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Privatization and Strategic Alliances in Latin American Telecommunications:

Legal and Contractual Issues that Impact the Business Plan

Emily S. Barbour1

I. Introduction.

In the late 1980s and early 1990s, the telecommunications industry in Latin America experienced explosive growth driven by the demand for basic and enhanced services.2 This dynamic growth reflects the forces of technological advancement, market globalization, privatization,3 deregulation4 and liberalization.5 These political and eco-

1. Emily Barbour is an independent practitioner and principle of the law firm Emily S. Barbour, P.C., Dallas, Texas. She practices in the area of international business transactions, with emphasis on foreign strategic investment of telecommunication service providers.

2. In Argentina, before the privatization, pent up demand was such that a telephone customer might wait from five to ten years for installation of a phone line. LATINFINANCE, ARGENTINA: THE SILVER GIANT 114 (1996). See also, Melissa Tomlinson, Latin American Telecommunications: A Study of Deregulation and Privatization in Argentina, Chile and Mexico (1st ed. 1995) [hereinafter Deregulation Study]; Lisa Sedelnik, Spanish Invasion, LATINFINANCE, June 1996, 32, 34; David Swafford, Great Potential: Global Players See Latin American Telecommunications as a Major Growth Market, LATINFINANCE, July/Aug. 1996, at 66.

3. Privatization occurs when the government sells part or all of the shares in the telecommunications entity to private investors. Eli Noam, TELECOMMUNICATIONS IN EUROPE 61 (1992).

4. Noam, supra note 3, at 62. Deregulation can mean a lowering of entry barriers and other restrictions. It can also mean a reduction in red tape and government involvement.

Nomic trends have permitted strategic investors from the United States and Europe early and considerable market access in Latin America. Facing maturing markets in domestic operations, foreign investors have sought to acquire assets at prices perceived as undervalued and to develop growth opportunities in international markets.

Although every Latin American government may differ in its approach, timing, and vision for the sector's structure, the general trend in the telecommunications sector in Latin America is advancement in stages from state-owned monopoly, to private "transitional monopoly," and, finally, to competition. The telecommunications sector in various Latin

6. From the United States, Southwestern Bell is a strategic investor in Mexico's Telefonos de Mexico ("Telmex") privatization. GTE and AT&T are investors in Venezuela's CANTV.

7. From Europe, Telefónica de España is a strategic investor in the following privatization transactions: Chile's CTC, Telefónica de Argentina, Venezuela's CANTV, Puerto Rico's TLD and Telefónica de Peru. France Telecom is an investor in Mexico's Telmex and Telecom Argentina. Stet (Italy) is also a strategic investor in Telecom Argentina. See Santillana, supra note 5, at 5. In late 1995, Entel-Bolivia accepted a capital infusion of US$610 million from Stet (Italy) for a 50% equity stake and management. Jorge A. Segura & Jeffrey W. Barry, Current Trends and Developments in Privatization, LATINFINANCE SUPPLEMENTS: CORPORATE FINANCE IN LATIN AMERICA 1996, at 31.

8. Tomlinson, supra note 2, at 3; Santillana, supra note at 5.


10. See SBC COMMUNICATIONS 1995 ANNUAL REPORT 12, 29 (1996); GTE 1995 ANNUAL REPORT 15 (1996). The rapidly growing economies of some Latin American countries create substantial demand for telephone service. Low penetration rates among potential telephone users create unsatisfied demand for basic telephone services. In addition, other services such as cellular and wireless service, value-added services, data transmission and public pay telephones may not be fully exploited by the telephone company prior to privatization. During the post-privatization exclusivity period granted in the concession agreement, the privatized company can build its system with limited competition. These factors combined present significant growth opportunities for the winning consortium in the privatization bid. See generally, Victoria Griffith, A Tough Connection, LATINFINANCE May 1996, at 30, 32; David Swafford, Great Potential, LATINFINANCE July/Aug., at 66, 68, 70.
American countries has reached different stages of development. The entry of foreign strategic investors into a Latin American country that is opening its telecommunications market may be viewed as occurring in three stages: (i) the privatization/monopoly stage; (ii) the strategic alliance stage; and (iii) the competitive entry stage.

In the privatization stage, a lead strategic investor and its consortia acquire an equity stake in the state-owned telecommunications company. In most Latin American telecommunications privatizations the pivotal event in the privatization stage has been the competitive bid to acquire operational control of the privatizing company. After privatization, generally the privatized company enjoys an "exclusivity period" during which the privatized company enjoys exclusive service.

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12. While these stages of market entry are used here for discussion purposes, in actuality, they overlap. Activities of a strategic investor that generally take place in one stage may sometimes occur during another stage. The order of events depends partly upon the market entry strategy of the investor and partly upon the occurrence of certain events, such as the capitalization of a new venture company by its partners and the granting of a concession from the government to operate a public telecommunications service.

13. The "exclusivity period" is also sometimes called a "transition period," hence the concept of a transitional monopoly after the privatization bid and before the entry of competition in the market for protected services. The duration of the exclusivity period may vary, as may the services reserved exclusively to the privatized telephone company.
which that company is the only concessionaire authorized to offer basic services such as local telephone service, national long distance and international toll.\textsuperscript{14} The exclusivity period is usually characterized by modernization and expansion of the telecommunications system and improvements in availability and quality of service.

During the second stage, new competitor companies form as a result of strategic alliances formed in and by the private sector. New competitors are often consortia of in-country, local partners who interrelate in and know the local business environment and foreign strategic investors, including telecommunications companies with technical and managerial expertise and financial partners. The negotiation of strategic alliances generally begins during the exclusivity period while the privatized company is still protected. The formation of joint ventures and associations between Latin companies and their foreign partners may be lengthy and complex, particularly when there are multiple parties on both sides of the venture. Companies sometimes undergo negotiations with more than one partner before finding the right fit. Before the commencement of competitive services, two or

\textsuperscript{14} Argentina, Venezuela, Peru, Puerto Rico and Bolivia are examples of countries in the privatization/monopoly stage. In Argentina, the monopoly concessions of privatized Telefonica, Telecom and Telintar expire in November 1997, but under current law can be renewed until 2000. Many law makers and politicians support the introduction of full competition in 1997, and will be debating legislation to reform the telecommunications industry, according to Juan Manuel Valcarcel, Chairman of the Communications Committee of the Argentine House of Representatives. \textit{See} Juan Manuel Valcarcel, \textit{Calling Someone in Argentina? Dial M for Monopoly}, \textit{Wall Street Journal}, August 16, 1996, at A9. \textit{See also}, Alejandra Herrera, \textit{The Privatization of Telecommunications Services - The Case of Argentina}, Vol. 28 \textit{Columbia Journal of World Business} No. 1 (Spring 1993) [hereinafter \textit{Case of Argentina}]. In Venezuela, CANTV was partially privatized in 1991 when the VenWorld consortium, led by GTE, bought 40% of CANTV's stock. The Venezuelan Investment Fund and Lehman Brothers/S.G. Warburry have signed a contract for the placement of the remaining government-owned CANTO shares in the international markets. \textit{National Trade Data Bank, Int’l Trade Mkt.}, IM 906701.019 (June 28, 1996). CANTV will continue to be Venezuela's exclusive provider of basic telecommunications services until the year 2000. \textit{See} \textit{Global Telecoms Business: The Americas Yearbook} 55 (Edward Russell - Walling et al. eds., 1996). In 1994 a consortium led by Telefónica de España bought controlling stakes in each of Peru's state-owned local and long distance companies. Telefónica del Peru was then formed by the merger of those companies. The Peruvian government completed its telecommunications privatization process in July 1996 by selling the remaining 29% government stake in a $1.1 billion international stock offering. Thomas T. Vogel, Jr., \textit{Peru's Telefónica Concludes $1.1 Billion Global Offering}, \textit{Wall Street Journal}, July 2, 1996, at A8; 1996 \textit{Latin Financing Review}, No. 79 \textit{LatinFinance}, July/Aug. 1996, at 60-61. Telefonica del Peru's privatized monopoly in the long distance and local markets is scheduled to open to competition from June 1999 onwards. \textit{See National Trade Data Bank, Int’l Trade Mkt.}, IS 970716.276 (July 19, 1996); \textit{Global Telecoms Business, supra}, at 37, 45. In Puerto Rico, Telefónica de España acquired a 79% stake in Telefónica Larga Distancia de Puerto Rico ("TLD") in the 1992 privatization. Currently PRTC has a monopoly on local service and TLD has a monopoly on long distance services. \textit{Id.} Stet, the Italian state holding company, bought 50% of Bolivia’s Entel in 1995. The privatized telecommunications company has a monopoly on long distance, paging, cable and cellular services for six years. \textit{Id.} at 9.
more strategic alliances that would otherwise compete in the opening market may combine to create a larger and more powerful presence in the market place.\textsuperscript{15} One critical event that characterizes the strategic alliance stage is the execution of joint venture agreements and association agreements among consortia of local and foreign partners.

In the competitive entry stage,\textsuperscript{16} new competitor companies implement their business plans, commence operations and emerge in the market place to provide competitive services. This stage may begin a year or more before the expiration of the monopoly period and continue as competition is permitted in the market place. This stage is characterized by the execution and performance of contracts between the partners in the new competitor company relating to the operation of the company, the application to the telecommunications regulatory authority for the requisite concessions and authorizations to provide telecommunications services\textsuperscript{17} and, most importantly, the offering of services.

In each of the privatization/monopoly stage, the strategic alliance stage and the competitive entry stage, specific legal and contractual issues impact upon the business plan and the financial viability of the investment. These key issues generally apply to all participants who seek to enter the market in a given country at that particular stage of development of the sector. Transactional counsel to a strategic investor in telecommunications in the Americas coordinates closely with business executives and in house counsel about these issues and their impact on the valuation of the investment opportunity and the business plan.

This article discusses telecommunications privatization, strategic alliances and start up operations of emerging competitor companies in the Americas. It examines, with respect to each stage of sector development, certain laws, regulations and contractual obligations that create critical issues for potential strategic investors who seek to enter the market during that stage. It identifies factors that can make the investment a viable opportunity for the foreign investor, and cites as examples the experiences of some major investors in several Latin American countries. Finally, it analyzes how the legal and contractual framework impacts the financial projections and business plan of the strategic investor in each stage, in effect, driving the investment decision.

\textsuperscript{15} For example, during the strategic alliance stage following the Mexican privatization, GTE Corporation of the United States and Mexico's Grupo Financiero Bancomer and its sister company Valores Industriales in early 1995 formed one venture, Unicom Telecomunicaciones, to enter the Mexican telecommunications market and compete in long distance services effective in August 1996. AT&T and Mexican Grupo Alfa had negotiated a separate venture, known as Alestra. In April 1996, the companies released the news that Unicom would combine with the Alestra venture to form one telecommunications powerhouse. \textit{See} Craig Torres, \textit{Mexican Phone Competition Heats Up}, \textit{Wall Street Journal}, April 23, 1996, at A18; \textit{New Lines of Communication}, \textit{Dallas Morning News}, April 23, 1996, at 1D.

\textsuperscript{16} Chile and Mexico are in the competitive entry stage. For a detailed discussion of the companies entering Mexico's telecommunications market in January 1997 to compete in long distance and other services, see Stephen I. Glover & JoEllen Lotvedt, \textit{The Mexican Telecommunications Market—The Interplay of Internal Reform and NAFTA}, \textit{NAFTA: Law and Business Review of the Americas} [hereinafter \textit{Mexican Telecommunications Market}], supra at 23.

\textsuperscript{17} \textit{Id.}, at 30 (discussion of the concessions to operate as public telecommunications service providers recently granted in Mexico.) \textit{See also} \textit{Mexico Telecom Partnerships Forming Rapidly}, \textit{Inter-American Trade and Investment Law}, June 14, 1996, at 602, 604.
II. Privatization.

The privatization process in Latin American telecommunications began in the late 1980s, and continues to progress. The privatization trend serves to implement governmental objectives that include obtaining massive capital infusion, reducing country debt, introducing competition in the telecommunications sector, eliminating employees from government payrolls, increasing business efficiency of telecommunications companies, expanding and updating networks, improving service and benefitting from technical expertise of international operators.

18. Chile was the first Latin American country to privatize its state-owned monopoly telephone companies. In 1988, Compania de Telefonos de Chile S.A. and Empresa Nacional de Telecomunicaciones S.A., respectively, Chile's largest government-owned local and long distance telephone companies, were sold to the private sector. Tomlinson, supra note 2, at 4. See generally, Sale of the Century, WALL STREET JOURNAL, October 2, 1995, at R1-R4.

19. Supra notes 11 and 14. Despite the actions of some governments in preparing for privatization, some commentators predict that the privatization process in Latin America will encounter obstacles, such as (1) a lack of properties for sale as attractive as those initially offered, (2) the Mexican peso devaluation of 1995 and the perception of economic instability that it caused, even with respect to other countries in Latin America, and (3) political instability in certain countries. Gizang & Pacheco, supra note 9, at 269. Other commentary suggests that because of the passage of the United States federal telecommunications bill in February 1996, United States telecommunications giants will forego international expansion in favor of new opportunities to compete in domestic local and long distance markets and to consolidate in mergers. See, e.g., Home is Where the Heart is for US Telcos, GLOBAL TELECOMS BUSINESS, June/July 1996, at 17.


21. For further discussion of governmental objectives for privatization, see GLOBAL TELECOMMUNICATIONS POLICIES: THE CHALLENGE OF CHANGE 152 (Merheroo Jusswalla ed., 1993), (comparing the rationale for telecommunication privatization in Chile, Argentina and Mexico); Jorge Kunigami Kunigami, Presentation Paper for Latin American Telecommunications: Opportunities for Investment, Trade and Development (presented by the Institute of the Americas in cooperation with the U.S. Commercial Service and the Organization of American States), Nov. 2-3, 1995, (Chairman of the Board of the Peruvian telecommunications regulatory body, OSIPTEL, noting governmental objectives including expansion and improvement of the quality of service, promotion of private investment, change from monopoly to free competition, investment in rural telecommunications, rebalance tariffs and contribute to belief and investment in the national economy) [hereinafter Kunigami Paper]; Thomas J. Casey & Simone Wu, Telecommunications Privatizations: An Overview, 17 HASTINGS INT'L & COMP. L. REV. 781, 782-84 (1994); Scott Beardsley and Michael Patsalos-Fox, Getting Telecoms Privatization Right, THE MCKINSEY QUARTERLY 1995 NUMBER 1; Tim Taylor, The Ring of Success, LATIN FINANCE SUPPLEMENTS Jan.-Feb. 1995, at 28. See generally, COMISION DE PROMOCION DE LA INVERSION PRIVADA (COPRI), LA PRIVITIZACION EN EL PERU, VERSION REVISADA 8 (April 1993) (explaining the Peruvian government's objectives for its multi-sector privatization program); Gizang & Pacheco, supra note 9, at 267.
The legal form of a privatization depends upon the government's objectives. In Latin America, a primary goal has been the modernization and expansion of the telecommunications infrastructure with the technical experience of an international operator from the United States or Europe.\textsuperscript{22} The experienced operator and its consortia are uniquely positioned to develop the infrastructure to maximize the value of the privatized telephone company. The sale of a controlling interest in the privatized company to a pre-qualified\textsuperscript{23} operator, through private negotiation, or, more commonly, international bid, is the legal form of privatization that best meets these objectives.

For a privatization to succeed, the privatized company must present a sound investment for the pre-qualified bidders. Buyers seek an economically attractive investment in a stable legal and political regime. Officers and directors of the strategic investor base the investment decision on the recommendations of the team that performs due diligence and evaluates the opportunity. That team formulates a base case scenario along with multiple alternative scenarios that incorporate drivers based upon assumptions about variables such as order backlog, demand and risk-adjusted cost of capital, to project earnings. The team then arrives at a valuation of the company based upon the projected future revenue stream discounted to present-day value and the terminal value of the privatized company's assets. Conditions in the enabling legislation, minimum bid price, assumption of debt, restrictions on tariff increases and requirements to retain employees after privatization are some examples of factors that impact both the decision whether to bid and the investor's valuation of the opportunity.

\textsuperscript{22} Santillana, supra note 5, at 4. Ignacio Santillana, chief executive officer of \textit{Telefónica Internacional}, the dominant strategic investor in Latin America telecommunications operations notes that, “Before the privatization of their telephone operators, most Latin American countries had few telecommunications services. Besides Argentina, none of the countries had penetration levels of more than 10%; long waiting lists and obsolete networks were commonplace. With privatization most of these problems were solved when major international telephone operators initiated significant capital expenditure programs and brought in new management methods to these previously inefficient and unprofitable companies.” \textit{Id}.

\textsuperscript{23} In the case of international public bid, the government usually requires potential bidders to "prequalify," by meeting criteria as to technical experience and financial capability before participating in the due diligence review of the company or companies being privatized.
A. IMPACT OF LEGAL AND REGULATORY FRAMEWORK ON VALUATION.

During the due diligence period, pre-qualified bidders usually have the opportunity to negotiate aspects of the legal and regulatory framework in which the privatized company will operate. In Latin America, the privatized telephone company and the government generally enter into a concession agreement. The government provides the pre-qualified bidders successive drafts of the concession for review and comment, usually during the due diligence review of the telephone company. Changes that are negotiated in the concession affect the bidder's view of the opportunity and the valuation of the company. Other issues upon which the prequalified bidders may comment include portions of the telecommunications act and implementing regulations, rules governing the formation and powers of the independent telecommunications regulatory authority and interconnection regulations and the concession agreement. The outcome of these negotiations also impacts the potential bidder's assessment of the investment opportunity and, therefore, its bid amount.

24. A company preparing for privatization usually secures the legal and financial audit of independent advisors before prequalified bidders undertake due diligence review of the company. Nevertheless, the potential bidder and its consortia make a thorough investigation of the company undergoing privatization. The legal review of the company may include, without limitation, material agreements, including existing concession agreements of the company undergoing privatization, concessions in effect or promised to other companies, interconnection agreements, and supply contracts (see infra note 63), pending litigation and contingent liabilities, labor matters including collective bargaining agreements and labor environment, severance obligations, insurance, intellectual property, real property, environmental liabilities, tax liabilities, foreign debt exposure and settlements among carriers. Local "in country" counsel is important in the review of the privatized company. The prequalified bidder must formulate a plan for the management of significant legal exposures. In addition to the company, the prequalified bidder and its advisors review the legal and regulatory environment. This review includes, without limitation, the constitutional framework, the privatization law, the foreign investment regime (including matters such as repatriation of capital, technology transfer, legal stability, registration of investment and investment insurance), expropriation law, import laws, antitrust law and regulation, securities law, telecommunications law and regulations, corporate law (including type of legal entity and applicable law, shareholders, corporate control, directors, general managers, external auditors, accounting and disclosure requirements and merger law), tax laws (including income tax law, equity tax, if any, value-added tax, municipal taxes, real estate taxes and import duties) and labor and collective bargaining laws (including right to work, hiring foreigners, salary and benefits, labor relations law). Finally, the prequalified bidder reviews the transaction structure. This evaluation covers, among other things, the stock purchase agreement, control issues, and the corporate structure of the company being privatized. If more than one company is for sale in the privatization (such as the local and long distance companies), then the prequalified bidder will also evaluate any plans for post-sale merger or consolidation of the company or companies being privatized in light of the corporate laws and any restriction that the government might place upon the powers of the privatized company to consolidate.

25. Prequalified bidders also have the opportunity to negotiate the stock purchase agreement and ancillary sale documents. The focus of this analysis, however, is the legal and regulatory framework in which the privatized company will operate.
B. AUTHORIZED SCOPE OF BUSINESS.

Because it defines, among other things, the scope of business, the concession is important in valuing future earnings of the business. The strategic investor generally favors broad definition of the services that the privatized company will be authorized to offer. Both the strategic investor and the public consuming the services stand to benefit if the authorized scope of the privatized company's business includes new services created by technological developments in telecommunications, and the carrier system infrastructure is permitted to consist of and utilize all forms of telecommunications media. The concession agreement (or the telecommunications law and regulations) should clearly define the authorized services. Clarity of definition of services avoids confusion between basic services that are protected during the exclusivity period and competitive services.

C. COMPETITION.

The effectiveness of restrictions on competition during the exclusivity period assures the economic viability of that period. The privatized company relies upon an exclusivity period during which the competitive boundaries are strong enough to control competitive entry so that the operator may direct and concentrate its capital and human and technical resources on expanding and modernizing the network. Successful infrastructure expansion and modernization to ensure broad coverage of service mutually benefits the operator and the customer base. The broader the coverage of service to all sectors of the economy, the stronger an economic driver for the country the telephone system becomes.

The exclusivity period is particularly important where local service is drastically underpriced and subsidized by national and international long distance service. If competition is allowed in the national and international toll markets, the telephone company risks rapid loss of customers and revenue streams needed to develop the basic telecom-

26. As part of the Peru telecommunications privatization, three concessions were signed, each of which contained expansion mandates. The Telefónica consortium is required to invest an additional $1.5 billion in the telecommunications infrastructure through 2000. Sedelnik, supra note 20, at 18.

27. The concession agreement typically requires the concessionaire to expand and modernize the network and advance line penetration as a condition of the concession. In Mexico, Telmex was required to expand the number of lines in service 12% each year between August 1990 and December 1994. Deregulation Study, supra note 2, at 2. For further discussion of modernization requirements associated with Mexico's telecommunications privatization, see Rafael X. Zahraldin & C. Todd Jones, Venture Capital Opportunities and Mexican Telecommunications After the Passage of NAFTA and the Ley de Inversion Extranjera, 20 DELOJ.CORPL.899, 921-24 (1995), and Brent Lee Vannoy, Mexican Telecommunications: Privatization and NAFTA Open the Door for U.S. Expansion into Mexican Markets, 17 HOUSTON J. INT'L L. 309, 321-22 (1994).
munications infrastructure. The host country receives massive investment in the telecommunications infrastructure and improved service upon which a competitive market may be built in exchange for the protected period.

The investment is more attractive when the rules clearly state (i) when and under what circumstances the government will permit additional concession holders to build network infrastructures in competition with the privatized company and (ii) what services are permitted to be provided through the competing infrastructure. If the government has issued or promised concessions to other public telecommunications services providers, the government should disclose the terms of those concessions to potential bidders as part of the due diligence. The concession may be negotiated so that the government has the right to grant other concessions during the exclusivity period only if the privatized company is unable or unwilling to provide the services. After the exclusivity period, other concessions for public telecommunications services should be nondiscriminatory and on terms no more favorable than the terms granted to the privatized company.

D. MODERNIZATION, EXPANSION AND SERVICE QUALITY MANDATES AND PENALTIES.

The concession agreement usually contains important mandates for network expansion and modernization. The consequence of not meeting the mandates may be cash penalties or even cancellation of the concession. The prequalified bidder will negotiate that penalties for failure to meet performance operations should not apply if the cause of the failure is events beyond the control of the concessionaire, such as a delay in switch deliveries. In any event, the time period for installation of new equipment and expansion of the network should be reasonable while consistent with governmental objectives to develop the country's telecommunications infrastructure.

Since expansion mandates are government projections, they may not reflect demand. Actual market demand for expanded service may be less (either overall or in certain locations) than the mandated quantities. Investment of capital and technology in excess of actual and projected demand wastes valuable resources. Therefore, the investment represents a more valuable opportunity to the strategic investor if the privatized company is deemed to meet the expansion mandates so long as it satisfies market demand.

28. Latin American governments have to weigh the perceived advantages of introducing competition against the need to protect profits that finance the extension of their networks to poorer and more remote citizens. Latin American Telecoms Half-Way There, THE ECONOMIST, (Feb. 4, 1995) 62, at 63. In Argentina, the government granted Telecom and Telefónica monopolistic powers for the provision of international telephone and data transmission, even as those companies controlled basic domestic services. Herrera, supra note 14, at 51. The explicit goal of the concessions was to allow the companies to pay for network expansion through cross-subsidies from international services to domestic services. Id. The concession agreements require the domestic service companies to use the surplus from the international services company to meet modernization and expansion goals. Id.

29. See supra note 24.
The concession agreement also usually contains service quality mandates. Frequently the pre-privatization state-owned telephone company will not have kept accurate records with which to measure existing quality levels, so the base line from which to measure quality improvement is unclear. In such case, the first year of privatization may be used to accurately measure quality levels and agree upon starting points for quality improvement. Contractual penalties for failure to meet service quality mandates should not be excessive or greater than the value of the services being provided. The amount of the penalty is an important factor, since excessive penalties pose a significant financial risk that can undermine the valuation of a privatization opportunity.

In addition to penalties for failure to meet expansion, modernization and service quality requirements, the concession may authorize the government to levy fines against the privatized company for other breaches of the concession agreement. Grounds for imposition of these penalties may include, for example, the unauthorized transfer of the concession agreement, the engagement of the privatized company in unfair competition, the occurrence of unexcused service interruptions, the charging of amounts higher than approved tariffs, the failure to pay taxes or concession fees, the violation of labor law or collective bargaining agreements, and other material breaches. Penalties present less risk to the concessionaire if the concession agreement provides for written notice of violations and an opportunity to cure the breach before the government imposes the penalty. If the concession imposes penalties for breach of its terms, then to avoid penalizing the operator twice, it should also provide that in a suit for damages for breach of the concession agreement, recovery will be limited to actual damages. In general, penalties in the concession agreement should not duplicate penalties already provided in the telecommunications laws and regulations.

E. Fees.

Another important concession issue is the taxes, royalties and fees that the concessionaire is obligated to pay. One such fee is the concession fee for the right to commercially operate public telecommunications service. One negotiation point is the computation of the fee: whether it is a percentage of net revenue actually collected or of gross revenue invoiced. Monies that the concessionaire collects on behalf of other telecommunications service providers under interconnection agreements should be excluded from the computation of net revenues. Another issue that the prequalified bidder may negotiate is whether the fee will be assessed only upon final services or upon all services authorized in the concession agreement (other than interconnection charges). The prequalified bidder is also concerned with whether the fee to operate public telecommunications service applies to services for which the law imposes a separate fee, such as a fee for the use of the radio-electric spectrum.

To finance the supply of telecommunications services in rural and social interest areas, the government may assess a fee computed as a percentage of revenues from
telecommunications services. In such cases, the states may require the concessionaire to contribute that fee to a telecommunications investment fund. The same issues discussed in connection with concession fees in the preceding paragraph apply with respect to telecommunications service fund fees. The pre-qualified bidder may also negotiate for a right of first refusal to develop, install and operate projects using monies in the telecommunications investment fund. In any event, the prequalified bidder may negotiate for a contractual commitment that the government will allocate penalties paid by the privatized telephone company for the failure to satisfy modernization, expansion and service quality mandates to the telecommunications investment fund instead of to the general coffers of the telecommunications regulatory agency or the general treasury.

The fees provided in the concession should generally be consistent with the telecommunications act and regulations. As the government and pre-qualified bidders negotiate the concession and regulatory structure, sometimes not all changes are incorporated consistently throughout the entire scheme at the same time. If the basis for fees contained in the concession agreement differs from the basis in the act and regulations, clarification is in order.

F. GOVERNMENTAL RIGHTS TO UNILATERALLY MODIFY AND TERMINATE THE CONCESSION.

The ability of the government to unilaterally modify the concession, and the circumstances under which the government may terminate the concession are also critical. Unilateral changes based on a political perception of the "public interest" create risk for the strategic investor and lower the valuation of the investment opportunity. Modifications to the concession should result in a corresponding financial compensation to the concessionaire and the elimination of concession obligations.

The strategic investor seeks assurance that the government cannot terminate the concession or eliminate concession rights except under clearly defined circumstances. The only grounds upon which the government may exercise an early termination option should be the concessionaire's failure to meet material and specifically delineated criteria, and not based upon vague standards. The concessionaire's failure to achieve expansion mandates should not be grounds for early termination if the mandates exceed actual market demand.

30. In Peru, for example, art. 12 of the Ley de Telecomunicaciones provides that operators of carrier services and final public services must pay a percentage of the total annual billing to the Fondo de Inversión de Telecomunicaciones ("FITEL"), a fund for telecommunications investment. The fund serves solely to finance telecommunications projects for rural areas and locations of social interest. art. 214 of Peru's Regulamentos de la Ley Telecomunicaciones provides that the fee is 1.5% of the total annual gross income for each year. Regulamento de la Ley Telecomunicaciones (1993) (Peru). The FITEL fund serves one of the government's stated objectives in its restructuring of the telecommunications sector: promotion of investment in rural telecommunications. See Kunigami paper, supra note 21.
Termination rights are more acceptable to the investor if they provide for written notice and a reasonable opportunity to cure any breach.

G. RATE REGULATION.

Rate regulation and the rebalancing of tariffs is an important part of preparing the privatized company and the market for the introduction of competition. The rate structure in most pre-privatization Latin American countries is similar to that in the predivestiture United States: rates for high-cost services such as local telephone service are below the cost of supplying the service. Local service is subsidized by national long distance and international toll services, subjecting the latter to competitive vulnerability.

To regulate rates, the regulator may use a price cap regulatory regime. During the transition period, services are divided into baskets and an average weight is established for each regulated service. After the transition period, the regulator applies a price cap formula to establish the maximum permissible price (the cap) for the weighted average of rates in each basket. Rates for other services may be set by the privatized company in accordance with maximum fixed prices established by the regulator.

Most countries restructuring their telecommunications regulatory systems have attempted to separate the provision of domestic services from international services. The theory supporting separation of services is that earnings from international service have always financed the development of the domestic network and it is not fair for some users to subsidize others. The new arrangement is intended to reduce the price of international calls.

Similarly, cross-subsidies can exist between services reserved exclusively to the privatized company and competitive services. Under rate-of-return regulation, the costs of providing a service that the privatized company reports to the government are recoverable through the rate charged for the service. If the imbedded carrier also offers competitive services (such as value-added services), regulators seek to prevent the privatized

31. Traditional rate regulation is based on rate of return. The carrier is permitted to establish its rates at a level that will return revenues sufficient to cover costs plus a reasonable return on investment. Because rate of return regulation effectively guarantees the carrier’s recovery of all costs, it can inflate rates by encouraging over-investment. Regulators have adopted the price cap (or incentive) system of regulation to replicate the cost savings aspects of a competitive environment. See Charles H. Kennedy & M. Veronica Pastor, AN INTRODUCTION TO INTERNATIONAL TELECOMMUNICATIONS LAW (Artech House 1996), at 156-157.
32. Id.
33. Id.
34. Herrara, supra note 14, at 51. The Argentine case, however, runs counter to international trends, in that the expansion of the network is being financed through cross-subsidies.
35. Id.
36. Id.
company from allocating the cost of competitive services to the reported costs for reserved services. The regulator seeks to prevent the privatized company from recovering misallocated costs for competitive services from the monopoly ratepayers and from distorting fair competition.

From the viewpoint of the strategic investor, the investment opportunity is attractive where the concession company will have the maximum flexibility to reduce costs, adjust prices, expand services and offer new products. The pre-qualified bidder will favor a rate regulation structure that permits the concession company to offset price reductions in services burdened with cross-subsidies with increases in under-priced services. In negotiating the rate regime, the prequalified bidder also seeks protection from inflation with language in the section of the concession agreement pertaining to rates that permits rate increases to offset inflation.

H. INTERCONNECTION.

Another important factor relating to the introduction of competition is the right of new market entrants to interconnect with the network of the privatized dominant carrier. Usually the government promulgates regulations to provide for competition to develop fairly in the market. The dominant carrier is legally required to provide other public telecommunications service providers and cellular operators access to its switching and transmission facilities. These requirements may appear in the telecommunications

38. Id.
39. Regulators have addressed this situation in several ways. One way is to prohibit the privatized company from providing competitive services. This solution can have the unwanted effect of lessening availability of services in the face of consumer demand. Another solution is to permit the privatized company to offer competitive services only through separate subsidiaries with their own personnel, facilities and accounting ledgers. This scenario raises the cost to the privatized company of providing competitive services because of the duplication of staff and facilities. While more attractive than preventing the privatized company from offering competitive service, this approach may actually create economic inefficiencies. A third method is to allow the same organization that provides reserved services to provide competitive services, but to require separate cost accounting. This solution allows the privatized company the greatest flexibility to provide competitive services and meet market demand at market prices. See generally id. at 157-158.
40. In Peru, for example, the dominant carrier and the carrier seeking interconnection have 60 days to negotiate an interconnection agreement. Once the agreement is signed, the telecommunications regulator, Organismo Supervisor de Inversion Privada en Telecomunicaciones ("OSIPTEL") has 30 days to agree or require the parties to modify the agreement. If the 60 day period expires and the parties have not agreed about the interconnection terms, then OSIPTEL will issue an interconnection regulation. Either party may request OSIPTEL to participate in the negotiations to contribute to the understanding and agreement of the parties. See Regulamentos de la Ley Telecomunicaciones art. 110 (1993) (Perú).
act, the implementing regulations and the concession agreement.

Interconnection is a mechanism through which the dominant carrier may establish limits to increased competition. Because the dominant carrier can impose unfavorable terms on emerging competitors, in the United States interconnection technology and fees are highly regulated. By contrast, the trend in the Latin American approach to interconnection is to permit competing carriers to privately negotiate an interconnection agreement in accordance with certain parameters established in the regulations. If the parties do not agree within a specified period of time, then the regulator will establish the terms and conditions of interconnection (including rates) and publish an order or regulation containing the terms.

In negotiating interconnection rules, the dominant carrier seeks a framework that permits it to charge an interconnection fee that includes its fully allocated costs in providing the interconnection and a contribution for the universal service obligation, and provides for a reasonable profit margin. Regulatory provisions governing interconnection arrangements are more attractive to the strategic investor if the regulator refrains from intervening unless either party requests intervention. Similarly, a framework in which the regulator reviews, but does not have approval of the interconnection agreement, is more attractive. At a minimum, the prequalified bidder will assert that regulatory approval should not be required for interconnection agreements that comply with approved tariffs.

I. THE LEGAL AND REGULATORY FRAMEWORK AS A WHOLE.

The concession agreement is a critical element in valuing the future earnings stream of the privatized company. Concurrently with the negotiation of the concession agreement, the government may also be enacting or fine-tuning the telecommunications act and regulations, as well as other laws that encourage private and foreign investment. To evaluate the investment opportunity and the risk, the prequalified bidder considers the concession in the context of the legal and regulatory framework as a whole. The interplay of the concession with the legal framework is also a factor in valuing the opportunity,

41. For example, in Peru, art. 109 of the Regulamento General de la Ley de Telecomunicaciones provides that interconnection agreements should address (1) interconnection capacity and provisions for future requirements, sufficient to permit reasonable quality transmission of traffic between networks, (2) interconnection points, (3) effective date and term of the interconnection, (4) matters affecting the signals transmitted and received, including routing arrangements, transmission, synchronization, signaling, numbering, rates, service quality, and telecommunications security, (5) guaranty of each party to maintain quality of services, (6) fees and economic terms of the interconnection and (7) periodic review of performance of contract conditions. Id.
42. Id.
43. See supra note 30.
especially if it appears that the privatized company might incur duplicative penalties or be subjected to the intervention of more than one regulatory agency for the same purported transgression.44

III. STRATEGIC ALLIANCES.

Although usually viewed as a less lucrative growth opportunity than winning a privatization bid, a foreign investor may form a strategic alliance with an in-country partner to compete with the embedded supplier upon the expiration of the exclusivity period.46 Since value-added services are usually not subject to the concession’s exclusivity-

44. For example, in addition to its antitrust law, Legislative Decree No. 701, pub. Nov. 7, 1991, effective July 19, 1992 (the “Antitrust Law”), Peru’s Telecommunications Law and Telecommunications Regulations contain antitrust provisions. The Ley de Telecomunicaciones, Decree Law No. 26096, published on May 6, 1993, contains several provisions of an antitrust nature. It states that services or final services, diffusion services and value-added services must be provided in free competition. See at Articles 14, 21, and 30. Art. 11 (relating to interconnection) provides that concessionnaires of carrier services guaranty free competition among all providers of final, diffusion and value added services. Art. 38 provides that providers of carrier and teleservice or final services must, if they intend to provide value-added services, guaranty that they will not use their status as providers of the former services to obtain advantages over other providers of value-added services, thereby impeding fair competition. Moreover, Ch. IV of Title II of the Telecommunications Law is fully devoted to antitrust issues. Art. 69 prohibits business practices that restrict fair competition and authorizes OSIPTEL to adopt corrective measures. The Regulamentos de la Ley Telecomunicaciones contain antitrust provisions similar to those found in the Ley de Telecomunicaciones. Art. 228 provides that OSIPTEL shall supervise and control the market for telecommunications services and adopt corrective measures. Article 229 specifies that “For what is not provided in the [Telecommunications Law] and the Regulations as relates to the prohibition of business practices that restrict free competition, there shall be applied the provisions of the Law against monopolistic practices that control or restrict free competition.” Id. One reading of this provision is that (1) with respect to antitrust matters, the Telecommunications Law, its Regulations and the Antitrust Law all apply to the telecommunications sector, and (2) both OSIPTEL and the Antitrust Division have a role in antitrust enforcement in the telecommunications sector, with the division of responsibility to be established.

45. Griffith, supra note 10, at 32 (Latin American telecommunications stocks are losing their clout due to maturation of the region’s markets and the industry and the introduction of competition). But see Great Potential, LATINFINANCE, July/Aug. 1996, at 66 (Even though privatization and increased competition has pushed profits of local telephone companies down, the growing technological capacity and volume of traffic in countries that have loosened regulations will benefit the entire sector and growth prospects are strong).

46. Glover & Lotvedt, supra note 16, at 30-34 for a discussion of the strategic alliances poised to enter Mexico's long distance market in January 1997. In Chile, the introduction of competition in long distance services triggered a price war. In response, some Chilean telecommunications groups have formed key international alliances such as the March 1996 announcement of a transaction between CTC and VTR owned by SBC Corporation and the Chilean Luksic conglomerate to pool resources in the mobile telephone business. Griffith, supra note 10, at 32. See also Scott Week & Maria Suarez, Dialing In: Competition Heats Up for Benchmark Latin Telecom Giants, LATINFINANCE, Jan./Feb. 1996, at 84-86.
ty, the strategic alliance may base its initial business on value-added services while it prepares to enter into competition with the dominant carrier upon the expiration of exclusivity of basic services. During this period, the strategic investor enters into a formal association with its local partner, forms the new joint venture company and develops its business plan. The likelihood of forming a successful strategic alliance increases when the investor finds one or more partners who negotiate an association or joint venture agreement satisfactory to all parties to the association.

A. CONTEXT OF THE STRATEGIC ALLIANCE.

As background, it is useful to consider the context in which the association arises. The United States or other foreign investor structures its partnership with a local

47. An important aspect of partner selection is locating partners with complementary skills, such as the association between foreign technological experts and domestic partners with access to local markets and knowledge. Another key factor is compatible corporate culture and philosophy, which includes symmetry in size of companies, financial capability, internal work environment, complementary management styles, performance measurement and correction mechanisms and mutual trust. The partners should share compatible goals and vision for the new business and should bear commensurate levels of risk. See Keith D. Brouthers, Lance Eliot Brouthers & Timothy J. Wilkinson, Strategic Alliances: Choose Your Partners, 28 Long Range Planning 18 (June 1995); Kenneth J. Fedor and William B. Werther, Jr., Making Sense of Cultural Factors in International Alliances, ORGANIZATIONAL DYNAMICS (Spring 1995), 33, at 41. For information about strategic alliances currently active in the Mexican telecommunications market, see Glover & Lotvedt, supra note 16, at 30-34; LATIN FINANCE SUPPLEMENTS: MEXICO: BUILDING FOR GROWTH 53 (Sept. 1996); Mexico Telecom Partnerships Forming Rapidly, supra note 17, at 602; Griffith, supra note 10, at 32; Torres, supra note 15, at A18.

48. The primary agreement (usually a "joint venture agreement" or an association agreement) governing the association of the parties is structured according to the needs of the business. It usually contains provisions relating to the formation and capital structure of the joint venture company and the identity of the partners. It also provides for financial aspects such as maintenance of books and records, financial reporting, audits, and profit distribution. Generally it will contain extensive provisions as to termination, transfers of interests in the venture to third parties, impasse, dispute resolution, and confidentiality of information. In addition, it may address governance issues such as consensus, arms-length dealings, election of directors and officers of subsidiaries. Discussion of treatment of all of the issues in the association agreement is beyond the scope of this paper, which concentrates upon legal and operational issues that impact most directly upon the business plan and operation of the new venture.
partner (often a major financial institution50 51 or business conglomerate). Because of the unreliability of the public telecommunications network, the local partner, more often than not, will own or lease a private telecommunications network that covers the entire country or all of the municipalities in the country where the local partner has operations, branches, or retail outlets. The new joint venture often will use that private network as a base upon which to build the network required to compete effectively with the dominant provider.

B. THE LOCAL PARTNER'S PRIVATE NETWORK.

The operation of the local partner's private network, its expansion, and its eventual disposition give rise to a plethora of legal and business issues. The joint venture agreement and ancillary documents address whether the existing private network will remain the property of the local partner or will be contributed to the venture. In the former case, the existing network must be defined in exhibits to the agreement so that new investments of the joint venture will not be confused with the property of the local partner in the event of a subsequent unwind of the venture. In the latter case, the parties must agree upon a fair valuation of the assets that the local partner will contribute, as well as consider the tax ramifications to the local partner and the joint venture of the contribution. If the existing network is contributed to the venture, additional legal issues arise as to the transferability of the permits and licenses for network operation.

The parties must also decide who will purchase and own additions to the existing network the joint venture or the in country partner. Issues of ownership of network improvements and operation and management control of the network can be particularly sensitive to the local partner, which relies upon the private telecommunications network to run its core business, (such as a national bank or an insurance operation). The local partner will negotiate for the right to use the network under all circumstances to operate its core business. The strategic investor will seek contractual assurance that if the local

49. In Mexico, for example, MCI partnered with Banamex to form Avantel. GTE initially partnered with Grupo Financiero Bancomer, S.A. to form the Unicom joint venture (which eventually merged into the Alestra venture). See Glover and Lotvedt, supra note 16, at 32-33. Banamex and Bancomer are among Mexico's largest banking institutions. The banks entering into such strategic alliances desire to improve their telecommunications quality and service while reducing the expense of their communications. Banks also seek growth opportunities in handling fund transfers between businesses, both within the country and internationally. See Nicholas Bray & Paul B. Carroll, Banks Go to the Source to Cut Phone Bills: Communications Companies Find Allies in Major Customers, WALL STREET JOURNAL, Oct. 6, 1995, at p. A10 for a sampling of international bank-phone alliances.

50. Financial institutions are likely to own private telecommunications networks because of the enormous amounts of data that they must transmit between branches and headquarters, many of which require long distance service.

51. When the local partner is a bank, due diligence should include verification of whether bank and bank holding company laws restrict the amount of ownership interest that a bank may hold in a non-bank investment. The organizational documents of the bank should also be reviewed for provisions that limit the bank's ability to invest in and own subsidiaries.
partner withdraws from participation in the joint venture or terminates the association, the telecommunications venture will be able to continue. The relative importance of issues relating to the existing network diminishes as the new network is built and the local partner shifts from reliance upon its old private network to the new facilities operated by the joint venture company.

C. TECHNICAL AND ADMINISTRATIVE SERVICES OF THE PARTNERS.

Another important operational issue is the foreign telecommunications partner’s provision of technical assistance and management services to the venture. The venture will exploit the technical expertise and managerial experience of the strategic investor in telecommunications operations to gain significant competitive advantage in the opening market. The parties may execute a separate agreement covering the foreign partner’s services. Similarly, the local partner may also provide special services or benefits to the venture. For example, many local partners already have a loyal customer base and can provide customer lists or design and implement strategic marketing and sales programs for the new telecommunications products offered.

D. TRADEMARKS AND TRADE NAMES.

In connection with marketing telecommunications services, the parties must also determine whether, and under what circumstances the venture will be entitled to use trademarks, trade names, service marks and logos of the partners. The parties should then sign appropriate license agreements. The local partner may negotiate for the licenses to be exclusive in the country where the joint venture operates with respect to telecommunications services provided by the joint venture. In that case, the license agreement should contain exceptions to the exclusivity of the license with respect to any enterprises that are grandfathered or otherwise permitted under the covenant not to compete.

52. An agreement covering the services of the strategic investor may include, without limitation, procedures for the identification and coordination of the scope of services, compensation for services rendered, reimbursement of expenses, taxes (including withholding), rates and provisions for revision of rates in extenuating circumstances, ownership of work product and intellectual property, including license of intellectual property rights, right to audit and confidentiality of information.

53. Where the local partner is a bank or a financial institution, banking law may restrict the use of customer lists and credit information on the grounds of customer privacy. In an agreement for marketing services of the local partner, issues would include, for example, the local partner’s obligation to make its customer lists available to the joint venture, ownership rights in the customer list, the right of the local partner to approve and control mailings and other marketing projects using the customer lists, access of the joint venture to the data base of the local partner and access of the joint venture to information other than addresses about the customers of the local partner. The local partner may also agree to provide the assistance of its senior management for contacts with potential major accounts.
E. **Non-competition Provisions.**

Restrictions upon the parties' ability to compete with the venture, both during the term of the association and after termination, are critical to the partners. Potentially at stake is the right of the strategic investor to play in a major growth market comprised of an entire country. In many cases, the strategic investor may already be operating or own an interest in enterprises that compete with the new venture in that country. For example, a foreign telecommunications company might venture with a local partner to compete in the long distance market and to operate as a full service telecommunications company upon expiration of the exclusivity period. The foreign telecommunications company might already have a cellular license in the country or have an investment in a consortium that provides value-added or other telecommunications services in the country. The partners face the challenge of agreeing upon non-competition language that protects the legitimate prior business interest of the strategic investor by "grandfathering" those competing operations, but also protects the new venture.

In addition to owning existing competing enterprises, the strategic investor may also be negotiating pending transactions in the country even as it signs a memorandum of understanding or other commitment to negotiate the joint venture agreement with the local partner. In that event, it may be possible to bring the pending transaction into the joint venture. Assuming that the third parties involved accept the local partner and the venture, then the local partner acquires an indirect interest in the pending transaction based upon its percentage of ownership in the joint venture. The local partner may compensate the strategic investor for the local partner's pro rata share of any expenses incurred and license fees paid by the strategic investor in creating the business opportunity.

Depending upon the nature of the business of the strategic investor and of the local partner, the non-competition provisions may contain additional exceptions. For example, the strategic investor and its affiliates may need to protect their right to sell telecommunications equipment and systems and spare parts in country, as well as to provide installation and maintenance services. The strategic investor may also need to protect its right to provide consulting and training services in matters such as network design and billing systems to support business that it already conducts in the country. Likewise, depending on the nature of its core business, the local partner may also need to protect its right to supply products and services in country, such as financial services, data processing services and data storage and retrieval. One way to preserve the financial viability of the venture in the face of such exceptions to the restrictions on scope of permissible activity of the partners is to require the partners to offer the competing products and services to the venture on at least as favorable terms and conditions as they are offered to third parties.

To further protect the parties and build greater flexibility into the operation of the non-competition covenants, the parties may create a mechanism whereby the venture has the right of first refusal to commercially exploit new competitive opportunities. The parties must present all such new opportunities to the venture. If declined by the venture within a specified time, the new business may be pursued by the presenting party apart from the venture without the restrictions of the non-competition language.
IV. Competitive Entry Stage.

The last stage of entry into the opening telecommunications market of a Latin American is competitive entry. This is the stage during which the start-up company formed by the venture partners emerges to seek recognition as a player in the soon-to-be competitive market place. This lively stage is characterized by the implementation of a business plan for the start-up company and the application for a concession and other required licenses. With the placement of personnel and the commencement of operations, this is also a critical time in a venture for cross-cultural communication and adaptation, in terms of differing national cultures as well as corporate cultures. In this stage, responsibility for much of the legal work transitions from the transactional lawyers representing the partners in negotiating the new venture to counsel for the joint venture company, which may consist of a local lawyer, an expatriate lawyer from the country of the strategic investor, or both.

A. BUSINESS PLAN IMPLEMENTATION.

Certain legal activities usually occur in connection with the business plan implementation. The joint venture company that will operate in the local market is formed and its partners make capital contributions to fund the start-up of operations. If the local partner has already registered in the country’s trademark office a trademark, trade name or service marks for products and services that the venture will offer, then the registrations should be transferred from the local partner to the venture. The joint venture company must obtain appropriate import licenses or authorizations from the country. The venture must apply to the telecommunications authority for licenses and permits that it needs to render the services contemplated by its business plan. Even if the venture is formed substantially in advance of the opening of competition in basic services, the venture may apply for permits and licenses related to value-added and other services that are already competitive.

54. See Making Sense of Cultural Factors in International Alliances, supra note 47, at 42. When the new company unfolds its business plan in a highly competitive environment, the resolution of internal management issues is critical to permit the venture to focus on survival and growth challenges. Factors such as the organizational chart, control, communication with employees, the flow of management information and reward systems all may vary with national culture and company culture. Those differences must be integrated to some extent to avoid ambiguity and disharmony. Id. at 42, 46. Management of the parent companies may enhance the chances of success for the venture by rejecting the idea that the cultural preferences of their country/company are superior and by recognizing, respecting and capitalizing upon cultural differences. Id. at 46.

55. In order to expedite the application process for trademarks and trade names, the partners may decide to apply for the marks in the name of the local partner before or concurrently with the incorporation of the joint venture company and transfer them to the joint venture later. This strategy allows the early reservation of names and marks before other competitors entering the market can secure them.
Any ancillary contracts between the partners, the terms of which they negotiated in connection with the joint venture agreement, may need to be executed. These might include, for example, the lease or assignment of the local partner's existing private telecommunications system to the venture, a network management agreement relating to the private network, services agreements between each partner and the joint venture and trademark licenses from each partner to the joint venture. Also, contracts with third parties, such as floor space leases, equipment leases, supply purchase agreements and employment agreements with key executives of the new venture company will be executed. If the joint venture plans to construct new network facilities, then the venture must also select a contractor and enter into contracts for design engineering and construction.

B. THE CONCESSION APPLICATION.

One of the most critical aspects of the competitive entry stage is obtaining the concession. The government's willingness to grant concessions may depend on whether the government intends to foster post-privatization full competition in the telecommunications sector, or, at least initially, to limit competition to two or three service providers. Other political considerations may come into play as well.

56. In opening its long distance market to competition, Mexico's government has chosen a very open liberalization. According to Secretaría de Comunicaciones y Transportes ("SCT") Carlos Ruiz Sacristán, by this liberal approach Mexico seeks to create the regulatory environment for the country to attract large investments in telecommunications. In response, by August of 1996 the government had granted nine concessions. Avantel, a joint venture between Grupo Financiero Banamex-Accival and MCI has invested almost US$900 million to complete a 5,300 kilometer fiber-optic network. Alestra, a joint venture between AT&T, GTE, Telefónica Internacional of Spain and Grupo Alfa and Grupo Visa is building a 4,600 kilometer fiber-optic network that will be ready in 1997.

57. In Argentina, for example, the key players are Telefonica and Telecom, each of which holds a regional monopoly in local and long distance voice services until 1997 (subject to extension until 2000 if the companies comply with predefined investment plans and quality standards), and Telintar (owned by Telefonica and Telecom), which holds a monopoly in international toll. See Case of Argentina, supra note 14, at 49; Global Telecoms Business: The Americas Yearbook 1996, supra note 14, at 7. See also Valcarcel, supra note 14, at A9 (protesting Argentine telephone monopolies and suggesting change in policy).

58. The concession and the services that it permits the operator to provide go directly to the heart of the business plan. For example, Bell Atlantic invested US$1 billion in Grupo Iusacell, S.A. in 1993. The intention of the investment was to enter the telephone market by converting a 1957 rural radio-phone concession into a second local telephone network. Bell Atlantic asserts that it received the assurance of then-President Carlos Salinas de Gortari that Iusacell would be permitted to extend its rural telephone network into urban areas, directly competing with Telmex. President Salinas left office in 1994, and the new administration contends that Iusacell had a series of authorizations that were granted under the old telecommunications law and the new law provides that changes in the uses of existing licenses require government approval. For months the implementation of the business plan is stymied while Iusacell and the government dispute the matter. See Joel Millman, Bell Atlantic Gets Hung Up in Mexico, Wall Street Journal, May 9, 1996, at A10.
Another factor that can impact the venture's ability to obtain a concession is covenants between the government and the dominant operator in the concession agreement with the dominant operator. The concession agreement may preclude the government from granting concessions to other operators with terms more favorable than those afforded to the dominant operator after the expiration of the exclusivity period. Also the concession agreement between the government and the dominant operator may require the government to ensure that concessions for the provision of services that enjoyed protection during the exclusivity period are granted only to "qualified" operators who must use certain technology, meet requirements to supply public pay telephones and meet service quality requirements and minimum waiting periods for new service.

The concession application must contain the information required by statute, regulations and other governmental guidelines. Once the application is submitted, the

59. In Peru, for example, the application of a corporation or other legal entity for a concession to the Ministry of Transportation, Communications, Housing and Construction must contain: (i) a certified copy of the applicant's charter document and power of attorney of the applicant's legal representative; (ii) the identity of applicant's partners or shareholders; (iii) a sworn statement that the applicant is not prohibited from executing contracts with the government and is not excluded from obtaining a concession by restrictions contained in the telecommunications law or regulations; (iv) a technical description of the project authorized by a qualified engineer; and (v) a forecast of the first five year's investment, and of the first year's investment, which shall not be less than 10% of the five year forecast. See Regulamentos de la Ley Telecomunicaciones, supra note 40, art. 163.

In Mexico, the statute requires a concession application to install, operate or exploit public telecommunications network to contain (i) the name and address of the applicant; (ii) the services the applicant wishes to provide; (iii) the technical specifications of the project; (iv) the programs and commitments regarding the investment, geographic coverage and the quality of services the applicant proposes to provide; (iv) the business plan; and (v) documentation demonstrating the financial, technical, legal and administrative ability and qualifications of the applicant. Federal Law of Telecommunications, published in El Diario June 7, 1995, art. 24. To amplify upon to the statutory requirements for concession applications, the SCT published detailed guidelines outlining the procedure to obtain a concession. See Secretaria de Comunicaciones y Transportes Acuerdo por el que se Establece el Procedimiento para Obtener Concesion para la Instalacion, Operacion o Explotacion de Redes Publicas de Telecomunicaciones Interestatales, al Amparo de la Ley Federal de Telecomunicaciones, D.O., September 4, 1995, (Mex.) [hereinafter SCT Guidelines.] The SCT Guidelines require, among other things, detailed disclosure of the equipment that will constitute the network, including the standards and technology to be used for transmission, switching, signalling and synchronization, geographic coverage and expansion plans, interconnection points, market analysis, pricing strategy, marketing strategy, service quality controls, pricing, billing and collection, personnel, qualifications and training. In addition, the SCT Guidelines call for the organizational documents (estatutos) of the applicant to contain statements to the general effect that (i) the purpose of the company is to install, operate or exploit a public telecommunications network, (ii) the company is Mexican, (iii) the duration of the company will be at least the term of the concession, (iv) that at least 51% of the share capital and the effective control of the company will at all times remain in Mexican investors, and (v) in the case of any disposition or transfer of shares representing 10% or more of the company's capital the company must notify the SCT, which may object to the disposition or transfer.
government usually has a statutory review period in which to grant the concession or request additional information. In Peru, for example, after the applicant submits its application to the Ministry of Transportation, Communications, Housing and Construction, the Ministry has 60 calendar days to approve the application if the Ministry considers it in order. Reglamentos de la Ley de Telecomunicaciones art. 137. After the Ministry has reviewed the application and verified compliance with the formal requirements, it will order the publication of a summary of the application once in the official newspaper El Peruano and in a larger national circulation newspaper. Id. If the Ministry determines that the application should be discussed at a public hearing, the publication will include a summons to the hearing. Id.

In Mexico, the SCT has up to 120 days to evaluate the application, during which it may request additional information from the applicant. Once the statutory requirements are satisfied, then the SCT shall grant the concession. Federal Law of Telecommunications art. 25.

Art. 52 of Peru’s Telecommunications Act, for example, requires concessions to provide public telecommunications services to indicate: (a) the duration of the concession; (b) the minimum expansion plan of the service; (c) the specific cases in which subcontracting will be allowed; (d) the coverage area of the service; (e) the compatibility of terminal equipment which may be connected; (f) the guaranty of confidentiality of telecommunications; (g) tariffs; (h) terms for the installation of the service; (i) characteristics and procedures to be followed for the connection of homologated terminals at connection points to the network and the termination points of the corresponding network; (j) obligation to provide integrated services in its area of influence; (k) requirements as to quality of service; (l) rules for interconnection of services; and (m) grounds for termination of the concession. See supra note 44.

In Mexico, the concession to install, operate or exploit a public telecommunications network must include (i) the name and address of the concessionaire, (ii) the object of the concession, (iii) the services which the concessionaire is authorized to provide, (iv) the rights and obligations of the concessionaire, (v) the duration of the concession, (vi) the amount and terms of the guaranty, if any, that the licensee must provide and (vii) the geographic coverage commitment of the network. Once the concession is granted, the statute requires the publication of an extract of the concession in El Diario Oficial at the concessionaire’s expense. See Federal Law of Telecommunications supra note 59, Art. 26.

See, e.g. art. 35, Mexican Federal Law of Telecommunications. The statute permits the termination of rights and obligations, including termination of the right to operate and exploit a public telecommunications network, in order to transfer that right to another licensee providing similar services in the same geographic zone. The SCT will approve the termination of rights beginning three years after the license was initially granted and only if the Federal Commission on Competition issues a favorable opinion.
authorization that enable an attorney-in-fact or agent of the concessionaire to exercise the rights and obligations of the concession. The concession may also incorporate, expressly or by reference, a condition regarding the concession the performance of provisions of the concession application, such as geographic coverage, stages of network expansion, service quality controls, and technical specifications.

C. TELECOMMUNICATIONS EQUIPMENT AND THE PROCUREMENT FUNCTION.

Another component of the competitive entry stage that impacts the business plan is the procurement function for the new venture. Foreign strategic investors in Latin America are generally telecommunications giants. Some of them manufacture telecommunications equipment; those who do not nevertheless have economically advantageous relationships with manufacturers and suppliers of equipment that far surpass the relationship that a start-up joint venture can negotiate. They have extensive capability in their domestic procurement function for contract negotiation, manage-

63. New ventures during the competitive entry stage may have considerably greater flexibility in equipment procurement than the privatized company has during its exclusivity period. During privatization, before bid submission, equipment suppliers (particularly domestic suppliers) may succeed in causing the state-owned telephone to sign contracts to accept equipment and materials with no relation to the network expansion and modernization requirements. See, e.g., Case of Argentina, supra note 14, at 53. The newly privatized company may thus be obligated to pay for equipment that the international operator would not have selected for purchase because of considerations such as obsolescence, technical qualifications and standards requirements for network modernization, and the ability to obtain better prices and terms from other suppliers. Moreover, in some such supply contracts executed before privatization penalties for late payment or non-payment may greatly exceed market rates. Id.

As for future equipment purchases, the concession agreement may require competitive bidding for purchases exceeding a threshold dollar amount. Id. The privatized company may be restricted from supplying terminal equipment, and the conditions under which they may provide installation and maintenance services for terminal equipment may be regulated. Id. The privatized company may be obligated to give preference to existing domestic industry, such as in Argentina, always and whenever purchasing from the domestic supplier does not imply a price difference greater than 10%. Id.

64. For example, supplying the Iusacell-Bell Atlantic wireless leader in Mexico is Northern Telecom of Canada which, in 1994, announced a $330 million contract to supply the infrastructure for Iusacell’s nationwide fixed wireless access network. In 1995 Nortel was instrumental in constructing the fiber optic network for Avantel, the joint venture between MCI and Banamex. Nortel’s Avantel contract was worth $380 million. Swafford, supra note 2, at 68. The AT&T spin-off equipment manufacturing company, Lucent Technologies, has plants in Mexico and Brazil that produce microelectronic and computer components and consumer product plants that produce telephone systems for residential and business customers. The firm provides basic infrastructure equipment, cabling and network equipment, including fiber optic cable, outside plant and central office switches. Customers include Mexico’s Telmex and Brazil’s Telebrás. Scott Weeks, AT&T Spin-off Poised to Create Tech Giant, LATINFINANCE, Mar. 1996, at 66.
ment and compliance, purchasing, inventory control, warehousing, distribution, acceptance and fleet transportation program development. Therefore, during the competitive entry stage the foreign investor is likely to undertake responsibility for the procurement function in order to acquire equipment at favorable prices and fast enough to meet customer demand in the face of fierce competition from other strategic alliances entering the same market.

In establishing the supply function for the new venture, the partners should keep in sight certain commitments contained in the joint venture agreement. For example, the agreement may require that contractual relationships between the joint venture company and its partners be at arms length. It may contain a covenant that transactions between a partner and its affiliates, on the one hand, and the joint venture, on the other hand, must be consistent with market conditions and on terms at least as favorable as terms granted to third parties. The foreign partner may receive consideration from the joint venture for managing the supply function. This consideration may be in the form of hourly rates for the foreign parent’s personnel services or a markup on the price of inventory purchased on behalf of the venture to cover shipping, warehousing and inventory management. In either case, the charges should be in accordance with the principles of the joint venture agreement.

Another joint venture agreement provision that warrants review during the competitive entry stage and impacts procurement is the non-competition clause. The joint venture agreement may provide that the foreign partner can sell equipment and services to "grandfathered" competing enterprises so long as the foreign partner offers the same terms and conditions to the joint venture. For example, a United States telecommunications company might sell, install and maintain billing systems to third party customers in the joint venture country and later provide the same service to the joint venture. The terms offered to the joint venture must be as favorable as the terms offered to the third party customers. Competition of a partner with the joint venture can be a very sensitive issue, and one of the most common reasons that strategic alliances fail is tension among the partners about observance of the non-competition provisions.

In the specific case of a joint venture between United States and Mexican partners, NAFTA may afford substantial advantages to the joint venture. Effective January 1, 1994, NAFTA eliminated duties on "category A" items, which included substantial categories of United States manufactured telecommunications infrastructure and consumer equipment. Included in this category are telecommunications line equipment, modems, broadcasting equipment, and telecommunications parts.

66. Id. (For a discussion of the impact of NAFTA on the telecommunications markets, see Glover & Lotvedt supra note 16, at 34-40).
V. Conclusion.

Despite the maturation of the Latin American telecommunications sector, the region will continue to attract foreign strategic investment. Brazil, Ecuador, Nicaragua, Panama, Honduras, Paraguay, and El Salvador have already commenced their privatization processes, and the sale of interests in their telephone companies will provide growth opportunities for strategic investors. As more countries complete the privatization/monopoly stage and open their markets to competition, strategic alliances between foreign strategic investors and local partners will also continue to form.

Latin American countries may experience greater challenge in locating strategic investors to bid in their privatization sales. This difficulty is partly due to a perception that, other than Brazil, the best opportunities have already been bought and sold. Also, some investors from the United States are allocating more of their capital and human resources to the opportunities presented in the United States domestic market by the emergence of competition in local and long distance services.

The modernization and expansion of telecommunications infrastructure by strategic investors will create significant markets for telecommunications equipment and materials. These markets will demand traditional consumer goods (such as telephones) and the needs of privatized telephone companies (such as fiber optic cable, digital switches and public pay telephones). Opportunities will also exist for growth markets such as internet services, pagers and paging services, mobile telephones and services and personal communications services.

The trends of privatization and the introduction of competition in Latin American telecommunications will continue to present significant strategic investment opportunities. Each government's long term vision for the structure of its country's telecommunications sector will impact the timing, the extent and the value of those opportunities. The most basic alternatives for the government involve the number of competitors, the timing of their market entry and the latitude afforded to the privatized company. As in the case of Mexico, the government may seek to attract large investment through the introduction of multiple competitors and the policy of allowing market forces to shape the evolution of the sector. Alternatively, the government may choose a duopoly or oligopoly regime in which regulation implements social objectives that were established as part of the privatization regime and the enactment of the telecommunications laws.

In the underdeveloped Latin American telecommunications infrastructures, most citizens lack telephones. The government must weigh the possible benefits of competition against the need for the privatized company to profit sufficiently to expand the infrastructure. Duopolies are easier to regulate and provide for an orderly transition with relatively stable competitor dynamics. Allowing multiple competitors from the beginning risks the rapid consolidation of competitors in the market and the possible failure to realize objectives of infrastructure development because of lack of funds for investment generated through profits.

The signals that the government gives of its long term vision for the sector's market structure, perhaps less obvious at the time of the privatization bid, grow more apparent with the approaching expiration of the exclusivity period. The strategic investor may interpret these signals in planning whether and with which partner to form a strategic alliance in the market of a given country. The government's vision for the sector may
evolve during the years of the exclusivity period, changing as a result of elections and political pressure, economic lobbying and progress in achieving social goals. By the time that the government permits competitive entry into the market, regulatory policy that takes into account the long term vision for the sector is being shaped. Such policy directly impacts how much monetary investment and infrastructure development new competitors will make and how they will market their services. Governmental policy also impacts the ongoing valuation of the privatized company's concession to the foreign operator-shareholder and its consortia and the resulting decision whether to hold or divest its shares in the competitive market.