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MOST-FAVORED-NATION CLAUSES AND TELECOMMUNICATIONS INTERCONNECTION: MAKING THE SAFEGUARDS SAFE

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This paper is one of a series of focused and timely NRRI analyses of issues in state telecommunications policy that derive from passage of the Telecommunications Act of 1996, which creates both challenges and opportunities for state regulators. The views and opinions expressed herein are those of the author. They are not necessarily those of The National Regulatory Research Institute, the National Association of Regulatory Utility Commissioners (NARUC), or any NARUC-member Commissions.

Executive Summary

In the Telecommunications Act of 1996 (1996 Act), the sections on interconnection contain several requirements that may be characterized as most-favored-nation (MFN) provisions. MFN provisions seek nondiscriminatory treatment. A nation, company, or individual must extend the same terms, conditions, and prices to all MFN-qualified customers. While most widely associated with international trade, MFN provisions appear in private contracts, government procurement laws, and other legislation. For the public utilities regulator implementing the 1996 Act, MFN interconnection provisions raise two concerns:

- The competition-inducing efficacy of MFN provisions depends upon the industry market structure. In concentrated industries, such as telecommunications, recent research indicates that MFN provisions can induce tacit collusion, reduced competition, and higher prices.
- Public utility regulators must serve an important institutional role. Without strong monitoring and dispute resolution institutions, the beneficial effects of MFN provisions decline.

While the 1996 Act's interconnection MFN provisions may provide new competitive opportunities, the provisions are not without problems. Public utility regulators must remain vigilant to potential anticompetitive consequences of the MFN provisions.

Introduction

Most-favored-nation (MFN) clauses are the cornerstone of nondiscrimination policies. In an international contract when an MFN clause is present, a nation must extend to any other qualifying nation the same privileges and concessions granted to any other nation.¹ A qualifying nation is any nation that has a bilateral or multilateral treaty specifying that one nation agrees to apply MFN status to another signatory nation. Within the international trade environment, MFN clauses are intended to enhance fair competition and economic efficiency. Because all qualifying nations receive equitable treatment, no nation is at a competitive disadvantage. All nations' goods and services receive equal tariff, standards, and regulatory treatment. This equitable treatment encourages economic efficiency. Consumers will purchase goods and services from a nation offering the superior price and quality combination, not based upon discriminatory tariffs, standards, or regulatory policy.

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The remaining sections of this report examine MFN clauses and their role in the Telecommunications Act of 1996 (1996 Act), especially the interconnection sections. The next section examines the different contexts in which MFN clauses appear and identifies lessons relevant for regulators. The third section compares the 1996 Act's MFN provisions with international trade MFN provisions. The fourth and fifth sections examine the economic and competitive effects and the institutional role associated with

¹ Congressional Research Service, *Most-Favored-Nation Status of U.S. Trading Partners* (Washington, D.C.: Library of Congress, 1991), 227.

MFN clauses. The last section provides several concluding lessons as regulators enter the new telecommunications regulatory environment.

Environmental Contexts Where MFN Clauses Appear

While most widely associated with international trade, MFN clauses appear in a variety of other settings. MFN clauses appear in private contracts, government procurement laws, and legislation, such as the 1996 Act. In each setting, the MFN clause's inclusion serves a somewhat different purpose and produces a different effect.

In many instances, private companies include MFN clauses in long-term contracts. Often, buyers seek MFN clauses to ensure equitable treatment. In this

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context, should a seller offer a third buyer a lower sales price than the buyer with an MFN clause, the seller must lower its sales price to the buyer with the MFN clause. This guarantees that the buyer with the MFN clause will

receive the seller's lowest price. Also, sellers include MFN clauses to gain a competitive advantage. In this context, sellers perceive that MFN clauses will enhance the attractiveness of their sales contract vis-à-vis that of their competitors. As explained below, MFN clauses in private contracts can produce favorable or unfavorable outcomes depending on the industry market structure.

Analogous to the MFN clause, federal government procurement law provides a most-favored-customer (MFC) clause. The Federal Acquisition Regulation (FAR) is the government-wide acquisition regulation jointly issued by the General Services Administration (GSA), the Department of Defense, and the National Aeronautics and Space Administration. The FAR appears as Title 48 of the Code of Federal

Regulations. The FAR provides the federal government protection similar to that afforded private buyers with an MFN clause. FAR 15.813-3 requires that “[c]ontracts entered into using other than full and open competition may not result in prices for parts or components offered for sale to the general public that exceed the contractor’s lowest commercial price.”² However, FAR 15.813-5(2) provides exceptions when a significant difference exists between the commercial sales contract and the government contract; differences can include quality, quantity, delivery requirement, or other terms and

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conditions.³ In a like manner, exceptions appear in international trade, private contracts, and the 1996 Act. A dispute resolution mechanism often is necessary and is available, as this report explains below in more detail. Finally, FAR 15.813-6(d) entitles the government to a price adjustment for any sales overcharge.⁴ Again, these price adjustments are analogous to similar provisions appearing in MFN clauses.

There is conflicting evidence regarding the MFC clause’s impact. While introducing Senate Bill 2619 in 1992, Senator John Glenn (Ohio) noted that “GSA’s imposition of [the MFC] requirement may actually result in increased cost to the government.”⁵ Alternatively, Marshall, Meurer, and Richard found that “GSA schedule prices characteristically are lower than the vendor’s published commercial catalogue

² Federal Acquisition Regulation (CCH), ¶ 30,163.25.

³ *Ibid.*, ¶ 30,163.35.

⁴ *Ibid.*, ¶ 30,163.40.

⁵ *Congressional Record*, 102nd Cong., 2nd sess., 1992, 138, no. 54: S5511.

prices. In fact, private sector customers frequently use GSA schedule prices as a desired target when negotiating with the respective vendor.”⁶

MFN clauses appear throughout the 1996 Act’s interconnection sections. The MFN clauses mandate that telecommunications providers permit interconnection in a nondiscriminatory manner. In establishing additional obligations for incumbent local exchange carriers (LECs), section 251(c)(2) requires that incumbent LECs provide interconnection “that is at least equal in quality to that provided...to itself or to any subsidiary, affiliate, or any other party” and “on rates, terms, and conditions that are just, reasonable, and nondiscriminatory.”⁷ In a similar vein, section 252(i) requires that once a carrier enters into an agreement, whether by negotiation or arbitration, it must “make available any interconnection, service, or network element...to any other telecommunications carrier upon the same terms and conditions as those provided in the agreement.”⁸ The intent of these sections is very similar to the traditional MFN

Exceptions necessitate a dispute resolution mechanism.

clause. Under like terms and conditions, all buyers (that is, those seeking interconnection to the incumbent’s telecommunications network) must receive the same rates.

Congress’ goal appears to be ensuring that all parties have an equal competitive opportunity, thereby encouraging competition. Similar to other MFN clauses, the 1996 Act provides important exceptions. Section 251(f) exempts from the 1996 Act’s MFN interconnection requirements incumbent rural LECs and those LECs serving fewer than two percent of the nation’s subscriber lines.⁹ Specifically, section 251(f) exemptions apply if a state public utility commission

⁶ Robert C. Marshall, Michael Meurer, and Jean-Francois Richard, “The Private Attorney General Meets Public Contract Law: Procurement Oversight by Protest,” *Hofstra Law Review* 20 (1991): 36-37.

⁷ Public Law 104, 104th Cong., 2nd sess. (8 February 1996), § 251 (c)(2).

⁸ *Ibid.*, § 251(i).

⁹ *Ibid.*, § 251(f).

determines that an interconnection offer (1) creates an adverse economic impact, (2) creates undue economic burden, (3) is technically infeasible, or (4) is inconsistent with the public interest (section 254 universal service goals). Again, exceptions necessitate a dispute resolution mechanism. In the 1996 Act, state commissions fulfill that role.

The Telecommunications Act of 1996 and International Trade MFN Policies

The 1996 Act's interconnection MFN provisions provide for more "liberalized" treatment than current international trade agreements require. For the United States, the North American Free Trade Agreement (NAFTA), the General Agreement on Tariffs and Trade (GATT), and the General Agreement on Trade in Services (GATS) represent the nation's principal trade agreements. NAFTA policies apply to the United States, Canada, and Mexico and cover a broad array of goods and services. With completion of the Uruguay Round, the World Trade Organization (WTO) manages the GATT and GATS agreements. GATT policies cover trade in goods while GATS policies cover trade in services. Currently, 128 nations are members of the WTO.¹⁰ As the global economy becomes increasingly integrated, nations must harmonize their laws and regulations with international policy. The 1996 Act's MFN interconnection provisions in fact go beyond current international policies.

Chapter 13 of NAFTA discusses telecommunications. Article 1302(1) requires access to and use of any public telecommunications transportation network or service on reasonable and nondiscriminatory terms and conditions. However, access to and

¹⁰ Bernard M. Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System* (Oxford: Oxford University Press, 1995), 275-276.

use of any public telecommunications transportation network or service does not necessarily include resale. Article 1301(3) permits a nation to prevent a private party from interconnecting and offering public telecommunications services over the network.

The 1996 Act's MFN interconnection provisions—which envision resale—exceed NAFTA requirements.

Thus, the 1996 Act's MFN interconnection provisions—which envision resale—exceed NAFTA requirements. Finally, the 1996 Act's rural and small carrier exceptions appear consistent with Article 1302(6) "safeguard" provisions. Article 1302(6) permits the imposition of specific conditions on access to

and use of the telecommunications network to ensure that (1) providers maintain the ability to make services available or (2) the network's technical integrity is maintained.

Within GATS, the Annex on Telecommunications (AOT) and the Annex on Negotiations of Basic Telecommunications (ANBT) cover telecommunications. Within GATS, nations establish schedules identifying those services to which GATS provisions apply—including MFN treatment. The AOT applies to all measures that "affect access to and use of public telecommunications transportation networks and services." The AOT section 5.1 requires nondiscriminatory access to and use of the public transportation network. This requirement is analogous to NAFTA Article 1302(1). In addition, the AOT section 5.5 provides similar "safeguard" provisions.

The 1996 Act's interconnection provisions clearly exceed the requirements of the General Agreement on Trade in Services.

These safeguards include provisions to ensure that (1) providers maintain the ability to make service available, (2) the network's integrity is maintained, or (3) service providers from another nation do not supply services unless the

nation's schedule permits such provision. From these sections, it appears the 1996 Act's interconnection provisions are consistent with GATS provision. However, the GATS provisions are not as "liberalized" as the AOT suggests. In the ANBT, Article II

states that the MFN provision will only apply when (1) the Negotiating Group on Basic Telecommunications (NGBT) reaches a final telecommunications agreement or (2) a nation includes telecommunications services in its schedule. Because the NGBT has not reached a final agreement, MFN provisions do not apply to telecommunications services. Thus, the 1996 Act's interconnection provisions clearly exceed the GATS requirements.

Within the GATS telecommunications environment, nation-specific industry structure and certain GATT provisions are creating a stalemate in negotiations and precluding more "liberalized" provisions. In the early stages of the Uruguay Round, the United States advocated a "liberalized" position; specifically, MFN treatment for services would apply to all GATT signatories. By 1990, the United States had dropped the MFN provision for services. The United States opposition centers on the asymmetrical impact of MFN for nations with state monopolies and those without. GATT requires MFN treatment for all signatories' services; at the same time, GATT permits state monopolies. Thus, a nation with a state monopoly can preclude MFN interconnection competition. With no state monopoly, the United States must adhere to the MFN provision—the United States cannot preclude other nations' state monopolies from interconnecting and competing with domestic carriers, but their state monopolies would not have to provide interconnection to a U.S. carrier. The NGBT's initial deadline to reach a final agreement was April 30, 1996. With no agreement in sight, the negotiations were extended until February 15, 1997.¹¹ Without resolution of this fundamental inconsistency, it is difficult to foresee an international telecommunications agreement in the near future.

¹¹ Office of the United States Trade Representative, *Statement of Ambassador Charlene Barshefsky: Basic Telecom Negotiations* (Washington, D.C.: Office of the United States Trade Representative, 30 April 1996).

Economic and Competitive Issues

Industry market structure strongly influences the economic and competitive impact of MFN clauses. MFN clauses create company-level incentives. When these company-level incentives combine with different industry market structures, MFN clauses can induce either procompetitive or anticompetitive results. To effectively evaluate the merits of MFN clauses, industry regulators must understand the interaction between MFN clause incentives and industry market structure.

In competitive markets, MFN clauses induce many benefits. These benefits include:

- *Improved price efficiency*
- *The efficient, allocation of risk between buyers and sellers*
- *Reduced competitive disadvantages*
- *The incentive to minimize cost*
- *Encourage earlier consummation of long-term contracts*

In competitive markets, MFN clauses introduce many benefits. These benefits most clearly manifest themselves in long-term contracts. First, MFN clauses can improve price efficiency. In a competitive market, prices are dynamic; however, long-term contracts establish static prices. Because MFN clauses permit price mobility, long-term contract prices will more closely resemble market prices and marginal cost. Second, MFN clauses facilitate the efficient allocation of risk between buyers and sellers. With long-term contracts,

future price uncertainty is a significant risk. MFN clauses permit the buyer and seller to

allocate the risk associated with future price uncertainty in a manner that maximizes their combined welfare.¹² This occurs when a risk averse buyer enters into a contract with an MFN clause; the seller bears the future price risk. Third, MFN clauses reduce competitive disadvantage. If a seller supplies a critical input, all buyers will incur the same input prices. In this manner, no competitor incurs an input price disadvantage. Fourth, MFN clauses maintain the incentive to minimize cost.¹³ To maintain or grow market share, the seller must provide competitive pricing. With an MFN clause, existing buyers must also receive any new, competitive prices. In this manner, the seller cannot utilize excess profits from high priced, existing contracts to subsidize new growth. Thus, the seller must innovate and seek cost minimizing production to maintain or grow market share. Fifth, MFN clauses encourage earlier consummation of long-term contracts. Because the buyer receives the benefit of any price decrease, MFN clauses should reduce the buyer's reluctance to enter into a contract.¹⁴ The preceding five benefits provide strong support for MFN clauses in competitive markets. From a policy perspective, individuals and organizations postulating these MFN clause benefits can only do so when the specific industry structure is competitive.

- *In oligopsonistic markets, MFN clauses appear to facilitate economic efficiency.*
- *In oligopolistic markets, MFN clauses appear to lessen competition and increase prices and profits.*
- *In monopoly markets, MFN clauses appear to induce higher contract prices.*

¹² Joseph J. Simons, "Fixing Price With Your Victim: Efficiency and Collusion With Competitor-Based Formula Pricing Clauses," *Hofstra Law Review* 17 (1989): 608.

¹³ *Ibid.*, 610.

¹⁴ *Ibid.*, 611.

In oligopsonistic markets, MFN clauses appear to facilitate economic efficiency. (Oligopsonistic markets contain a few large buyers and numerous and uncoordinated sellers.) In an empirical examination of the natural gas market, Crocker and Lyon find that “nondiscrimination guarantees are more likely to facilitate efficiency than collusion.”¹⁵ Similar to the competitive market, this efficiency arises because MFN clauses induce price adjustments in long-term contracts. Thus, the contract price will more closely mirror the market price and marginal cost.

In oligopolistic markets, MFN clauses appear to lessen competition and increase prices and profits. (Oligopolistic markets contain a few large sellers and numerous and uncoordinated buyers.) MFN clauses can produce tacit collusion in two respects. First, MFN clauses facilitate information exchange.¹⁶ MFN clauses increase the visibility of price changes. Thus, companies cannot garner a competitive advantage by offering selective discounts;

competitors can quickly identify and respond to price decreases. This reduces price uncertainty about competitors’ actions. Second, MFN clauses alter management incentives.¹⁷

Anticompetitive forces appear significantly detrimental to new entrants, especially small companies without name recognition.

Because all existing MFN-covered buyers must receive the lowest sale price, MFN clauses substantially increase the cost associated with selective discounting. At the same time, companies will be unlikely to garner a competitive advantage by discounting. By substantially increasing the cost of discounting and reducing its

¹⁵ Keith J. Crocker and Thomas P. Lyon, “What Do ‘Facilitating Practices’ Facilitate? An Empirical Investigation of Most-Favored-Nation Clauses in Natural Gas Contracts,” *Journal of Law and Economics* 37 (1994): 320.

¹⁶ Steven C. Salop, “Practices that (Credibly) Facilitate Oligopoly Co-ordination,” chapter 9 in *New Developments in the Analysis of Market Structure*, eds. Joseph E. Stiglitz and G. Frank Mathewson (London: Macmillian Press LTD, 1986), 271.

¹⁷ *Ibid.*, 272.

competitive advantage, MFN clauses reduce the incentive to offer selective discounts.¹⁸ Thus, MFN clauses reduce price competition and uncertainty. These anticompetitive forces appear significantly detrimental to new entrants, especially small companies without name recognition. New entrants must compete against established incumbents. Without name recognition, new entrants often require a price advantage to compete effectively. Because sellers will be unwilling to offer selective discounting, new entrants will possess little to no basis on which to challenge established incumbents.¹⁹

In monopoly markets, MFN clauses appear to induce higher contract prices.²⁰ While negotiating an initial contract, the monopolist is in reality negotiating the price and conditions for all subsequent contracts. Because the monopolist seeks to maximize its total payoff, the MFN clause influences the monopolist's bargaining decision. In subsequent negotiations, the monopolist is in a stronger bargaining position because the MFN clause links the initial contract's price and conditions with all future contracts. To maintain its maximum payoff, the monopolist cannot offer lower subsequent prices. Thus, this linkage can result in higher future contract prices than negotiations without the MFN clause present in the initial contract.

The FTC found that MFN clauses, when combined with other facilitating practices, raise prices above competitive levels in oligopolistic markets. A federal Court of Appeals rejected the finding.

¹⁸ Donald S. Clark, "Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices After *Ethyl Corp.*," *Wisconsin Law Review* (1983): 902.

¹⁹ Arnold Celnicker, "A Competitive Analysis of Most Favored Nations Clauses in Contracts Between Health Care Providers and Insurers," *North Carolina Law Review* 69 (1991): 879-880.

²⁰ This discussion relies heavily upon Thomas E. Cooper and Timothy L. Fries, "The Most-Favored-Nation Pricing Policy and Negotiated Prices," *International Journal of Industrial Organization* 9 (1991): 209-223.

The potential anticompetitive effects of MFN clauses have not escaped regulatory attention. The Federal Trade Commission (FTC) initiated several cases involving MFN clauses and anticompetitive behavior. In *Ethyl Corp.*, the FTC found that MFN clauses, when combined with other facilitating practices, raise prices above competitive levels in oligopolistic markets:²¹ “the FTC found recorded evidence demonstrating that the MFNs exerted both incentive management and information exchange effects.”²² However, a federal Court of Appeals rejected the Commission’s finding.²³

Within the health care industry, MFN clauses appear to create anticompetitive concerns. In *Reazin v Blue Cross and Blue Shield of Kansas, Inc.*, the Tenth Circuit

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Court of Appeals found “the ‘most favored nations’ clause effectively prevents competing insurance companies from offering more favorable insurance rates to

consumers. This clause gives defendant the ability to prevent insurance prices from falling, thus providing it the ability to effectively control insurance prices.”²⁴ In 1994, the Justice Department settled antitrust lawsuits involving MFN clauses with Delta Dental Plan of Arizona and Vision Service Plan of Sacramento, California.²⁵

Industry regulators must closely examine the economic and competitive effects of MFN clauses. Industry market structure is a central consideration. In competitive

²¹ *In re Ethyl Corp.*, 101 F.T.C. 425 (1983).

²² *Simons*, 638-639.

²³ *E.I. DuPont de Nemours and Co. v FTC*, 729 F.2d 129 (2d Cir. 1984). The court indicated that the FTC’s findings were not supported by record evidence.

²⁴ *Reazin v Blue Cross and Blue Shield of Kansas, Inc.*, 899 F.2d 951, 971 (10th Cir. 1990).

²⁵ Michael Bradford, “Most Favored Nation’ Clauses Falling Out of Favor,” *Business Insurance* (April 3, 1995): 10, 14.

markets, MFN clauses encourage economic efficiency and fair competition. However, in concentrated markets, MFN clauses encourage tacit collusion, reduced competition, and higher prices. These conditions are especially deleterious to an industry seeking a transition from monopoly to competition and to small, relatively unknown companies seeking market penetration.

Administrative Regimes and Organizations

Without appropriate monitoring and enforcement, an MFN clause's impact will decline. MFN clauses are subject to conflicting interpretations and cheating. Administrative regimes and organizations help ensure that MFN clause rules are adhered to and are applied equitably. These regimes and organizations fall into two broad categories: monitoring and dispute resolution.

Without appropriate monitoring and enforcement, an MFN clause's impact will decline.

Monitoring is important to ensure contracting parties adhere to their MFN commitments. Regardless of their form (nation, company, or individual), incumbents seek out, attempt to protect, and profit from information asymmetry. Monitoring helps reduce the information asymmetry problem. In international trade, monitoring includes three mechanisms: transparency, enquiry points, and surveillance.

Transparency is the principal mechanism facilitating monitoring. Transparency implies that all rules, regulations, and agreements are published and updated regularly. GATT Article X, GATS Article III, and NAFTA Article 1802 require that signatories publish all laws, regulations, procedures, judicial decisions, and administrative

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rulings influencing international trade or the specific agreements. GATS requires that signatories publish their “positive schedules.” “Positive schedules” identify those service sectors that the signatory agrees to open to GATS commitments, including MFN treatment. Finally, GATS requires that once a year signatories inform the Council for Trade in Services of any new laws or changes to existing laws, regulations, or administrative guidelines significantly affecting services covered by their schedule.

Transparency provides two benefits. First, parties are less likely to violate their commitments if they must publish their policies. Incumbent information asymmetry

Under both GATT and NAFTA, signatories must maintain enquiry points. Enquiry points are organizations or departments that answer questions and provide relevant information.

advantages vis-à-vis other parties declines when policies are widely known. Second, new and existing parties are likely to possess greater knowledge regarding existing and improved commitments. This is especially important for new entrants seeking

market access. In the case of GATS, new entrants can identify the specific service sector commitments of all signatories. This permits new entrants to target their service offerings.

Enquiry points facilitate information exchange. Under both GATT and NAFTA, signatories must maintain enquiry points. Enquiry points are organizations or departments that answer questions and provide relevant information.²⁶ These organizations and departments serve as contact points to facilitate communication. By establishing enquiry points, GATT and NAFTA ensure new entrants can gain prompt access to relevant rules and regulations. This helps facilitate market access.

External surveillance provides a final means of monitoring. The WTO’s Trade Policy Review Mechanism (TPRM) performs country-specific reviews.²⁷ TPRM

²⁶ Hoekman and Kostecki, 44.

²⁷ Ibid., 45.

examines the impact of signatories' trade policies and practices on the world trading system. While TPRM's reviews are not unannounced (the European Union, United States, Japan, and Canada are subject to biannual review), the reviews facilitate compliance through greater transparency. First, signatories understand TPRM will review their trade policies and practices; this provides an incentive to adhere to commitments. Second, TPRM findings provide other signatories with valuable information regarding the signatory's policies and practices. Thus, this surveillance mechanism helps facilitate compliance and encourage open information transmission.

Once a dispute arises, organizations and policies must exist to facilitate an equitable resolution. Policies should be flexible to permit collaborative and innovative solutions. Because of the inherent complexity, few solutions will adhere to a set resolution. At the same time, organizations and sanctions must exist to resolve lingering disputes. Without these attributes, the recalcitrant disputant encounters no compelling reason to alter its course. Thus, the dispute resolution mechanism should encourage collaborative and innovative solutions with the threat of organizational proceedings and sanctions to deter obstinacy.

Once a dispute arises, organizations and policies must exist to facilitate an equitable resolution. Policies should be flexible to permit collaborative and innovative solutions. Because of the inherent complexity, few solutions will adhere to a set resolution.

GATT's dispute resolution mechanism adheres to these principles.²⁸ The process begins with a sixty-day bilateral consulting and mediation session. During these sessions, the disputants seek a mutually agreeable resolution. This represents the flexible and individual approach. If the disputants fail to reach agreement, the WTO's Dispute Settlement Body establishes a panel. The panel is independent of the disputants. Typically, panel members are former GATT representative and experts in

²⁸ NAFTA provides an analogous dispute resolution mechanism for North American trade.

trade matters.²⁹ The panel meets with the disputants, examines facts, and hears arguments and rebuttals. Upon completion of its work, the panel issues its recommendation. The panel process represents an objective and investigatory mechanism. Disputants dissatisfied with the panel's recommendations can turn to the WTO's Appellate Body. Again, the Appellate Body is independent. When the appeals process concludes, GATT assumes prompt compliance. Disputants failing to adhere to the recommendations are subject to retaliatory sanctions. These sanctions provide the compelling force to induce compliant behavior. Thus, GATT's dispute resolution process contains a flexible component, a formalized organization, and sanctions.

While GATT, GATS, and NAFTA provide mechanisms and organizations, individual parties handle most monitoring and dispute resolution.³⁰ The WTO's

While all parties to disputes under GATT, GATS, and NAFTA will desire full compliance from all other parties, only those parties with sufficient resources will be in a position to seek redress.

Secretariate handling monitoring and dispute resolution is small—approximately 450 staff members in 1995—and NAFTA's Trade Commission is more supervisory in nature. Thus, individual parties perform most of the work. This poses critical equity concerns. While all parties to

disputes under GATT, GATS, and NAFTA will desire full compliance from all other parties, only those parties with sufficient resources will be in a position to seek redress. Thus, it is not surprising that of the fifty-six GATT Dispute Settlement Body panels, the United States, the European Union, Canada, or Japan requested thirty-five (62.5 percent) panel proceedings.³¹ Of the remaining, most were initiated by other large parties, notably Brazil, Mexico, and Australia.

²⁹ Hoekman and Kostecki, 47.

³⁰ Ibid., 13.

³¹ Ibid., 278-280.

Concluding Lessons

While the 1996 Act's MFN provisions appear to encourage market access and competition, guaranteed results toward that end are not certain. Clearly, Congress desires resale and facilities based competition. Interconnection provides a mechanism through which competing providers can offer full telecommunications services. With the MFN provision, all providers, including the incumbent LEC's affiliates, incur similar rates, terms, and conditions. However, these conditions do not necessarily guarantee full and fair competition. Thus, industry regulators must proceed cautiously.

While each industry is different, several critical lessons emerge from research in other industries and the international trade arena. These lessons concern competition and organizational issues.

- **The competition-inducing efficacy of MFN clauses depends upon the industry market structure.**

In competitive markets, MFN clauses encourage fair competition and economic efficiency. In concentrated markets, MFN clauses encourage tacit collusion, reduced competition, and higher prices. These conditions are especially harmful to small, relatively unknown firms seeking market penetration. Given the current telecommunications industry

State public regulatory commissions must serve a role analogous to the GATT's Dispute Settlement Body panels. Failure to fulfill this organizational role will hinder competition, especially competition resulting from relatively small firms.

structure (local service monopoly and long distance oligopoly), industry regulators must remain vigilant for potential anticompetitive behavior.

- **Industry regulators, especially state public utility commissions, must serve an important institutional role.**

As the GATT structure illustrates, a strong institutional structure for monitoring and dispute resolution is essential. State public utility commissions must perform important surveillance actions. By facilitating transparency, surveillance enhances the effectiveness of MFN clauses. Further, state public regulatory commissions must serve a role analogous to the GATT's Dispute Settlement Body panels. That is, state public utility commissions are independent arbitrators under the 1996 Act. Failure to fulfill this organizational role will hinder competition, especially competition resulting from relatively small firms.

The 1996 Act fosters great hope for a new, competitive telecommunications era. Interconnection is an important component in a competitive telecommunications industry. However, the MFN provisions of the interconnection sections pose several challenges. To ensure the 1996 Act fulfills its competitive promise, state public utility commissions are well placed to ensure that potential anticompetitive behaviors do not arise from the MFN provisions.