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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN MEXICO

-- 2006 --

This annual report is submitted by the Mexican Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 6-7 June 2007.

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1. Changes to competition laws and policies, proposed or adopted

1.1 Summary of new legal provisions of competition law and related legislation

1. In April 2006, Congress unanimously approved amendments to the Federal Law of Economic Competition (LFCE). The purpose of these amendments was to enhance operative tools available to the Federal Competition Commission (CFC or Commission) and increase the monetary and non-monetary sanctions for anticompetitive behaviour. (Further reference can be found in the 2005 OECD report).

2. As a result of the reforms approved by Congress, in October 2006 the Executive Power submitted before the Supreme Court a constitutional review of several articles of the LFCE. In particular, the Supreme Court will have to rule on the constitutionality of those articles related to the powers given to the Congress to veto commissioners' appointments by the Executive and on the need for judicial warrants for in-situ inspections and divestiture of assets.

3. In November 2006, the CFC's internal statute was modified, allowing for a reorganisation of the Commission's operative and support areas in a manner designed to better meet the new challenges raised by the reformed LFCE. These changes involved the creation of four new general directorates: hard core cartel investigations; a break up of the current regulated sectors general directorate into two sectorially specialised directorates; a break up of the legal affairs directorate into an internal counsel and an external prosecutorial area; and a competition advocacy general directorate. No additional resources were involved in the reorganisation.

1.2 Government proposals for new legislation

4. During 2006, Congress made no proposals to amend the LFCE.

2. Enforcement of competition laws and policies

2.1 Action against anticompetitive practices, including agreements and abuses of dominant positions

2.1.1 Summary of activities

5. In the period under review, 77 investigations registered activity, 32 of which had been initiated in previous years, with the remaining 45 initiated during 2006. The CFC closed 39 case files and imposed sanctions in 2 cases involving absolute monopolistic practices (hard core cartels) and in one investigation involving relative monopolistic practices (unilateral conduct). See Annex 1 for further details.

2.1.2 Description of significant cases, including those with international implications

Pepsi v. Coca-Cola¹

6. Mexico is the second consumer of carbonated beverages in the world. In 2000, several companies related to the Pepsi brand lodged a complaint against companies related with the Coca-Cola group for preventing or limiting their access to a number of points of sale.

¹ Case Files DE-06-2000, RA-30-2005 and RA-45-2005.

7. In its complaint, Pepsi alleged that Coca-Cola agreed with owners and managers of retail outlets and restaurants (mainly through verbal contracts) that they would buy only Coca-Cola products in exchange for incentives, such as cash, quantity discounts, refrigerators, awnings, paint jobs and advertising articles.

8. The Commission pursued Pepsi's complaint, conducted an investigation, and found the following:

- i. There is a nationwide market for carbonated beverages in Mexico. In this market, the companies within the Coca-Cola system held a 72% share in 1999, while their closest competitors, those companies within the Pepsi system had an 18% share.
- ii. The main distribution channels for carbonated beverages are retailers and restaurants (with at least 950,000 retail locations);
- iii. Companies in both the Coca-Cola and Pepsi systems have tried to improve their market shares through exclusive contracts with retail outlets and restaurants, and in exchange for these contracts they have offered various incentives;
- iv. In its analysis, the Commission found that exclusive contracts with retail outlets did not generate gains in efficiency and only resulted in a reduction of competitors' market share from 32.5% to less than 28%. In contrast, exclusive contracts with restaurants could generate gains in efficiency; as a result, the relevant market excluded this distribution channel from the analysis.

9. The Plenum of the Commission ruled that exclusive contracts are prejudicial to the market in question and constitute an obstacle to the entry of new products or competitors. As a result, the CFC ordered the immediate suppression of the practice and fined each of the 55 companies that made up the Coca-Cola group.

10. The sanctioned parties requested an appeal before the CFC, arguing, among other things, that the investigation phase exceeded the legal period; the relevant market was not clearly defined; and that the substantial power analysis was biased against Coca Cola. After reviewing these arguments the Commission considered them unfounded and confirmed its previous resolution.

11. An additional appeal for review was introduced by Pepsi who considered that the relevant market should include all distribution points as Coca Cola had never proven that efficiency gains could arise from the use of exclusive contracts in some locations. The CFC deemed the arguments unfounded and confirmed its previous resolution.

Miller v. Grupo Modelo²

12. In July and November 2004, Miller Trading Company, S.A. de C.V. (Miller) together with other similarly situated firms brought complaints against Fomento Económico Mexicano, S.A. de C.V. (Femsa), Grupo Modelo S.A. de C.V. (Grupo Modelo) and its subsidiaries alleging monopolistic practices related to exclusive dealings.

13. During the course of the investigation, the Commission determined that the relevant market was off-premise beer production, distribution and marketing at retail locations. The geographic dimension was

² Case Files DE-25-2004 and RA-26-2006.

regional and included the northeast, northwest, centre, the Valley of Mexico and the southeast. It also found that the exclusivity contracts had been offered in exchange for economic incentives provided by Femsa and Grupo Modelo.

14. The CFC determined that such contracts could have an effect of limiting the distribution and marketing processes of competing agent's products, such as Miller's. Furthermore, the two economic agents undertaking these practices had distinct regional influences with Femsa possessing market power in the northwest, northeast and southeast regions, while Grupo Modelo possessed market power in the centre and the Valley of Mexico.

15. In August 2006, the CFC issued a final resolution for Grupo Modelo. It determined that Grupo Modelo was guilty of the monopolistic practice consisting of exclusive dealings and ordered the immediate suspension of the practice. The procedure associated to Femsa is still in process.

16. Subsequently, Grupo Modelo requested an appeal arguing that the Commission's analysis did not properly take into account the substitution possibility between low alcohol content beverages and beer, an argument that could modify the CFC's conclusions about market power. The Plenum of the Commission considered that this argument was partially founded, reversed its previous resolution and closed the file.

The Transport Union of Los Cabos and its guilds²

17. Based on the analysis of newspaper spreads published during February and March 2005, the Commission became aware of possible anticompetitive acts in tourist transportation services offered in Los Cabos, Baja California Sur.

18. During the investigation phase, the CFC found evidence that supported an allegation of relative monopolistic practices undertaken by the Transport Union of Los Cabos and its guilds (Unions of cab service providers).⁴ The practice consisted of agreements aimed at exerting pressure over tourists to discourage them from the use of tourist land transportation services and instead pressuring them for the use of cab services. The effect of the practice was the displacement of tourist transportation service providers in the relevant market.

19. In June 2006, the Plenum of the Commission determined that the firms were guilty of relative monopolistic practices in the relevant market of tourist transportation in Los Cabos. The CFC imposed fines ranging between \$48 pesos and 1.34 million pesos (about \$4.5 dollars and \$120,000 US dollars) but agreed to waive them if the guilty parties admitted through mass media spreads the monopolistic practice and committed not to undertake anticompetitive acts in the future.

20. The parties requested an appeal, arguing that worker unions are not subject to the LFCE and questioning the relevance of the evidence gathered during the investigation phase, the definition of the relevant market and the determination of substantial power. Regarding the fines, the parties complained that these had been determined without a previous study of their economic capacity.

³ Case Files IO-01-2005 and RA-24-2006.

⁴ Unión de Trabajadores No Asalariados Taxistas Misión Los Cabos, Gremio Frente Único de Choferes Proprietarios de San José, Sitio Rosarito, A.C., Sitio San José, A.C., Sindicato Único de Choferes Proprietarios de Automóviles y Camiones de Alquiler de Cabo San Lucas, Sitio San Lucas, A.C. and Sitio Nuevo Atardecer.

21. In November 2006, following the appeal by the Union, the Commission resolved that all arguments were unfounded except for those relating to fines. As a consequence, the CFC modified the previous resolution and reduced them.

2.2 *Mergers and acquisitions*

2.2.1 Statistics on number, size and type of mergers notified and/or controlled under competition laws

22. In 2006, the FCC reviewed 237 merger files, including notifications, complaints and *ex officio* investigations of alleged anticompetitive transactions. Of these, 252 cases were concluded, with 3 horizontal mergers and one vertical merger blocked; 2 horizontal mergers were authorised subject to conditions, and 2 mergers were conditioned by the inclusion of non-competition agreements that may have negative effects to the markets involve.

2.2.2 Summary of significant cases.

Gruma / Agroinsa de México / Agroindustrias Integradas del Norte⁵

23. In July 2005, Gruma, S.A. de C.V. (Gruma) notified the acquisition of all shares of Agroinsa de México, S.A. de C.V. and Agroindustrias Integradas del Norte, S.A. de C.V. (Agroinsa).

24. In defining the relevant market, the Commission took into account the following information. Gruma is a Mexican firm that belongs to Grupo Industrial Maseca, S.A. de C.V. (Maseca). It manufactures and markets corn and wheat flour, tortillas and related activities. Agroinsa manufactures and markets corn and wheat flour, animal feed, and grits. When the transaction was notified, the agents' activities coincided in the manufacture and marketing of corn and wheat flour. In corn flour production, Maseca was the leader with 16 plants in numerous states, while Agroinsa owned two plants in Guadalupe, Nuevo León and Celaya, Guanajuato. As a result, when determining the geographic dimension for the relevant market, the Commission, after considering points of sale and transport costs, determined that plants had a regional influence, and specifically identified two regions that would be affected as a result of this transaction: the northeast and centre-west. A similar methodology was used to analyse the effect of this transaction on the wheat flour market. In this case, one of the firms belonging to Maseca, Gruma's parent, possessed 9 industrial plants throughout the country, while Agroinsa had one plant in Guadalupe, Nuevo León. The geographic area affected by this operation was the north-eastern region of the country.

25. Concentration indices were at a high level, which indicated that there was a risk for competition. In addition, Gruma was an important buyer and consumer of white commercial corn in Mexico, so that the operation would endow it with market power when purchasing national harvests. On the other hand, barriers to entry would grant Gruma the ability to develop strategies that would stall entry and development of competitors. As a result, the CFC concluded that Gruma's participation would significantly increase in the markets for both these types of flour.

26. In November 2005, the CFC determined that it would not authorise the merger. In January 2006, Gruma appealed the resolution claiming that the CFC had notified its resolution extemporaneously, which meant that Gruma would receive the benefit of an implied affirmative as stipulated under paragraph III of article 21 in the LFCE; as a result, the merger would be considered authorised. In April 2006, the Commission confirmed its resolution, arguing that the resolution itself and its notification were issued within the time limits dictated by the law.

⁵ Case files CNT-79-2005 and RA-02-2006.

Whirlpool / Maytag⁶

27. In March 2006, the Commission reviewed the merger notification whereby, as part of an international operation, Whirlpool Corporation (Whirlpool) acquired Maytag Corporation (Maytag). Both firms are recognised domestic appliances manufacturers. Whirlpool markets products under the brand names Whirlpool, Acros, Supermatic, Crolls, Kitchen Aid, Roper and Estate; Maytag does so under the brand names Magic Chef, Amana, Jenn-Air, Admiral, Jade, Dixie, Maytag and Hoover.

28. The CFC determined that in Mexico the operation would have a negative impact on competition in the following markets: stove tops, washing centres, freezers, washing machines, dishwashing machines, refrigerators and clothes dryers. It also observed that a significant part of the products sold in Mexico were US imports, as signatories of the North American Free Trade Agreement (NAFTA) could import these goods free of tariffs. Hence the geographic dimension was defined as the NAFTA region.

29. The analysis of concentration indices suggested a risk that competition could be harmed in the markets for washing machines, dishwashing machines, refrigerators and clothes dryers. Nevertheless, the Commission resolved to authorise the transaction after weighing these concerns against the non-existence of import barriers and the domestic presence of important competitors such as Sears/Kenmore, GE/Mabe, Samsung, Daewoo and LG.

Ferromex / Ferrosur⁷

30. In 1995 the Mexican Railway System (SFM) was restructured, dividing all lines based on a regional segmentation whereby three trunk lines were created, along with an independent interconnection and services terminal for the Valley of Mexico. At the time, the government gave concessions for the North-eastern railway (TFM), the Pacific Northern railway (Ferromex) and the South-eastern railway (Ferrosur).

31. In 2002 the holding companies for Ferromex and Ferrosur notified a merger whereby both railways would become part of the same economic group. The CFC did not authorise this operation. In 2005 two transactions were notified that effectively had the same outcome as the blocked 2002 operation. Since both operations were succeeding acts, they were investigated jointly.

32. After analysing the market for railway freight transportation services, the CFC resolved not to authorise the merger. The CFC found that for a significant portion of routes, users and types of freight land transportation and maritime transport were not close substitutes. Even though Ferromex and Ferrosur's railway lines do not overlap, the railway system is designed to have complementary lines to allow different concessionaires to transport freight through any route by using rights of way and interlinear traffic. Hence, even if concessionaires do not directly compete, the system's structure tries to foster competition through complementary means of transport to offer users different alternatives.

33. Risks to competition derived from this transaction included:

- A high level of concentration in the domestic railway transport market.
- Concentration of origin-destination points, which would increase the group's negotiating power with users and other railway concessionaires.

⁶ Case file CNT-36-2006.

⁷ Case files CNT-132-2005, CNT-134-2005 and RA-21-2006.

- Risk of redirecting freight to suboptimal routes, thus hurting other concessionaires or users.
- Disequilibrium in the holding of shares for the Mexico City Terminal, which offers services to all three trunk lines, who are shareholders together with the government.
- Increase in tariffs for interlinear and intralinear traffic, in charges for rights of way and for care-hire expenses.

34. After facing the CFC's prohibition to merge, ITF and ITM filed reconsideration appeals on August 2006, which were deemed unfounded. The Commission confirmed its previous resolution.

Grupo Aeroportuario del Pacifico / Pacífico Cargo⁸

35. In August 2005, Pacífico Cargo, S.A. de C.V. (PCargo) notified a co investment among Grupo Aeroportuario del Pacífico, S.A. de C.V. (GAP), Agentes Aduanales Asociados de Jalisco para el Comercio Exterior, S.A. de C.V. (AAACESA Jalisco) and Agentes Aduanales Asociados para el Comercio Exterior, S.A. de C.V. (AAACESA). Its object was to allow PCargo to build and operate a multimodal centre in the International Airport of Guadalajara (AIG), while AAACESA Jalisco and AAACESA would be in charge of operating the business as GAP maintained corporate control.

36. GAP is a firm in charge of managing, operating and exploiting airports, mostly in Mexico's Pacific region.⁹

37. AAACESA Jalisco gathers customs agents that offer management, storage and custodial services for foreign merchandise.

38. AAACESA is an association that gathers different customs agents operating air freight in the area surrounding the International Airport of Mexico City.

39. The operation implied the integration of a chain of services, which included the management and storage of air freight for foreign merchandise. Specifically, the markets where PCargo would participate were:

- i. Fiscalised storage services: include guarding and custodial work for imported merchandise left in deposit within the customs area awaiting discharge by a customs agent.
- ii. Ramp handling services: include the reception and steering of airplanes in the airport's ramp area; transfer of domestic freight towards the ramp area; transfer of export merchandise from storage facilities to the airplane; transfer of import freight from the airplane to the storage facilities; placement of merchandise inside the aircraft; unloading of aircraft merchandise and transfer of aircraft merchandise to reception points.
- iii. Assistance for land services: includes electricity generation for aircraft; loading and unloading; mechanical maintenance; cleaning of interior and freight compartments; waste water services; clean water services; starting and moving aircraft to the takeoff and landing areas.

⁸ Case Files CNT-91-2005 and RA-52-2005.

⁹ GAP controls 12 airports located in Guadalajara, Puerto Vallarta, Tijuana, San José del Cabo, Silao (Bajío), Hermosillo, Mexicali, Los Mochis, La Paz, Manzanillo, Morelia and Aguascalientes.

40. The CFC considered that by vertically integrating into the fiscalised storage service, GAP, through PCargo, would be able to carry out monopolistic practices at AIG that would benefit PCargo; and that customs agents who participated in this co-investment (those in charge of PCargo operations) would be able to transfer freight from competing storage facilities to PCargo warehouses by exploiting the definition of “transfer” contained in the Customs Law. Meanwhile, ramp handling services and land assistance services which, under article 48 of the Customs Law, can be offered directly by concessionaires (e.g. GAP) or through third parties (e.g. PCargo), could be monopolised as GAP can decide whether it is convenient or not to allow entry into these services.

41. As a consequence, in November 2005 the CFC determined not to authorise the merger and confirmed its resolution in March 2006, following an appeal for reconsideration.

3. The role of competition authorities in the formulation and implementation of other policies, e.g. regulatory reform, trade and industrial policies

3.1 Regulatory framework

3.1.1 Opinions on the pension system

42. In 2006, the CFC issued a general recommendation on the competition features of Mexico’s defined contributions pension system. The CFC stated that the system has brought significant benefits to the population, but still faces some challenges related to an inelastic demand and unexploited economies of scale that prevent pension funds administrators (Afores) from competing more efficiently. Despite the efforts for improving competition in this sector, commissions are still very high when compared to international references. In addition, competition between Afores is not focused on risk-return strategies, a decisive aspect when considering the value of a worker’s pension. To overcome this challenges, the CFC proposed several public policy measures aimed at enhancing efficiency and feasibility of the pension system so as to consolidate the improvements achieved to date. These included:

- i. The use of public bidding schemes for account allocations and to focus the Afores’s attention on improving their savings management;
- ii. Strengthening prudential regulation; widen investment options in portfolios available to the Pension Funds Specialised Societies or Siefors; as well as increasing the number of Siefors allowed for each Afore and to promote transparency in the system;
- iii. The development of criteria to protect workers who are not interested in optimising their accounts.

43. In March 2007, Congress approved changes to the pension system law in line with the CFC’s preoccupations.

3.1.2 Opinion on audiovisual contents for video services

44. The CFC issued an opinion on the public policies and the regulatory framework for the sector of audiovisual contents, focused on television services. This opinion was issued considering a demand increase foreseen within the process of telecommunications convergence.

45. In this opinion, the CFC proposed to develop a consistent and neutral regulatory framework for the audiovisual contents sector. In particular, the CFC proposed that the telecommunications law establish the access terms and conditions for audiovisual contents. It also proposed to allocate spectrum through

competitive mechanisms considering the CFC's participation in order to prevent anticompetitive market concentrations and to favour entry of new competitors.

46. In addition, and most importantly, the CFC proposed the application of must carry and must offer rules to enhance competition and non-discriminatory access to audiovisual contents and video services, guaranteeing pay television providers the access to public network channels and vice versa.

47. Finally, the Commission proposed the promotion of independent producers as well as granting them access to network television channels in order to encourage competition in the audiovisual content production.

3.1.3 Opinion on the liquefied petroleum gas (LPG) market

48. The CFC issued an opinion on a project by the Ministry of Energy aimed at preventing negative effects on competition in the LPG markets and a reduction in provision options for consumers. The project was to amend the LPG Regulations on matters related to first hand sales (FHS), self-supply, operative reach of distribution plants, and foreign investment.

49. In its opinion, the CFC considered that the condition which determined that FHS should take place at PEMEX's (the state owned oil company) processing centres would impose logistic limits to distributors that could compete with PEMEX. The project also proposed a whole price for the FHS including LPG transportation and storage services without specifying LPG transportation and storage prices. Furthermore, the project included provisions that would diminish access to PEMEX's pipelines, prohibit large users from storing LPG and would allocate geographic areas to each distributor of LPG. Successive versions of the project have taken into account the CFC's recommendations, but no amended regulations have yet been issued.

4. Resources of competition authorities

4.1 Resources overall (current numbers and change over previous year):

4.1.1 Annual budget (in your currency and USD)

50. The annual budget exercised by the CFC in 2006 was 150.1 million Mexican pesos, equivalent to US\$13.6 million¹⁰. It represented an 8% nominal decrease with respect to its 2005 budget.

51. 75 percent of the annual budget was allocated to wages.

4.1.2 Number of employees (person-years)

52. At the end of 2006, the CFC employed 143 people: 108 of them worked in the enforcement divisions (23 lawyers, 36 economists, 20 from other professions and 29 support staff), 29 provided administrative support and 6 were focused on internal control and evaluation of public servants.

53. The average tenure for the Commission's personnel is five years and the productivity index was 5.2 cases concluded per person. The average age for the Commission's personnel was 40 years.

¹⁰ 2006 average exchange rate published by Banco de México.

4.2 *Human resources (person-years) applied to: enforcement against anticompetitive practices, merger review and enforcement, and advocacy efforts*

54. In enforcing activities, the staff was distributed as follows: 8.3% worked on mergers; 13.9% were involved in investigations of anticompetitive practices; 11.1% worked on enforcing sectoral dispositions; 8.3% worked on advocacy activities; 21.3% offered economic and legal support; 9.3% were focused on coordination and 27.8% corresponded to the Plenum.

4.3 *Period covered by the above information: January through December 2006*

5. *Summaries of or references to new reports and studies on competition policy issues*

55. In 2006, the CFC published its 2005 Annual Economic Competition Report describing its activities and evaluating its performance during that year. The report is divided into three chapters, which summarise selected CFC decisions and illustrate their impact on the markets, providing elements that guided the final resolutions. The Report also includes a Statistical Appendix with detailed information on the CFC's activities and a complete list of cases resolved during the year. Available at www.cfc.gob.mx.

56. Additionally, during 2006, three issues of the Gazette (numbers 21, 22 and 23) were published including final resolutions issued from January 2005 through December 2005.

Annex 1

FEDERAL COMPETITION COMMISSION
Files Processed 2005-2006¹

	2005	2006
MERGERS		
Cases filed and <i>ex officio</i> investigations initiated	232	237
Notifications	230	234
Ex officio investigations	0	0
Complaints	2	3
Concluded	218	252
Approved without conditions	202	234
Approved with conditions	8	4
Opposed	2	4
Others ^{2/}	6	10
In process	43	28
PRIVATISATIONS, CONCESSIONS AND PERMITS		
Cases filed	528	379
Concluded	568	384
Approved without conditions	77	15
Approved with conditions	0	1
Opposed	0	0
Others ^{2/}	491	368
In Process	40	35
MONOPOLISTIC PRACTICES AND OTHER RESCTRCTIONS TO COMPETITION		
Cases filed and <i>ex officio</i> investigations initiated	33	45
Ex officio investigations	2	4
Complaints	31	41
Concluded	62	39
Remedies including recommendations	11	3
Concluded in advance, based on Art.41 of the RLFCE	0	0
Others ^{2/}	51	36
In Process	32	38
CONSULTATIONS		
Filed	26	30
Concluded	26	32
In process	5	3
MARKET POWER AND COMPETITION CONDITIONS		
Filed	0	1
Concluded	0	0
In process	1	2
APPEALS FOR REVIEW		
Filed	53	30
Concluded	56	30
In process	3	3

Annex 1

**FEDERAL COMPETITION COMMISSION
Files Processed 2005-2006¹**

	2005	2006
TOTAL		
Cases filed	872	722
Concluded	930	737
In process	124	109

1. Figures only include administrative proceedings concluded by the CFC.

2. It includes closed, withdrawn and dismissed proceedings.