to the Board, at least during the three years following the privatization (since the beginning of the process a separation of the government and Telmex was not achieved).
- The Concession Title does not give or create property rights over the public domain equipment, and therefore Telmex shall not accumulate it.
- The concession does not grant exclusive rights and therefore the SCT may grant other similar concessions for the same services and areas.
- Telmex will operate the network solely during the six years following the date of the modification of the title (December 10, 1990). After such date, the SCT will gradually open the market to different services.
- Foreign unincorporated governmental enterprises may invest in Telmex's common shares if they agree to be considered like Mexicans with regard to the shares they acquire, and if they agree not to invoke the diplomatic intervention of their country of origin or other foreign countries nor any private or public international organism, with the

data, text and images at the national and international level; (iv) commercialization and installation of terminal equipment; (v) manufacturing of electronic, computer and telecommunications equipment; (vi) distribution of television signals, rural telephony, mobile radio-telephony, additional services, etc; (vii) mobile telephony with cellular technology; and (viii) adjudication of the microwave federal network.

⁷⁷ *Teléfonos del Noroeste, S.A. de C.V.* (Telnor) is a Mexican telephone company that operated in the territories of Tijuana and Mexicali in the state of Baja California after being granted the concession title in March 15, 1924. In 1975 the SCT notified Telnor that their concession would not be extended, which meant that Telnor could no longer operate. The incorporation of Telmex in 1976 into the governmental administration was indirectly responsible for the change because it gave Telmex the exclusive right to exploit the telecommunications sector. However in 1990 Telnor was given back its territories. Today it exists as a subsidiary of Telmex.

understanding that doing so will result in them automatically losing all their property or acquired rights to the Mexican government.⁷⁸

- Monopolistic practices are prohibited, as are all acts, contracts, agreements, mergers or combinations that have the purpose of obtaining an unlawful exclusive advantage in Telmex's favor or in the favor of others, or that tend to create a monopoly of complementary markets of the licensed services.
- Cross-subsidization is prohibited.
- Expansion and modernization of the infrastructure and services guidelines are also included, giving special importance to universal service and to modernization of infrastructure and equipment.
- Interconnection is obligatory and will be set through inter party agreements; quality and technical standards will be regulated by the authority.
- Majority stock control shall remain with Mexican nationals.

The foregoing are some of the aspects that are generally covered by the Modification of the Concession Title of 1976. As will be further discussed in the following sections, many of them require further development. The agreement also includes such important aspects as tariffs, operation of the service and quality requirements, etc.⁷⁹

⁷⁸ The "Calvo Doctrine", first applied by an Argentinean Minister in the late 19th century, provides for the equality of sovereign states and equal treatment between nationals and foreigners. Therefore, when a foreign investor is involved in a dispute, he cannot claim protection from his own government and ought to submit his claims to local tribunals. For more information regarding the Calvo Doctrine, see I. Morales, "NAFTA and the Governance of Economic Openness. Assessing trade regimes as a means for "deepening" integration", Online Universidad de las Américas - Puebla, <http://gente.pue.udlap.mx/~imorales/naftamorales.html> (date accessed: May 4, 2000).

⁷⁹ See *Modification to Concession Title*, *supra* note 74.

D. The Sale of Stock

In order to maintain control of Telmex by Mexican investors and to permit greater foreign investment, changes had to be made to Telmex's share structure. Telmex basically had two kinds of shares: (i) *Series AA* shares, which represented 56% of the total shares of Telmex and were limited to governmental ownership, and (ii) *Series A* shares, which were of free subscription, represented the remaining 46% of Telmex's stock, and were traded in the Mexican Stock Market and at the National Association of Securities Dealers, Inc. (NASDAQ) in the US.

Obviously the *Series AA* shares provisions in the corporate bylaws had to be modified in order for private parties to be able to purchase them. The change was made in the sense that the *Series AA* shares could not only be purchased by the Mexican government but also by private Mexican investors. The next change was made in order to permit more foreign capital investment in Telmex without losing control by Mexican parties. In this regard Telmex paid a dividend of 1.5 preferred shares of limited vote *Series L* for each circulating *Series A* or *Series AA* share, in order to prepare the corporate structure and make it compliant with foreign investment requirements.

Thereafter, the structure became:

20.4%	<i>Series AA</i> shares	<i>representing 51% of the voting shares</i>
19.6%	<i>Series A</i> shares	<i>representing 49% of the voting shares</i>
60.0%	<i>Series L</i> shares	<i>with no right to vote</i>

1. Sale of Stock to the STRM

The government, through the *Secretaría de Hacienda y Crédito Público*⁸⁰ (SCHP), began by selling 4.4% of the voting shares of Telmex to the STRM, as explained above. This transaction was made possible through a trust established by *Nacional Financiera*⁸¹ for US \$325 million.⁸² The 4.4% was composed of 186 million *Series A* shares and 280 million *Series L* shares.⁸³

2. The Public Auctions

a. Sale of Stock to Grupo Carso, S.A. de C.V.

The SHCP offered 20.4% of the stock of Telmex for sale through a public auction where the interested parties had to be Mexican enterprises with up to 49% foreign participation. As a result 23 foreign and Mexican companies visited the headquarters of Telmex and evaluated the conditions of the company. Finally three companies were heard and the government evaluated their proposals.

⁸⁰ *Secretaría de Hacienda y Crédito Público* is Spanish for Ministry of Taxation and Public Credit.

⁸¹ *Nacional Financiera* is a major industrial development bank in Mexico.

⁸² See Ruelas, *supra* note 3.

⁸³ See "Historia de la Telefonía", *supra* note 7.

On December 9, 1990 the government announced the select group, which was composed of *Grupo Carso, S.A. de C.V.* (Carso),⁸⁴ Southwestern Bell International Holdings, Inc. (SWBIH)⁸⁵ and *France Cables et Radio* (FCR).⁸⁶ Carso, WSBIH and FCR purchased the *Series A* shares, which represented 20.4% of the capital stock and 51% of the voting stock of Telmex, for US \$1.757 billion.⁸⁷ Due to foreign investment restrictions, Carso purchased 10.4% of the shares individually, while SWBIH purchased 5% and FCR the remaining 5%.

Further analysis in connection with foreign investment requirements will be discussed in Chapter Five II. A. below.

b. Sale of the Remaining Stock

The remaining stock was to be sold in the *Bolsa Mexicana de Valores*⁸⁸ (BMV), the New York Stock Exchange and other major international markets. The first public offering

⁸⁴ A Mexican enterprise owned by Mexican tycoon Carlos Slim.

⁸⁵ A subsidiary of Southwestern Bell Corporation.

⁸⁶ A subsidiary of France Telecom.

⁸⁷ The Mexican leader of the *Partido de la Revolución Democrática* (PRD), Cuauhtémoc Cárdenas (today mayor of México City) and other leaders of the PRD appeared before Congress and filed a suit against former President Carlos Salinas de Gortari, accusing him of a multimillion dollar fraud resulting from the sale of Telmex. Cárdenas sustains that the company was valued prior to the privatization at US \$8.5 billion, but that such valuation was just a trick because the real value of the company was around US \$30 million. Likewise, Cárdenas accused Mr. Pedro Aspe (former Minister of Finance), Mr. Andrés Caso Lobardo (former Minister of Communications and Transport) and Mr. Carlos Slim, majority shareholder of Grupo Carso, S.A. de C.V., of corruption and trafficking of influences. He said that as a result of corruption between Mr. Salinas and Carlos Slim, an alleged close friend and business partner of the President in the privatization of Telmex, 20.4% of the shares of Telmex were bought at US \$1.757 billion, when the real value was approximately US \$14.5 billion. See E. Gallegos & I. Romero, "En la Cámara, Dos Nuevas Demandas de Juicio a CSG," *La Jornada*, December 1, 1995, Online *La Jornada*,

http://serpiente.igc.com.mx/revista/1995/01-95/951201/LA_JORNADA_22-PCG.html (date accessed: December 10, 1999) [hereinafter "Demandas de Juicio a CSG"].

⁸⁸ *Bolsa Mexicana de Valores* is Spanish for Mexican Stock Market.

was made in mid-1991, when the government sold in the international markets a total of 1.5 billion *Series L* shares, which represented 15.7% of the capital stock, for US \$2.166 billion.⁸⁹ Of these shares Carso purchased 5.1%, increasing its participation substantially. In May 1992 the government made another offering, representing US \$1.24 billion, and the remaining group of stock was sold in the markets by 1994.⁹⁰

After the sale of all stock the corporate structure was:

4.4%	<i>STRM who would distribute such stock between its fellow workers</i>	<i>Represented by 186 million Series A shares and 280 million Series L shares</i>	<i>US \$325 million</i>
20.4%	Grupo Carso, S.A. de C.V.	<i>Representing 51% of the voting stock; Carso had 10.4%, SWBIH 5% and FCR 5%</i>	<i>US \$1.757 billion</i>
75.2%	<i>Traded in the BMV and major stock markets</i>	<i>Composed by 15.2% of capital stock of Series A shares and 60% of capital stock of Series L shares</i>	<i>Over US \$3.406 billion</i>

III. Regulatory Framework After the Privatization

Important changes were made prior to and during the privatization process, and others came after the telecommunications market opened to competition.

The government moved fast in order to diversify all the different powers and tasks given to the SCT. As mentioned before, matters concerning regulations, surveillance and

⁸⁹ Another controversial issue in connection hereto was that when the first offer of shares was made in the BMV and international markets, six months after the sale of shares to Carso, the price per share had almost

control of telecommunications were given to the DPNC, which was an office of the SCT, and telecommunications services reserved for the state by law were given to Telecomm, which was a new commercially-oriented public agency. This permitted the SCT to concentrate on regulating the sector.

The *Ley Federal de Telecomunicaciones*⁹¹ (LFT), passed in 1995, regulated the use, benefit and exploitation of the radio-electric spectrum, telecommunications networks and via satellite communications. This act temporarily filled the void left in 1990 by the RT, which did not address many essential aspects that had to be regulated. The LFT, on the other hand, included key elements such as public networks and services, allocation and use of spectrum, satellite communications and interconnection.⁹²

By virtue of a presidential decree and in accordance with Transitory Article 11 of the LFT, the *Comisión Federal de Telecomunicaciones*⁹³ (COFETEL) was incorporated in August 1996 for the purpose of regulating and promoting the efficient development of the sector within a healthy competitive environment and of managing scarce national resources such as spectrum and orbital slots efficiently.⁹⁴ As previously mentioned, the creation of such a body came late as did the passing of the LFT. Telmex had been privatized in 1990, five years before the LFT was passed and six years before the creation of COFETEL. Moreover

tripled.

⁹⁰ See Ruelas, *supra* note 3.

⁹¹ See *Ley Federal de Telecomunicaciones* (DOF June 7, 1995) [hereinafter *LFT*], which is Spanish for Federal Telecommunications Law.

⁹² See *ibid.*, arts. 7, 10-30 & 41-44.

⁹³ *Comisión Federal de Telecomunicaciones* is Spanish for Federal Telecommunications Commission.

competition was beginning to appear and many aspects were left unsolved or unregulated, practically being left to experimentation as they became issues.

The players changed during and after the privatization process. By 1997 the SCT and COFETEL were separately regulating and dictating policies, and the DPNC was patrolling, as were other authorities that will be discussed below; Telecomm was dedicated to state reserved areas; and Telmex was providing local service and new companies were providing cellular telephony and long distance service.

A. The Federal Telecommunications Commission (COFETEL)

COFETEL is an administrative body decentralized from the SCT, with technical and operational autonomy.⁹⁵ It is responsible for all telecommunications matters in Mexico; however its attributions, as provided by law, are subject to the observance of important criteria such as competition, non-discriminatory access to services, legal certainty and efficiency.⁹⁶ COFETEL's main functions are:

- (i) to issue administrative rules, create and manage technical plans and pass technical rules in connection with Mexican telecommunications;

⁹⁴ See Ministry of Communications and Transport, *Decreto de Creación de la Comisión Federal de Telecomunicaciones* (DOF August 8, 1996) [hereinafter *COFETEL Creation Decree*], which is Spanish for Decree Whereby the Federal Telecommunications Commission is Created.

⁹⁵ See *ibid.*, art. 1.

⁹⁶ See *ibid.*, art. 2.

- (ii) to perform research and studies in telecommunications and to develop modification, adaptation and updating plans for statutes and regulations requiring it;
- (iii) to express its opinion regarding the giving, modification, extension and assigning of licenses and permits, as well as revoking them;
- (iv) to coordinate the auction processes for the exploitation of geostationary orbits assigned to Mexico;
- (v) to determine procedures for the harmonization of equipment and certifications thereof;
- (vi) to manage the radio spectrum and promote its efficient use;
- (vii) maintain to the National Telecommunications Registry in accordance with the provisions of Chapter VI of the LFT;
- (viii) to promote and supervise efficient interconnection of equipment and public telecommunications networks, including foreign networks, and concerning interconnection, to determine conditions not agreed upon by networks during their negotiations;⁹⁷
- (ix) to register telecommunications services tariffs and to impose particular obligations on networks in connection with tariffs, and quality of service and information, to those networks that have substantial power in the relevant market in accordance with the LFCE;
- (x) to supervise obligations contained in licenses and permits granted to operators; and

- (xi) to propose to the head of the SCT the setting of applicable sanctions and fines for violations of laws and regulations.

COFETEL is equivalent to what in the US is the Federal Communications Commission (FCC) and what in Canada is the Canadian Radio-television and Telecommunications Commission (CRTC).⁹⁸ Although there are differences, both structural and operational, the general concept of these bodies is similar. Mainly governed by the *Broadcasting Act* of 1991 and the *Telecommunications Act* of 1993, the CRTC's purpose is to regulate telecommunications and broadcasting in Canada.⁹⁹ In the US, the *Communications Act* of 1934 created the FCC, whose functions consist of regulating interstate and international communications by radio, television, wire, satellite and cable.¹⁰⁰ However, in the case of COFETEL it seems that many attributions are not completely delegated to it, as seen above, which lessens its power substantially and differentiates it from the FCC or the CRTC.

1. Independence

A key element in any of these organisms is independence. In order to achieve and further ensure healthy competition, regulators and operators must be kept separate. In terms

⁹⁷ This attribution of COFETEL is a key issue in matters of interconnection of Mexican telephony networks. For further discussion on the subject, see *LFT*, *supra* note 91, art. 42; Chapter Four, below.

⁹⁸ It was created by the Broadcasting Act of 1968 as the Canadian Radio-television Commission and later became the Canadian Radio-television and Telecommunications Commission in 1976.

⁹⁹ See *Canadian Radio-television and Telecommunications Commission Act*, S.C. 1974-75-76 G. 49; ss. 12(1) & 12(2); *Broadcasting Act* S.C. 1991, c. B9-01, s. 5(1); *Telecommunications Act*, S.C. 1993, c. 38, ss. 41, 46.3(2), 46.4 & 46.5(3).

¹⁰⁰ See US *Telecommunications Act* of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified in scattered sections of 47 U.S.C.), s. 151.

of this independence, there are no conflicting interests in one same organization. Thus when operation, regulation and surveillance are all kept separate, unbiased evaluations and decisions concerning the correct functioning of the system may be taken.

a. Regulator Independence from Government

The first form of independence came as a result of the existence of government monopolies or equity participation of the government in private companies. Since the government was commonly the regulator, regulated and judge, the need for independence was evident; the regulator must be separated from the government to make such regulatory body as autonomous as possible.

COFETEL, like the FCC and CRTC, may be considered essentially independent from the government. However, there are issues particular to each organism that must be considered. The CRTC and COFETEL are not as independent as the FCC. In Canada, the government may issue general directives to the CRTC regarding objectives of broadcasting policy and regulatory policy¹⁰¹ as well as telecommunications policy.¹⁰² This is similar to the situation in Mexico where the SCT can dictate directives and policy over COFETEL.¹⁰³ COFETEL is not as independent as the CTRC or the FCC, since a substantial part of its work and operation is subject to the opinions, revisions and approval of other organisms, as

¹⁰¹ See *Broadcasting Act* (1991), *supra* note 99, s. 7(1).

¹⁰² See *Canada Telecommunications Act* (1993), *supra* note 99, ss. 8 & 75(1).

¹⁰³ See *LFT*, *supra* note 91, art. 7; *COFETEL Creation Decree*, *supra* note 94, art. 3; *SCT Internal Regulation*, *infra* note 105, arts. 5 & 23.

explained in (b.) below. Finally an almost inevitable form of dependence on the government or a superior in the governmental hierarchical structure is the appointment or designation of commissioners. In Mexico, commissioners are appointed and removed freely by the President through the SCT;¹⁰⁴ in Canada, commissioners are appointed by the Governor in Council;¹⁰⁵ and in the US, they are appointed by the President with the advice of the Senate.¹⁰⁶ Certainly the lock provided in the US system ensures even more independence, since movements cannot be made so freely.

The appointment or removal of commissioners has definitely been a major issue in the case of Mexican telecommunications, which has spurred serious criticism and suspicion regarding the independence of such body and its commissioners. In the four years since the creation of COFETEL, there have been four sudden changes to the Presidency of the organism.

Regarding COFETEL's independence from the SCT, although COFETEL is autonomous from the SCT, it was created after the LFT was passed. The LFT provides that the highest organ is the SCT, and numerous attributions are allocated throughout regulations to the SCT and other organs therefrom. As seen in A. above, Article 2 of the decree, whereby COFETEL was created, outlines its functions, subject only to limitations of competition, efficiency, legality and non-discriminatory access. However, similar functions and attributions are granted to the SCT in the LFT.¹⁰⁷ In an attempt to solve conflicts

¹⁰⁴ See *COFETEL Creation Decree*, *ibid.*, art. 3.

¹⁰⁵ See *Canadian Radio-television and Telecommunications Commission Act*, *supra* note 99, s. 3(1).

¹⁰⁶ See *US Telecommunications Act (1996)*, *supra* note 100, s. 154.

¹⁰⁷ See *LFT*, *supra* note 91, art. 7.

stemming from these regulations, we may look at the text of Transitory Article 11 of the LFT, which provides for the creation of “a technically and operationally independent body that will have the necessary attributions to regulate and promote the efficient development of telecommunications in the country, in accordance with the provisions of its decree of creation”.¹⁰⁸ The foregoing does not solve possible conflicts and neither does the decree; therefore the independence of COFETEL may be compromised by the SCT, since both have powers in the same fields and there is no regulation to solve possible conflict. Moreover, when looking at the SCT's internal rules we find a similar situation, since the General Directory of Telecommunications Policy of the SCT (DGPT) has attributions that may conflict with those of COFETEL.¹⁰⁹ Finally, depending directly on the SCT, there is the Sub-ministry of Communications (SMC) that also has its own attributions, which certainly add to the confusion.¹¹⁰

All the foregoing results in an uncertain situation for private parties procuring services from these organisms, since these bodies have overlapping jurisdictions and obligations of consultation and opinion.¹¹¹ Private parties may even lose themselves in the organizational chart of the SCT, and what was submitted to COFETEL may be one day at the DGPT and the next at the SMC. The applicant may end up with a simple procedure

¹⁰⁸ See *ibid.*, transitory art. 11.

¹⁰⁹ See *Reglamento Interno de la Secretaría de Comunicaciones y Transportes* (DOF June 19, 1995), art. 23 as amended by *Decreto por el que se reforma, adiciona y deroga el Reglamento Interior de la Secretaría de Comunicaciones y Transportes* (DOF October 29, 1996) [hereinafter *SCT Internal Regulation*], which is Spanish for Internal Regulation of the Ministry of Communications and Transportation.

¹¹⁰ See *ibid.*, art. 6.

¹¹¹ See *LFT*, *supra* note 91, art. 7; *COFETEL Creation Decree*, *supra* note 94, art. 3; *SCT Internal Regulation*, *supra* note 109, art. 5.

with conflicting opinions that the authorities, between themselves, will have problems to solve.

b. Regulator Independence from Operators

As worldwide telecommunications markets evolved, countries around the world not only privatized their telecommunications networks but also opened their markets to competition. Consequently a division between government and operator was not enough since there could be independence between them but there would not necessarily be independence between regulator and operator. Thus a second type of independence was required, namely, independence of the regulator from operators.

The degree of independence is essential, since not only should the governmental organism be independent from the operators but also from the commissioners leading the regulatory body. In the case of the FCC the obligation is strict and clear that commissioners should not in any way have interests in a company or companies or holding companies with interests in companies relating to telecommunications business, including stocks, bonds, securities, etc.¹¹² The case of the CRTC is very similar; a person is not eligible to be appointed as a commissioner if he/she has, directly or indirectly, as owner, shareholder, director, officer, partner or otherwise an interest in a telecommunications undertaking or has any pecuniary or proprietary interest in a telecommunications undertaking or the

¹¹² See US *Telecommunications Act* (1996), *supra* note 100, s. 154.

manufacture or distribution of telecommunication equipment.¹¹³ The case of COFETEL is a little different and somewhat confusing, since the decree that created COFETEL only states that in order to be a commissioner two requisites must be fulfilled. The person must: (i) be a born Mexican national; and (ii) have had outstanding performance in professional matters, of public service or academic, related to the telecommunications sector.¹¹⁴ Evidently the foregoing is far from being as strict as the provisions set forth for the CRTC or the FCC. However the last article of the internal regulation of COFETEL provides for the impediments of commissioners. Surprisingly, such regulation does not follow the approach of the FCC or the CRTC; rather it only states that commissioners shall excuse themselves from any matters in which they have interests. Interpreted *a contrario sensu*, they can have interests in any form of telecommunications business, but when deciding about a matter in which they have interests, they have to point that out to the collegiate body, which will excuse them from that specific case.¹¹⁵ The foregoing is evidently a risky formula, since the commissioner must first excuse himself from the particular matter. The fact that a commissioner refrains from participating because of a conflict of interest does not prevent possible conflicts of interests that other commissioners have as a result of their relationships with the commissioner refraining from that matter.

The implications of the preceding sections in the international context will be discussed in Chapter Five II. B. below, where the obligations on Mexico under the WTO and NAFTA will be discussed.

¹¹³ See *Canadian Radio-television and Telecommunications Commission Act*, *supra* note 99, s. 5(1).

¹¹⁴ See *COFETEL Creation Decree*, *supra* note 94, art. 4.

¹¹⁵ See *Reglamento Interno de la Comisión Federal de Telecomunicaciones* (DOF December 9, 1996), art. 35 [hereinafter *Reglamento Interno COFETEL*], which is Spanish for Federal Telecommunications Commission Internal Rules.

B. Jurisdiction of the Mexican telecommunications authorities

Throughout this study the general jurisdiction of COFETEL has been outlined. In broad terms the SCT is the main body responsible for telecommunications matters, but has delegated powers to the SMC and the DGPT. When COFETEL was created some powers were transferred from the SMC to it, but not all of them. Apart from the resulting confusion (see C (3) below), these organisms' sphere of application is related to all telecommunications matters in the Mexican telecommunications market as well as in international matters affecting Mexico and its nationals.

When trying to regulate a market in hopes of healthy competition, it is important to clearly state the powers of the different authorities. After all, COFETEL is an organism that was created to deal with telecommunications matters and not other aspects relating to the particular business. There are also competition issues that go hand in hand with the telecommunications issues. Thus, COFETEL and the Federal Competition Commission must work together to solve any issues that arise. However it is important to limit the jurisdiction of each organism in order not to have a situation with overlapping jurisdictions. Unfortunately a clear line cannot be drawn between one and the other, since particularly at this stage in the process of opening to competition both issues (telecommunications and competition) are inherently mixed. Hence the importance of adequate delimitation of powers and jurisdiction.

In the case of the sphere of application of telecommunications regulations in Mexico, the main act is the LFT, which early in its text limits its application to telecommunications matters.¹¹⁶ The importance of competition matters is recognized in the LFT, which states that one of its objectives is to “promote a healthy competition between telecommunications service providers in order to achieve better prices, diversity of services and quality, resulting in benefit to consumers.”¹¹⁷ However healthy competition is not an asset that the LFT has to police or regulate. These attributions correspond to the Federal Competition Commission.

The attempt to distinguish jurisdictions is evident for example in the granting of concession titles for the use of frequencies, where applicants must submit, together with other requisites for their application package, a favorable opinion given by the Federal Competition Commission, and in COFETEL’s Creation Decree, where its scope of participation in important telecommunications matters is restricted to the provisions of the LFCE.¹¹⁸ However both COFETEL and the Federal Competition Commission must work together on these and other matters, since they are inherently related. Two important telecommunications aspects having a close links with competition issues are interconnection and rate regulation. In the case of interconnection, the LFT limits the powers of telecommunications authorities to achieving interconnection of networks and “promoting healthy competition through effective interconnection.”¹¹⁹ Violations to the provisions of

¹¹⁶ See *LFT*, *supra* note 91, arts. 1, 2, 4, 5 & 7.

¹¹⁷ *Ibid.*, art. 7.

¹¹⁸ See *ibid.*, art. 16; *COFETEL Creation Decree*, *supra* note 94, art. 2 XI.

¹¹⁹ See *LFT*, *supra* note 91, arts. 41-49.

the LFT will be treated as such, and not as competition violations. In case there is also a violation to competition issues, then the corresponding authorities, namely the Federal Competition Commission, shall look into it. Regarding rate regulation, the case is similar, since practices like cross-subsidization or discrimination in rate fixing can hinder competition. However the power of telecommunications authorities to police, determine and sanction these practices as competition violations is questionable, but not insofar as they affect telecommunications law policy issues.¹²⁰

Moreover, in connection with rate regulation, the LFT provides that specific obligations related to tariffs can be imposed on operators having substantial power in the relevant market, in accordance with the LFC.¹²¹ This issue has raised serious concern, since in accordance with the foregoing, operators denounced Telmex's power in the market. Despite how evident it may have been, a resolution from the Federal Competition Commission stating that Telmex had substantial power in the relevant market was needed. With such resolution COFETEL tried to impose specific obligations on Telmex in connection with its rates, which had been frozen since 1996. But Telmex used the "Amparo" procedure, claiming a violation to the provisions of Transitory Article Fifth of the LFT, which provides that concession titles granted prior to the passing of the LFT shall be respected in their original terms, thus compromising COFETEL's authority to impose specific obligations on Telmex.¹²²

¹²⁰ See *ibid.*, arts. 60-63.

¹²¹ See *ibid.*, arts. 63; *COFETEL Creation Decree*, *supra* note 94, art. 2 XI.

¹²² See Sections C (1) & (3), below; *LFT*, *supra* note 91, transitory art. 5; *COFETEL Creation Decree*, *ibid.*, art. 2 XI.

Other aspects, such as monopolistic behavior and mergers are entirely dealt with by the Federal Competition Commission under the applicable LFCE provisions. The general premises are that horizontal monopolistic behavior, as defined in the LFCE, will be deemed unlawful *per se* and vertical monopolistic behavior will be unlawful when the objective or effect is to prevent access of competitors to the market, expulsion from the market or the establishment of competitive advantages for certain individuals.¹²³ Likewise, mergers will be treated under the premise that the Federal Competition Commission will sanction them when the objective is to lessen, impede or hinder competition.¹²⁴

C. Disputes Under the Mexican Telecommunications Framework

In general terms we can divide disputes under the Mexican telecommunications regulatory framework into those between private parties and the authorities and those between private parties themselves. The first type of disputes help us to understand the attributions of Mexican telecommunications authorities and the strength of their decisions, whereas the second type of disputes are significant for the purposes of interconnection and development of the network.

¹²³ See *LFCE*, *supra* note 48, arts. 9-15.

1. Disputes Between Private Parties and Authorities

As seen in 1 (a) above and mentioned throughout this study, plurality of regulatory and supervising organisms and their overlapping attributions have been particularly problematic in terms of the Mexican regulatory framework. This has created uncertainty for government organisms, as well as for private parties appearing before Mexican telecommunications authorities. When COFETEL was created in 1996, attributions were transferred, to it from those of the SMC; however, not all attributions were transferred and both organisms were maintained and presently coexist.¹²⁵ For example, while COFETEL investigates violations to the law and proposes suitable sanctions, the sanctioning organism is the DGPT; COFETEL reviews and evaluates applications for concession titles, but the DGPT receives them and they are issued and signed by the head of the SCT. Thus, responsibility is highly diluted and procedures become long and complex for both authorities and private parties.¹²⁶

Another issue adding to the controversy is that the LFT constrained the authorities by providing that concessions granted prior to the passing of the LFT had to be respected in their original terms.¹²⁷ This gave Telmex more arguments to defend themselves from new administrative rules that may seem different from the provisions of their Concession Title.¹²⁸

¹²⁴ See *ibid.*, arts. 16-22.

¹²⁵ See *COFETEL Creation Decree*, *supra* note 94, art. 3; *SCT Internal Regulation*, *supra* note 109, arts. 2 & 6.

¹²⁶ From personal interview and correspondence with Mr. César Hernández Ochoa, former Director General of Long Distance and Value Added Services at COFETEL (February 23, 2000).

¹²⁷ See *LFT*, *supra* note 91, transitory art. 5.

¹²⁸ See *ibid.*

2. Disputes Between Private Parties

Disputes between private parties normally arise with regard to interconnection. All other controversies are solved by denouncing a certain practice or violation of the law, in which case the controversy will become an issue between the authorities and a private party. The LFT provides an obligatory arbitral mechanism for solving interconnection disputes¹²⁹ that is certainly innovative and fit for a much more evolved, competitive market than Mexico's, with more balanced participants. This procedure is discussed more thoroughly in Chapter Four. The obligatory arbitral procedure provided by the LFT has important flaws regarding the bargaining power of operators. Before the LFT there was virtually no competition and for a long time a government monopoly; consequently disputes were minimal. Moreover Mexico was certainly not used to issuing rules of a general nature for the regulation of services, which complicates procedures of appeal and disputes.¹³⁰

3. Appeals to Decisions of Authorities

Whenever decisions are made by the SCT or COFETEL under the provisions of the LFT and applicable norms and regulations, affected parties may appeal the determination. Mexican telecommunications regulations do not provide for custom-made procedures;

¹²⁹ See Chapter Four, below; *LFT*, *supra* note 91, art. 42.

¹³⁰ See *ibid.*

however according to the LFT¹³¹ the applicable regulation is the *Ley Federal del Procedimiento Administrativo*.¹³² After a decision has been made on a certain matter, the affected party must submit an appeal before the authority issuing the decision.¹³³ The immediately higher authority will resolve the appeal. In case the decision is confirmed and still affects the appellant, the affected party has the option to pursue the “nullification of the act”, alleging a lack in motivation and supporting of the decision.¹³⁴ In case the act is still violating the rights of the appellant, there is the constitutional procedure of “Amparo”.¹³⁵

The decisions of Mexican telecommunications authorities lack strength in the sense that with so much intervention of different organisms in the process of reaching a decision, and consequently with so many different authorities involved, there are many ways of attacking a decision through the mechanisms mentioned in the preceding paragraph. Consequently decisions are weak and time consuming; before their implementation they may be suspended or delayed commencing on the date of issuance.

Finally, adding to the controversy is the fact that COFETEL was created by a presidential decree, which in the Mexican legal framework has less strength than an act passed by Congress. This is true not only in Mexico but also in the US and Canada. For

¹³¹ See *ibid.*, art. 74.

¹³² See *Ley Federal del Procedimiento Administrativo* (DOF July 14, 1994) [hereinafter *LFPA*], which is Spanish for Federal Administrative Procedure Law.

¹³³ See *Mexican Constitution*, *supra* note 37, art. 104(I)(B); *LFPA*, *supra* note 132, Arts. 1 & 86.

¹³⁴ See *Código Fiscal de la Federación* (DOF December 30, 1981 as amended by DOF December 31, 1998), arts. 198 & 207, which is Spanish for Federation's Tax Code.

¹³⁵ The “Amparo” is a type of constitutional trial particular to Mexico aimed at suspending an act of an authority when it violates or affects the sphere of constitutional warranties and rights of an individual, as determined by the Mexican Constitution. See *Mexican Constitution*, *supra* note 37, Arts. 103 & 107; *Ley de Amparo, Reglamentaria de los Artículos 103 y 107 de la Constitución Política de los Estados Unidos Mexicanos* (DOF January 8, 1936), which is Spanish for Amparo Act, which regulates Articles 103 and 107 of the Mexican Constitution.

example, the FCC and the CRTC were both created by acts passed by Congress and Parliament, respectively. Often parties in dispute with COFEEL question the legal strength or attribution for such organism to regulate an act passed by Congress (LFT), arguing it exceeds its powers by regulating *de facto* the LFT.¹³⁶

D. Forbearance?

Forbearance is a rather innovative concept adopted in Canadian and US telecommunications laws, among those of other countries. It is a mechanism whereby direct regulation is replaced by selective competition.¹³⁷ The mechanism works as an option given to the regulatory authority to refrain from applying regulations or provisions of their acts to a telecommunications carrier, group of carriers or telecommunications service.

The case is similar in the US and Canada. In the US the FCC may forbear from applying regulations or provisions of the Telecommunications Act (1996) to a telecommunications carrier or telecommunications service, if it determines that: (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations in connection with that carrier or service are just and reasonable and are not unjustly or unreasonably discriminatory; (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and (3) forbearance

¹³⁶ From correspondence with Mr. Antonio Garza Cánovas, former Counsel of COFETEL, Long Distance Services (February 23, 2000).

from applying such provision or regulation is in the public interest.¹³⁸ In Canada the CRTC may make a determination to refrain from the exercise of any power or the performance of any duty under Sections 24, 25, 27, 29 and 31¹³⁹ of the Telecommunications Act in relation to a telecommunications service or class of services provided by a Canadian carrier, where the CRTC finds that to refrain would be consistent with Canadian telecommunications policy objectives.¹⁴⁰ Canadian telecommunications policy objectives are outlined in the Telecommunications Act of 1993 and certainly include (i) improving services; (ii) enhancing efficiency and competitiveness; and (iii) fostering increased reliance on market forces for the provision of telecommunications services.¹⁴¹

In both the US and Canada there are specific provisions regulating the general principle of forbearance. Although forbearance in the US and Canada is outside the scope of this study, it is important to relate it to the Mexican context. First of all, forbearance is an innovative step towards advanced deregulation, not only understood as “avoiding excessive regulation” but also that which leaves certain matters to operators and market forces. We cannot talk about deregulation if the proper channels for it do not exist. As markets grow stronger and more competitive and operators in the market balance their powers with one another, the grounds for deregulation begin to appear, and this is where the faculty of forbearance is applied.

¹³⁷ See W.L. Stanbury, “Competition Policy and the Regulation of Telecommunications in Canada” in Handa S. & Montero J., *Communications Law: Course Materials* (Montreal: McGill University, 1999), at 457, [hereinafter *Communications Law Course Materials*].

¹³⁸ See US *Telecommunications Act* (1996), *supra* note 100, s. 401.

¹³⁹ The mentioned sections relate to offering and provision of services; tariff fields approved by the CRTC; reasonable and just determination of rates; agreements between carriers regarding interchange of telecommunications, management or operation of facilities or appointment of rates and revenues; and limitations of liability for carriers.

As discussed throughout this thesis, the Mexican market does not yet seem prepared to take such steps. However the appropriate channels can be prepared for when the time comes. Recently at a speech at "Expo Comm Mexico 2000",¹⁴² Mr. Jorge Nicolás, head of COFETEL, expressed his views on deregulation in Mexico:

Regulation in this sector has to be understood as a process. Even if the privatization of the State Company indeed represented the first step toward a sector open to private investment, this by itself does not guarantee the development of a healthy competition. The foregoing is precisely the objective that takes up a great deal of the efforts of a regulator.

In this process, we have achieved great progress and now have strong foundations. However he must admit that competition is in an initial phase. In this initial phase, regulation is more direct and emphatic. The regulator's intervention must be greater, trying to establish the rules that will determinate the development of competition.

However, in a following phase when competition is more consolidated, the functions of the regulator will be much different to those of today.

The tendency of the authority will be that of "deregulating" or regulate less insofar as competition develops. The desired view of the regulator is that every time it will have to resolve fewer disputes between the industry, as a result of the implementation of clear regulatory measures. That in the future, the regulator will be a "facilitator" of the market and that it does not have to keep verifying that telecommunications services are provided under principles of universality and non-discrimination.

¹⁴⁰ See Canada *Telecommunications Act* (1993), *supra* note 99, s. 24.

¹⁴¹ See *ibid.*, s. 7.

¹⁴² Expo Comm México 2000, *Convergencia de Soluciones: Enlace al Tercer Milenio* is Spanish for Expo Comm Mexico 2000, Solutions Convergence: Link to the Third Millennium.

Insofar as competition develops and matures, regulators can destine more time to ensure that markets function effectively and less time in issuing regulations to restrict rate policies or service providing to competitors of the dominant company.

It is important to have this vision to the future since we can say that confidence of investors will be consolidated with less intensive regulation. This is, if the telecommunications industry does not need excessive regulation, it will be because it has accomplished the requisite of high competition, and thus permits the entrance of new competitors.¹⁴³

As expressed above, since the case of Mexican competition in telecommunications is still young and unbalanced, it is probably not the best time for deregulation and forbearance. However steps in that direction can be taken. After all, the CRTC and the FCC did not forbear in all matters at the same time; it was done slowly, as it became possible.¹⁴⁴ Such opportunities for deregulation will definitely appear in the Mexican framework, but the law must provide the channels for deregulation to happen in order to give the necessary strength to such decisions.

IV. From Government Monopoly to Private Monopoly

The privatization of a State's telecommunications monopoly does not necessarily mean that the performance of an enterprise will improve.¹⁴⁵ However, in the case of Telmex, after the sale of stock was made it kept operating as a monopoly; the only differences were

¹⁴³ See Speech of Mr. Jorge Nicolín at Expo Comm Mexico 2000, Solutions Convergence: Link to the Third Millennium, Mexico, (February 10, 2000), Online COFETEL, http://www.cft.gob.mx/html/1_cft/7_dis/disc_nic/dis_expocomm1.html (date accessed: May 4, 2000).

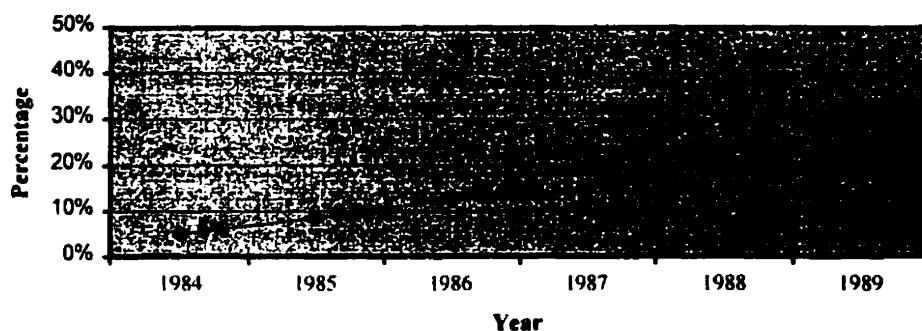
¹⁴⁴ See CRTC, Telecom Decision 94-14, Telecom Decision 94-15, and Telecom Decision 94-19. Online CRTC, <http://www.crtc.gc.ca> (date accessed: May 4, 2000).

that now it was privately-owned and that the main purpose of the company shifted from public service to revenue. Telmex took advantage of its monopolistic position by raising its tariffs. From 1990 to 1994 the price of the service increased by 328.6%.¹⁴⁶ This, together with the improvement of its collection procedures substantially improved its financial position.

Before being privatized, Telmex demonstrated impressive growth, as is shown in Chart 3-IV.1 below (Profit percentages are expressed from total yearly income).¹⁴⁷ The decrease in the profit percentage from 1988 to 1989 aroused serious concern and suspicion, for the decrease in net profits coincided with the year in which the government prepared to sell Telmex.

Chart 3-IV.1

Telmex's Net Profit Percentages Prior to Privatization



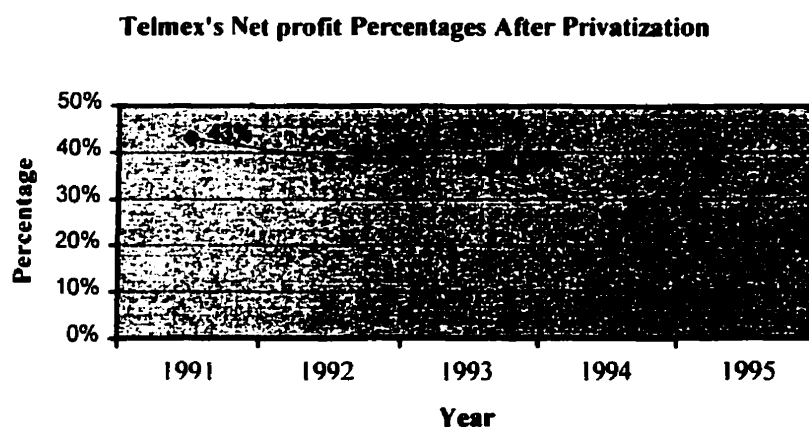
¹⁴⁵ See Jiménez, *supra* note 20.

¹⁴⁶ See Ruelas, *supra* note 3.

¹⁴⁷ See Chart 3-IV.1. For Chart Source, see Ruelas, *supra* note 3.

From 1991 to 1995 Telmex's net profits percentages dropped, as shown in Chart 3-IV.2 below.¹⁴⁸

Chart 3-IV.2



It is important to point out the extraordinary leap in net profits from 1989 to 1991, precisely the decrease from 42% to 21% (1988-1989) to the increase from 21% to 43% (1989-1991).¹⁴⁹ Moreover, although the performance of Telmex declined after the privatization, it should be noted that immediately after its privatization, in accordance with the Modification to the Concession Title of 1976, Telmex was granted six years of exclusive operation and therefore could continue to take advantage of the situation.¹⁵⁰ However soon

¹⁴⁸ See Chart 3-IV.2. For Chart Source, see Teléfonos de México, S.A. de C.V., Financial Results, Online Telmex, http://www.telmex.com.mx/edos_fin.html (date accessed: January 15, 2000).

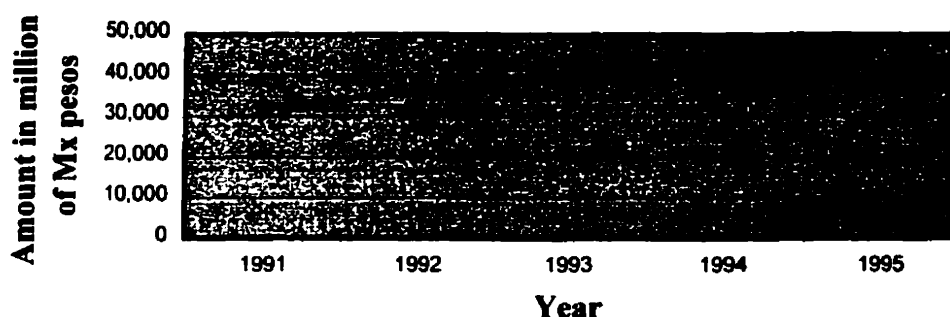
¹⁴⁹ More controversy came as a result of this leap in profits, for at least one of the main opposition parties in Mexico sustains that Carso used its political influence to agree with the government to take control of the company immediately and to a payment term of six months following the date of sale, which permitted Carso to benefit from the fact of being the exclusive provider, and to finance the purchase of stocks with the profits gained during that time. See "Demandas de Juicio a CSG", *supra* note 87.

¹⁵⁰ In 1997 the international telecommunications consulting firm "Interamericana" found in an audit made to Telmex, that the company had illegally billed seven million US dollars to a group of companies and hotels in

the different telecommunications sectors would be opened to competition, and Telmex could not continue to abuse its customers because once they had another available choice they would leave Telmex. In late 1996 Telmex substantially increased its local service rates, while it lowered its long distance rates, in view of the incoming competition in long distance.¹⁵¹ Thus, the reduction in Telmex's net profits does not necessarily mean lower performance. Chart 3-IV.3 shows Telmex's gross incomes, which do not look as dramatic as the profits chart.¹⁵²

Chart 3-IV.3

Telmex's Gross Incomes After Privatization



As a result of the Modification to the Concession Title of 1976 Telmex acquired new commitments, which had to be met in order to comply with the obligations of the Concession. Even though Telmex was now dissociated from the government, both them

Mexico. See O.Cruz, *Cobra Teléfonos de México Indebidamente US 7 Millones*, El Universal, (September 1, 1997), Online El Universal, <http://www.unam.mx/universal/net1/1997/sep97/01sep97/finanzas/01-fi-a.html> (date accessed: January 15, 2000).

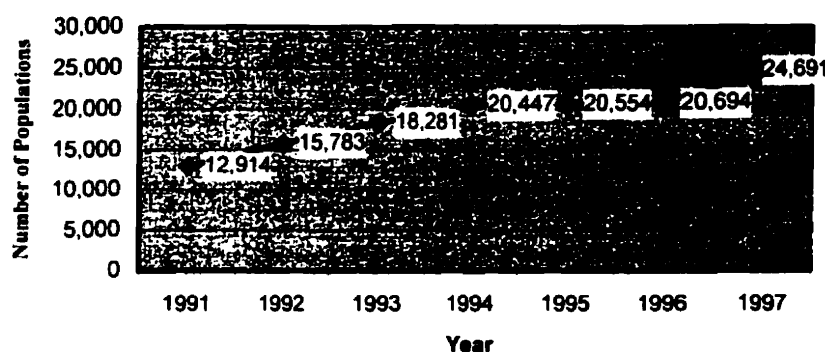
¹⁵¹ See Media Comunicación, *Terminan 49 años de monopolio telefónico en nuestro país*, Media Comunicación, No. 24, (January-February 1997), Online Media Comunicación, <http://www.planet.com.mx/media/edicion24/telmex.htm> (date accessed: May 4, 2000).

¹⁵² See Chart 3-IV.3.

were in the national and international spotlight. Therefore even more protection could make potential investors much more uncomfortable than they already were. The landscape was completely changed, with new players, tighter surveillance, and regulatory and inspection authorities. As mentioned before, one of the main commitments that Telmex entered into with the Modification to the Concession Title of 1976 was the expansion and modernization of the service. These commitments provided for a revision of the performance three years after the modification of the title. The expansion of the service commitment progressed as shown in Chart 3-IV.4.¹⁵³

Chart 3-IV.4

Telmex Expansion of Telephone Service per Year

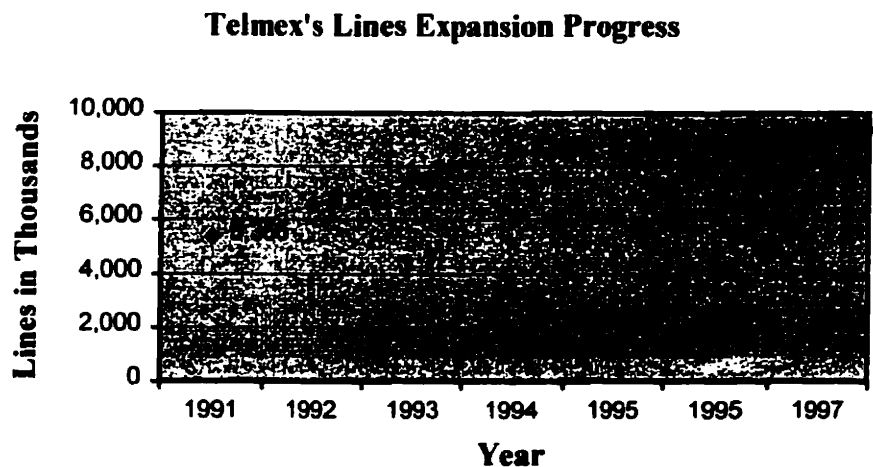


Together with the foregoing Telmex also increased the number of lines considerably after its privatization. Chart 3-IV.5 shows the increase in the number of lines installed from 1991 to 1997.¹⁵⁴ Note the leap from 1996 to 1997, bearing in mind that 1996 was the last year of total and exclusive operation. The period from 1990 to 1996 was the best for high pricing and deepening the company's pockets. After 1996, with other players in the market,

¹⁵³ See Chart 3-IV.4.

Telmex had to conserve its long distance customers, and also in the eyes of international players meet its obligations under its Concession Title.

Chart 3-IV.5



As shown in the preceding charts, after privatizing Telmex continued operating as a highly profitable corporation, perhaps even more so. By 1992 Telmex was ranked the second most profitable company of the services sector in the world, after AT&T; it had reported profits of US \$2.577 billion, whereas AT&T had reported US \$3.8 billion. By 1994 Telmex was the fifth largest telecommunications company in the world.¹⁵⁵ However this information is based exclusively on profits and not on factors like infrastructure, high technology, services, etc. Certainly Telmex was far from being as technologically important as the other companies in the scale (Ameritech, GTE, AT&T, British Telecom, Singapore

¹⁵⁴ See Chart 3-IV.5.

¹⁵⁵ See Ruelas, *supra* note 3.

Telecommunications, Hong Kong Telecommunications, Nippon Telegraph and Telephone, etc.).

CHAPTER FOUR

COMPETITION IN MEXICAN TELEPHONY NETWORKS

Privatization of government monopolies does not happen *per se*, but because of the advantages and benefits that accompany such privatization, which are ultimately reflected on consumers. In the case of Mexico, as previously mentioned, the privatization of Telmex came together with the intention to open the market to competition, domestic and foreign, ideally resulting in more options for consumers and consequently better prices. In order to ultimately benefit consumers and the industry through economic growth and healthy competition, it is important to regulate, promote and manage the industry.¹⁵⁶ Therefore in order to ensure the achievement of the foregoing objectives measures have to be taken, mainly in connection with competition and development of the industry. Since this particular section attends to competition-related matters we shall focus on them. With healthy competition being our main concern, two related aspects are of the utmost importance, one being effective interconnection of networks and the other avoiding cross-subsidization in companies.

¹⁵⁶ See J. Nicolín Fischer, *Telecommunications in Mexico: Regulatory Changes and New Opportunities*, Comisión Federal de Telecomunicaciones, Washington D.C., (August 12, 1999) at 2 [*hereinafter* Nicolín: Speech: Washington D.C.].

I. Competitors in the Mexican Telecommunications Market

In order to focus on the subject of interconnection of networks, it is important to attend to the previous step needed for interconnection to be an issue, namely the entering of competitors, since in a scenario with no competitors interconnection would not even be needed.

A. Obtaining a License/Concession¹⁵⁷ in Mexico

In order to operate a telecommunications network in Mexico and consequently participate in the Mexican telecommunications market, there are certain requisites that must be fulfilled. The type of license required depends on the needs and operations of a company. Thus an individual or company may obtain a concession for: (i) exploiting radio frequencies for a determined use; (ii) exploiting geostationary orbits and other orbits assigned to the country; and (iii) installing, operating and exploiting public telecommunications networks.

According to the LFT there are five classifications for the use of radio spectrum frequencies: (i) spectrum for free use; (ii) spectrum for determined use; (iii) official use spectrum; (iv) spectrum for experimental use; and (v) reserved spectrum.¹⁵⁸ Under the LFT the spectrum for determined uses, (ii) above, will be granted by concession for its use in

¹⁵⁷ Some authors draw a distinction between the term concession and the term license. Since Mexican Telecommunications do not draw a distinction, the term Concession will be used, which is precisely the term used by the LFT.

¹⁵⁸ See *LFT*, *supra* note 91, art. 10.

accordance with the purposes and standards set by the SCT.¹⁵⁹ A concession granted by the SCT is required for: (i) the use and exploitation of a band of radio frequencies in the Mexican territory, except for cases of spectrum for free use and spectrum for official use; (ii) the installation, operation and exploitation of public telecommunications networks; (iii) the occupation of geostationary orbits and satellite orbits assigned to Mexico, and the exploitation of the frequencies thereof; and (iv) the exploitation of the rights of emission and reception of bands of frequencies of foreign satellite systems that cover and can provide services in Mexico.¹⁶⁰

B. Assigning of radio frequencies and technical standards

It is essential to have a clear, objective and non-discriminatory procedure for assigning radio frequencies. In Mexico the SCT, with the assistance of COFETEL, periodically issues a program whereby bands of frequencies of the spectrum for determined use, together with their terms of usage and geographical coverage, are set out. Such program lists each frequency band, how it will be used and its coverage, as well as how the different frequencies will be bidden on during the corresponding year.¹⁶¹

¹⁵⁹ See *ibid.*

¹⁶⁰ See *ibid.*, art. 11.

¹⁶¹ See *ibid.*, art. 15; Program for the frequency bands of the radio electric spectrum for specific uses whose corresponding public auction procedures will be held during 1998 (DOF May 25, 1998); Program for the frequency bands of the radio electric spectrum for specific uses. Public auction procedures that will be held during 1997 (DOF January 28, 1997) and Program for the frequency bands of the radio electric spectrum for specific uses. Public auction procedures that will be held during 1996 (DOF June 21, 1996).

Regarding technical standards, networks must adopt similar technical designs in order to permit interconnection and interoperation. The SCT has the power to issue and manage fundamental technical plans of numeration, commutation, signaling, transmission, tariffs and synchronization, among others.¹⁶² Operators must submit to such standards in order to ensure appropriate interconnection and interoperation of networks. In 1994 the SCT issued a resolution containing guidelines for the interconnection plan of public long distance networks considering the dominant network (Telmex) and the introduction of new networks to the Mexican market.¹⁶³ In connection with the foregoing, fundamental technical plans were issued for numeration and signaling.¹⁶⁴

C. Eligibility

In order to be eligible for a concession the candidate must be an individual or company of Mexican nationality. In other words companies must be incorporated in Mexico. This requirement, used by many countries in various industries, has frequently been the subject of criticism, since it is seen purely as an element of control of the industry and its participants. Still, it is widely used. The same approach has been adopted by Canada,¹⁶⁵ but

¹⁶² See *LFT*, *supra* note 91, art. 41.

¹⁶³ See *Resolución sobre el Plan de Interconexión con Redes Públicas de Larga Distancia* (DOF July 1, 1994), which is Spanish for Resolution over the Interconnection Plan for Public Long Distance Networks.

¹⁶⁴ See *Plan Técnico Fundamental de Numeración* (DOF June 20, 1996), which is Spanish for Technical Fundamental Numeration Plan; *Plan Técnico Fundamental de Señalización* (DOF June 20, 1996), which is Spanish for Technical Fundamental Signaling Plan.

¹⁶⁵ See Canada *Telecommunications Act* (1993), *supra* note 99, s. 16(1).

not by the United States. In Mexico control by Mexican nationals is still stricter than in Canada due to mechanisms used in Mexican Foreign Investment Law.¹⁶⁶

In addition to the foreign investment statutory requirements, applicants for concessions, whether for the use of bands or for the installation and operation of telecommunications networks, must also comply with other requirements set forth in the corresponding basis for bids. The basis for bids must fulfill some formalities, namely: (i) the requirements that interested parties must fulfill in order to participate in the bid; (ii) the frequency bands to be licensed, their use requirements and their geographical coverage; (iii) the period of duration of the concession; and (iv) the criteria that will be used in order to select winners.¹⁶⁷

As described above, applicants must also meet certain criteria determined as the basis for the bid by the SCT, including: (i) programs and commitments of investment, coverage and quality; (ii) business plan; (iii) technical specifications of the project; and (iv) the approval of the Federal Competition Commission.¹⁶⁸

¹⁶⁶ For further discussion on international issues and foreign investment in telecommunications in Mexico, see Chapter V, below.

¹⁶⁷ See *LFT*, *supra* note 91, art. 16.

¹⁶⁸ See *ibid.* For further discussion hereof, see Chapter Three III C above.

D. Procedure

Concessions under the LFT are granted depending on the activity the concession is going to cover. Thus concessions for spectrum frequencies for determined use and concessions for exploitation of geostationary orbits and other orbits assigned to the country will be opened to public bid;¹⁶⁹ and concessions for the installation, operation and exploitation of public telecommunications networks will be granted upon the request of the interested party.¹⁷⁰

For publicly-bidded concessions the procedure shall be subject to a plan issued by the SCT containing a program of use of the bands of frequencies of the spectrum for determined use, and its modalities and geographical coverage.¹⁷¹ For the actual bidding process the SCT publishes the terms of the bid in the DOF inviting interested parties to participate in the process.¹⁷²

A telecommunications network operator willing to enter the market of long distance or local telephony may enter it with a concession title for the installation, operation and exploitation of telecommunications networks, or with the foregoing and a concession title for the exploitation of bands of determined use frequencies, depending on the desired operations.

¹⁶⁹ See *ibid.* See also *LFT*, *supra* note 91, arts. 14 & 29.

¹⁷⁰ See *ibid.*, art. 24.

¹⁷¹ See *ibid.*, art. 15.

¹⁷² See *ibid.*, art. 16.

In 1995 the long distance telephony market was opened in Mexico. Although there is no provision requiring it, the SCT issued a procedure for obtaining a concession for the installation, operation and exploitation of public telecommunications networks at the interstate level.¹⁷³ As a result the following concession titles were granted:¹⁷⁴

Title Holder	Date
<i>Avantel S. A.</i>	September 5, 1995
<i>Iusatel S. A. de C.V.</i>	October 16, 1995
<i>Investcom S. A. de C.V.</i>	October 26, 1995
<i>MarcaTel S. A. de C. V.</i>	October 26, 1995
<i>Alestra S. de R.L. de C.V.</i>	December 16, 1995
<i>Miditel S.A. de C.V.</i>	February 20, 1996
<i>Bestel S. A. de C.V.</i>	May 13, 1996
<i>Telefonía Inalámbrica del Norte S.A. de C.V.</i>	June 17, 1996
<i>PCM Comunicaciones S.A. de C.V.</i>	December 20, 1996
<i>Amaritel S.A. de C.V.</i>	December 20, 1996

Likewise in January 1996 the SCT issued a notice containing the procedure for obtaining a concession for the installation, operation and exploitation of public local telecommunications networks, resulting in the granting of the following concessions:

¹⁷³ See *Acuerdo por el que se establece el procedimiento para obtener concesión para la instalación, operación o explotación de Redes Públicas de Telecomunicaciones Interestatales, al amparo de la Ley Federal de Telecomunicaciones* (DOF September 4, 1995), which is Spanish for Governmental notification that provides the procedure for obtaining a concession for the installation, operation or exploitation of interstate public telecommunications networks, under the LFT [hereinafter *Acuerdo September 4, 1995*].

¹⁷⁴ See *First Annual Report 1996-1997*, *supra* note 29.

Table 1	
<i>Amaritel, S.A. de C.V.</i>	February 1997
<i>Red de Servicios de Telecomunicaciones, S.A. de C.V.</i>	July 1997
<i>Metro Net, S.A. de C.V.</i>	July 1997
<i>Megacable Comunicaciones de México, S.A. de C.V.</i>	August 1997
<i>Telefonía Inalámbrica del Norte, S.A. de C.V.</i>	June 1996

E. Fees

For the request, submission, evaluation and processing of applications, applicants must pay fees to the government. These fees range between US \$900 to US \$1,230 for either request of evaluation and issuing of title for the use of bands of frequencies of the spectrum for determined use or the evaluation and issuing of an extension of a concession.¹⁷⁵ The fees for a concession title for the installation, operation and exploitation of public telecommunications networks range between US \$1,800 and US \$2,400.¹⁷⁶ These fees are set only for the processing and issuing of licenses and for the types of operation of the companies involved. Obviously these fees are nominal and do not represent an obstacle.

¹⁷⁵ See *Ley Federal de Derechos* (DOF December 30, 1981 as amended by DOF December 31, 1998), arts. 93-105, which is Spanish for Federal Contributions Act. Amount calculated according to exchange rate of February 12, 2000, \$1.00 USD = \$9.4348 MEX.

¹⁷⁶ See *ibid.*

However the LFT also provides for other fees that the titleholder shall pay to the federal government in the case of concessions for use of frequencies of the spectrum for determined use.¹⁷⁷ It refers to this fee as a “*counter benefit*” the titleholder gives in return for the granted concession. The counter benefit paid by titleholders to the federal government depends on the type of frequencies in the spectrum and their intended use. For example, recently *Axtel, S.A. de C.V.* (formerly *Telefónica Inalámbrica del Norte, S.A. de C.V.*),¹⁷⁸ in exchange for nine concessions for the use, profit and exploitation of frequency bands of spectrum in different areas within the Mexican territory, paid as a counter benefit to the federal government approximately US \$15 million.¹⁷⁹ Also *Avantel Servicios Locales, S.A. de C.V.*¹⁸⁰ paid approximately US \$4 million for 5 concessions for the use, profit and exploitation of frequency bands of spectrum for local telephony.¹⁸¹ The counter benefit is determined by the bidding offered by the operator in each particular auction of frequencies.

The bidding begins not from a zero amount but rather from an established amount, according to specifications issued by COFETEL. The specifications contain information on the frequency and a numeric value given to each frequency expressed as points. For example,

¹⁷⁷ See *LFT*, *supra* note 91, art. 14.

¹⁷⁸ *Axtel, S.A. de C.V.* is the main local service provider in Mexico after Telmex. It is partnered by a group of Mexican Entrepreneurs together with Canadian Bell Canada International and British WorldTel Limited.

¹⁷⁹ See *Extracts of Concession Title for use, profit and exploitation of frequency bands of the radio electric spectrum for determined use in the United Mexican States in favor of Telefónica Inalámbrica del Norte, S.A. de C.V., for segments of: 22150.0-22200.0 MHz; 14648.0-14676.0 MHz; 10150-10180.0 MHz; 14676.0-14704.0 MHz; and 10150-10180.0 MHz* (DOF July 5, 1999 and July 9, 1999) [hereinafter *Extracts of Concession Titles: Telefónica Inalámbrica del Norte*]. Amount calculated according to exchange rates of July 5, 1999: \$1.00 USD = \$9.3513 MEX and July 9, 1999: \$1.00 USD = \$9.3303 MEX.

¹⁸⁰ *Avantel Servicios Locales, S.A. de C.V.* is Avantel's local service provider for the Mexican market. Avantel originally entered for the long distance market and is recently entering the local telephony market. It is partnered by Grupo Banamex Accival, a big Mexican Financial Group, and MCI Worldcom.

¹⁸¹ See *Extracts of Concession Title for use, profit and exploitation of frequency bands of the radio electric spectrum for determined use in the United Mexican States in favor of Avantel Servicios Locales, S.A. de C.V., for segments of: 21339.5 - 21367.5 MHz; 21367.5 - 21395.5 MHz; 21395.5 - 21423.5 MHz; 22100.0 - 22150.0 MHz; and 14732.0 - 14760.0 MHz*

in the bidding process for the use, profit and exploitation of bands of frequencies for determined use for point-to-point links in the band between 7,110 and 7,725 MHz held in 1998, 32 points were assigned to each of four slots of 56 MHz within 7,110 and 7,725 MHz. Participating bidders are required to pay a seriousness or reliability fee when entering a bid, which may range from US \$5,000 to US \$50,000 per point, depending on the technical specifications of the frequencies. Thus in the case of the foregoing example, if an applicant were to seek two slots, the reliability fee would amount to 64 points times the value of such points, as determined by COFETEL in the bid's terms and rules.

In any country and case an important aspect to consider is whether the fees or counter benefits corresponding to concessions or licenses encourage or discourage competition in the sense of whether potential participants are or are not being blocked from accessing the market. In the case of Mexico, as seen above, fees for processing applications represent practically no obstacle for a network operator, since such fees are set only for the purpose of covering the costs of that evaluating and granting a concession. Substantial payments are required where there is a good pertaining to the federal government involved, namely spectrum, which is licensed by the government to a private party for its exploitation, profit and development. The real value of frequencies is difficult to determine. However an estimate may be calculated from the profits such bands may generate, together with many other economic considerations of the market.

(DOF April 2, 1999) [hereinafter *Extracts of Concession Titles: Avanced Servicios Locales*]. Amount calculated according to exchange rate of April 2, 1999: \$1.00 USD = \$9.9072 MEX.

A justification for the counter benefit fee arises from the fact that the ultimate ownership of the frequencies lies with the citizens. Therefore, since the frequencies will be licensed to private parties, these have to compensate the people for the use and exploitation of their frequencies.¹⁸²

The main way to license radio frequencies adopted by a majority of countries is through a process where applicants give evidence of their qualifications in three main areas: (i) legal good standing; (ii) financial capability; and (iii) technical qualifications. Once applicants have proven their qualifications in all three areas there are two main procedures for deciding who shall obtain a license; one is by an auction process, where the highest bidder obtains the license,¹⁸³ and the other is by the so-called “Beauty Contest”, where those applicants having good technical, legal and financial qualifications obtain the licenses without having to pay fees.¹⁸⁴

Requiring a reliability fee or counter benefit may have two effects on competition, one positive and one negative. On one hand high fees for the use of radio frequencies may indeed prevent starters from entering the market with their own bands. But on the other hand they may also prevent unscrupulous bidders who try to resell, sub-license or partner-up with other operators from taking advantage of the fact that they hold a title. Thus the ideal

¹⁸² Interview with Professor Ram Jakhu, Professor at Institute of Air and Space Law, (February 23, 2000), Montreal, QC, Canada.

¹⁸³ This is the case of the US, Canada and Mexico. Fees vary from one country to another.

¹⁸⁴ This is the case of Argentina. See *Argentinian Comisión Nacional de Comunicaciones*, Resolución No. 477/93 (Boletín Oficial February 17, 1993); J. Hermida, “Telecommunications Law in Argentina: From State Monopoly to Market Deregulation” (1998) 5 *Telecom. & Sp. J.*, 201.

scenario would be to combine the prevention effect with lower fees for obtaining concessions.¹⁸⁵

F. Duration

The duration of concessions for the use, profit and exploitation of frequency bands of spectrum in Mexico is normally 20 years. After such term the titleholder may request an extension thereof. If such extension is not granted bidding for the frequency will begin anew. Again in the case of the term of the title there are conflicting interests. On one hand the titleholder wants as much time as possible to earn profits and to recuperate any investment made. On the other hand the Government wants to recover the frequency in the least time possible in order to auction it again. Once again there may be a positive and a negative effect on competition. If the term is set too long the entrance of new competitors may be halted, since those with longer operations will gain more power and eventually more spectrum. On the other hand, if the term set is too short operators will invest more skeptically in the market and may also result in a technical drawback.¹⁸⁶

¹⁸⁵ Interview with Professor Ram Jakhu, *supra* note 182; Interview with Professor Julián Hermida, Professor at National Institute of Air and Space Law, Buenos Aires, Argentina, (February 23, 2000), Montreal, QC, Canada.

¹⁸⁶ Interview with Professor Ram Jakhu, *supra* note 182.

G. Universal Service Obligations

Basically the titleholder has the right to use and exploit the frequencies in accordance with the terms of the concession. Such terms contain among other rights, obligations and information: (i) the licensed frequencies, their terms of use and geographical coverage; (ii) the corresponding investment plan; (iii) the services the titleholder is allowed to provide; (iv) the technical specifications of the project; (v) the duration of the concession; and (vi) the counter benefit that the titleholder must pay the government.¹⁸⁷

One of the main obligations that titleholders undertake together with the concession is related to universal service. As mentioned in Chapter Three II. B. above, the main universal service plan and obligations were imposed on Telmex in its Modification to the Concession Title of 1976, since it is the dominant network, the one with most coverage and the owner of the infrastructure. However universal service is not only about having a telephone line in every rural area around the country, but also about consumer welfare. Thus if consumer welfare can be achieved through a process of plurality of networks and healthy competition between networks, then such plurality has to be achieved also in margined populations.¹⁸⁸

The universal service obligations of the titleholder are determined according to the type of concession. In the case of a concession for the installation and operation of a

¹⁸⁷ See *LFT*, *supra* note 91, art. 18.

¹⁸⁸ For further literature in connection herewith, see A.A. Cocca, "The Domain of the Right to Communicate" in *Communications Law Course Materials*, *supra* note 137 at 68; International Telecommunications Union,

telecommunications network, the coverage obligations are determined in accordance with the universal coverage programs issued by the SCT¹⁸⁹ and are generally expressed as an obligation to cover a certain number of localities throughout Mexico within a certain period of time and with a minimum requirement of services.¹⁹⁰ In the case of frequency concessions the coverage obligations are determined depending on the frequency specifications, the terms of the concession and the services allowed, and in accordance with the universal coverage programs issued by the SCT.¹⁹¹ Basically, depending on the coverage plan and the service to be offered, the titleholder will be required to satisfy coverage obligations in the corresponding area. The obligations are structured according to percentage of coverage and to short-term and long-term periods. The percentage of the population to be covered and the term of the period will be determined by the geographical areas and the needs of the project. After the long term is reached the titleholder and COFETEL will discuss and agree on a plan of universal service for the next period equal to the long term previously determined; this procedure will be repeated until the term of the concession expires.¹⁹² Failure to comply with universal service obligations may result in a sanction imposed on the titleholder or having its concession revoked,¹⁹³ depending on the importance of projects and on its viability and economic considerations.

"Proposal to Establish an ACC Inter-Agency Project on Universal Access to Basic Communication and Universal Services" in *Communications Law Course Materials*, *supra* note 137 at 71.

¹⁸⁹ See *LFT*, *supra* note 91, arts. 50 & 51.

¹⁹⁰ See *Extracto del Título de Concesión para instalar, operar y explotar una red pública de telecomunicaciones, otorgado en favor de Unicom Telecomunicaciones, S. de R.L. de C.V.* (DOF February 20, 1997), art. A.4; *Extracto del Título de Concesión para instalar, operar y explotar redes públicas de telecomunicaciones, otorgado en favor de Amariel, S.A. de C.V.* (DOF March 3, 1997), art. I.B.3.

¹⁹¹ See *LFT*, *supra* note 91, arts. 50 & 51.

¹⁹² See *Extracts of Concession Titles: Avantel Servicios Locales*, *supra* note 181; *Extracts of Concession Titles: Telefonía Inalámbrica del Norte*, *supra* note 179.

¹⁹³ See *ibid.*; *LFT*, *supra* note 91, art. 38 IV.

A controversial issue with regard to universal service obligations is the fact that concession titles granted to new operators contain clear and determined universal service plans, whereas Telmex, which is the network supposed to have the greatest number of universal service obligations, only has general directives concerning universal service obligations.

Mexico's international commitments in connection with the foregoing aspects, including licensing and universal service obligations, will be discussed in Chapter Five II. B. below.

II. Interconnection

A. The Need to Interconnect

Opening to competition does not only mean that multiple of players will be granted access to the market, since for competition to function properly it has to be accompanied by a regulatory framework that seeks to maximize long-term social welfare. Thus competition has to be regulated in order to avoid the negative effects that may come with it. The ultimate goal is not competition between networks but rather satisfaction of consumers' tastes and preferences. Therefore public policy shall be directed not by how well competitors perform in the competitive market but by how well consumers fare.¹⁹⁴

¹⁹⁴ See H.N. Janish, "From Monopoly Towards Competition in Telecommunications: What Role for Competition Law?" in *Communications Law Course Materials*, *supra* note 137 at 425.

The opening to competition of the telecommunications sector in Mexico has created new obstacles in the process of maximizing its potential for competition. Once the monopoly is privatized and the market opened to competition it is necessary to create a competitive environment where one did not exist because the sector was being reserved for the State.¹⁹⁵ As previously mentioned, such environment has to be well planned and strictly regulated in order for *healthy competition* to be ensured.

One of the most important aspects of competition in telecommunications markets is interconnection. In Mexico there is on one hand a dominant provider (Telmex) who virtually owns and controls the entire network and on the other hand new providers who are willing to enter the Mexican telecommunications market. Since the objective is to open the market to other providers who will compete with the dominant provider in the different services in search of maximization of long-term social welfare, the conditions that will ensure the correct interaction between networks have to be set.

Once competition is introduced the key to effective telecommunications competition lies in interconnection. The need to interconnect arises from networks interacting together and competing to provide services; such networks also require input provided by competitors in order to end traffic originating in their network. In connection hereto, one of

¹⁹⁵ See R. Tovar Landa, *Policy Reform in Networks Infrastructure: The Case of Mexico* (Mexico: Instituto Tecnológico Autónomo de México, 1998), Online Virtual Institute of Information, <http://www.vii.org/papers/mextel.htm> (date accessed: May 4, 2000).

the most important and difficult issues in the context of developing competition is the determination of interconnection frameworks and interconnection tariffs.¹⁹⁶

B. Regulation of Interconnection

1. Why regulate

The need to regulate interconnection derives mainly from the asymmetry of networks.¹⁹⁷ In a perfect scenario with equal networks and equal coverage, where the components provided by each network are essential to the other networks, interconnection is mutually beneficial and would only require negotiation between parties.¹⁹⁸ However networks are far from being equal, and in a scenario where there is a dominant network and a smaller one providing substitute services the benefits of obstructing competing networks would clearly outweigh the benefits of interconnection with a small or new network in the market. Moreover, even when interconnected, a dominant network can use interconnection as an instrument to reduce competition from other networks.¹⁹⁹ From the foregoing arises the need to regulate interconnection in a way that ensures access to networks and creates competition between them.

¹⁹⁶ See APEC, *Effective Interconnection in the APEC Region: A Report for the APEC Telecommunications Work Group*, (1998), Online Asia Pacific Information Infrastructure, <http://apii.or.kr/telwg/interTG/ovum.doc> (date accessed: January 15, 2000) at 5 [hereinafter *Interconnection in APEC*].

¹⁹⁷ See Tovar Landa, *supra* note 195.

¹⁹⁸ See *ibid.*

¹⁹⁹ See *ibid.*

2. How to Regulate?

Reciprocity between connecting networks must be achieved in order to assure healthy competition; this will limit the dominant network's capacity to take advantage of their position to the detriment of smaller networks. In a scenario with no reciprocity the dominant provider may charge high tariffs for entering its network and obtain low tariffs for ending its traffic on a rival network. In a reciprocal scenario the result would be lower prices to use the final service.

There are different approaches that can be taken toward interconnection, the main ones being:²⁰⁰

- (i) linking two networks that have been built and managed by two different operators;
- (ii) where there is a single network, permitting other operators to lease part of the network by unbundling the service elements; and
- (iii) where there is a single network, permitting other operators to purchase unbundled or bundled services for resale at a wholesale price.

The foregoing scenarios and particularly the pricing of interconnection charges will have a direct effect on the development of networks and competition between them. The ideal is to set interconnection tariffs that will promote greater efficiency in a highly competitive environment. If interconnection charges are set too low, under investment in

²⁰⁰ See *Interconnection in APEC*, *supra* note 196 at 6.

new and additional infrastructure will result, since the price is low and service availability is presumed. If on the other hand tariffs are set too high, there will be increased investment in infrastructure, which will provoke an economically negative bypass of the dominant network's infrastructure.²⁰¹ Whatever the case may be, either too high or too low, an inaccurate setting of tariffs will result in competition and economic inefficiency.

C. Interconnection in Mexican Telephony Networks

1. Regulatory Framework

As a result of the decision to re-privatize Telmex, a regulatory framework to sustain the whole process was required, and consequently interconnection rules had to be implemented in order for competition to function properly. Although privatization and opening to competition generally comes after a solid regulatory framework that will sustain the process has been established,²⁰² the case of Mexico was different, since there was no regulatory framework until two months prior to the privatization, and once the Modification to Telmex's Concession Title of 1976 had already been adopted. Although the Modification to Telmex's Concession Title did contain some provisions regarding interconnection, it is a document that establishes a relationship between Telmex and the government and in no way can it have the general applicability effects of a law.²⁰³

²⁰¹ See *ibid.*

²⁰² See UNCTAD, *supra* note 16 at 404-406.

²⁰³ See *Modification to Concession Title*, *supra* note 74, c. 5.

The rules concerning interconnection are contained in diverse laws, regulations, policies, Telmex's Concession Title and authority decisions. As mentioned before, the whole privatization and opening to competition process has been affected by legislative and administrative disorganization. The first rules of interconnection regarding Mexican telecommunications after the re-privatization are contained in the Modification to Telmex's Concession Title of 1976.²⁰⁴ Two months later came the rules contained in the RT,²⁰⁵ which was essentially an adapted copy of the Modification to Telmex's Concession Title of 1976. As previously mentioned, the RT was an express effort to comply with the requirements of the negotiations of NAFTA, and it was also intended to serve as a minimum framework for Mexican telecommunications; but it lacked specific rules and regulations concerning services.²⁰⁶ The foregoing may have fulfilled its short-term objectives regarding NAFTA, but it was not enough to make potential investors confident about Mexico's telecommunications market. Therefore the LFT was passed in order to create a more solid regulatory framework to sustain the whole sector.

From the foregoing it is important to underscore the great deal of confusion that too much legislation may provoke. Although there is an expressed intent to deregulate, an excess

²⁰⁴ See *ibid*.

²⁰⁵ See RT, *supra* note 15, arts. 93-99.

²⁰⁶ See S. Legorreta González, "La Nueva Regulación de las Telecomunicaciones en México: Parte I: El Marco Jurídico General", La Barra, Barra Mexicana de Abogados, No. 16, (Dec. 1997), Online Barra Mexicana de Abogados, <http://www.bma.org.mx/publicaciones/labarra/num16/actividad.html> (date accessed: May 4, 2000).

of laws and regulations has provoked an uncertain legal framework, for both the LFT and the RT in some cases regulate equal matters and in some others contradict each other.²⁰⁷

2. Policy

The policy on interconnection, also presented in numerous documents but specifically contained in Article 41 of the LFT, calls for an obligation to interconnect networks, with the objective to:

- (i) permit a wide development of new licensees and telecommunications services;
- (ii) provide licensees with non-discriminatory treatment; and
- (iii) promote healthy competition between licensees.²⁰⁸

These three important issues are the key elements for opening the market to competition and ensuring healthy competition between service providers, with the ultimate goal of benefiting the final consumer. In a nutshell, plurality of licensees is required in order to promote and ensure competition, and one licensee shall not have an unlawful competitive advantage over another.

More specifically and regarding interconnection under the LFT, the current Director of COFETEL has set out the basic principles or policy issues as follows:²⁰⁹

²⁰⁷ See *ibid.*

- (x) public networks must provide interconnection based on public architecture;
- (y) basic principles: (1) non-discrimination and (2) reciprocity; and
- (z) private arrangements between operators; government will intervene only as arbitrator.

With these issues in mind we will address Mexico's present situation with regard to interconnection rules and practice and come to a conclusion about the fulfillment of the foregoing objectives.

3. Current Situation

The situation regarding interconnection of networks in Mexico has been affected by the overwhelming power of the dominant operator and service provider (Telmex) together with the strong protection provided to it by the government. Obviously from the start the policies set by the LFT were not achieved, since the complete separation of Telmex from the government's interests and influence was not accomplished.

Separating the government and Telmex has been a very difficult task. Although continuous efforts have been made in order to effect a proper separation, there have been others high up in political and governmental positions and in Telmex strongly opposing such separation. When Telmex was privatized, according to the Modification to the Concession

²⁰⁸ See *LFT*, *supra* note 91, art. 41.

Title of 1976, the SCT had the right to appoint a director to Telmex's board, which certainly represented a strong bond between the corporation and the government.²¹⁰ Moreover the initially appointed director of COFETEL, Mr. Carlos Casasús López-Hermosa, was known to have strong ties to Mr. Carlos Slim and was on numerous occasions accused of favoritism towards Telmex. Undoubtedly Mr. Casasús' strong ties to Mr. Slim and Mr. Salinas de Gortari during his time at COFETEL represented a strong risk for Mexico's plan of opening to competition and attracting foreign capital, since the government's credibility and efficiency was strongly questioned.²¹¹ Despite the political speeches and how straightforward the process may appear, the facts are very different. Often operators would complain about COFETEL's favoritism, imprecision, lack of clarity, etc. A strong blow to COFETEL and to Mexico was delivered by a procedure followed by *Avantel*, S.A. de C.V. (Avantel),²¹² which will be discussed later, and international complaints followed by the US, in representation of AT&T and MCI, before the WTO against Mexican authorities for unlawful practices and preferential treatment.²¹³

²⁰⁹ See Nicolín: Speech: Washington D.C., *supra* note 156.

²¹⁰ See *Modification to Concession Title*, *supra* note 74, art. 2.3.

²¹¹ See Jiménez, *supra* note 20.

²¹² *Avantel* is a Mexican long distance operator partnered by Banamex Accival and MCI WorldCom.

²¹³ See Jiménez, *supra* note 20; O. Cruz, *Califican de "tibia" la actitud de Cofetel para aplicar la ley*, El Universal, Mexico (March 6, 1998).

3.1. Interconnection Tariffs

a. Setting Interconnection Tariffs

Once the need to interconnect and the obligation to do so have been acknowledged it is critical to provide rules for the determining the tariffs that the dominant network will charge new networks attempting to enter the market. As previously mentioned, if interconnection tariffs are set too high or too low this will result in a situation not representative of the infrastructure and technological needs of the network.²¹⁴

There are basically two ways to reach interconnection agreements between networks: (1) the authority can set them; or (2) the parties can commercially agree to them.²¹⁵ When set by the authority there is the advantage of having a reliable and objective calculation of costs considering the relevant factors, assuming that the government is interested in benefiting consumers, not a particular person or company. The disadvantages are governmental intervention and less knowledge of technical, commercial and pricing issues. Regarding the commercial negotiations approach the advantages are: (i) less government intervention, a step towards deregulation and self-regulation; (ii) commercially-reached interconnection charges are more sustainable; and (iii) operators are generally more acquainted with the technical, commercial and pricing issues to be negotiated.²¹⁶ However this approach also has disadvantages, mainly that: (i) if an agreement is not reached, the process may take a long

²¹⁴ See *Interconnection in APEC*, *supra* note 196 at 6.

²¹⁵ See *ibid.* at 14.

²¹⁶ See *ibid.*

time to complete; and (ii) there is a risk that a dominant carrier will abuse its market position in the interconnection negotiations in order to prevent competitors from gaining power in the market.²¹⁷ These disadvantages may be lessened through special mechanisms designed to minimize the delays and risks of commercial negotiations, although some degree of regulatory intervention is required. Such mechanisms are: (i) dispute resolution procedures and regulatory intervention to resolve deadlocks or breakdowns in the negotiations; (ii) setting of timetables for completion of negotiations, with sanctions for failure to comply; or (iii) providing an indication of likely outcomes if regulatory arbitration or determination is sought.²¹⁸

b. Setting Interconnection Tariffs under the LFT

Mexico has chosen the commercial negotiations approach.²¹⁹ The LFT provides that a network is obliged to interconnect with another network upon the request of the latter. The parties shall execute an agreement within 60 days, counted from the date of the request. Under the agreement they would set the terms of interconnection of their networks. In case they cannot agree on any of the points being negotiated, then the SCT has the power to intervene in order to resolve the non-agreed issues.²²⁰ This situation in Mexico is not an exception to the above-mentioned advantages and disadvantages. However it seems that the authority in Mexico decided to benefit from the advantages but did little or nothing to try to

²¹⁷ See *ibid.*

²¹⁸ See *ibid.*

²¹⁹ See *LFT*, *supra* note 91, art. 42.

²²⁰ See *ibid.*

prevent the disadvantages, mainly those arising from the overwhelmingly powerful position of Telmex.

The LFT provides a mechanism for setting interconnection charges based on negotiation between the parties,²²¹ which in a well-balanced scenario may be positive, but in this case this mechanism results in an evident imbalance in bargaining power in favor of Telmex.²²² Since Telmex has complete power over the network new operators have almost nothing to offer Telmex during negotiations. Once with complete power and having benefited over the decades from a monopolistic operation, even if it has modernization requirements and an obligation to interconnect set by the authority, the benefit obtained by Telmex from the entering of new networks to the market is minimal and does not compare in any way to the benefits obtained from monopolistic behavior. Therefore it is logical that the dominant network will try to charge high tariffs for interconnection to new networks. This by itself may not be categorized as illegal, since as a private corporation Telmex's priorities are set in the corporation's profits and subsequently the profits of its shareholders. But high pricing directed at eliminating competitors is indeed illegal. Thus the authority's intervention is required in order to help the parties come to an arrangement regarding the amount to be charged for interconnection.

This phenomenon in the Mexican context has been highly criticized since it is obvious that the negotiation would result in a very high price set by Telmex in order to benefit from such networks and to prevent other networks from gaining market power that

²²¹ See *ibid.*

would later affect Telmex's profits. It is obvious too, under the negotiation approach, that it would be very difficult for the parties to reach an agreement and that the SCT would probably have to intervene in order to find a compromise. In an ideal scenario the outcome should be calculated considering all the relevant economic and technological issues to the network and the use of infrastructure in order not to experience a shortage or an excess of investment. However with Mexico recently opening its market there was little experience in the area, and moreover there was not much interest in balancing negotiating powers between networks. As mentioned before the LFT only provides that the SCT will resolve the unsettled matter without providing any procedure or guidelines from which to reach a decision, consequently giving too much discretionary power to the authority. In the end an obvious scenario results; the dominant network proposes a very high interconnection tariff and the counter-party proposes a very low tariff. Both are unreasonable since the one from the dominant network is excessively high, obviously trying to maximize its profits and make it difficult for other networks to compete with it, and the other is too low, since the smaller network is afraid of not coming to an agreement and having the price set in a midpoint between the bids by the authority. As predictable as the scenario is the outcome, a setting of an amount in between the offers of each network. Tovar Landa considers the foregoing as one of the greatest flaws in this process and describes the process of regulation by arbitrage as a "chilling effect", where the arbiter's tendency is simply to divide the difference between the final bids of the parties involved.²²³ Considering the foregoing and the close relationship between the government and the dominant network, the latter would have no interest in granting any concessions, since these would only benefit its competitors. Consequently the

²²² See Tovar Landa, *supra* note 195.

more discretionary power given to the authority, the greater the possibility for the settlement of the agreement to prove inefficient.²²⁴

c. Mexico's Interconnection Experience

Before the opening to competition in long distance telephony came the opening in cellular service. However cellular service was not operated as a monopoly, since two main cellular providers, *Grupo Iusacell* (Iusacell) and *Telcel* (a Telmex subsidiary), commenced with the service at the same time. Interconnection tariffs charged by Telmex to competitors for the service, compared to the tariffs applied by Ameritech in the US, represent a 600% surcharge in Mexico; even if Telmex's costs were twice as high as Ameritech's the margin is still extremely high.²²⁵ Against a powerful monopoly and government protection Iusacell had virtually no alternative; however Telcel benefited from the high tariffs and its relationship with Telmex. Things had to change since the opening of long distance service and to foreign capital was about to take effect; in order to attract foreign capital the scenario had to be made clearer and less uncertain.

During negotiations for long distance interconnection charges the LFT's flaws were exposed. As previously discussed Telmex and the new long distance operators could not reach an agreement regarding tariffs. The 60-day term provided by the LFT had expired,

²²³ See *ibid.*

²²⁴ See *ibid.*

²²⁵ See *ibid.*

prompting the SCT to intervene in order to set the amounts. In April 1996 competitors had proposed amounts ranging between 1 and 1.5 cents for national long distance traffic.²²⁶ However due to the lack of agreement between competitors and Telmex, the SCT set the interconnection tariffs at 2.5 cents²²⁷ for 1997 and 2.3 cents for 1998 (70% to 250% higher than the amount proposed by the competitors).²²⁸ Regarding international entry traffic the rates for 1997 and 1998 were established by the SCT at almost twice the amount proposed by Telmex.²²⁹ Convinced of the lack of clarity in the assessment of interconnection tariffs by the authority, Avantel repeatedly requested that COFETEL supply information explaining the concepts and formulas taken into account in determining the interconnection charges that operators had to pay Telmex. Receiving no response from COFETEL, Avantel promoted a Constitutional violation suit under Article 8 of the Mexican Constitution, which refers to the right of petition and the right to information.²³⁰ Avantel won the suit.²³¹ This had a strong domestic and international political effect, since Mexico's supposed conviction for economic and commercial opening was being seriously questioned.

At the peak of this uncertain situation operators other than Telmex were seriously reconsidering their investments in Mexico. In February 1998 MCI announced that it would freeze a planned investment for Mexico of over US \$900 million and denounced "frustrating

²²⁶ See *ibid.*

²²⁷ Amounts expressed in US Dollars unless otherwise specified. The US Dollar - Mexican Peso exchange rate in April 1996 was \$7.5 pesos per \$1.00 US Dollar.

²²⁸ See *Resolución administrativa por la que la Secretaría de Comunicaciones y Transportes establece la regulación tarifaria aplicable a los servicios de interconexión de redes públicas de telecomunicaciones, autorizadas para prestar servicios de larga distancia* (DOF April 2, 1996) [hereinafter *Long Distance Interconnection Resolution*].

²²⁹ See Tovar Landa, *supra* note 195; *Long Distance Interconnection Resolution*, *ibid.*

²³⁰ See Cruz, *supra* note 213.

²³¹ See Jiménez, *supra* note 20.

conditions of competition in Mexican telecommunications market".²³² That same month Marcatel announced it would freeze an investment of US \$75 million for similar reasons.²³³ Moreover five of the most important new operators in Mexico (others than Telmex) sent a letter to the President, Mr. Ernesto Zedillo Ponce de León, denouncing unlawful trade practices incurred by Telmex.²³⁴ These practices included *slamming*, blocking of 800 (toll free numbers) from public pay phones, etc.²³⁵

Domestic and international pressure grew. MCI had also requested the US government to act before the WTO, denouncing Mexico's excessive network access tariffs and a 58% surcharge in international traffic charges.²³⁶ On April 27, 1998, as pressure continued to mount, Mr. Carlos Casasús López-Hermosa resigned from his position at COFETEL. This certainly came as a triumph and temporary relief for operators and foreign investors.

d. Government Protection of Telmex

As previously discussed, when the privatization of a long-time public entity is so recent it is difficult to clearly separate two types of functions: (i) that of the now private

²³² See F. Vidal, *La disputa más fuerte durante el año pasado se vivió en Telefonía de LD: Crece la batalla en el mercado nacional de las telecomunicaciones*, Revista Mexicana de Comunicación, Fundación Manuel Buendía, (January-March 1999), Online Revista Mexicana de Comunicación, <http://www.cem.itesm.mx/dacs/buendia/rmc/rmc57/francisco.html> (date accessed: May 4, 2000).

²³³ See *ibid.*

²³⁴ See *ibid.*

²³⁵ See Jiménez, *supra* note 20; Vidal, *supra* note 232.

²³⁶ See *ibid.*

employees who are no longer part of the bureaucratic organization; and (ii) that of the government, which should now have no interests in the business of the new private corporation. The latter is probably the most difficult to accomplish in the scenario of opening to competition, even more so when the government or those in the government have personal interests in the company, and competitors are foreign corporations. It is difficult for the regulator to cut its bond to the former government corporation, and for its people too. The combination of the regulator's goal of universal access and the negotiations between entering operators and the dominant operator, lead to a situation of protection of monopolistic revenues by considering some kind of compensation to the income of Telmex because of its giving-in in the opening to competition.

Protection to Telmex has been evident and proven. Once the decision to open the market was made the authorities decided to grant telecommunications concessions to operate competing networks indiscriminately, without providing a precise instrument that would regulate general interconnection matters. The protection provided to Telmex is evident, since the authorities' actions limit the entry or performance of competitors in a way in which only those more or as efficient as the dominant network are allowed to enter the market. Moreover the only networks allowed were those with a national presence operating with their own infrastructure, since resellers were prohibited and "callback"²³⁷ was blocked. Callback would obviously represent an important factor for domestic long distance rates to

²³⁷ Callback is a simple way of routing international phone calls for voice, fax or data transmission, through the a country that enjoys lower long distance tariffs. It works by calling a trigger number in the Country "Low-Rate", after hearing a distinctive ring you immediately hang up. Within a few seconds you are called back from the service provider with a dial tone from Country "Low-Rate". Therefore, you may now place your call anywhere in the world enjoying the rates of Country "Low-Rate".

equal those at international levels. These actions somewhat compensated Telmex for the costs incurred when opening to competition.

The LFT provides for the existence of “telecommunications services commercializers”²³⁸ and states that their incorporation and operation shall conform with the corresponding regulatory laws. However the authorities have declared that concessions to operators with a leased capacity are limited and there can be no resellers in international long distance. These measures were issued under the argument that they were made to “prevent unfair competition and not discourage investment on the part of the concessionaires”.²³⁹ Despite the foregoing argument, restrictions in such areas have a negative impact on competition, since plurality of service providers means plurality of rates and further benefits to the consumer, even if provided by operators with minimal infrastructure who assemble low-cost networks by taking advantage of a combination of elements of other operators. In the US and Canada minor operators and those with leased capacity represent an important part of the telecommunications services market and a substantial part of the revenues derived from telecommunications services.²⁴⁰

International commitments undertaken by Mexico regarding interconnection, resulting therefrom the entering to the WTO ATS and NAFTA will be discussed in Chapter Five below.

²³⁸ As defined by Article 52 of the LFT, a telecommunications services commercializer is any person who, without being owner or proprietor of means of transmission, provides telecommunications services to third parties through the use of capacity of a telecommunications public network of a licensed operator. See *LFT*, *supra* note 91, art. 52.

²³⁹ See Tovar Landa, *supra* note 195.

III. Cross-Subsidization

Given the asymmetry of operators and the natural unbalance of their market power, competition has to be ensured and guarded in connection with the diverse services that competitors may provide in relation to those they already provide and the income they receive therefrom. A clear example of cross-subsidization is when an operator provides services at a tariff that is insufficient to cover average long-term incremental costs, and simultaneously provides another service at a tariff that is higher than its average long-term incremental costs.²⁴¹ In other words the operator generates higher incomes as a result of high pricing in the market of its dominant or strong position and uses such incomes for the benefit of other activities in other markets where its position is weaker in order to support the setting of low tariffs in such market. The foregoing results in an unfair advantage gained over competitors in the second market.

As constantly mentioned throughout this study, the privatization and competition process in Mexico began in the late eighties and early nineties. The Modification to Telmex's Concession Title of 1976 did contain some general provisions on the prohibition of cross-subsidization;²⁴² however these were general principles applied only to Telmex and Telnor. These principles, together with a relationship between the government and Telmex that was

²⁴⁰ For example, in the US these operators represented 23% of the market in local telephony and 22% in long distance telephony.

²⁴¹ See *Modification to Concession Title*, *supra* note 74, art. 6.2.

²⁴² See *ibid.*, arts. 2.11, 6.2, 6.3(b)(4)(d)(ii) & 7-5.

far from being transparent, were not a determining barrier against cross-subsidization. This was the case from the first opening to competition and until late 1998, when the government finally adopted two pieces of stricter legislation relating to the prevention of cross-subsidization. The question remains whether Telmex enjoyed the benefits of cross-subsidization from the early nineties until early 2000.²⁴³ It is important to remember that Telmex was privatized in great part because of a technological drawback of its networks and services, providing only local and long distance telephony. After competition was opened and before the above-mentioned cross-subsidization rules were adopted Telmex was not only the dominant provider in the services that it had exclusively offered for decades, but it had also gained strong market power and even dominance in other services such as the Internet and mobile telephony, which were initially provided by other companies.

As a result of Telmex's dominant position in the market, a specific legislation was adopted for Telmex and Telnor and a general one for all other operators, requiring them to provide clear evidence of separate accounting, justifying all expenses and allocation of incomes and profits.²⁴⁴ The guidelines for separate accounting differ for the dominant carrier from those of other carriers. The general guidelines of separate accounting for all carriers are (i) simplicity; (ii) equitable treatment; and (iii) transparency, whereas for Telmex and Telnor there is an added duty to provide greater detail and communication with the authorities.²⁴⁵

²⁴³ Although the rules were passed in 1998, as explained below, they were not enforced but until the early year 2000. See *Today in Telecommunications: January 19, 2000*, *infra* note 246.

²⁴⁴ For further information regarding the mentioned legislation, see *Metodología de separación contable por servicio bajo la cual Teléfonos de México, S.A. de C.V., y Teléfonos del Noroeste, S.A. de C.V., deberán entregar la información contable a la que hace referencia la condición 7-5 de la modificación a sus títulos de concesión* (DOF December 1, 1998); *Metodología de separación contable por servicio aplicable a los concesionarios de redes públicas de telecomunicaciones* (DOF December 1, 1998).

The adequate and strict application of the foregoing will always be questioned. After all, the application of the rules contained in 2.11, 6.2, 6.3(b)(4)(d)(ii) and 7-5 of the Modification to Concession Title was questionable and indeed questioned. Such questioning brought the passing of the above-mentioned separate accounting rules, which after they came into force, in early 1999, were not strictly enforced until early 2000. On January 18, 2000, after much pressure and criticism, and a judicial appeal filed by Telmex against the decision of COFETEL to raise long distance charges in March 1999, one year after the passing of the law and ten years after the opening to competition, Telmex was ordered to raise its long distance charges.²⁴⁶ In August 1996 Telmex had frozen its long distance charges to the users of "LADA Empresarial" service,²⁴⁷ who enjoyed a drawback of 80%²⁴⁸ from the charges of other companies. Telmex also benefited from this, for it meant more long distance customers and the opportunity to maintain low prices in its long distance service due to high pricing in local service. The problem however has not yet been solved. First it is important to underscore that Telmex has still one more judiciary appeal instance, and second, and even more important, Mr. Jorge Nicolás of COFETEL is now arguing that it is not sure COFETEL can force Telmex to nullify its existing agreements with low long distance rates, since these are entered by private parties.²⁴⁹

²⁴⁵ See Nicolás: Speech: Washington D.C., *supra* note 156.

²⁴⁶ See *Hoy en Telecomunicaciones: Informe Diario de los Negocios de Telecomunicaciones en México* (January 19, 2000) [hereinafter *Today in Telecommunications: January 19, 2000*].

²⁴⁷ *LADA Empresarial* is Spanish for Corporate LADA, which is a long distance service directed at companies.

²⁴⁸ See *Today in Telecommunications: January 19, 2000*, *supra* note 246.

²⁴⁹ A matter of another study would be to determine whether the authority has the power to nullify agreements that prove to contain illegal provisions. See *Hoy en Telecomunicaciones: Informe Diario de los Negocios de Telecomunicaciones en México*, (January 24, 2000) [hereinafter *Today in Telecommunications: January 24, 2000*].

IV. Rate Regulation

Rate regulation goes hand in hand with cross-subsidization, since one way to avoid cross-subsidization is through rate regulation. When a market has been recently opened and healthy competition is in a very vulnerable stage, rates for services cannot be left completely to the determination of the service providers. Even though an ideal scenario would be for rates to be set solely by operators and according to market conditions, if the market is not yet well developed it has to be supervised with the intention of creating the best conditions for the correct development of the market.

The policy behind rate regulation in Mexican telecommunications is to achieve conditions where operators will set their tariffs freely, under certain conditions of quality of service, competitively, safety and permanency.²⁵⁰ As mentioned before leaving the setting of rates to market forces is an ideal scenario. Thus parameters must be established in order to ensure the realization of policy issues.

In general terms, as provided by law operators shall: (i) register their tariffs with the SCT²⁵¹ before making them effective; (ii) not discriminate in the application of tariffs; and (iii) not cross-subsidize services that they provide.²⁵²

²⁵⁰ See *LFT*, *supra* note 91, art. 60.

²⁵¹ In accordance with *LFT*, *supra* note 91, transitory art. 11; *COFETEL Creation Decree*, *supra* note 94, art. 2 IX, COFETEL is to be created and within its attributions it shall maintain the National Telecommunications Registry, therefore although *LFT* provides that registration of tariffs shall be made before the SCT it is in fact made before COFETEL.

²⁵² See *LFT*, *supra* note 91, arts. 60-63.

Registration of tariffs requirements include: (i) date of commencing of application of tariff; (ii) fees corresponding to modality, type of service or tariff package or plan; (iii) rules of application of tariffs; (iv) discount tables, if applicable; and (v) commercialization policies and/or penalties, if applicable.²⁵³ After the registration requirement is fulfilled, COFETEL may require operators to provide information concerning tariffs, and where COFETEL considers there is a violation to the provisions of tariff regulation provided in the LFT, it shall inform the SCT, which will apply the corresponding sanctions.²⁵⁴

V. Interconnection of other networks

As explained above, the interconnection experience in telephony networks has been somewhat turbulent. However conditions seem to have improved insofar as situations and needs are being solved. Until now the main experience has been in local, long distance and mobile telephony. However, in light of new technology and new services available, interconnection will soon be a major issue between the aforementioned networks and Internet Service Providers (ISPs) as well as broadcasting networks.

The general framework is already provided in the LFT,²⁵⁵ since ISPs and broadcasting companies are definitely within the general definition of public

²⁵³ See *Acuerdo por el que se establece el procedimiento para el registro de tarifas de los servicios de telecomunicaciones, al amparo de la Ley Federal de Telecomunicaciones* (DOF November 18, 1996) as amended by *Modificación a los numerales 2 y 6 del acuerdo por el que se establece el procedimiento para el registro de tarifas de los servicios de telecomunicaciones, al amparo de la Ley Federal de Telecomunicaciones* (DOF June 13, 1997) [hereinafter *Tariff Registration Procedure*].

²⁵⁴ See *Ibid.*, art. 8.

²⁵⁵ See *LFT*, *supra* note 91, art. 42.

telecommunications networks of the act.²⁵⁶ However, as telecommunications and technology merge and evolve, the need for specific regulation will be greater.

Hardware and software are developing so fast that high technology equipment is now available to consumers. Today computer modems can handle a transmission data rate of 80 kilobits per second through an analog phone line and up to 3,000 kilobits per second through a coaxial cable or integrated services digital network (ISDN), and the tendency is to go faster every day. Software has also evolved according to the new technology. Transmission of text, voice, images, sounds and all sorts of data are within the reach of millions of people, and the dream of making a long distance call through an internet connection is now a reality, as is live video transmission. New services like Web TV, video on demand, teleconferencing, among others, will change the way business is done and consolidate the terms of international trade in services and globalization. A simple example would be a person wanting to watch a movie or a TV program not available in Mexico but having the possibility of ordering it on demand from a web server in the US or Canada; not the video tapes, but the streaming movies and TV programs, upon request and direct to his/her web-based television or computer.²⁵⁷

With this in mind, the regulatory framework will have to be upgraded, and there will be many lessons learned from the experience of telephony networks that shall make the next experience less difficult and more certain for operators and ultimately more beneficial for

²⁵⁶ See *ibid.*, art. 3X.

²⁵⁷ For further and extensive related literature, see D. Johnston, S. Handa & C. Morgan, *Cyberlaw* (Toronto: Stoddart, 1997).

consumers. Moreover the experiences of other countries like the US and Canada in terms of interconnection with these services shall also be studied in order to learn from them.

Many issues not addressed in this study will arise, but they definitely have to be dealt with; among these are copyright, taxes, advertising, domestic broadcasting prohibitions and guidelines, and most importantly conflicts of laws.

In connection with our subject the fact is that ISPs' and broadcasters' interconnection to other networks is now an issue in highly developed networks in other economies throughout the world, and it will soon become an important issue in Mexico. For this to happen in a better and more efficient way than the past telecommunications experiences; the field has to be prepared by avoiding those mistakes that were made in the past.

CHAPTER FIVE

INTERNATIONAL ISSUES OF MEXICAN TELECOMMUNICATIONS

I. Basic Concepts

As a result of the need to modernize telecommunications infrastructure and services many countries around the world have decided to privatize their telecommunications networks, open their markets to competition and accept the entrance of foreign capital and technology to their domestic markets. The need is more evident in countries where the network cannot be fully developed by the government or its own nationals.

The international trend towards free trade in goods and services has played an important role in foreign investment in telecommunications in countries around the world. Mexico has been no exception, and as mentioned in Chapter Two Mexico's privatization and opening to competition has been highly motivated and influenced by the Mexico's will to enter into the GATT Agreements as well as NAFTA. The reasons and conditions for the privatization and opening to competition have already been discussed in Chapter Two hereof; however reference to some relevant aspects will be made again.

Mexico's legislation regarding foreign investment, telecommunications, competition and international trade changed dramatically during the late eighties and early nineties, when Mexico was entering the international market of trade of goods and services.

II. Foreign Investment in Mexican Telecommunications

A. Domestic Regulations

Until 1993 foreign investment in Mexico was regulated by a protectionist act passed in 1973.²⁵⁸ This act deemed telegraphic and radiotelegraphic communications as an area reserved exclusively for the State.²⁵⁹ Radio and television were reserved exclusively for Mexican citizens under the condition that their articles of incorporation and bylaws contain a so-called “clause of exclusion of foreigners”.²⁶⁰ As mentioned before, in the late eighties and early nineties when Mexico was opening to foreign investment substantial changes were made to regulations that involved international trade and investment. By 1989 the executive branch had issued a regulation to the LPIMRIE,²⁶¹ modifying the latter by increasing the percentages for foreign investment in certain areas. Such regulation was highly criticized together with the executive branch because a regulatory instrument to the framework act (the LPIMRIE) exceeded its provisions. In 1993 the LPIMRIE was replaced by the LIE. The LIE was a much more liberal act providing more mechanisms and areas of opportunity for foreign investment. However telecommunications, excepting radio and television, were

²⁵⁸ See *Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera* (DOF March 9, 1973), which is Spanish for Act for the Promotion of Mexican Investment and Regulation of Foreign Investment [hereinafter *LPIMRIE*].

²⁵⁹ See *ibid.*, art. 4(g).

²⁶⁰ *Ibid.*, art. 4 (a).

²⁶¹ See *RLPIMRIE*, *supra* note 55.

still reserved for the State.²⁶² Finally in 1995, when the LFT was passed, foreign investment in the Mexican telecommunications market was provided in an amount of up to 49% of ownership of a Mexican company, except in cellular telephony where the percentage could be higher.²⁶³

The 49% foreign investment limitation in Mexican telecommunications is an interesting issue to discuss. Although the premise seems clear and straightforward, it is still possible to have more foreign capital participating in Mexican telecommunications companies. The LIE provides the concept of “neutral investment”, whereby foreigners may invest in a Mexican company and receive stock with limited voting rights, or through trust mechanisms, as approved by the National Banking and Securities Commission.

The first case in the telecommunications sector was seen in the sale of Telmex, where a corporate restructuring was made in order to change types of shares, the end result being 40% of the total stock with voting rights and 60% without voting rights. Thus Mexican nationals did not hold 51% of the company but rather a diluted percentage not reaching 30% of the total stock, while SWBIH and FCR held 5% of the voting stock each plus their corresponding share in Grupo Telmex (as seen below). The total was 20.4% of the total stock, which was enough to accumulate 51% of the voting stock. The final structure was as follows:²⁶⁴

²⁶² See *LIE* (previous to amendment by LFT in 1995), *supra* note 45, art. 5.

²⁶³ See *LFT*, *supra* note 91, art. 12.

²⁶⁴ From SHCP.

Stockholder	Type of Shares	Percentage	US \$ Millions
Grupo Carso	AA	10.4	860
Southwestern Bell	AA	5.0	425
France Cable et Radio	AA	5.0	425
STRM	A	4.4	325
Grupo Telmex ²⁶⁵	L	5.1	701
Investors in Markets	L and A	60.6	2,270
Mexican Government	L	9.5	1,307
TOTAL	A, AA and L	100	6,313

The foregoing is now commonly applied, and although it is understood as such it is common to see in concession titles for the installation and exploitation of telecommunications networks a provision stating that neutral investment will not be calculated for purposes of the 49% limitation of foreign investment provided by the LFT.²⁶⁶

B. International Instruments

1. North American Free Trade Agreement

In 1994 the US, Canada and Mexico entered into NAFTA. Within a comprehensive set of rules liberalizing trade among member countries, Part Five of the agreement is dedicated to services, where Chapters 11 to 16 deal with investment, cross-border trade in services, telecommunications, financial services, competition and temporary entry for business persons, respectively.

²⁶⁵ Company incorporated by Grupo Carso, FCR and SWBIH.

NAFTA represented a particularly important impulse to foreign investment in Mexico, since with this agreement investors in Mexico would not only benefit from competitive advantages such as cheap labor, lower taxes, etc. But would also gain direct access to the US market.²⁶⁷ Regarding telecommunications the case was no different, since NAFTA was expected to increase economic activity between the member countries, and thus telecommunications services would increase rapidly due to the growth of economic activity.²⁶⁸ Reform in the Mexican telecommunications market and further transformation of the industry has also lead to significant investment by US companies in Mexico. By 1995 the Mexican telecommunications market was the US's largest market in Latin America and its fourth largest internationally.²⁶⁹

Under the premise of applying the best of national treatment and most-favored nation treatment, Chapter 11 of NAFTA represents a commitment by the NAFTA countries to open their markets to foreign investment.²⁷⁰ Although the Chapter is the framework for investment matters under NAFTA, it is provided that in case of any conflicts arising from other provisions of NAFTA, specific provisions will prevail over framework provisions.

Chapter 13 addresses deregulation, market access, tariff reduction and cross-border investment in telecommunications equipment and services. The policy goal behind NAFTA

²⁶⁶ See *Extracto del Título de Concesión para instalar, operar y explotar redes públicas de telecomunicaciones, otorgado en favor de Unicom Telecomunicaciones S. de R.L.* (DOF February 27, 1996), art. 1.2.

²⁶⁷ See Petrazzini, *supra* note 67 at 124.

²⁶⁸ See *ibid* at 125.

²⁶⁹ See S.I. Glover, *The Mexican Telecommunications Market: The Interplay of Internal Reform and NAFTA* (NAFTA Law and Business Review of the Americas, Kluwer Law International, Winter 997).

is to eliminate all trade barriers in the telecommunications sector during the first 15 years of the Agreement. Together with the foregoing, NAFTA targets such key issues as: (i) transparency; (ii) monopolies; (iii) the reduction of barriers in cross-border investments; (iv) technical cooperation; and (v) international standards for global compatibility and interoperability.

2. World Trade Organization

Perhaps one of the aspects that has influenced the Mexican telecommunications market the most is Mexico's participation in the WTO. This organization, together with the ITU, has spearheaded new trends towards liberalization of trade in telecommunications services. The transition from monopolistic to competitive markets in telecommunications made the issue of market access of central importance in international trade issues.²⁷¹

Upon completion of the Uruguay Round negotiations, member countries decided to create a similar agreement for trade in services.²⁷² The result was the General Agreement on Trade in Services (GATS).²⁷³ Since an agreement was reached only on value added services, countries agreed to continue working with the purpose of achieving an agreement on basic telecommunications. Thus was created a Negotiating Group on Basic Telecommunications (NGBT). By February 1997 the NGBT came up with the WTO Agreement on

²⁷⁰ See NAFTA, *supra* note 2, arts. 1101-1111.

²⁷¹ See M. Fredebeul-Krein & A. Freytag, "Telecommunications and WTO Discipline: An Assessment of the WTO Agreement on Telecommunication Services" (1997) 21:6 Telecommunications Policy, 477 at 477.

²⁷² See *ibid.*

Telecommunications Services of 1997 (WTO ATS),²⁷⁴ which is part of the framework agreement of GATS.

The GATS basically establishes multilateral rules regarding market access and national treatment of foreign services and service suppliers, and government regulation of trade in services, combining elements of trade and investment.²⁷⁵ It includes most-favored nation treatment²⁷⁶ obligations for member countries, as well as market access²⁷⁷ and national treatment,²⁷⁸ applied to negotiations on a sector-by-sector basis.²⁷⁹

A total of 69 countries entered into the WTO ATS, representing 90% of the world's basic telecommunications revenues.²⁸⁰ This Agreement includes a series of important and straightforward obligations undertaken by its signatories aimed to ensure the adequate development of international trade in telecommunications services. The agreement addresses key factors such as competitive safeguards, appropriate interconnection as well as transparency and dispute settlement thereto, universal service, availability of licensing criteria, independent regulators, and allocation and use of scarce resources,²⁸¹ all the foregoing in an attempt to provide legal certainty for investment in such markets. The foregoing issues have been discussed in the preceding chapters insofar as they affect Mexico's telecommunications market.

²⁷³ See *General Agreement on Trade in Services*, Marrakesh, April 15, 1994, [hereinafter GATS].

²⁷⁴ See WTO ATS, *supra* note 4.

²⁷⁵ See L.B. Sherman, "Introductory Note", *WTO Agreement on Telecommunications Services* (1997).

²⁷⁶ See GATS, *supra* note 273, art. II.

²⁷⁷ See *ibid.*, art. XVI.

²⁷⁸ See *ibid.*, art. XVII.

²⁷⁹ See *ibid.*, art. XX and Sherman, *supra* note 275.

²⁸⁰ See WTO ATS, *supra* note 4.

3. Mexico's compliance with NAFTA and WTO obligations

In connection with this study we can identify in NAFTA and the WTO ATS some essential obligations that relate to international trade in telecommunications services. Thus the WTO and NAFTA, combined, include the following aspects, as discussed below.

a. Competitive safeguards / monopolies

Both agreements target anti-competitive practices such as cross-subsidization and discriminatory practices. We can say that Mexico's experience in this area was at first tainted by a lack of regulation, together with a close relationship between the dominant network and the regulator. Evidence thereof is the slow process whereby Telmex was finally forced to increase the long distance rates that had been frozen since 1996.²⁸¹ However regulatory efforts in this respect have been made and are beginning to function properly.

²⁸¹ See *ibid.*, arts. 1-6.

b. Interconnection

We can identify three main issues related to interconnection: (i) ensuring it, (ii) a dispute settlement mechanism, and (iii) transparency. Under these three aspects of interconnection, as discussed in Chapter Four II herein, we can identify two main concerns that have to be resolved in order to comply with obligations under NAFTA and the WTO. Although there is an obligation to interconnect, the negotiations approach, as provided by the LFT, is not well suited for the Mexican telecommunications market, since networks are still quite unbalanced and consequently bargaining power is too. Moreover, in the event of not reaching an agreement under negotiations, transparency is required in order for networks to be able to know how the authority is determining the interconnection tariffs. Such determination has to be made through an evaluation of costs, not arbitrarily set, in order to reflect the true needs of the network.

c. Independent Regulators

NAFTA Chapter 13 does not have provisions relating to independence of regulators; however the WTO ATS does. In Chapter Three III. A. 1. hereof, we discussed two types of independence of the regulator, one from the government and the other from the operators. The provisions of Article 5 of the WTO ATS refer only to the separation of regulator and operators. As mentioned before, it is important to make the distinction even greater,

²⁸² See Chapter Four III above.

particularly in the case of commissioners. Nevertheless, in general terms, a separation of the regulator from the operators does exist. Regarding the second part of Article 5 of the WTO ATS, the situation has been critical, mainly due to political and not purely legal situations, although it may be said that improvements are being made.

d. Universal service

Universal service has also been a critical factor in Mexico since Telmex was imposed with only general rules with regard to universal service plans and coverage,²⁸³ while concession titles for other networks are very specific about their coverage obligations and the time they have for the completion of the obligations. COFETEL has still to determine a universal service plan under which Telmex would have to fund universal service under the same conditions as competitors.²⁸⁴ Although not provided as such in the WTO ATS, an ideal universal service plan would have to include (i) the scope of services that have to be offered universally, and whether or not it has to be increased in the future according to technological development and service obligations; (ii) the prices of the services; (iii) the number of service providers that are obliged to provide the universal service; and (iv) who is going to finance the universal service obligations and how.²⁸⁵

²⁸³ See *Modification to Concession Title*, *supra* note 74, c. IV.

²⁸⁴ See United States Trade Representative, *Press Release on Telecommunications Agreements* (March 31, 1999).

²⁸⁵ See Fredebeul-Krein & Freytag, *supra* note 271 at 482.

e. Availability of Licensing Criteria

The granting of concessions has been fairly clear. The general and specific rules are all publicly available. Moreover specific regulations are also issued in connection with every particular process, and times and procedures are made available to all the interested parties as well as to the general public. However there are still some aspects that remain unclear, for example resellers, which are provided for by the LFT, but access to the network has been inexplicably blocked to them.

f. Allocation of Scarce Resources

Despite the fact that WTO ATS provides that procedures for the allocation and use of scarce resources shall be conducted in an objective, timely, transparent and non-discriminatory manner,²⁸⁶ rules on the actual policies of allocating these resources are not provided by the WTO ATS.²⁸⁷ Thus the time and objectivity requirements cannot be determined so easily. In the case of Mexico it may be argued that the public auction process for allocation for scarce resources fulfills the requirement of non-discrimination;²⁸⁸ however if there were clear methods for evaluating foregoing criteria, a re-evaluation could be made

²⁸⁶ See *WTO ATS*, *supra* note 268, art. 6.

²⁸⁷ See Fredebeul-Krein & Freytag, *supra* note 271 at 490.

²⁸⁸ See *ibid.* at 479.

of how discriminatory or not these procedures are, considering the issues discussed in connection with fees in Chapter Four I. E.

"Progress, far from consisting in change, depends on retentiveness. Those who cannot remember the past are condemned to repeat it."

- George Santayana

CONCLUSION

Throughout this thesis the evolution of Mexican telecommunications from its earliest stages has been addressed. We have seen how Telmex became a government-owned monopoly. Furthermore we have appreciated how the concept of *natural monopoly* weakened internationally as well as in Mexico, just as the international trend towards liberalization in telecommunications services grew stronger.

The privatization process was done expeditiously, in less than two years, and by the time the government's stock in the corporation was sold Mexico had a completely new legal framework for its telecommunications market. New statutes and regulations were adopted in an attempt to provide the necessary conditions for healthy competition. However insufficiency in regulations and unclear provisions held back attempts to achieve an adequate regulatory framework for an emerging market with extremely unbalanced negotiating powers between players.

Commitments undertaken as a result of the entering into the WTO and NAFTA definitely influenced the scenario. These agreements required more clarity, certainty and

liberalization obligations. However these are still preliminary instruments, requiring further detail and stricter provisions in order to obtain a serious commitment from member countries.

Despite the flaws and errors incurred, from which there are certainly lessons to be learned, the fact is that just over 10 years ago Mexico privatized Telmex and gradually opened its market to competition. Today service and coverage have radically improved. Plurality of providers exists, at least in urbanized areas, and the *de facto* separation between the government and Telmex is gradually being achieved. Many of the errors made are being rectified, with the help of legislators, competitors and authorities. As mentioned throughout this thesis, Telmex and the Mexican authorities are in the national and international spotlight, which serves as a policing force in ensuring independence of government and operators in favor of healthy competition. Moreover competitors get stronger every day, which increases their bargaining power under negotiations and balances forces in the market.

An essential lesson to learn herefrom is not to wait until situations arise or regulation is required, and by no means leave grounds unregulated, but anticipate and prevent. Soon, if Mexico continues to liberalize its market, it will have to make a serious commitment towards deregulation, not only in the sense of avoiding excessive regulation, but in the sense of leaving specific situations to the forces of the market. Forbearance will become a major issue, as it is already being spoken about in Mexico.²⁸⁹ However in order for the foregoing to function adequately, the correct channels have to be provided by law. Ideally Mexico should

²⁸⁹ See Nicolín, *supra* note 143.

look to the experiences of other countries like Canada and the US, and learn the lessons their markets have taught.

Finally, with respect to the past, there is little to do but learn. Today solutions to the problems of the Mexican telecommunications market lie not in weakening or excessively controlling the dominant carrier but in providing the means to balance powers between parties around the negotiations table, with the objective of having a healthy market capable of standing on its own in the near future. Abraham Lincoln once said: "You cannot bring about prosperity by discouraging thrift. You cannot strengthen the weak by weakening the strong. You cannot help the wage earner by pulling down the wage payer."

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