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QUESTIONNAIRE ON THE CHALLENGES FACING YOUNG COMPETITION AUTHORITIES

Contribution from Mexico

-- Session III --

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CHALLENGES FACING YOUNG COMPETITION AUTHORITIES

--Mexico¹--

1. Competition Enforcement

1.1. Conduct cases and investigations

1. For decades, the Mexican economy was characterised by strong protectionism and heavy government intervention. As a result, most sectors of the economy were highly concentrated and presented important barriers to entry.

2. In the early 1990's Mexico initiated a process of trade liberalisation and regulatory improvement which was designed to modernise the economy, improve competitive conditions and facilitate Mexico's insertion in the global economy. The Federal Law of Economic Competition (FLEC), which created the Federal Competition Commission (CFC or Commission), came into effect in 1993 and was part of this modernisation effort.

3. The initial years after the Competition Law entered into force (1993-1995) saw very few complaints for anticompetitive practices filed before the CFC: 22 in 1993-1994 and 12 throughout 1994-1995. Most of these complaints were rejected because they did not fulfil the minimum requirements needed to initiate an investigation or because they denounced practices that were not considered as anticompetitive under the FLEC. This was not surprising given that competition policy was a new field, and economic agents had little experience in dealing with such issues and often tried to present complaints before the CFC merely as a tool against their competitors.

4. In the early years, the ex-officio investigations initiated by the CFC on relative monopolistic practices took several months or even years to resolve, and most of them without positive results. For example, in the period of 1993-1994, only 6 of the 16 ex-officio investigations, most of them on cartels, concluded with the imposition of a sanction, while 7 concluded that there was no violation to the FLEC. This was explained by the lack of experience of the CFC in taking on complex cases.

5. During our 15 years of experience, key actions have been conducted in three main areas in order to improve effectiveness in enforcement of competition law regarding abuse of dominance cases. First, a new policy has been adopted to apply more restrictive criteria when choosing what cases will be initiated, investigated, and eventually sanctioned. Second, we have developed an advocacy strategy aimed at strengthening communication between the Judiciary Branch and the Competition authority, and increase understanding of competition issues by judges. Third and perhaps most importantly, are the amendments to the FLEC in 2006 (described below). It is important to note that the amendments to the FLEC did not change the core analytical principles of the law, but they strengthened the CFC's operative tools.

6. Prior to the 2006 amendments to the FLEC, the law defined anticompetitive conducts for relative practices as i) non-price unilateral restraints, ii) resale price maintenance, iii) tied sales, iv) exclusive dealings, v) refusal to deal, and vi) exclusionary boycott. Other anticompetitive conducts were defined in the FLEC as relative monopolistic practices that unduly damage or impair the competition process and free access to production, processing, distribution and marketing of goods and services (article 10, paragraph VII). This lack of detail became the subject of legal controversy and led to the inclusion of five additional relative monopolistic practices in the 2006 amendments to the FLEC.

¹ Submitted by the Mexican Federal Competition Commission

7. One of the main changes to the FLEC was encouraged by a Supreme Court decision in 2005. After four judicial procedures in district courts, the Supreme Court analysed and resolved on the constitutionality of article 10 paragraph VII in the following terms: The Supreme Court judged that this paragraph was unconstitutional, since it only included general criteria on conducts that can hinder free market access and economic competition, and failed to establish the parameters that the CFC must follow in order to sanction the relative monopolistic practices involved.

8. In order to overcome the legal weakness pointed out by the Supreme Court with regard to the unconstitutionality of article 10 paragraph VII, the reforms to the FLEC sought to include five additional relative monopolistic practices² that were originally contained only in the FLEC's bylaw. These five conducts are typified as: a) predatory pricing, b) rebates and loyalty discounts, c) cross-subsidisation, d) price discrimination and e) raising rivals' costs.

9. The modifications to the FLEC also included specific economic concepts that firms can use to argue efficiency gains that offset the effects of anticompetitive practices. Moreover, these amendments granted the CFC limited powers to conduct on-site verifications in order to gather evidence, increased fines, and allowed for divestiture of assets as a last resort.

10. Our experience shows that the criteria for selecting cases are of vital importance for a competition authority. As we have gained experience, the quality of the cases accepted has improved, as well as that of the analysis conducted by the CFC. Our rate of success before the courts has improved dramatically, in large part because we have tried to understand the reasons why we lost some of the early cases. In addition to learning from our mistakes, we have become very proactive with the judicial tribunals, and are working actively to present our viewpoints throughout the process, and generate a clearer understanding of competition issues among the members of the judicial branch.

1.2. Leniency

11. The amendments to the FLEC have strengthened the CFC's enforcement capacity, by establishing a leniency program aimed at detecting and fighting collusive agreements that fix prices, segment markets or facilitate bid rigging. The leniency program is based on article 33 bis 3 of the FLEC. Its principal feature is to grant the reduction of fines to the economic agents involved in an absolute monopolistic practice (hardcore cartel) that apply to the leniency program.

12. The leniency program is aimed at the first economic agent that: i) provides evidence to prove the existence of an absolute monopolistic practice; ii) cooperates completely and continuously with the Commission during the course of the investigation and the defence of the case; and iii) undertakes necessary actions to end its participation in the cartel. The leniency program also considers a reduction in fines for those agents that are not the first to come forward, as long as they contribute information towards the investigation.

13. Anyone interested in applying for the leniency program must do so either through a voicemail message or e-mail. The Directorate General for Investigations of Absolute Monopolistic Practices and Interstate Trade Restrictions is the only department within the Commission which is authorised to process the leniency requests submitted to the Commission.

² These practices are considered illegal when the agent has substantial market power in the relevant market and whose conduct has the goal or effect of unduly displacing other economic agents, impeding their access to the market or establishing exclusive advantages in favour of one or more persons.

14. In general, cartel cases are easier to win than abuse of dominance cases, provided that there is reasonable evidence of an agreement among competitors. This is precisely because in abuse of dominance cases, the application of the rule of reason requires sophisticated economic analysis, which ultimately goes before tribunals that are not specialised in competition matters. In the early days of the CFC, most of the cartel cases won by the Commission had to do with a lack of understanding of the FLEC and of competition policy in general by the firms, primarily on the part of business and trade associations.

15. An important challenge for every young authority is the ability to sanction anticompetitive conduct in an effective manner, so as to generate the incentives and the deterrent for the practice not to be committed again. The level of fines that an authority can assess is therefore fundamental in order to create this set of incentives and deterrents. In Mexico, fines used to be extremely low (the maximum fine was approximately \$1 million dollars US), and while the 2006 amendments to the Law increased fines substantially (\$7 million dollars for cartels and \$4.5 million for abuse of dominance), they are still much lower than in other countries. Among other problems, the fact that fines remain low is a disincentive for large firms to join the leniency program. Efforts have been made recently to modify the FLEC in order to levy fines based on a percentage of yearly sales by the company involved in the anticompetitive activity, but the issue is still being debated in Congress.

1.3. Mergers and acquisitions

16. For the purpose of the FLEC, a merger is understood to consist of acquiring the control of a corporation, or any other action through which corporations, associations, stocks, equity interest, trusts and assets in general are combined amongst competitors, suppliers, customers or any other economic agents. The CFC can prohibit a merger or acquisition if the resulting economic agent would be able to fix prices unilaterally, limit supply, or facilitate any of the monopolistic practices considered in the FLEC.

17. The 2006 amendments to the FLEC focused on increasing notification thresholds, implementing a fast track for mergers that do not put in risk the competition process, and modifying the waiting period before a merger may take place.

- Increases of thresholds: Thresholds increased by 50% and 75% depending on the nature of the transaction.
- Timing: The natural days originally established in the Law were changed to business days, in order to allow for a better handling of cases.
- There is a simplified procedure that allows for a rapid treatment of operations when it is clear that the transaction is not going to affect competition
- Information is classified along the following criteria: i) confidential, ii) reserved, and iii) public.
- Increase of the sanctions: Applied to extemporaneous notification, false declaration, prohibited mergers, and non-fulfilment of the conditions imposed to authorise a concentration.

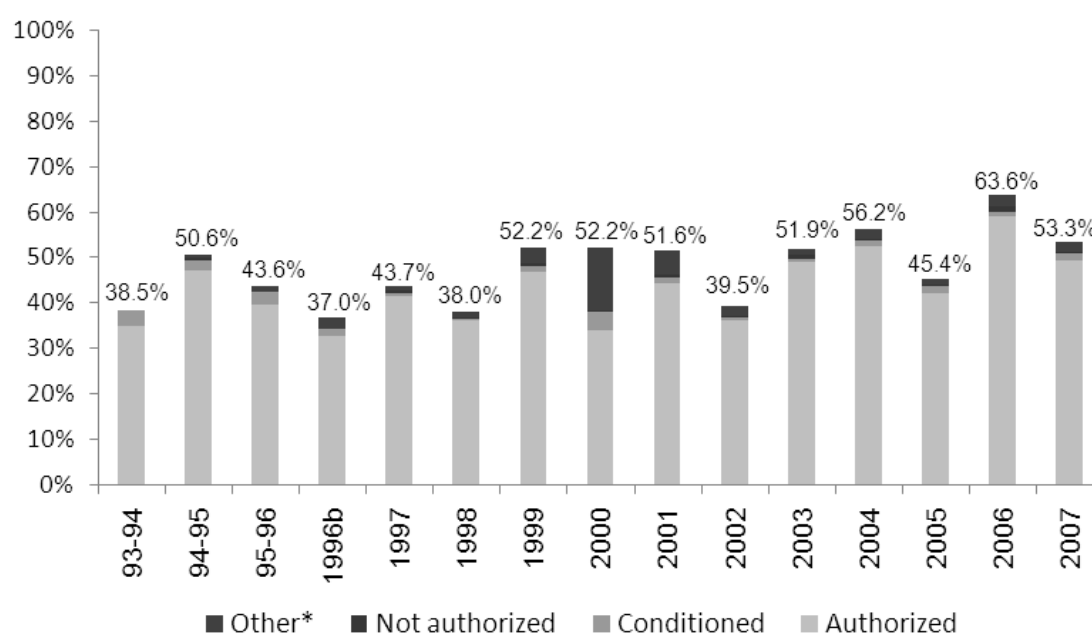
18. The Commission has the power to issue an order not to carry out a merger until it is cleared by the Commission. Art. 20 of the FLEC provides for three alternative reporting thresholds and establishes that a pre-closing filing is required if any of the following three thresholds is met:

- When the value of the transaction exceeds 946 million Mexican pesos (approximately 72 million dollars).

- When the transaction giving rise to the concentration involves the accumulation of 35 per cent or more of the assets or shares of stock of an economic agent, whose assets or annual sales in Mexico exceed 946 million Mexican pesos (approximately 72 million dollars).
- When the transaction giving rise to the concentration involves the accumulation in Mexico of assets or capital stock in excess of 441 million Mexican pesos (34 million dollar approx.) and the economic agents involved (buyer and seller) in the concentration have assets or volume of annual sales, jointly or individually (worldwide), that exceed 2,524 million Mexican pesos (approximately 194 million dollars).

19. Concession and permits for State assets (such as radio-spectrum, port infrastructure, and satellite concessions) are subject to a similar analysis as that used for mergers. Art. 22 of the FLEC establishes that those mergers reaching favourable resolution shall not be investigated, except if it is later found that said resolution was reached through false information, or if the resolution conditioned the merger and such conditions were not met. In addition, after a one-year period, a transaction not subject to notification cannot be challenged.

Figure 1. Annual merger cases as a percentage of total cases, by type of decision ¹



* Includes cases rejected, withdrawn, not admitted for processing or closed.

¹ LP gas permits are not included in total cases.

20. The ex-ante notification process for mergers requires an intensive use of human resources, but it is one of the most important aspects of competition enforcement in Mexico. Merger control has proven to be one of the most successful areas of enforcement of the FLEC. Our experience shows that the conditioning of mergers or the establishment of structural remedies is very difficult to implement and should be avoided if possible. Furthermore, the dissolution of assets once the merger has been concluded (ex-post) presents enormous legal challenges.

21. An important challenge for the CFC, and for most young authorities, is to increase the efficiency of operations and streamline the analysis of mergers so that human resources can be concentrated on the

handling of complicated cases. In order to accomplish this, a fast track procedure for the analysis of harmless mergers is of the utmost importance.

1.4. Judicial appeals

22. An economic agent can request an appeal of a decision before the Commission. The purpose of this appeal is to allow the individual to communicate to the CFC the reasons why he or she considers that the CFC erred in its decision.

23. One of the main activities between the CFC and the Judiciary is perhaps the time spent in handling appeals presented by economic agents before the tribunals. The *amparo* suit reviews the legality and constitutionality of any administrative matter and, has become the main legal recourse to challenge CFC decisions. From the creation of the CFC and until April 2004, the Judiciary resolved 375 competition-related *amparo* suits: from these, only 35% were resolved in less than a year, while 23% of the cases took from 3 to 5 years to resolve. As was mentioned previously, we have improved our record on *amparo* suits, and the latest figures show that the Commission won 79% of the *amparo* suits presented in 2007.

24. During that year, the CFC faced 199 appeals before the Judiciary: 150 *amparo* suits and 49 nullity trials³; 54 *amparo* suits were resolved (out of which the CFC won 79%). Regarding the nullity trials, only one was resolved in that year which was favourable to the CFC.

25. Until February 2008, in addition to the *amparo* suit, there was another legal instance for judicial appeal: the nullity trial. In Mexico the jurisdictional body overseeing this type of litigation is the Federal Fiscal and Administrative Justice Tribunal (TFJFA), which is part of the Executive Branch but remains fully autonomous. This legal instance reviews whether the actions of an authority are legal, and the effects of its sentences confirm or annul such actions.

26. However, a recent Supreme Court decision established that the TFJFA is no longer empowered to handle competition cases. The ruling established that the only competent jurisdictional body to litigate competition cases is the Federal Circuit Tribunals on Administrative Matters, and also concluded that the *amparo* suit is the sole vehicle of judicial defence to appeal a Commission's resolution.

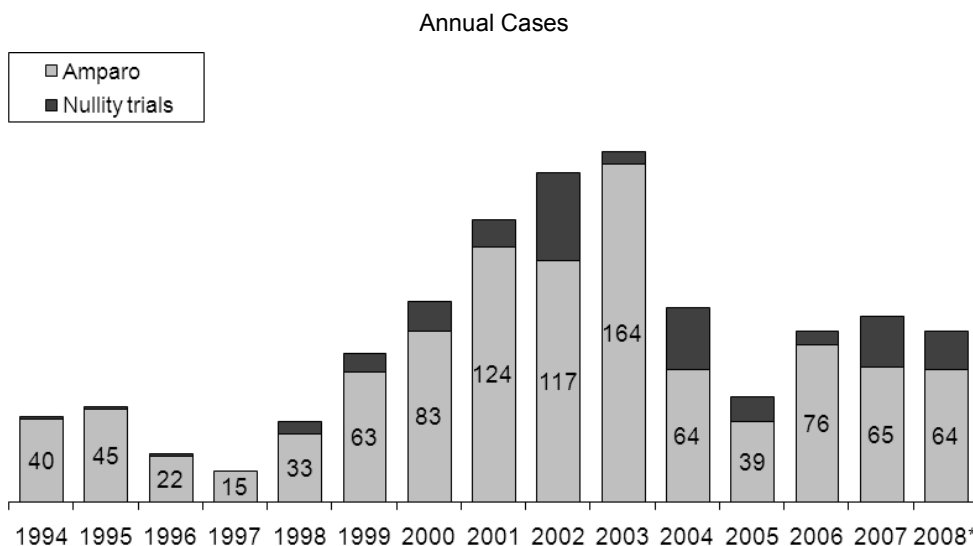
27. Some important judicial decisions have confirmed the constitutionality of seven articles of the competition law, and confirmed economic sanctions imposed by the CFC. Thus, the Judicial Branch has validated the CFC's actions in several markets with high impact on consumer welfare, in which it is essential to resolve competition problems to guarantee better prices and a wider variety of choices.

28. Another important amendment to the FLEC in 2006 was the inclusion of Article 33 bis 2, which allows economic agents to present undertakings to suspend, eliminate, and correct an anticompetitive practice or prohibited merger. After a request of this sort is filed before the Commission, it shall suspend the proceeding and issue a resolution in a period of 15 days. This modification, aimed at preventing the excessive use of resources which instead can be used for other relevant enforcement cases, has allowed the CFC to solve competition problems and restore healthy competition conditions and avoid the complex process of judicial review.

³ The nullity trial is the process followed before a jurisdictional body, to solve controversies between citizens and the public administration. These controversies arise when an individual deems that an action by an authority was carried out without adhering to the letter of the law. Hence, this process reviews the strict legality that an administrative action must follow.

29. As a result of the recent CFC actions, the number of *amparo* suits and nullity trials before the Judicial Branch have decreased considerably since 2003, as shown in the following graph:

Figure 2. Amparo and Nullity Trials against CFC rulings

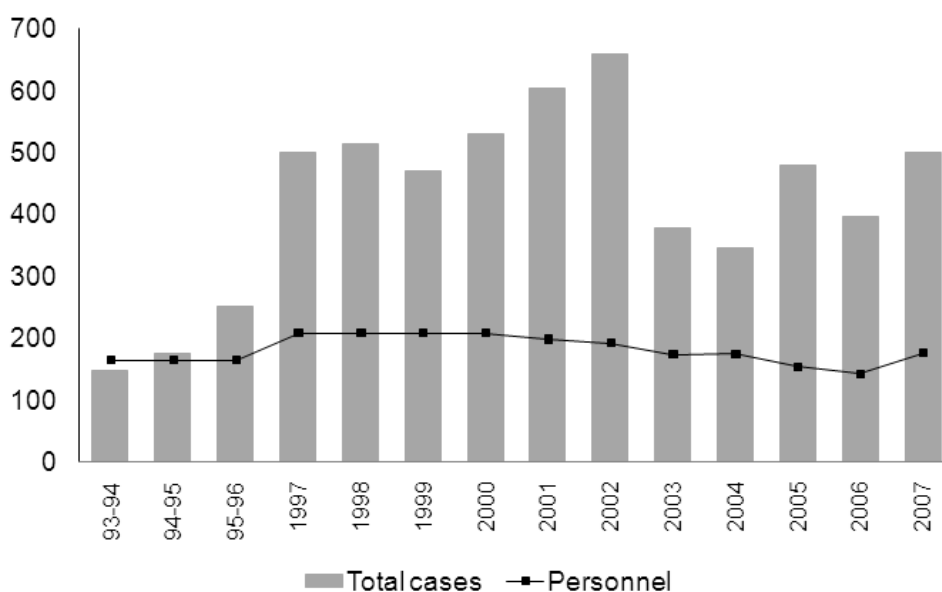


* Data as of November, 2008

1.5. Resources and structure

30. The CFC’s institutional design guarantees its technical and operational autonomy. However, the CFC is dependent on the Ministry of the Economy for its budget, but this has never put in jeopardy the independence of its decisions.

Figure 3. Annual cases and personnel¹



¹ LP gas permits are not included in total cases. Second semester of 1996 was omitted to compare annual periods.

31. The number of CFC employees increased slightly during its first years. As years went by, this number became stable and even showed a small decrease. Given the permanent situation of limited resources faced by the CFC, it became necessary to apply measures to encourage a more efficient use of resources, and to seek support from bilateral and multilateral international organisations in the form of Cooperation Programs. These measures also included an internal restructuring and encouraging multidisciplinary collaboration and improving teamwork.

- In 2005, the Commission initiated a restructuring process that was completed in 2007. The process created five new departments:
 - the Unit for Planning, Institutional Relations and International Affairs;
 - the General Directorate for Institutional Relations and International Affairs;
 - the General Directorate for Contentious Affairs, which used to be embedded in the General Directorate for Legal Affairs. This new area defends the CFC in any procedure before the Judiciary. The second area serves as the CFC's Legal Counsel;
 - the General Directorate for Investigations was divided into two areas: the General Directorate for Absolute Monopolistic Practices and Restraints on Interstate Commerce, and the General Directorate for Relative Monopolistic Practices;
 - the General Directorate for Regulated Markets was separated from the General Directorate for Privatisation and Bidding Processes.

32. The CFC was restructured in order to provide more human resources to the technical areas that handle cases. This was done by shifting resources from the non-technical areas of the Commission, and the process was implemented without any additional financial resources than those assigned yearly by the Mexican Congress to the CFC.

33. Other measures adopted to improve the efficiency of our day-to-day activities had to do with using Information Technologies in order to implement a competition information system. This web-based mechanism facilitates information sharing, provides a platform for on-line work, and allows for efficient follow-up on the development and handling of casework. The implementation of this system has helped to streamline internal procedures and to keep better track of the deadlines established in the FLEC.

2. Competition culture and competition advocacy

2.1. *Fostering a competition culture*

34. In Mexico, the evolution of a competition culture has been the product of advocacy efforts carried out by the Commission over its 15 years of operation. Since 1994, the CFC has implemented countless activities to promote the understanding of competition as a key tool to promote productive and allocative efficiency.

35. During the first years of the Commission, advocacy efforts were centred on promoting an understanding of the FLEC among different constituencies, including other government institutions. Since the FLEC had substantial implications for a large number of participants in the economy, a wide-ranging media program was implemented.

36. The establishment of an active media program proved to be essential in sparking public debate on the importance of competition issues, and placing these on the national agenda.

37. A broader knowledge of the competition legislation and the institution in charge of its application is essential to underpin competition as part of the overall government policy to protect consumer rights. The main activities followed by the Commission to enhance competition culture have been based on i) the transparency of the investigations and resolutions; ii) the response to the economic agents' consultations; iii) the consideration of society's views and comments for the improvement of agency performance; iv) the issuing of studies on competition in regulated sectors; v) and the dissemination of achievements and priorities of the Commission.

38. The President of the Commission has the authority to issue and publish an annual report on the performance of the Commission, including the results of its actions on free market access and competition matters. The process of transparency is strengthened through the publication in the Official Gazette of an abstract of every investigation initiated by the authority.

2.2. *Advocacy on regulatory issues*

39. The FLEC empowers the CFC to issue opinions on legislative bills, and technical regulations, as well as any public policies or administrative acts which may affect competition. The Commission also has the authority to issue opinions on secondary regulations and legislative proposals to Congress. This mandate has been an essential tool to create and promote a competition culture among government bodies and institutions, and to advocate for the inclusion of competition criteria in public policies, including new laws and regulations.

40. The Commission regularly issues opinions and general recommendations on these key sectors of the Mexican economy, which have been instrumental in influencing the design of public policies and ensuring that these incorporate competition principles. Nevertheless, much work remains to be done, especially in Mexico's key regulated sectors such as telecommunications, energy, transportations, and financial services. Issuing opinions and making them public would not have had the same positive effects if the CFC lacked autonomy in its decision-making process. Publishing CFC opinions and making them part of the public debate has allowed us to make progress with sectoral regulators who would be less inclined to follow competition recommendations in a less transparent environment.

41. Through its opinions, the CFC has specifically looked for i) enhancing efficiency and competition in the private pension system; ii) promoting a more competitive structure of the retail banking system; iii) facilitating technological convergence and promoting a more competitive environment in telecommunications; iv) developing a pro-competitive regulatory framework to facilitate access to audiovisual content; v) minimising regulatory inefficiencies in the supply of airport services; vi) reducing barriers to entry in the gasoline retail sales and transport and distribution of liquefied petroleum gas markets; and vii) removing barriers to international trade.

42. Currently, the CFC is working with the OECD on the implementation of a Competition Assessment ("Toolkit") whose main objective is to issue recommendations on how to strengthen competition in key sectors of the economy.

2.3. *Latest progress in the advocacy strategy and challenges for the future*

43. In June 2006, after more than a year of analysis and discussion, the FLEC was amended as a result of a unanimous Congressional vote. This new law has provided the Commission with better operative tools to fight anticompetitive conducts and strengthened the agency's advocacy capabilities. The new FLEC contains provisions allowing the CFC to issue binding opinions on secondary laws and

regulations. As of today, no binding opinions have been issued, but we continue to be very active in issuing non-binding opinions.

44. Over the last two years, the Commission has acquired greater powers through legal reforms, and through its advocacy efforts (i.e. sectoral opinions, public events, and working with Congress and Media, just to mention some of them) has been able to position the importance of defending competition principles on the national agenda.

45. While the CFC has made important progress over the years in establishing an effective advocacy program, many of the challenges that we faced when the Commission was created, still remain. These include the lack of natural allies for the promotion of competition principles. The “competition community” remains very small and academic discussion is incipient. Furthermore, private sector groups and the federal or local regulators that could benefit the most from the adoption of competition principles are precisely the ones that adopt the most defensive positions when it comes to dealing with the CFC.

46. In other words, it is still hard, today, to approach the private sector and other regulators through advocacy efforts when their main concern remains whether a rapprochement with the CFC is likely to put them under the investigative microscope. We therefore need to break this negative cycle and generate confidence among key groups in society as to the benefits of engaging the CFC and embracing the principles that we defend through the FLEC.

2.4. *Relationship with the Judicial Branch*

47. One of the most important tasks for the Commission has been the interaction with the Judiciary in trying to win cases. In order to strengthen the relationship with the Judicial Branch, there are three tasks that the CFC has considered to be key:

- effective communication of CFC’s legal and economic reasoning;
- solid investigations (meaning clearer and better motivated conclusions derived from investigations); and
- mutual capacity building activities.

48. The CFC is currently working with judges and magistrates to enhance their understanding of competition law and policy through a series of seminars and workshops. The goal of these programs has been to promote a deeper understanding of economic concepts involved in competition law.

49. The activities considered in these programs have been enriched by the participation of Judicial Branch members from other countries. This involves conducting seminars with foreign judges and officials from other competition agencies, who share experiences regarding their own handling of competition cases.

2.5. *Advocacy at the state and local levels*

50. The Commission has undertaken a regional advocacy strategy with the aim of deepening competition principles at the state and local levels. As part of this effort, in 2008, the Commission renewed its cooperation agreement with the Office of the Federal Attorney for Consumer Protection (PROFECO) to work jointly in detecting monopolistic practices and strengthening the promotion of competition advocacy and consumer protection across Mexico.

51. This institutional agreement includes reciprocal training activities between both agencies and joint activities to promote competition /consumer culture throughout the country. These activities are also part of an international cooperation program signed by the Commission and the Inter American Development Bank (IADB), which is aimed at ensuring market access for small and medium-sized enterprises through competition policy.

52. In the light of this cooperation program, the Commission has conducted a series of road-shows in different states of the country with the purpose to inform local communities about the Commission's work. However, an effective regional strategy of promotion of competition principles can be very expensive, and this area used to be neglected in Mexico because of other pressing business, such as the large workload of cases, which are the bread and butter of the organisation. Nevertheless, in the last few years, existing resources have been reallocated to a "Regional Coordination Division" which is in charge of implementing such a strategy. It is in the interest of young authorities to allocate enough resources to regional advocacy activities, as most anticompetitive behaviour in developing countries takes place at the state and local level.

53. The consolidation of a competition culture requires the formation of professionals in economics with a legal background, and lawyers who understand how to apply economic analysis to competition cases. In this respect, the Commission has been working with academic institutions to help develop courses and seminars related to competition issues. This approach consists in working together with academic institutions in order to develop specific competition curricula for economics and law students. The goal is to instil competition principles in the new generations of professionals that will enter the labour market in the near future. This is an important element of the CFC's overall advocacy strategy, and it adds to the development of skills of potential Commission employees.

3. Five key elements needed to improve the effectiveness of a young agency

- Full independence.
- Enough financial and human resources.
- Proper legal framework.
- Increased efficiency in operations and quality of resolutions (internal management; knowledge management; and development of professional skills).
- Effective advocacy program in order to position competition issues at the forefront of the national agenda and engage key actors (judicial branch, private sector, sectoral regulators and state and local governments, academic community, consumer associations and other NGO's).