205 Developments in Mexican Law

Eduardo R. Arrocha
Legal Vice President
Coca Cola North Latin American Division

Steven P. Reynolds
Senior Counsel, Law Department
Texas Instruments Inc.

Francisco Velazquez Osuna
Senior Partner
Goodrich Riquelme

Faculty Biographies

Eduardo R. Arrocha

Eduardo Arrocha is the legal counsel for Coca-Cola North Latin America Division, residing in Mexico City. His responsibilities include providing legal advise to the division in all fields of law including corporate, contracts, food law, environmental labor, antitrust, industrial property, tax law, and litigation.

Prior to joining Coca-Cola, Mr. Arrocha established his own office providing legal counsel in the fields of corporate, commercial, labor, and administrative law. He also served as general counsel for Syntex Laboratories in Mexico City and worked for Mexicana de Aviación as legal advisor for labor matters.

He is currently the president of the national corporate lawyers association in Mexico, Asociación Nacional de Abogados de Empresa (ANADE), a member of the Mexican Bar, and the Inter-American and International Bar Associations. Mr. Arrocha is a professor of Labor Law in the Master Programme of the Anahuac University.

Mr. Arrocha is a graduate of the University of Mexico (Lawyer, 1972). He holds diplomas in economic law, fiscal law, constitutional law, and administrative law from the Panamerican University of Mexico and a diploma on comparative law from Columbia University.

Steven P. Reynolds

Steven P. Reynolds is senior counsel in the law department of Texas Instruments Incorporated. He is based in Attleboro, Massachusetts, where he supports the worldwide operations of the sensors and controls segment of Texas Instruments. This segment is a $1.1 billion annual revenue operation, with manufacturing activity in the Americas, Europe, and Asia. It sells technology products to a diversified range of commercial and industrial customers.

Mr. Reynolds has been with Texas Instruments for 11 years, with generalist positions in Attleboro and Dallas, a couple years on a specialized mergers and acquisitions team in Dallas, and a two and one-half year assignment in Europe. His prior experience was with the law firm of Jackson & Walker and IBM Corporation.

He is currently the president of ACCA’s Northeast Chapter and program manager for the International Affairs Committee.

Mr. Reynolds received a BA from Georgetown University and is a graduate of the Rutgers University School of Law.

Francisco Velazquez Osuna

Francisco Velazquez Osuna is senior partner of the Mexican full-service law firm Goodrich, Riquelme y Asociados.

He is a licensed attorney in Mexico and has written several articles and lectured in the United States and Mexico on doing business in Mexico, strategic alliances, foreign investment, competition law, product liability, NAFTA, and cross border legal issues. Mr. Velazquez taught the legal aspects of NAFTA at the Universidad Iberoamericana in Mexico City and Family and Estates, Obligations Civil Procedure, Economic Law, and Consular Law at the Universidad Nacional Autónoma de México, Acatlán Campus.

Mr. Velazquez was the chair of the national association of corporate attorneys in Mexico, Asociación Nacional de Abogados de Empresa (ANADE.) He has been a board member of ANADE for 12 years. He is also the coordinator of the NAFTA Dispute-Settlement Committee of the Mexican Business Coordinating Council during NAFTA negotiations. He is a member of the Mexican Bar Association, the Mexican Law Committee of the American Chamber of Commerce of Mexico, and the Section of International Law and Practice of the ABA.

Mr. Velazquez graduated from the Universidad Nacional Autónoma de México and received a Master of Laws degree from American University. He served as an intern at the U.S. International Trade Commission.

Developments in Mexican Law

Mexican Labor Law

I. HISTORICAL BACKGROUND

The Mexican Labor Law has to be understood as a result of the class struggle of the end of the 19th. Century and beginning of the 20th.

The Law regulates the implementation of Art.123 of the Mexican Constitution.

Article 123 was introduced in the Mexican Constitution of 1917 by the workers representatives; this Constitution was a result of the Mexican Revolution.

The Mexican Revolution was not only political but had a strong social content.

II. PROTECTIVE NATURE OF THE LABOR LAW

The Mexican Labor Law has the specific objective to protect the labor class.

The philosophical principles of the Mexican Labor Law are opposed to some Civil Law principles such as "pacta sund servanda" and the parties free will.

The workers cannot waive their legal rights. (Art. 5).

Labor relations are generally considered for an indefinite period of time. (Art. 39).

Dismissal can only be made with justification. Otherwise an indemnity has to be paid to the worker or he can elect to be reinstated.

The Labor Law is of federal nature.

Labor Courts are three member collegiate tribunals: one from the government, one from the workers and one from the employers.

Labor Courts are considered Courts of Equity, not constrained to the rigid interpretation of the Law, as in the case of Civil Courts. (Art. 841).

III. CORPORATIVIST NATURE OF THE LABOR LAW

The first Labor Law was issued on 1931. This Law was influenced by the ideas of President Calles.

This explains the corporativists aspects of the Law. Mr. Calles was the creator of the "PRI". The Party that governed Mexico for the last 71 years.

The Party based its structure on several corporations: Official Unions, Peasants Associations and what was called the Popular Sector, which included Business Associations.

This might explain why the Law in one part (individual workers' rights) is very socialist due to the origin of Art. 123; and in collective matters, the Law is a corporativist code: incorporation and registry of unions, union representation, collective contracts, and conflicts of collective nature.

The official unions were responsible for bringing workers votes and in exchange, the government gave them strong protection to control workers insurgency.

This has caused corruptive practices such as "protection contracts", through Mafias that sell "sweetheart agreements".

The Law was reformed in 1970, but its corporativist structure, remained untouched.

In 1980, a major reform was made in the procedural aspects of The Law. This reform has been very criticized by the employers because it was very lopsided on the workers favor.

For example, the burden of the proof is on the employer.

IV. EFFORTS TO REFORM THE LAW.

Since the times of President Salinas there has been a strong movement to reform The Law.

It is considered that a deep reform is long overdue to adequate The Law to a modern economy.

The labor movement has been very reluctant to accept major reforms, specially in the area of individual rights and union protection.

With that objective, both sectors, official unions and employers, have been negotiating with the mediation of the government since 1990.

In absence of consensus to that end, in the meanwhile, they have agreed in a general frame work: "The New Labor Culture".

The purpose of this new culture is to abandon the old concept of struggle of the classes, achieve a cooperation between the sectors, and give an impulse to productivity.

It seems that in the area of workers' rights or what we call the substantive part of the Labor Law, it might be possible to make some adjustments, but not a radical reform.

The Labor Unions, both official and independent, as well, will not accept employers' demands suggested by the World Bank, such as:

- elimination of severance payments,
- disparition of collective agreements,
- liberation of employers from the legal obligation to provide training,
- flexibilitation of temporary employment.

It is most likely that in the area of Procedural Labor Law, and Collective Conflicts, important progress can be made.

In fact, at the end of President Zedillo s Administration, a consensus was reached amongst the sectors, including the Government, for a new "Procedural Code".

This Code will represent a very significant advancement, for example:

- ✥a legal process more equitable,
- ✥better rules in the area of legal strikes,
- ✥obligation for labor unions to legitimize their demands of collective contracts,
- ✥disputes in the administration of collective contracts,
- ✥stream-line collective economic conflicts.

Unfortunately this bill was not sent to Congress before the new Administration took office.

The new authorities want to reopen the negotiations for a total reform. We are of the opinion that it will be very difficult to achieve a consensus in the near future.

In the other hand, with the democratization of the country, the Official Unions have lost their protection.

This has made possible to challenge the way in which unions were granted their registration, which in Mexico has been the way in which the government has been able to control the labor movement.

The Mexican Supreme Court has questioned the legality of the so called "Exclusion Clause", which has been a corner stone of the Corporativist Unions. (Art.395).

I am very skeptical with regard to a total reform within the near future. The most optimistic scenario will be a reform in the procedural rules and possible changes forced by courts' decisions in the areas of :

- union registration,
- legitimization to demand collective contracts,
- legitimization to initiate strike procedures,
- impossibility to stop legal economic conflicts by means of strike procedures.

However, the loss of control by the PRI Party will open the opportunities for a more democratic and modern legal system.

ACCA/SAN DIEGO OCT. 2001
PROGRAM 205/MEXICA LAW
FRANCISCO VELAZQUEZ-OSUNA

AEROMEXICO/MEXICANA/CINTRA
(www.cfc.gob.mx)

Press Release/October 4, 2000

The Federal Competition Commission (CFC) has decided that Aerovías de México (Aeroméxico) and Mexicana de Aviación (Mexicana) must be sold separately as independent companies to different buyers, given that if they were to be sold together, they would represent the consolidation of a company with market power. This would thus violate the Constitution of the United Mexican States and the Federal Economic Competition Act (Ley Federal de Competencia Económica or LFCE).

In response to the consultation made by Cintra's majority shareholders concerning the possibility of transferring the airlines without placing any restriction on their operation or sale, the CFC has determined that should these companies be sold jointly, the resulting economic agent would have the power to unilaterally fix prices and prevent the entry of or unduly displace other market competitors.

Since both the Constitution and the LFCE prohibit the above-described concentration, the Commission has decided that the airlines must be sold separately, thereby re-establishing competition in the domestic market for commercial passenger and cargo air transportation.

Given the precarious financial situation that Aeroméxico and Mexicana were undergoing, in 1995 the CFC authorized the creation of Cintra as a temporary financial vehicle that would enable: financial recovery and survival of the airlines by means of debt capitalization undertaken by a group of domestic banks; strengthening the airlines with additional investment; and selling the companies separately once their financial and operating feasibility were re-established.

The Commission conditioned its authorization to the acceptance and strict observation of several measures that would affect the competition process to the least extent possible. Foremost among the conditions imposed was that in which Aeroméxico and Mexicana were prohibited from merging their operations or managements

The temporary existence of Cintra was successful, as the situation of the airlines is currently very different. Both are financially sound, have very attractive international alliances and are good business opportunities.

Separating the airlines is not only feasible, it is also consistent with a long-term view of the industry, in which the objective is to have safe, efficient and accessible air transportation for an increasing number of users within the country.

By being more competitive, aviation will be in a position to develop more, to lower its costs and improve its supply of services. This will substantially contribute towards fostering economic activity and new jobs in the country, where development of communications and transportation plays a significant role with the prevailing worldwide context of economic opening and international integration. It is noteworthy to mention that as the industry becomes more competitive, the number of employees holding jobs in the sector will grow.

The CFC believes that consolidation of a dominant company in the field of commercial aviation would be contrary to the interests of users at large, that it would hinder the development of air transportation and, in general, the economic growth in the country.

If Cintra were permanently consolidated as the holding company of Aeroméxico and Mexicana, it would be able to unilaterally set airline fares in the majority of domestic routes. In the long-run, it would be difficult to prevent the company from setting higher that fair fares, and from reducing flight frequencies. The holding company would have little in the way of incentives to improve its passenger service. Furthermore given its size within the domestic environment, the company would be able to unduly displace its competitors and prevent the entry of new companies into the market, along with having the added protection from foreign competition.

The CFC resolution is based on a meticulous analysis of all possible sales alternatives, and consideration was moreover given to all the legal, economic, social and strategic issues inherent in said alternatives.

About Market Growth

National and international experience in the aviation industry clearly shows that greater market competition represents a strong incentive to reducing costs and offering better fares. And a fare reduction in real terms would in turn substantially increase passenger volumes.

Whereas when only one company exists in the market, there are strong incentives so that sooner or later that single company will set and maintain high prices at the users' expense, which ends by constraining production levels or the supply of the service involved.

Market growth is very important for Mexico. Use of air transportation in the country is currently very low, barely one percent of all passengers being transported.

Greater competition in air transportation services would likewise favor labor interests in the sector, since with increased passenger volumes, the demand for personnel would also rise, along with new better-paid jobs.

About the Existence of Two Network Airlines

Some have doubts about whether or not the Mexican market is large enough for two network airlines, as is the case of Aeromexico and Mexicana. They would have to share the same center of operations –the Mexico City Airport-, where the majority of demand for air transportation to other cities in the country is concentrated.

With the aim of reducing their costs, network companies create hubs in stopover airports where they concentrate passengers from varying origins and heading to different destinations. Most of the demand in a hub comes from passengers in transit, not local passengers.

In the case of Mexico City, location of the airport that registers the highest traffic in the country, over four fifths of the passengers either originates from or is headed to the city's Metropolitan Area. It is location with high relative demand for travel to and from other places in the country, where both Aeroméxico and Mexican have operation centers, because there are more passengers. Any savings obtained from concentrating passengers in the Mexico City airport would only come from one fifth of the traffic, unlike an airport like Atlanta for instance, where passengers in transit represent 70% of total traffic.

Mexico City concentrates passengers on international flights that begin or end in Mexico, yet it lacks the essential characteristics of a hub since the carrier for the international portion of the flight will not necessarily be Aeroméxico or Mexicana.

It is the mistaken idea that the Mexico City airport offers the synergy of a hub that has led to the conclusion that one of the two companies would unavoidably displace the other. Yet this fear is actually unfounded in view of the above explanation.

About a Possible Price War

Another fear is that the airlines could incur in a fare war, which would lead one or both to bankruptcy.

In the opinion of the Commission, this fear is not well founded either, since experience shows that fare wars do not last long and are limited only to certain routes. There is no evidence of generalized fare wars that have been the sole cause of an airline going bankrupt. All bankruptcies registered are the outcome of mistaken management or ill-planned strategies by companies.

Contrary to what some would think, international experience shows that airlines competing among themselves within a market can continue to grow without destroying each other.

In the case of Mexico there is very little likelihood that national airlines of a similar size and with like financial resources could become involved in a self-destructive price war.

Nevertheless in light of the possibility of a price war that could lead one of the airlines to bankruptcy, the CFC and the Ministry of Communications and Transportation have agreed on a mechanism to ensure effective and sound market competition. This mechanism includes modifying the Regulations of the Civil Aviation Act in order to make the provisions contained therein more expeditious.

About the Fleet Size

It has been pointed out that the size of the airlines, taken separately, would be insufficient to compete with foreign airlines. It has moreover been mentioned that, as result, the airlines would be unable to make the most of earnings gained through the greater efficiency resulting from one single company, merged from the two.

With reference to the first point, it is fair to say that the size of both airlines is quite modest in comparison to the fleets of the most important foreign carriers, especially American Airlines that represent that main direct competition for Aeroméxico and Mexicana on international routes.

Nonetheless, the difference in size between large international carriers and the Mexican airlines is so vast that even if the latter merged, the size of the company would still be much smaller that international carriers. This is precisely why national airlines have teamed up in global alliances that group airlines from several countries in order to compete in the word market. This separating Aeromexico and Mexicana would make it more feasible for the airlines to remain in different global alliances, thereby strengthening competition in benefit of users flying abroad.

Regarding alleged gains in efficiency, technical studies show that the so-called economies of scale - meaning greater efficiencies that stem from having a larger fleet are limited in the aviation sector. In fact there are small fleet airlines that compete successfully in the routes where they operate against the world's largest companies.

About the Sales Value of the Companies

Pursuant to its mandate, one of the core objectives of the Institute for the Protection of Bank Savings (IPAB), Cintra's main shareholder, is to obtain the highest recovery value possible from the sale of its assets. Some have argued that if the companies were sold as part of a “package deal”, the recovery value would be higher than it would be were they to be sold separately.

False. It is important to note that the value of a monopoly, if unregulated by the authorities, is always higher than that of companies operating in a free market environment. This is so because the excess profits and benefits that a monopoly generates for its owners are at the expense of the consumer who has to pay higher rates.

If Cintra were to be sold as a “single unit”, the authorities would be forced to impose severe regulations in order to avoid abuses in view of the market power of the resulting company. Under such circumstances, the value of the company would be much lower than if the companies are sold separately.

The rule of law stipulates that the conduct of the authorities must abide by the law. Pursuant to its mandate, the Commission does not authorize a concentration prohibited by the Constitution and the LFCE since it would be harmful for society in general.

Separating Aeroméxico and Mexican, as ordered by the CFC, will foster greater competition in the aviation market. This will in turn be an important factor in reducing fares, expanding the market and offering better services to users without sacrificing safety. It will likewise enable sound development of the industry and technological progress based on fresh investments. As a result the aviation sector will be contributing towards the country’s development.

ACCA/SAN DIEGO OCT. 2001
PROGRAM 205/MEXICAN LAW
FRANCISCO VELAZQUEZ-OSUNA

GRUPO FINANCIERO BANAMEX-ACCIVAL/CITIGROUP (www.cfc.gob.mx)

Press Release/2001

The Federal Commission on Competition (CFC) resolved to authorize the merger between Grupo Financiero Banamex-Accival, S.A. de C.V. (Banacci) and Citigroup Incorporated (Citigroup), conditioning it to compliance, within a period of no more than one year, with the measures stipulated by the CFC to protect and promote the process of competition in the markets that could be negatively affected by the transaction. The conditions are:

1st Garante, S.A. de C.V. retirement fund management company, and Afore Banamex Aegon, S.A. de C.V., must be amalgamated.

2nd The agents must withdraw their share of the capital stock of the company Servicios Electrónicos Globales, S.A. de C.V. (E-Global).

3rd The agents must extinguish existing patrimonial links with Grupo Financiero BBVA Bancomer, S.A. de C.V., in the company Crédito Familiar, S.A. de C.V., Sociedad Financiera de Objeto Limitado.

After appraising the consequences of the operation in domestic markets for financial intermediation services, the CFC concluded that, in most of these, the merger does not imply risks to competition.

The markets that could be affected are: retirement fund management (afores), electronic processing of payment and to a certain extent, financing for comsumption.

In regard to the afores market, the latter shows regulatory limits on participation, in terms of the number of affiliates that each management company can register. The presence of one same agent in two afores would give rise to a situation of competitive disadvantage for the other participants in the market.

In relation to the market for electronic payment services, the conjunction of both agents as principal partners of the two most important electronic processing companies Banacci participates together with BBVA-Bancomer and Bital in E-Global and Citigroup participates, through Citibank, in Prosa.

In regard to Crédito Familiar, the CFC considered it necessary for the resulting agent not to participate in the company linked to its main competitor. Therefore, the CFC ruled that Citigroup should sell its share.

The measures stipulated as conditions for authorizing the operation reflect the preventive work carried out by the CFC by protecting the process of free competition in markets.

The merger of Grupo Financiero Banamex.Accival and Citigroup is an important step toward the consolidation of the financial sector, indispensable for our country's economic development. Through different processes of restructuring and consolidation, the Mexican banking system is being strengthened and is leaving behind the problems faced in the past.

ACCA/SAN DIEGO OCT 2001
PROGRAM 205/MEXICAN LAW
FRANCISCO VELAZQUEZ OSUNA

KIMBERLY CLARK DE MEXICO, S.A. de C.V. / COMPAÑÍA INDUSTRIAL DE SAN CRISTOBAL, S.A.(www.cfc.gob.mx/reports /1995-1996/chap. 2.htm)

In 1995, Kimberly Clark Corporation (KCC) announced its intention to carry out a merger with Scott Paper Company. Both companies, incorporated under U.S. law, have major investments in that country and in the rest of the world. As a result, they control a significant share of the markets for tissue paper byproducts in the United States and in those countries in which they have subsidiaries. The merger of these two U.S. companies threatened to cause high levels of concentration in certain Mexican markets, because of their stakes in Kimberly Clark de México (KCM) and Compañía Industrial de San Cristóbal (Crisoba). On account of the major market power that would have arisen from the operation, the Commission decided to place conditions upon it, involving the divestiture of productive capacity, brands, and products. This served to protect the benefits of the merger while eliminating its threats to competition.

Under the merger in the United States, KCC would acquire 100% of Scott's capital stock. Thus, the 49% stockholding in Crisoba belonging to Scott Worldwide Inc. (a Scott subsidiary), as well as its option over 3.1% of the Mexican company's capital stock, could end up in KCC's hands. As a result, the merging U.S. company could obtain control over Crisoba and the other companies in its group.

As indicated in the notification, the operation would involve a merger between Crisoba and KCM. After the operation, the corporate structure would be as follows: 55% of KCM's stock would be in Mexican hands and the remaining 45% would be under the control of KCC (31% directly and 14% through Scott Worldwide Inc.). In turn, KCM's corporate responsibilities would expand after incorporating Crisoba and its subsidiaries into its group.

KCM and Crisoba have a major share in the production and marketing of feminine hygiene products, tissue paper byproducts, writing and printer paper, and disposable baby wipes. On account of the different market shares of the two companies, the impact of the merger on conditions of competition would vary in each affected market.

Feminine hygiene products. The sanitary towel market is characterized by expanding demand, but demand that is relatively inelastic because there are only distant substitutes made with cotton or cloth. Sanitary towels, tampons, and panty-liners have different levels of substitutability. However, panty-liners and sanitary towels are generally complementary.

Marketing takes place throughout the country through different channels. The relevant market is that of the three products at the national level.

The two merging companies were estimated to have a 63% share of this market. The remainder was mostly covered by Procter & Gamble (22%) and by other manufacturers and imports (15%).

Technological and promotional expenses raise market entrance costs for new companies, protecting the shares of the three main domestic producers. Competition from foreign articles can be largely discounted because domestic production is more advantageous as a result of import costs. As a result, this merger would grant substantial power over the relevant market and would facilitate monopolistic practices.

Tissue paper byproducts. The derivatives of tissue paper include toilet tissue, facial tissues, table napkins, and absorbent kitchen towels. Although each is intended for a specific purpose, the possibility of substituting one for another does exist. Since these products are sold nationwide, their relevant markets cover the entire nation.

KCM and Crisoba supply more than two-thirds of domestic sales of tissue paper products: a combined total of 331,000 tons a year. This volume, while important for Mexico, is not significant globally: in volume terms, the operation would rank KCM/Crisoba 110th among the world's largest paper companies. This fact and the relationship between scale and efficiency were taken into account during deliberations on the operation's favorable effects on competition. However, consideration was also given to the high domestic market share of the two companies (67.4%), which did threaten competition.

The following facts are relevant to this matter:

- KCM alone has a 70% market share in facial tissues and kitchen towels;
- in the facial tissue market, Kleenex and Scotties (belonging to KCM and Crisoba, respectively) account for 98% of domestic demand;
- in napkins, KCM's Regio brand covers 12% of demand;
- the brands of absorbent paper towels with the largest market shares are KCM's Kleenex and Vogue and Crisoba's Pétalo; and
- most of the two companies' business comes from toilet tissue, where they handle the two major brands sold domestically (Pétalo and Regio), each of which accounts for slightly over 20% of total market volume.

KCM/Crisoba's substantial share of the tissue paper market must also be seen in conjunction with their highly integrated productive processes, the extensive coverage of their distribution networks, and the high market penetration of their brands.

This situation would be a major discouragement to the consolidation of existing competitors and the entry of new companies, on account of the investments that would be necessary to set up a nationwide industry and of the high outlay, in terms of both time and resources, required to establish new brands. All these factors would grant the two companies substantial market power, threatening competition and free market access.

Writing and printer paper. This includes a wide range of paper types and products made from paper, the characteristics of which depend on their intended use. Substitutability between them is subject to certain restrictions. Similarly, paper products manufactured for other purposes are not a reasonable alternative.
For this reason and on account of its national distribution, the relevant market covers the entire country. Of this market, KCM/Crisoba have a 36% share, with imports supplying another 50%. To meet foreign competition, the Mexican industry must raise its quality standards and levels of efficiency. The merger could increase KCM/Crisoba's efficiency without threatening competition among most of the products that make up this market. However, competition in the notebook segment would be threatened, where KCM and Crisoba respectively cover 80% and 6.5% of domestic demand. Given these conditions, the merger would raise, but not drastically modify, the structure of the relevant market. Nevertheless, the market power arising from such stakes in the total volume would hinder competition.

Other products. In the disposable baby wipes market, the following facts were noted: KCM and Crisoba supply 38% of the market through imports. 70% of domestic demand is covered by imports from the United States. The two companies are major producers in that country.

Considering this, the Commission decided that the merger would restrict competition in the affected market.

To summarize, the merger between KCM and Crisoba posed threats to or imposed restrictions on competition and free market access in the above markets. As a result, its completion in the way described in the notification would have facilitated the displacement of competitors and the unilateral imposition of prices, to the detriment of consumers. To prevent this, the Commission took steps to reduce the merger's market power and facilitate immediate participation by new competitors. With this in mind, and after hearing the opinions of the main competitors, the Commission decided to impose the following conditions on the operation.

Feminine hygiene products. Divestiture of Sancela and Comercializadora Sancela, which also meant the divestiture from Grupo Crisoba of the brands produced and marketed by Sancela (Saba, Confort, Evax). With this, KCM's share of the relevant market was kept at 38%. The 25% previously controlled by Crisoba was opened up to competition.

Tissue paper derivatives. In this sector, the Commission ordered

- the sale of all rights over Regio brand toilet tissue and napkins;

- 25-year transfer under license, extendible indefinitely in 25-year increments, of all rights over Scotties brand disposable tissues; and
- cessation of Suavel brand napkins. These steps were supplemented by the divestiture of sufficient assets to produce at least 67,000 tons of tissue paper, and of the converters necessary to manufacture toilet tissue, facial tissues, and paper napkins in proportions equal to the market shares of Regio and Scotties. In addition, the purchasers of those assets would be offered the option of entering into a supply contract for 13,000 tons of tissue paper a year. In this way, competitors would be able to enter the market with a supply of 80,000 tons of tissue paper derivatives, already supported by known market brands.

As a result of these measures, KCM/Crisoba's share of the tissue paper derivatives market could be limited to 50%. In terms of specific products, this meant that a good proportion of KCM's supplies of toilet tissue and table napkins would be transferred to the competition. It also meant that the merger would have no effect on facial tissues, since other economic agents were to acquire Crisoba's share of that sector.

Writing and printer paper. Sale of all Mexican rights over Shock, Crisoba's main brand of notebooks. This measure would reduce the entry costs to be met by new competitors in the corresponding market.

Other products. 25-year transfer under license, extendible indefinitely in 25-year increments, of all rights in Mexico over Baby Fresh brand baby wipes.

Similar measures were introduced in other countries. The Mexican response was perhaps of greater scope, since it obeyed the need to prevent the negative effects from operations much larger than those occurring in other countries. The ruling, while appearing harsh, was consistent with the need to effectively eliminate threats to competition in domestic markets.

To insure that the implementation of these conditions would favor competition and free market access within as short a space of time as possible, the Commission granted the merging companies a period in which to submit a transparent, non-discriminatory scheme that would allow the participation of other economic agents with a real capacity to compete in the affected markets.

ACCA/SAN DIEGO OCT 2001
PROGRAM 205/MEXICAN LAW
FRANCISCO VELAZQUEZ OSUNA

THE DECISION OF THE FEDERAL COMPETITION COMMISSION ON THE SALE OF CINTRA (HOLDING OF AEROMÉXICO AND MEXICANA) (www.cfc.gob.mx)

October 2000

I. MOTIVATION

Corporación Internacional de Aviación (Cintra) is a financial holding company that controls Aerovías de México (Aeroméxico), Compañía Mexicana de Aviación (Mexicana), the feeder airlines mexicana Inter and Aerolitoral, as well as other subsidiaries and affiliates. The federal government and the IPAB (Institute for the Protection of Bank Savings), which hold a majority share of the corporate voting rights with 66% of Cintra's stock, and the banks that hold 21% requested a consultation with the Federal Competition Commission (CFC) relative to their intention to divest themselves of their Cintra stock holdings.

The decision to sell those assets is of great importance for the country given that Cintra is the largest airline group in Mexico, rendering service to 80% of passengers traveling domestic routes in December 1999.
Likewise this holding company is subject by the CFC to conditions aimed at avoiding abuses of market power and antitrust conduct in the domestic airline market.

Responding to the consultation, the Plenary of the CFC decided to order that Aeroméxico and Mexicana be sold separately to independent owners. This decision has triggered numerous comments derived from the concern that independent operation of the companies would jeopardize development of commercial aviation in Mexico and employment in the sector.

This document describes the central points of the Commission's decision and the reasons why said decision will fuel significant benefits for the country and the domestic air transportation industry, in addition to being compatible with the interest of attaining the highest market value for Cintra's owners.

II. BACKGROUND

At the end of the 80s Aeroméxico and Mexicana were privatized using different privatization procedures. As a result the companies' starting points implied different initial conditions. In the case of Aeroméxico, the old Aeronaves de México was first declared bankrupt and then a new company, free of financial and labor liabilities, Aerovías de México, was created. The new company was acquired by a group of domestic investors.

Mexicana, on the other hand, was capitalized by means of resources contributed by a new group of private investors who acquired control over the company by purchasing two-thirds of its shares, while the federal government held the remaining 34%.

Both new managements were entering the field of aviation for the first time at a moment when expectations for the development of airline transportation appeared promising. However a set of bad decisions, motivated by a lack of vision and personal ambition, led both companies to enormous debts, to leasing or acquiring equipment outside of market conditions, to disproportionate hiring of non-unionized personnel and to other extravagances common in bad management.

In August 1991 the federal government made its permit and concession process more flexible, which encouraging the entrance of new passenger airlines. As such an intense price war arose between Aeroméxico, Mexicana and their new competitors. Implementing aggressive commercial strategies, the companies gained market share and reduced fares benefiting users. To give the reader an idea of just how much decreasing fares impacted demand, between 1993 and 1994 the volume of passengers rose from close to 15 to 18.4 million passengers, growth that is equivalent to 22.6% of airline passenger traffic in 1993.

High operating costs and excessive debt resulting from bad management, added to inadequate supervision of new competitor operations, placed Aeroméxico and Mexicana in a difficult financial situation. It is noteworthy to recall that during the previous administration, fuel supplies did not always meet commercial criteria, which enabled unfair competition by a few of the new companies. Aeroméxico and Mexicana gradually lost capital until reaching the edge of bankruptcy.

Before the Federal Economic Competition Act (LFCE) entered into force, the federal government authorized Aeroméxico, experiencing a better apparent financial situation, to acquire stock control over Mexicana, until then the former's main rival in the market. In this operation, prior to the LFCE, the Ministry of Communications and Transportation (SCT) imposed a set of conditions aimed at maintaining market competition. The operation, nonetheless, only had palliative effects that were unable to avert creditor banks from taking over control of both companies in September 1994. Accused of fraud and misappropriation of funds, the companies' chairman and major shareholder escaped, leaving the companies immersed in the worst crisis of their history. It is noteworthy to mention this background because since Aeroméxico and Mexicana were the property of one single control group, the majority of which was private, the domestic air transportation industry was placed in grave danger.

The conjunction of bad management and inadequate supervision of the new companies created the false perception that the Cintra airlines had failed due to market competition.

The creation of Cintra. In May 1995, the banks that were managing Aeroméxico and Mexicana requested that the Federal Competition Commission issue the permit required by the LFCE in order to form a holding company for the shares of both companies. In other words, to create a "financial vehicle" that would enable the banking institutions to capitalize the liabilities of the aviation companies.

The Plenary of the CFC analyzed the banks' request in line with the following considerations:
That an imperfect partnership existed between the two airline companies, which began prior to the entrance into force of the LFCE. This was inadequate both for company operations and for competition in regular passenger air transportation within the country. That it was essential that effective competition be established as soon as possible in the market, hence between Aeroméxico and Mexicana.

That as long as complete competition was not re-established, the CFC should have control mechanisms aimed at avoiding antitrust practices.
In view of these considerations and within the term called for by the LFCE, the CFC ordered the temporary creation of Cintra, conditioning the latter to respecting a set of measures aimed at preventing abuses of market power, as well as at maintaining separate operation of the companies for a term of three years, to then separately sell the companies. The core of the issue for the CFC was and still is avoiding market abuses and practices contrary to competition in domestic routes.

Cintra subsequently requested that the case be reconsidered, arguing that the three-year term was insufficient to conduct an appropriate financial restructuring. In the recourse decision, the CFC evaluated the information provided by the company, heard the opinions of aviation authorities, as well as those of Cintra's competitors, of pilot unions, flight attendants and ground workers. The CFC furthermore consulted the legislative committees working on the issue in both chambers of Congress and their observations and recommendations were duly taken into consideration.

The CFC decided to ratify its decision to authorize temporary operation and introduced several modifications to the original conditions so as to have close surveillance over the companies' conduct.

The CFC changed the term from three years to an undefined term, albeit subject to restructuring both companies financial and operative affairs. Once the objectives set were accomplished or in the event of a failure to comply with the conditions, the companies were to be unconsolidated. Cintra consented to the term set by the CFC as well as to the procedure, which states to the letter:

"The Commission will periodically review the conditions of competition prevailing in the pertinent air transportation market. If the reports issued to such effect conclude that conditions of effective competition do not exist, the Commission shall instruct the promoters as to the actions that they must perform in order to help establish such conditions. The Commission may order that antitrust practices be suspended or corrected or order a partial or total unconsolidation of the economic agents involved in the transaction served, as well as to impose the remaining sanctions foreseen in the Law."

The Commission identified the following elements for effects of composing the reports relative to market evaluation and follow-up and to development of the Cintra companies: Market share of Cintra subsidiaries and of the competition; Evolution of fares and price-cost ratios; Comparative analysis of costs vis-à-vis similar companies in other countries; Commercial practices undertaken with the general public and travel agencies; Co-coding programs; and Administrative standards and measures for market entry.

In order to conduct this follow-up, the Commission had to periodically assess conditions of competition with the support of an independent consultant. As consultant, Cintra chose one firm from a set of three alternatives presented to and approved by the Commission. The consultant has presented 23 competition audit reports and other supplementary reports over a period of three years, thus enabling the Commission to closely follow the companies' behavior.

III.- PRESENT SITUATION

With the arrival of the banking crisis, which was aggravated in 1995, part of Cintra's assets became the property of FOBAPROA (Banking Fund for the Protection of Savings), and then later of the IPAB. And this is how the latter inherited majority ownership of the company's corporate voting rights. The federal government currently holds, directly and indirectly, a 66% share of the company, while the remainder is in the hands of Banamex, Bancomer and the investing public at large.

Information available indicates that from 1994 to 1999 Cintra has strengthened financially and operatively. Consequently the risk of bankruptcy has completely dissipated.

Table 1
Aroméxico and Mexicana indicators of results, 1995 – 1999
Millions of 1999 pesos

	1995	1996	1997	1998	1999
Aeroméxico					
Gross operating profit (loss)	207	725	1,063	533	638
% with respect the operating income	2.00%	6.07%	9.03%	4.07%	5.03%
Mexicana					
Gross operating profit (loss)	848	1,099	1,270	499	753
% with respect the operating income	8.04%	10.08%	11.05%	4.05%	6.07%

Source SAI, Summary of the financial evolution of Aeroméxico and Mexicana between 1996 and 1999, May 2000

The evolution of operating profits in Aeroméxico and Mexicana shows positive results even in 1995, as can be seen in Table 1. A first example of the success of the company's financial and operating restructure was observed in 1998 when the company proposed the possibility of a public stock placement in several stock exchanges.

The financial success has nevertheless been accompanied by a deterioration of conditions of competition in the domestic market. The foregoing is due to a strengthening of Cintra's market power and to the precarious financial situation of the company's competitors, including the recent bankruptcy of one such competitor.

IV. CONDITIONS OF COMPETITION

The consultation undertaken by the shareholders with the CFC proposed eliminating the conditions under which Cintra presently operates and proceeding towards the joint sale of the companies, without said sale being subject to any type of restriction. Eliminating current operating conditions is tantamount to authorizing the concentration of a set of airline companies and subsidiaries, for which the CFC must assess resulting market conditions and the effects thereof on competition. It is to this aim that this section explains the aspects to which the LFCE stipulates its determination: pertinent market, power of the participants, economic and regulatory barriers for entry of new competitors, and power of competitors to offset that of Cintra's companies and the conduct of its companies in the market.

Pertinent Market. Cintra's airlines offer regular air transportation services between cities. Each link between a pair of airports or cities (routes) within the country conforms a specific market. Similar substitutions of said services are those offered by competing companies in the varying routes.
Other passenger transportation services, the most important of which is transportation by bus, present substantial differences in terms of quality, price and travel times. As such they are not analogous substitutes.

The geographic dimension corresponds to the country's national territory since there are regulatory barriers that prevent free concurrence of foreign suppliers. The following are the most important of the latter regulations:

- The Civil Aviation Act and the bilateral agreements prevent foreign companies from being involved in domestic air traffic.
- The Foreign Investment Act (LIE) sets a 25% ceiling on direct foreign participation in air transportation companies, which precludes foreign companies from acquiring control of a domestic company. Although the Act allows foreigners to have additional indirect ownership, in practice neither direct nor indirect foreign investments have been authorized in domestic air transportation companies.

The foregoing considerations confirm that set fort in the resolutions that authorized Cintra's creation: the pertinent market is regular (of a predetermined frequency) air transportation of passengers within the country.

Concentration. Having determined the pertinent market, the role of Cintra's companies in said market must be examined, in which case one initial criterion is market share.

In 1999 Cintra's airlines transported 71.7% of all passengers in the country. In view of the retreat from the market of the company Taesa, the subsidiaries' market share rose to 79.9% in December of that year (Table 2).

Table 2
Share of air transportation companies in the domestic market 1999
Percentages of the total number of passengers transported

Company	% of Anual Share	% of Share December 1999
Aeroméxico ***(1)***	41.10	45.95
Mexicna ***(2)***	30.60	33.95
CINTRA	**71.7**	**79.9**
Aerocalifornia	8.80	9.91
Consorcio Aviacsa	6.00	7.31
Aerocuahonte	0.20	0.21
Aeroejecutivo	0.00	0.05
Aeromar	2.30	2.62
Taesa y otras	11.00	0.00

(1) Includes Aerolitoral
(2) Includes Aerocaribe and Aerocozumel
Source: SAI, Report of the competition audit conducted of Cintra and its subsidiaries, May 2, 2000

If the airlines are analyzed independently, the figures corresponding to 1999 provide a Herfindahl rate of 2,860. When the companies are consolidated, the previous rate rises to 5,380. The companies' rate of dominance when considered separately stands at 4,570, while it would be 9,140 if consolidated. Both rates measure the level of concentration on a scale of 0 to 10,000.
When using figures from December 1999, the previous rates stand as follows: the Herfindahl rate rises to 3,430 if the companies are kept independent and to 6,558 if they are concentrated; while the dominance rates increase to 4,951 and 9,526, respectively.

The afore-mentioned calculations show that the levels of concentration would widely exceed the criteria foreseen. The Herfindahl rate, even without consolidation, is well above 2,000 units and its increase would substantially exceed 75 units. The dominance rate stands well in excess of 2,500 units and its value does not decrease after consolidation.

When bearing in mind the definition that each route represents a separate market, the concentration is higher than nationwide market share averages. In 1999, in a sample that includes 41 of the major routes for domestic airline passenger traffic in which Cintra's companies operate, joint market share and levels of concentration are those shown in (Table 3.)

Table 3
Cintra's share in major routes
Percentages of total number of passengers transported

The Subsidiaries have	Number of Routes	Average Cintra Share (1)	Herfindahl rate	Dominancy Rate (2)
100%	15	100%	10,000	10,000
From 90 to 100	7	95.40%	9,109	9,988
From 80 to 90	7	84.50%	7,207	9,835
From 70 to 80	5	77.00%	6,069	9,572
From 60 to 70	5	65.00%	4,538	8,711
From 50 to 60	2	59.50%	3,950	8,058
Total (3)	41	83.50%	7,040	9,807

(1) Simple Average
(2) Assuming the existence of four symmetrical companies competing against Cintra
(3) Weighted average considering the full sample
Source: SAI report of audit conducted of Cintra and its subsidiaries May 2, 2000

In each of the 41 routes, the concentration of the subsidiaries would well exceed all thresholds. This initial fact confirms national results, which is why it is highly likely that the concentrated participant would be in a position to unilaterally set prices or restrict supply in regular passenger air transportation without economic agents being able to offset said power. Entry Barriers. The main financial barrier for new competitors is the high cost of setting up an airline company. This service implies high capital costs, requires highly skilled personnel, as well as complex organizational, administrative and marketing systems.

New entrants into the civil aviation market face barriers such as the cost of promoting their services, consumer brand recognition, and commercial practices to promote user loyalty, such as frequent flyer programs.

Furthermore there are practices in existence among already established companies, such as interline agreements and co-coding programs that limit access of new suppliers. By the same token, artificially maintaining companies in the market (exit barriers) as was done in the previous administration, represents a negative incentive for entry of new companies and generates uncertainty and a lack of legal security for new market entrants that would be forced to compete against bankrupt airlines.

In addition to the previously mentioned obstacles, there are also regulatory barriers in the domestic air transportation market, in terms of airport space allotments. In this sense, rules of seniority prevail, thus favoring existing companies particularly during peak hours, such as in the Mexico City airport, which is the most important point of origin and destination in domestic and international routes. Added to the above are obstacles in granting concessions, route permits or frequency expansions.

The previously noted economic and regulatory entry barriers imply substantial obstacles for entry of competitors and reinforce the market power of Cintra's companies.

The competition has scarce power in the domestic market due as much to its low market share as to its insufficient financial capacity and the magnitude of the obstacles. This is precisely why competition is only seen in some high-density routes or in lower density routes neglected by Cintra's companies. Cintra's competitors also face difficulties in terms of accessing facilities and airport shifts, as well as those mentioned regarding brand advantages and passenger loyalty programs.

Conclusion. With respect to the conduct of Cintra's companies, it is important to note that this Commission has filed procedures relative to fates, commissions to travel agencies, granting cross guarantees, as well as to other issues, which reflect exercising market power.

As a result of the previous facts, the Plenary of the CFC has concluded that the joint and non-conditioned sale of the Cintra airlines would create an economic agent with the power to unilaterally set prices, which would hinder concurrence and free competition. This would represent a concentration forbidden by the Federal Competition Act. It is for this reason that the CFC has ordered the companies to be sold separately to independent buyers.

V. CONSIDERATIONS RELATIVE TO THE SALE OF THE COMPANIES

In the event that the CFC were to authorize the joint sale of the companies, given that it would be a prohibited concentration, any economic agent involved could file a complaint with the Commission itself and with judicial authorities and this would result in great legal uncertainty for the company. The LFCE allows, under special circumstances, the imposition of conditions of concurrence and free competition and a strict fulfillment thereof could give a legal defense to the company. It is under a like system that Cintra currently exists. In view of the importance of the case and the intention to jointly sell the companies as proposed in the consultation, the CFC has studied the conditions under which said sale would be compatible with the LFCE.

The Plenary of the CFC has concluded that such conditions would be much stricter that those now in existence.
Given their market power, the companies would have been subject to price controls, asymmetrical access regulations regarding routes, frequencies, airport shifts and facilities, opening frequent flyer programs and interline agreements. In view of the lack of competition, the joint sale would have significantly increased the need to open the market to foreign competition and investment, as well as to accelerate reciprocal

agreements containing "open" domestic routes, and to open the skies in international routes as well.

The new conditions would have considerably reduced the value of the companies or have made their sale unfeasible, which is contrary to the interest established by the shareholders at the consultation Given the market concentration, entry barriers and remaining elements analyzed, the joint unconditioned sale is contrary to the Federal Competition Act and is, as such, not a real option.

The CFC ordered that the companies be sold separately given that this is the option that abides by the Law, but also because of its favorable effects on the air transportation industry. Greater competition in the domestic market would substantially enhance the volume of passengers. According to Cintra’s own estimates, a 10% reduction in air travel fares would increase demand for air transportation by 12 to 14%. This repercussion is very important for the development of the country’s air transportation industry and to consumers of passenger air transportation services. The foregoing figures mean, for instance, that a 10% decline in air travel fares would have resulted in an increase in total domestic traffic in 1999, which at the time stood at 18.3 million passengers, of 2.2 to 2.6 million passengers. A company with market power, such as that which would result from a joint unconditioned sale, and without the incentives of competition to reduce fares would prevent growth of the industry.

Nonetheless some are of the opinion that selling the companies separately endangers the survival of the air transportation industry. In order to address such concerns the Commission has meticulously examined the arguments so as to provide a solid basis for its decision.

Fears about the airline industry arise from three major points of concern: a) that by being separated, the companies would enter into a destructive form of competition that would lead one of the two to abandon the market; b) that neither of the two companies would achieve the size necessary to attain the levels of profitability needed in order to face the competition; and c) that they would not be able to take advantage of the cost savings that could result from concentration.

With respect to the first point of concern, it is noteworthy to clarify that the mechanisms for avoiding destructive price practices have been foreseen in the LFCE and in the Civil Aviation Act and its regulations. The laws give the authorities the power to act in the event of collusive actions or predatory conduct, which would consist of selling under cost, artificially increasing capacity or any other form of unfair competition. Nonetheless in order to address this concern, the CFC and the SCT have developed legal mechanisms aimed at making actions to fight such practices more expeditious. The mechanisms are based on provisions already established in the laws and make it possible to prevent any company, not just Aeroméxico and Mexicana, from damaging the domestic air transportation industry. These mechanisms would operate on a by exception basis, in such a way that they would not hinder development of competition in the domestic market, but they would curb any attempt at destructive competition.

The second point of concern is that because of the size of the domestic market, on the long-term only one network company will survive, which is the system under which Aeroméxico and Mexicana currently operate. According to the studies submitted by Cintra, demand for domestic transportation is only strong enough for one network company that must additionally operate through a hub. A network airline offers service to any destination, with or without stopovers, in first or economy class, at different timetables, to and from a series of cities in which the company operates.

Whereas companies operating on a point-to-point basis, offer flights between pairs of cities, albeit not within a network system. Nonetheless all airlines connecting to more than two cities are network airlines in that they offer connections between all of their destinations, even though they may not be immediate connections or be available under different service categories. Network airlines connect to more points more frequently, but they have higher costs in exchange since they must also coordinate connections and operations with different aircraft and personnel depending on the density and distance involved in each route. Operating a network airline is costlier than operating a point-to-point airline and this is even more so when there is no chance of creating a hub for passengers in transit. This fact is reflected in the effects of the deregulations that took place in the US market, where competition decreased costs by 9.3% in network airlines and by 19.9% in point-to-point companies.

In order to reduce their costs, network companies create hubs in stopover airports, where they concentrate passengers from different points of origin and heading for different destinations. In a hub most demand arises from passengers in transit, rather than local passengers. Similarly in few or no hub destinations does demand justify offering direct flights. Hubs represent a type of synergy in which a company is able to multiply the size of its network in order to offer many different destinations.

In the case of Mexico City, location of the airport that registers the highest traffic in the country, over four fifths of the passengers either originates from or is headed to the city's Metropolitan Area. It is a location with high relative demand for travel to and from other places in the country, where both Aeroméxico and Mexicana have operation centers because there are more passengers. Any savings obtained from concentrating passengers in the Mexico City airport would only come from one fifth of the traffic, unlike an airport like Atlanta for instance, where passengers in transit represent 70% of total traffic.

Mexico City concentrates passengers on international flights that begin or end in Mexico, yet it lacks the essential characteristics of a hub since the carrier for the international portion of the flight will not necessarily be Aeroméxico or Mexicana. Nor does the Metropolitan Area offer advantages for companies that might want to use the area as an international hub (such as Amsterdam, Frankfurt or London), in other words as a center in which to concentrate passengers headed somewhere else abroad.

It is the mistaken idea that the Mexico City airport offers the synergy of a hub that has led to the conclusion that one of the two companies will unavoidably displace the other. The inference is based on an empiric observation known as the "S curve". According to said "S curve", in a hub, the company that obtains more than 50% of the passengers will obtain a more than proportionate part of the revenues.

According to the "S curve" argument, passengers will give more than 50% of the market to the network company that offers the most destinations. The "S curve" is based on the assumption that other companies do not react. In other words, when the competition sees that passengers prefer a company that operates a larger network, that competition does nothing to reduce fares and defend its market, which is reasonable in the United States where there is competition amongst hubs.

Even when the deficiencies inherent in the "S curve" arguments are set aside, the fact is that the "S curve" does not apply to the case of Mexico. Aeroméxico and Mexicana’s center of operations is located in the Mexico City airport because that is where demand is centered, not because of synergy derived from passengers in transit to and from other destinations.

There is no reason why Aeroméxico and Mexicana should displace each other since both companies can offer similar options for travel between the Metropolitan Area and the rest of the country, as can be presently seen in the most important routes to and from Mexico City (Guadalajara, Monterrey, Tijuana, Cancún). There is no reason to assume that passengers in transit (one fifth of the total) would prefer one of the two companies because it offers more destinations than the other, as per the pre-requisite inherent in the "S curve".

Both companies operate a network in which both have their hub in Mexico City, but without the characteristics or cost savings of a hub. There is no reason to assume that such a practice cannot continue, unless one or both of the companies decide to change their business strategy. By the same token their alliance policies and other international commercial strategies can also continue; in fact the companies have successfully organized their strategies and alliances and they have done so separately.

The concern that as separate companies, Aeroméxico and Mexicana will have insufficiently large fleets to operate at costs that enable them to face the competition head on refers to the international market. Even taken together, the size of the companies’ joint fleet would be much smaller than that of large carriers operating global networks, especially the US carriers. This does not however imply any profitability problem in internal market operations, as shown by the fact that smaller sized companies operate within Mexico.

Economies of scale are quickly depleted in the air transportation industry. As such a company can be profitable and compete in terms of price and quality with a reduced number of homogenous aircraft, as can be seen in the economic literature relative to the air transportation industry. The most profitable companies in the world are not the largest companies, with huge fleets, hubs and many different destinations.

Companies with large fleets exploit economies of density and scope, as well as public preferences for companies offering more destinations. However these economies of scope are based on operating and commercial strategies that are only possible with much larger fleet sizes than that of Aeroméxico and Mexicana taken jointly, and even larger than the fleet size of all Mexican airlines together. The need to expand the size of fleet in order to compete with large US companies is of concern to companies looking for markets in international routes. But this does not apply in the internal Mexican market, in which foreign companies cannot operate and, therefore, do not represent a threat. It would furthermore be contrary to the country’s best interest to subsidize operations on international routes with excessive earnings obtained from abusing power in the domestic market.

With respect to the concern about the cost savings that would enable a joint sale, the Commission examined the origin and magnitude of the cost savings implicit in eliminating redundant functions, or synergy, as well as those already derived from operating through hubs. In order to make the most of such synergy, under the assumption of a joint sale, the companies would seek to restructure their routes and to operate them with less pilots and flight attendants, with less ticket sales personnel, land operations personnel, etc. Besides the fact that selling the companies jointly implies serious competition problems that would limit domestic market growth, making the most of the implied synergy would adversely impact employment.

The strategy of creating one large company with market power would make the domestic air transportation industry much more vulnerable than would be the case with two companies, a situation that some refer to as "systematic risk". The possibility of one large company going bankrupt, which already came close to happening, would put the country in the severe dilemma of having to bail the company out or open the market. Investors undoubtedly see the option of a joint sale as a guarantee in which the federal government would be practically compelled to bail the company out, given that a greater opening would imply reciprocal open air agreements on domestic routes or legislative amendments to the Foreign Investment Act and the Civil Aviation Act.

It is furthermore important to note Canada’s experience, to which some refer as an example of a decision in which the concentration route was chosen. The transportation authorities in Canada authorized the merger of the two main airline companies. But the decision has had adverse consequences since an air transportation monopoly has been created in the country’s domestic market.

Canada’s smaller airlines, such as Westjet, CanJet and Roots Air, and air cargo transportation companies have been able to increase their market share but have been unable to affect prices in routes where their main competitor operates because their market share is too small. Canadian authorities are presently analyzing the possibility of adopting severe price surveillance and consumer protection measures, to the extent of considering opening the market to foreign companies in the event that they are unable to attain greater competition in their domestic market.

In the case of a joint sale, the financial studies submitted by Cintra failed to consider the conditions that the CFC would be forced to impose in order to legally guarantee the operation. Consequently said valuations do not represent a real option.

Selling the companies separately, according to those same financial studies, is feasible: it abides by the Law; it does not jeopardize the domestic industry; and its value may even be higher than that of a joint conditioned sale.

VI.- WORLD COMMERCIAL AVIATION TRENDS

Some opinions about the effects of competition and the Cintra decision are based on observations of aviation experiences in other countries. The Commission has also examined these aspects. Up until two decades ago, aviation policies the world over started with the idea that passenger air transportation was a matter of national security and pride, and that it was a means of transportation for the well-to-do. Over time the enormous financial cost of maintaining "flag airlines" became clear, as they were subsidized by the government, protected from foreign competition and from the entry of new competitors in their own markets.

Commercial aviation almost all over the world, just like other economic activities, is currently subject to a deregulation and opening process. Deregulation began at the beginning of the 80s in the United States and has continued in several countries, including Mexico. Despite the fact that in most countries protection from the competition and from foreign investment prevails, sustained above all by pressure from subsidy-dependent companies and labor organizations, deregulation has fueled in-depth changes in company conduct and in market structures. As a result of intensified competition, the more efficient companies have consolidated and been able to develop at a more accelerated pace. Even entry of new companies and attrition of inefficient companies has been done without labor costs, since the latter’s personnel have been absorbed by a sounder, larger industry. Competition has generated net social benefits, measurable both by the unprecedented increase in air transportation traffic and by significant fare reductions.

Deregulation and technological progress in the form of building and maintaining safe equipment, as well as organizational and administrative systems, have made it possible to cut costs to the extent that in Europe and the United States, commercial aviation is now a means of transportation for hundreds of millions of passengers. In the world's main markets, air transportation is no longer an exclusive service aimed at higher income populations.

The United States is the most outstanding example. The country has the largest domestic air transportation market in the world. From 1980 to 1997 in the US, deregulation increased the average number of airlines in each market from 1.7 to 2.3 and reduced market concentration units from 6,051 to 5,183 units. During the foregoing 7-year period, inflation-corrected fares declined by 38% and the number of passengers grew from 164 million to 368 million per annum. The number of routes served grew from 3,631 to 5,605 and the occupancy rate rose from 57% to 69%, thus ending the era of half-empty flights. The most notable point however is that the number of people employed in commercial aviation grew from 330,000 to 586,000 people.

The experience of the European Union is also important given that it is the only case in which opening air transportation has been gradually extended to all member states over the past ten years. Since 1997 airlines in the region are able to connect any two cities within European Union member countries. For instance, this implies that Iberia is competing with Lufthansa and that Air France will have to face the competition of British Airways on its home turf. The European Union is presently negotiating an expansion of this openness to eastern Europe and Switzerland. If European Union countries are considered one single domestic market, there are now many more companies that can potentially take part in all of the region's routes.

Over the past few years the United States has fostered the open skies principle, but this refers only to international routes which are not the market segment presently under CFC analysis. Under this principle and always by means of bilateral agreements, a country may carry out any number of trips destined for another country without being subject to any restrictions relative to routes, flight frequency or the number of companies participating under the wing of the signatory country.

These considerations concerning the air transportation industry in other countries support the decision to promote competition in Mexico's domestic market, from which great benefits are expected for domestic business and tourist consumers.

VII. CONCLUSIONS

The Commission has assessed the evolution of Cintra and of its competitors; it has further been vigilant of the performance of the domestic aeronautical sector. The Commission has maintained a balanced position, acknowledging the efficiencies and advantages derived from the creation of Cintra and, in turn, testing the risks to competition in the sector. The following conclusions can be drawn from the foregoing pages:

1. The resolution issued by the CFC to create Cintra made it possible to regulate the legal situation of the companies, to restructure their finances and avoid bankruptcy in either of the two.

2. The CFC has undertaken a meticulous and thorough follow-up of Cintra's evolution and of market competition, in compliance with the power conferred upon the Commission in order to
fight monopolies. Said powers include that of ordering the dissolution of Cintra in the event that conditions of competition in the market justify such action.

3. Although the financial position of Cintra and its subsidiaries has been consolidated substantially since 1995, the financial situation of its competitors has deteriorated. The above added to entry barriers that continue to exist have enhanced Cintra's power in the domestic commercial aviation market.

4. There are indications that, as a result of its dominant position, Cintra's subsidiaries have set fares at levels other than those that would be prevailing in a situation of effective competition.

5. The core issue for the CFC is effective competition in the domestic air transportation market. Given the protected status of said market, foreign companies do not represent any form of competition for national companies.

6. The CFC has not issued a recommendation relative to the specific form of sale, nor about the participation of national or foreign investors in the transaction. The CFC has also refrained from issuing a recommendation concerning changes in air traffic transportation policy or agreements to open domestic skies.

7. Experiences in other countries clearly show that competition brings benefits for the air transportation industry, derived from substantial growth in the volume of passengers. Developing efficient companies benefits all sectors of economic activity and the general public.

8. Commercial aviation trends the world over are oriented towards market liberalization and globalization. International experience shows that developing a strong and competitive aeronautical industry in a domestic market is indispensable for development of a competitive aeronautical industry in the international market.

9. Fears about a loss of soundness in the domestic aeronautical industry as a result of separating the two airlines are unfounded. The companies will be making the decision as to what type of operating system they will be adopting, depending on profitabilities, be it a network system, a network and hub system, a point-to-point system, or any other system.

10. Keeping the companies together does jeopardize growth of the industry and employment, as well as imply significant costs to consumers and other economic activities.

VIII. RECOMMENDATIONS

Addressing national interests and in order to strengthen the process of competition in the sector, the Commission has decided to make the following recommendations:

1. The joint sale of the companies, hence eliminating the effect of the conditions imposed on Cintra and its subsidiaries is contrary to the LFCE. To undertake such a joint sale would represent an operating merger of said companies that would create an agent with market power both in the majority of its routes and in the domestic market, protected from foreign competition and with limits to foreign investment. For these reasons the CFC will not authorize the joint and unconditioned sale of Aeroméxico and Mexicana, but will authorize their sale as independent competing companies. Selling the companies separately would eliminate the basis of the conditions imposed on Cintra in the August and November 1995 resolutions.

2. The information and facts examined infer that selling and operating Aeroméxico and Mexicana separately favor competition, are feasible and do not represent foreseeable dangers for development of the companies. Applicable legislation at any rate foresees mechanisms aimed at avoiding destructive conduct or practices in the domestic air transportation industry.

IX. FINAL COMMENTS

The Federal Competition Commission, in compliance with the Constitution and the Federal Competition Act, has ordered that the companies be separated. This decision sets the foundations for competition in the domestic passenger and cargo air transportation market. The analysis conducted by the Commission was not limited to bodies of laws, it rather equally considered the effects of competition on the air transportation industry and the consumers of such services. In addition to the fact that competition creates incentives for achieving cost and quality efficiencies, hence sounder companies, the existence of two major competitors in the domestic air transportation market reduces the sector's vulnerability to adverse circumstances.

The Commission foresees that competition will lead to lower prices, which will trigger an accelerated expansion in the volume of passengers and cargo in the country, as well as to a supply of services to a much larger number of domestic destinations, without sacrificing air transportation security. Competition will heighten the demand of those who already use air transportation, and it will also make the service accessible to a large number of new users of domestic routes, thus bearing an important social impact. Passenger air transportation services in the country must grow in order to reach a substantially higher rate than its current standing within overall transportation services in Mexico –barely 1%- and to no longer be the means of transportation of a small minority.

Growth of demand for domestic air transportation services will translate into accelerated employment growth in the sector, besides producing important indirect effects on the growth of other economic activities, foremost among which are tourist and business routes.

ACCA SAN DIEGO, OCT. 2001
205 PROGRAM: DEVELOPMENTS IN MEXICAN LAW

INTERNATIONAL MERGERS REVIEW UNDER MEXICAN LAW

By: Francisco Velazquez Osuna
(fvelazquez@goodrichriquelme.com)
Partner, Goodrich, Riquelme & Associates/Mexico City
(www.goodrichriquelme.com)

I.- INTRODUCTION.

Eventhough in the 1857 and in the 1917 Mexican Constitutions Congress incorporated provisions on competition and monopolies, it was until 1931 when Congress passed the first Competition Law under the name of "Law Regulating Article 28 in the matter of Competition", statute which never was duly and fully applied and which was repealed in 1992 by the Federal Law on Economic Competition ("Competition Law"), published on December 24, 1992 but effective beginning on June 23, 1993.

The Competition Law created the Federal Competition Commission ("Competition Commission"), a semi-independent administrative agency of the Ministry of Trade, which was granted technical and operational autonomy to issue its resolutions and is charged with the prevention, investigation and combating of monopolies, monopolistic practices and trusts.

To implement some of the Competition Law provisions, on March 4, 1998 the Regulations of the Competition Law were published. The Regulations have been a good legal tool to better understand the concepts of absolute monopoly practices, relative monopoly practices and concentrations as well to have a very broad and vague idea as to how the Competition Commission would assess such practices and very important, of the notions of market power, relevant market and economic efficiencies, among others. In order to have a more clear understanding of the way the Competition Commission assesses the cases presented before it, one have to read the resolutions published by it and since 1998 available on-line.

Besides having authority to investigate, approve, modify and challenge monopolistic practices, the Competition Commission is also empowered to grant its opinion on upcoming legislation which would affect competition in the markets, on government bidding processes for acquiring goods and services, and on privatization of government-owned businesses.

During my oral presentation in San Diego I will briefly cover international mergers, the energy industry and Mexico's possibility and legal implications for supplying energy to California, the large deregulation of the legal framework for conducting business announced by President Vicente Fox in early August, 2001. On this paper, however, due to time constrains, I am just focusing on the review of international mergers and acquisitions in Mexico.

For a most updated version of this presentation and for information on "Mexico Business Opportunities and Legal Framework", please visit our web page www.goodrichriquelme.com

II.- ABSOLUTE AND RELATIVE MONOPOLY PRACTICES AND CONCENTRATIONS IN A NUTSHELL.

Since the 1931 Monopoly Law was practically never enforced and therefore, there was no legal experience of monopolies in Mexico, the drafters of the law initiative of the Competition Law had to resort to the US and European legal documents and experiences in order to prepare the bill which was discussed and virtually approved by Congress, as it was presented.

A) SCOPE OF THE LAW.

The purposes of the Competition Law is to protect the process of competition and free market participation, through the prevention and elimination of monopolies, monopolistic practices and other restrains of trade on the efficient operation of the markets of goods and services.

All economic agents are subject to the Competition Law, whether they are individual or corporations, agencies or entities of the federal, state or municipal levels, public administration, associations, professional groups, or any other form of participation in business activities.

Activities performed by the federal government in a strategic sectors such as petroleum and electricity, associations or workers, holders of intellectual property rights and copyrights, and associations of cooperatives selling directly their products abroad, are however, exempt from the application of the Competition Law.

B) ABSOLUTE MONOPOLY PRACTICES.

Horizontal restrains of trade or absolute monopoly practices consisting of monopolies and tax corners are prohibited, as are practices which pursuant to the Competition Law diminish, impair or prevent competition and free participation in the production, processing, distribution and marketing of goods or services.

Contracts, agreements, arrangements or cartels of economic agents competing among themselves are considered as absolute monopolistic practices when their aim or effect is:

(i) to lower, raise, fix, or manipulate the sale or purchase price of goods or services at which they are supplied or demanded on the market, or the exchange of information which has the same purpose or effect;

(ii) to establish an obligation not to produce, process, distribute or market but a restricted or limited amount of goods or a restricted or limited type, volume or frequency of service;

(iii) to divide, distribute, assign or impose portions or segments of a present or potential market of goods and services, on the basis of certain customers, suppliers, time or space of those to be determined; and,

(iv) to establish, rig or coordinate bids of to abstain from submitting proposals in tender competitions or bidding in public auctions.

Absolute monopoly practices are per se unlawful and therefore the alleged violator can raise no argument to reduce the negative effects of the practice in the market, such as economic efficiencies. If the Competition Commission determines that the practice exists, it may order the suspension, correction or elimination of the practice and impose a fine up to 375,000 times the daily minimum wage prevailing in Mexico City (daily minimum wage Mex.$40.35 x 375,000 times = Mex.$15,131,250 = US$1,513,125 –Mex$10 to US$1-).

C) RELATIVE MONOPOLY PRACTICES.

Vertical restrains of trade or relative monopoly practices are considered to be those acts, contracts, agreements or cartels, whose purpose or effect is or could be to wrongfully displace other agents from the market, substantially impede their access thereto or to establish exclusive advantages in favor of one or several entities, in the following cases:

(i) between economic agents that do not compete with one another, the fixing, imposition or establishment of exclusive distribution of goods or services, by reason of a certain entity, geographic location or period of time, including the division, distribution or assignment of customers or suppliers; as well as the imposition of the obligation to not manufacture or distribute goods or render services for a certain period of time or a period of time subject to determination;

(ii) the imposition of a price or other conditions which a distributor or supplier must comply with when selling or distributing goods or offering services;

(iii) the sales or transaction contingent on the purchase, acquisition, sale or supply of another additional normally different or distinguishable product or service, or on the basis of reciprocity;

(iv) the sale or transaction contingent on not using or acquiring, selling or providing the goods or services produced, processed, distributed or marketed by a third party;

(v) the unilateral action consisting of refusing to sell or supply certain agent with available goods or services, normally offered to third parties;

(vi) the agreement between several economic agents or an invitation extended to them to exert pressure on a certain customer or supplier, for the purpose of dissuading it from a certain practice, to retaliate or force it to act in a certain manner;

(vii) the systematic sales of goods or services at prices below their total average cost or their occasional sale below the variable average cost;

(viii) the granting of discounts by producers or suppliers to purchasers with the requirement of exclusivity in the distribution or marketing of the products or services, when such can not be justified in terms of efficiencies;

(ix) the persistent use of profits that an economic agent obtaines from the sale of a good or service for financing losses on another good or service;

(x) the establishment of different prices or conditions of sale for different purchasers situated in equality of conditions; and,

(xi) the action of one or several economic agents, the object or effect of which is or may be, directly or indirectly, to increase costs from the competitors, or to impede the productive process or reduce demand.

Relative monopoly practices are judged under the rule of reason and taking into account 2 elements: market power and whether it is exercised in the relevant market. Economic efficiencies help to eliminate or minimize the possible adverse effects on the market of such practices. Relative practices which the Competition Commission finds unlawful may be penalized up to 225,000 times the daily minimum wage prevailing in Mexico City (daily minimum wage Mex.$40.35 x 225,000 times = Mex.$9,078,750 = US$907,875 –Mex.$10 to US$1-).

D) CONCENTRATIONS.

There is a very comprehensive definition of the concept of concentration or “mergers and acquisitions” in the Competition Law which provides that a trust shall be understood to mean a merger, acquisition of control or any act whereby companies, partnerships, shares, equity, trusts or assets in general are concentrated among competitors, suppliers, customers or any other business entity, aimed to diminish, impair or impede competition and free market participation in regard to equal, similar or substantially related goods or services.

As described below, the filing or notification of any concentration is mandatory when the thresholds are met. The Competition Commission may establish conditions for the concentrating economic agent prior to or after the concentration takes place or order a partial or total breaking up of the trust which has been wrongfully created, or the end to the control or the elimination of the act as it considers convenient. Fines could go up to 225,000 times the daily minimum wage prevailing in Mexico City (daily minimum wage Mex.$40.35 x 225,000 times = Mex.$9,078,750 = US$907,875 –Mex.$10 to US$1-) for taking part in a prohibited concentration. So far fines have been imposed for lack or late filings only.

Assessments of concentrations require the analysis of the relevant market, the identification of the economic agents participating in the relevant market, the determination of their market power, and the degree of concentration in such market.

Since the Competition Commission started operations in mid 1993 and up to 1999, when the last official published report was issued, 2066 concentrations were resolved by it. From January 2000 to June 2001 its web page reports 238 filings. All together make a total of 2,304 cases of concentrations from 1993 to June 2001.

On the 1999 Competition Commission Report it is stated that the following main achievements were accomplished by it: (i) the protection of consumers against attempts of price manipulation; (ii) the prevention of the use of market power to affect competition by strategic government-owned entities; (iii) the assurance that government concessions to provide public services are granted under fair conditions of competition; (iv) the assurance that privatization or government-owned entities is carried out under conditions of competition; (v) the assurance that international mergers do no affect competition in the domestic market; (vi) the prevention of collusion on public biddings; (vii) the prevention of abuses from large corporations in detriment of low scale competitors; and (viii) the prevention of abuses from agents with market power in detriment of agents with whom they do business.

The Competition Commission always is arguing that competition, jointly with liberalization of markets, privatization and deregulation made up the 4 foundations of an economic policy seeking efficient and competitive markets.

III.- ASSESSING INTERNATIONAL CONCENTRATIONS.

The standards contained in the Competition Law and its Regulations as well as the practice in Mexico is quite similar to those standards laid down by OECD countries. Transactions involving only Mexican entities as well as transactions involving foreign and Mexican business or just foreign entities are treated alike. In other words foreign business concentrating in Mexico or concentrating abroad and whenever effects are produced in Mexico are given national treatment and with the degree of transparency provided by the Competition Law and its Regulations.

Among the goals pursued by entities concentrating could be: (i) the growth and creation of companies or groups that are more efficient and able to meet international competition; (ii) exploring opportunities arising from the removal of legal barriers to entry and the opening up of new areas to private participation, the development of which demands experience, specialized technology, and major investment; and (iii) tackling financial problems that threaten companies' performance or survival. The Competition Commission has put forward on its 1995-1996 Report that if those goals are achieved it would bring unquestionable benefits for strengthening the domestic economy and the population's well-being, provided that they do not occur along with negative repercussions on efficient market functioning.

A) TYPE OF CONCENTRATIONS.

The greatest risk to competition are posed by horizontal concentrations on transactions involving competitors between themselves and that therefore operate on the same level of chains of production or distribution. They shall be objected or conditioned whenever they bear structural effects on competition.

Mergers and/or acquisitions between agents that participate in one same relevant market have clear effects on competition, when one or more agents with substantial market share intervene or when they take place between major companies facing low competition. In both cases the immediate impact is a greater market share of the agent resulting from the merger and a reduction in the number of competitors. However, only horizontal mergers made up of large-scale companies tend to imply risks to competition. On the other hand, mergers of this type carried out between smaller companies facing major competitors generally favor competition (1999 Competition Commission Report).

On the other hand, vertical concentrations are those in which business entities located at different levels of chains of production or distribution are involved. Typically they enhance competition when they are carried out to join synergies and create sound and competitive efficiencies.

Another classification deal with diversification, which are concentrations between economic agents participating in different relevant markets not related with a chain of production or distribution. Diversification could be: (i) by extension of geographical markets, and happens among producers of similar goods or services or substitutes participating in different geographical markets, or (ii) by extension of product line, and take place between companies belonging to the same line of business whose goods and services are not readily substituted by each other.

As oppose to domestic concentrations, international concentrations with effects on markets originate international operations, known generally as mega-concentrations or mega-mergers in transactions carried out directly in national territory by foreign economic agents or their subsidiary companies, and, in purchases by Mexican economic agents of assets owned by foreign companies or their subsidiaries.

The last type of concentration and which is the most popular in Mexico, is the merger or acquisition which implies a corporate restructuring, aimed to improve operations and efficiencies and which does not involve changes in market structure leading to adverse modifications in competition.

B) OBLIGATION TO NOTIFY OR PROVIDE PLAIN NOTICE?

Concentrations exceeding the following thresholds require prior authorization or notification (the Competition Law uses the term notification when in fact concentration filings imply a request for authorization) from the Competition Commission: (i) when the transaction value exceeds MexCy. $484,200,00.00 (US$48,420,000.00 if one dollar is equivalent to MexCy.$10.00 pesos); (ii) when there is an accumulation of more than 35% in assets or shares by an economic agent whose assets or sales exceed same amount as item (i); or (iii) when in the transaction are participating two or more economic agents whose annual sales or assets, jointly or individually, exceed MexCy. $1,936,800.00 (US$193,680,000.00 considering MexCy. $10.00 pesos to one dollar) and the relevant transaction will imply an additional accumulation of shares or assets exceeding MexCy.$193,680,000.00 (US$19,368,000.00 considering MexCy. $10.00 pesos to one dollar).

The only exception to such prior authorization is regarding those corporate restructuring where an economic agent has held for the last 3 years 98% of the shares or social parts of the economic agents participating in the concentration. In this case a plain notice has to be given within 5 days following the effectiveness of the transaction.

As it always happens, little by little the Competition Commission penetrated in the minds of businessmen, who at the beginning were unaware of the existence of the Competition Law and of the Competition Commission. The first fines imposed by the Competition Commission were due to lack of notification or late notification of some concentrations. It was expected that the Regulations of the Competition Law were to free corporate restructuring concentrations, but it did not. The reason seems quite simple: fees (around US$10,000 per filing) and fines for lack of notifications or late notification are the main source of income generated by the Competition Commission for the Mexican Treasury.

C) CRITERIA FOR ASSESSING INTERNATIONAL CONCENTRATIONS.

In determining whether a concentration should be approved, conditioned or objected, the Competition Commission must first, identify the relevant market and the economic agents participating in that market, second, analyze their market power and third, see how the relevant market would be if the concentration is approved (or not objected, on the Commissions's jargon)

The following criteria must be taken into account to identify the relevant market: (i) the possibilities of substituting the goods or services in question, with others of domestic or foreign origin, bearing in mind the technological possibilities, the extend to which substitutes are available to consumers and the time required for such substitution; (ii) the cost of distribution of the product itself, its raw materials, its supplements and substitutes from other areas and from abroad, taking into consideration freight, insurance, import duties and non-tariff restrictions, the restrictions imposed by economic agents or by their associations and the time required to supply the market from those areas; (iii) the cost and probability of users or consumers seeking other markets; and (iv) federal, local or international restrictions which limit access by users or consumers to alternate sources of supply or the access by suppliers to alternate customers.

In order to determine the market share, sales indicators, number of customers, productive capacity, or any other factor that the Competition Commission deems appropriate should be taken into consideration.

Now, in order to determine whether a business entity has substantial power in the relevant market, the following must be taken into consideration: (i) its share of said market and whether it is able to fix prices unilaterally or to restrict supply in the relevant market without the competing agent being able, at present or potentially, to offset such power; (ii) the existence of barriers to the entry and the elements which could foreseeable alter both said barriers and the supply from other competitors; (iii) the existence and power of its competitors; (iv) the possibility of access by the business entity and its competitors to sources of input; (v) its recent conduct ; (vi) the degree of positioning of the goods or services in the relevant market; (vii) the lack of access to import or the existence of high importation cost; and (viii) the existence of high cost differentials which could face consumers on turning to other suppliers.

Entry barriers include; (i) financial cost or the cost of developing alternative channels, limited access to financing, technology or efficient channels of distribution; (ii) the amount, indivisibility and period of recovery of the required investment, as well as the absence or scarce profitability of alternative uses of infrastructure and equipment; (iii) the need to possess concessions, licenses, permits or any kind of governmental authorization, as well as rights of use or usufruct protected by legislation in the area of intellectual and industrial property; (iv) the investment in advertising required for a trademark of trading name to acquire a presence in the market sufficient to enable it to compete with already established trademarks or names; (v) the limitations on competition in international markets; (vi) the restrictions constituted by the common practice of the economic agents already established in the relevant market; and (vii) the acts of federal, state, or municipal authorities which discriminate in the awarding of promotional incentives, subsidies or assistance to certain producers or distributors, or firms marketing or supplying goods or services.

The Competition Commission has published on the Official Gazette of the Federation the methodology for calculating the ratios for determining the degree of concentration which exists in the relevant market and the criteria for their application.

D) LEADING CONCENTRATIONS CASES.

The great majority of the concentrations notified to the Competition Commission have been approved without imposing any condition whatsoever and they roughly account for almost 95% of the total. Conditions have been placed on some cases and only very few filings have been objected. To my understanding, very few challenges have been raised by merger applicants who in all cases have withdrawn from them.

I am briefly describing 4 cases which could be of the most interest to an American audience, 3 of them are international concentrations (Kimberly Clark/Compañía Industrial San Cristobal, Coca Cola/Cadbury Schweppes and Banamex/Citigroup) and the other 1 is a domestic case involving the 2 main Mexican air carriers (Cintra/Aeroméxico/Mexicana).

Resolutions or press releases dealing with each of them are attached to this presentation, with the reference of the web page of the Competition Commission from where they were taken. Unfortunately, the full text of the resolution of the Coca Cola/Cadbury Schweppes proposed concentration was not available in English at the time of writing this presentation, but it is attached in Spanish.

1.- KIMBERLY CLARK DE MEXICO, S.A. DE C.V./COMPAÑÍA INDUSTRIAL DE SAN CRISTOBAL, S.A. (CRISOBA)

In 1995 Kimberly Clark Corporation announced its global merger with Scott Paper Company. Both companies have subsidiaries in Mexico. After hearing the case in 1996 the Competition Commission imposed on the Kimberly Clark/Crisoba the following conditions: (i) elimination of production capacity for tissue paper and derivatives, minimum 67,000 tons; (ii) sale of the Regio brand, used in toilet paper and napkins; (iii) licensing of the Scotties kleenex brand; (iv) elimination of the Suavel napking brand; and (v) offer a contract to supply 13,000 tons of tissue paper annually. These conditions prevented the concentration of Kimberly/Crisoba from curtailing competition, on the one hand; and on the other, facilitated the development of competitors. To achieve this, the Competition Commission ensured that the buyer of the assets package was an economic agent independent of Kimberly, with the capacity to actually compete.

In short, the Competition Commission resolutions on transactions on the tissue paper and derivatives market prevented excessive concentrations in this market, particularly monopolistic in the kleenex market. They also prevented a weakening of established competitors and created conditions to foster the entry of manufacturers with well-known technologies, brands and distribution capacity.

Such conditions were aimed at preventing an excessive concentration of the market for tissue paper and derivatives and opening up opportunities for strengthening competition and for entry of new competitors. These goals became a reality in 1997 with the purchase of the companies' divested assets by Copamex Co. and the entry of Procter & Gamble into the market (1997 Competition Commission Report).

2.- COCA COLA/CADBURY SCHWEPPES

This transaction covered more than 100 countries, and was therefore the object of reviewing by various competition authorities. The complexity of this transaction give rights to an exchange of technical opinions on relevant market and distribution channels, etc. The Competition Commission determined that this transaction would substantially increased the degree of concentration in the relevant market of carbonated beverages, in which, there are high barriers to entry in favor of the merging economic agents, such as brands with a strong presence in the market, publicity expenses and control of important distribution channels. The proposal to license brands presented by Coca Cola was insufficient to eliminate the anticompetitive aspects of the merger (1999 Competition Commission Report).

In a February 2000 interview by Business Mexico, Mr. Fernando Sanchez Ugarte, Chairman of the Competition Commission in replying to the question of What happen with the Coca/Cola Cadbury Schweppes Global merger, and why was Mexico the first country to block it?, responded: "As part of its international portfolio of beverages such as Dr. Pepper and Canada Dry, Cadbury holds important brands in Mexico, including Squirt and Peñafiel. Mexico is the second-biggest soft drink market in the world behind the United States and Coca Cola's market share has grown notably. It currently controls about 2/3 of the market. In second place is Pepsi, with around 18 or 19% , and then various domestic and international brands with less importance that are in the process of losing market share".

"So what we saw was the most important cola brand joining with the most important mineral water brand in Mexico, which would create a market force that really was going to displace other competitors in an undue manner. We called it the "portfolio effect" in the sense that if you have a distributor like Coca Cola that has an entire line on beverage products –cola, flavored drinks, and mineral water- it has everything, and this would create a situation of dominance in the beverage market from our perspective. What Coca Cola claimed was that in Mexico and other countries it competes not only with other soft drinks, but with coffee, milk, water, and so on. That's not completely true. There are many situations were (people believe) soft drinks can not be substituted, and furthermore it is the principal source of liquid for Mexican families. So we ruled that the soft-drink market is a distinct beverage market. Since Coca Cola holds most of that market, we blocked the operation."

3.- BANAMEX/CITIGROUP.

According to the press release attached to this presentation the Competition Commission conditioned in 2001 the concentration Banamex/Citigroup in order that within a period of no more than one year, the merging financial institutions do the following: (i) to amalgamate each retirement fund they have; (ii) to cease to be shareholders of E-global; and (iii) to terminate their patrimonial relationship and links with BBVA Bancomer in the company Crédito Familiar.

4.- CINTRA/AEROMÉXICO/MEXICANA.

Two attachments are referring to this case, one is the 2000 decision by the Competition Commission on the sale of Cintra and the other is the press release summarizing such decision. In short the Competition Commission is blocking the Mexican Government for selling through Cintra the majority stake it holds in both Mexican aircarriers together as a single package. It is really worth to go through both documents to get a sense of the power which the Competition Commission has been gaining over the years.

This case begun in 1995 when the Competition Commission was asked to authorize Cintra to purchase stock of Aeromexico and Mexicana, giving Cintra control over the two companies and its subsidiaries. At that time the concentration transactions were approved, but the following conditions were placed:

(i) the administrative restructuring was subjected to the obligation of keeping separate accounts and independent managements for each of the two companies under the auspices of their respective Board of Directors;
(ii) anti-competitive actions were to be prevented by a consultant agent, appointed by the Commission, responsible for periodically analyzing observance of the conditions imposed and for preparing regular reports on conditions of competition;
(iii) the timely correction of any anti-competitive practices that might arise, by means of: the setting of rates by the Commission and the Secretariat of Communication and Transportation ("SCT"), in cases in which the Commission rules competition to be non-existent; the immediate suspension of any unlawful practices detected by the

Commission; the establishment of agreements between the Commission and the SCT for the implementation of steps to protect or reestablish conditions of competition; and the cooperation of the companies involved in preserving and improving the competitive environment; and

(iv) if conditions deemed serious enough, the partial or total dissolution of the operation.

Please feel free to contact me should you have any questions regarding the above at fvelazquez@goodrichriquelme.com

Francisco Velazquez-Osuna
Goodrich, Riquelme & Associates

ACCA SAN DIEGO, OCTOBER, 2001
205 PROGRAM: DEVELOPMENTS IN MEXICAN LAW

MEXICO'S ANTITRUST LAW

MARTIN MOGUEL GLORIA

General Counsel of the Federal Competition Commission.[1]

(mmoguel@cfc.gob.mx)

I. INTRODUCTION

In recent years, Mexico has experienced an intense process of economic change as a result of both internal and external measures. The Federal Law of Economic Competition (LFCE) is part of this process. This paper will present an overview of Mexico's competition law.

II. MEXICAN CONSTITUTION AND ANTITRUST REGULATIONS

One of the first precedents in competition legislation was the Mexican Constitution of 1857, which prohibited monopolies. The 1857 Constitution preceded the competition laws of Canada and the United States of America,[2] indicating that concern with competition legislation and monopolies is not new in Mexico. However, Mexico has

[1] Opinions expressed in this paper are of the author's and do not necessarily represent those of the Federal Competition Commission.
[2] Comisión Federal de Competencia, *Annual Report 93-94,* p. 9-10. Hereinafter Report-94. Unofficial translation of the antitrust legislation and the annual reports in english are available on the Commission's web site at www. //cfc.gob.mx.

not, in practice, enacted any provisions or procedures to prohibit anticompetitive behaviour until recently.

The Constitution of 1917 granted free competition and a prohibition of monopolies.[3] In 1934, Congress put into effect these broad statements of economic objectives enacting the Organic Law of Article 28 of the Constitution in matters of Monopolies.[4] The Law prohibits monopolies and established a number of presumptions of monopolisation or an attempt to harm free competition,[5] such as sales below costs,[6] price fixing,[7] or tie-sales.[8] The Law entitled the executive to set maximum prices or to restrict the production of certain goods and to limit the entry of competitors when the supply was highly concentrated.[9] Sixteen years later, the Congress passed the Law on the Powers of the Federal Executive relating to Economic Matters.[10] A great number of goods and services were subject to price controls. The executive could impose restraints on distribution and imports when the supply was not sufficient. As in many other Latin American countries, the provisions were applied to protect consumers against price rises rather than as devices for controlling economic structures.[11]

[3] After several amendments, Article 28 of the Constitution currently prohibits monopolies and monopolistic practices, establishing that the Law will severely punish all agreements, procedures, or combinations of producers, industries, merchants, or services providers whose intent is to avoid free competition and charge unreasonably high prices to consumers.
[4] Ley Orgánica del Artículo 28 Constitucional en Materia de Monopolios (Monopoly Law), Diario Oficial de la Federación, August 31, 1934. This is the official gazette of Mexico. Hereinafter D.O.
[5] Monopoly Law, Article 5.
[6] Monopoly Law, Article 5(I).
[7] Monopoly Law, Article 5(II).
[8] Monopoly Law, Article 5(VIII).
[9] Monopoly Law, Article 11.
[10] Ley sobre Atribuciones del Ejecutivo Federal en Materia Económica, D.O. December 30, 1950.

These laws are the 'precedent' laws in antitrust matters.[12] Both statutes were repealed and replaced by the LFCE. Before the enactment of the latter, the government has shown little if any concern about monopolies and monopolistic practices. In fact, the few decisions of the Supreme Court of Justice against competition outnumber the decisions in favour of competition.[13]

Mexico's about-turn in the mid-1980s towards trade liberalisation and free market was guided by two objectives: "to set the foundations of a modern market economy that can generate sustained growth in the medium term; and to redefine the State's role in the economy so that it may assist more effectively those that are most in need."[14] The enactment of the LFCE is part of the process of trade liberalisation and structural economic reforms.

III. THE FEDERAL LAW OF ECONOMIC COMPETITION

The LFCE was issued in December, 1992, and went into effect on June 23, 1993.[15] The statute created the Commission (CFC), the agency responsible for implementing and enforcing the LFCE. In March 4, 1998, the President issued the Regulations of the LFCE.[16] In this paper, I shall consider the powers of the Commission and the main

---

[11] UNCTAD Secretariat, 'Control of Restrictive Business Practices in Latin America', *The Antitrust Bulletin*, 21 (1976) 137-152 (p. 140).

[12] In fact, price controls were still regulated under Article 7 of the LFCE. See Presidencia de la República, Exposición de Motivos de la Ley Federal de Competencia Económica, 18 November 1992, p. VIII. Hereinafter Presidential Bill.

[13] *Report-94*, p. 52.

[14] *Report-94*, p. 9.

[15] Ley Federal de Competencia Económica, D.O. December 24, 1992.

[16] Reglamento de la Ley Federal de Competencia Económica, D.O. March 4, 1998. (Rulings of the LFCE)

provisions of the statute, namely: scope of application; subjects of the law and its exemptions; monopolies and monopolistic practices; procedures and finally, the penalties for antitrust violations.

3.1. THE COMMISSION

The Commission is an administrative body of the Ministry of Economy. The Commission is a self governing agency, with its own budget and with autonomy to prescribe its resolutions.[17] The Commission consists of five members including its chairperson, and has broad powers to enforce the law.[18]

The Commission is authorised to: (I) investigate monopolies, monopolistic practices, and concentrations prohibited by the law; (II) issue administrative rulings and assess penalties for such violations; (III) upon request by the Federal Executive, issue advisory opinions regarding competition implications of draft laws and regulations; (IV) issue opinions concerning adjustments in programs and policies of the Federal Public Administration, whose effects may damage competition and free market participation; (V) participate in the negotiations of international agreements in competition issues; and, (VI) exercise the powers conferred by other laws and regulations.[19]

[17] LFCE, Article 23; Internal Regulations of the Federal Competition Commission, D.O. August 28, 1998, Articles 3-4. Hereinafter IRFCC.
[18] LFCE, Article 25.
[19] LFCE, Article 24.

Operationally, the Commission is divided into the Presidency, which is responsible for the Commission's policy development and implementation,[20] and the Plenum, which consists of the five Commissioners, appointed by the Federal Executive for a 10 year-renewable term,[21] who deliberate and decide the cases brought before the Commission.[22] A Commissioner can be removed from office only for serious reasons duly justified.[23] Decisions are made by majority vote by the Commissioners. While the President has the power to cast the deciding vote in cases involving a deadlock.[24]

The Executive Secretariat co-ordinates the preparation of cases and assists the Commission's President in implementing policy.[25] The Executive Secretary, in turn, is aided in his functions by five general directors in the areas of investigations, mergers, legal affairs, economic studies, privatisation and bidding processes, and regional coordination.[26]

The various General Directors prepare the cases brought before the Commission. Once the legal file is completed, the Executive Secretary turns it over to the President, who in turn, assigns a Commissioner who presents the case with his recommendation to the Plenum, which vote the decision.[27]

---

[20] LFCE, Article 28; IRFCC, Article 8, par. II, and Article 22.
[21] Only the first Commissioners' appointment were made for 2, 4, 6, 8, and 10 years, respectively.
[22] LFCE, Articles 25 and 27; IRFCC, Articles 8, par. I and 13.
[23] LFCE, Article 27.
[24] LFCE, Article 25.
[25] LFCE, Article 29; IRFCC, Articles 8, par. III and 23.
[26] IRFCC, Article 8, par. IV. See also Articles 26 to 33. There are also General Departments for coordination and administrative support.
[27] IRFCC, Article 18.

3.2. SCOPE OF APPLICATION

The objective of the law is to "protect the process of competition and free market participation, through the prevention and elimination of monopolies, monopolistic practices and other restraints on the efficient operation of goods and services markets."[28] The Commission's efforts will focus on fostering economic efficiency and increasing social welfare.[29] The purpose is the protection of the competitive process, rather than competitors. To have a competitive market economy, firms should be able to enter markets as freely as possible, and those firms that succeed do so because of superior foresight, skills or technology, and not because of artificial advantages. The LFCE rejects the idea that small firms be supported at the expense of large firms.

The LFCE applies in the Mexican territory and to all sectors of business activity.[30] The Commission has jurisdiction over all economic agents, national or foreign, whose actions have a bearing on markets in the territory of Mexico.[31] It seems that the CFC will follow the direct, substantial, and reasonably foreseeable effect test. It appears, from the construction of the LFCE and in accordance with Mexico's private international law rules[32], that the Commission has jurisdiction over any economic

[28] LFCE, Article 2.
[29] *Report-94*, p. 10.
[30] LFCE, Article 1.
[31] *Report-94*, p. 28.
[32] See Código Civil Federal. Articles 12 and 13(V). D.O. 26 May 1928. Hereinafter Civil Code.

agent; therefore, the LFCE could have “extraterritorial” application for acts occurring abroad but having a substantial effect on the competition process in Mexico.[33]

Mexican competition legislation does not only base its object on the investigation, restriction and prevention of anticompetitive conducts which take place and have effects on national territory and which object or effect could harm or obstruct the competition process and free market access, it also may be applied to conducts which have their source in a foreign country but which object is direct, indirect or foreseeable over domestic commerce.

The Commission seeks to prevent any possible international jurisdictional conflict through co-operation and reciprocity.[34] For instance, it initiated some negotiations in connection with the commercial agreement with the European Community and within the context of the North-America Free Trade Agreement, it signed an international agreement for antitrust co-operation.[35]

33 Rogelio López-Velarde Estrada, ‘La Ley Federal de Competencia Económica y Algunas Consideraciones desde la Perspectiva del Derecho Internacional Privado’, *Jurídica: Anuario del Departamento de Derecho de la Universidad Iberoamericana*, 24 (1995) 281-310 (p. 285).
34 *Report-94*, p. 47.
35 The agreement was signed in July 11, 2000.

3.3. SUBJECTS OF THE LAW

The law applies to all economic agents, whether they are private or public entities, governmental agencies, associations, trusts or any form of participation in business activities.[36] The law includes all economic agents whether they are juristic persons or not; hence, the economic units without personality are subject to the law. The underlying aim is to avoid simulations through trusts or other juristic forms.[37] Under Mexican legislation some economic units are not juristic persons, therefore do not have rights and duties.

3.4. EXCEPTIONS

The law provides some exceptions from the statute: (I) the functions performed by the state exclusively in the strategic sectors[38], but the provisions shall apply in those sectors that are not strategic;[39] (II) the labour unions and the privileges granted to authors and artists for the production of their works (i.e. patents, trademarks, copyrights) and those granted for the exclusive use of their inventions to inventors and persons engaged in the perfecting of an improvement (i.e. know-how, industrial secrets);[40] (III) associations or co-operatives which sell their products directly abroad, provided, ***inter alia***, that: a) the products are the principal source of income of the

[36] LFCE, Article 3.
[37] Santiago Levy, p. 72.
[38] The strategic sectors are mail, telegraph, radiotelegraphy, satellite communications, oil and other hydrocarbons, basic petrochemicals, electricity, nuclear energy, issuance of currency. Article 28 of the Federal Constitution.
[39] LFCE, Article 4.
[40] LFCE, Article 5.

region in which they are produced, or are not essential products and, b) that they are neither sold nor distributed in Mexico.[41]

The law states that those exemptions ‘do not constitute monopolies’, but the CFC enforce the statute and therefore ‘monopolies’ will be subject to the law if they engage in monopolistic practices.

The statute authorises the price control of products and services that are essential for the domestic economy or mass consumption. Only the Federal Executive should determine what goods and services may be subject to maximum prices. The Ministry of Economy shall fix the maximum prices of goods and services, pursuant to criteria that shall prevent shortage of supply. The Federal Consumer Protection Agency, shall be responsible for inspection, surveillance and penalisation.[42] In February the President issue a decree in which set maximum prices for liquefied petroleum gas, decree that has force from March 12, to September 12, 2001.[43] In September 5 of 2001, a new decree was issued that shall remain in force until August 31, 2002.[44] The Ministry of Economy is responsible in determining the maximum prices. It was the first time since the enactment of the FLEC that this provision was enforced.

[41] LFCE, Article 6.
[42] LFCE, Article 7.
[43] Decreto por el que se determina que el gas licuado de petróleo quedará sujeto al precio máximo de venta a usuarios finales que fije la Secretaría de Economía. D.O. March 12, 2001.
[44] Decreto por el que se determina que el gas licuado de petróleo quedará sujeto al precio máximo de venta a usuarios finales que fije la Secretaría de Economía. D.O. September, 5, 2001.

3.5. MONOPOLIES AND MONOPOLISTIC PRACTICES

3.5.1. Monopoly

The elimination of monopolies is one of the aims of the LFCE.[45] However, the Commission's power to enforce this general provision is not so straightforward. The Presidential Bill stated that the main objective of the proposed law was to promote economic efficiency and to avoid monopolistic practices.[46] One commentator, based on the literal interpretation of Article 8 of the LFCE, pointed out that under Mexican legislation all monopolies are prohibited (except from constitutional and other exceptions stated in the law) because they harm the process of competition; therefore, it cannot be argued that the monopoly or monopsomy is beneficial for the economy in terms of price, quality and service.[47] However, it has been noted that the underlying aim of the law is not the size of the firm, but the conduct of the firms within the market.[48] The emphasis is on conduct, and not on the size or number of firms in a given market.[49] Moreover, while Article 8 prohibits monopolies, and the Commission is empowered to investigate the existence of monopolies,[50] the penalties that the Commission may impose are in relation to 'the suspension, correction or elimination of the ***practice or concentration*** in question'. The LFCE does not entitle the

45 We stated above, that the objective of the law is the prevention and elimination of monopolies.
46 Presidential Bill, p. X.
47 Rogelio López-Velarde, *La Ley*, p. 293.
48 Santiago Levy, p. 66.
49 Santiago Levy, p. 66.
50 LFCE, Article 24.

Commission to impose a fine on a monopoly ***per se***, which is not found to be implementing monopolistic practices.

3.5.2. MONOPOLISTIC PRACTICES

The LFCE distinguishes two categories of illegal behaviour or monopolistic practices: absolute and relative monopolistic practices, a distinction roughly analogous to the United States ***per se*** violation and rule of reason criteria.

Absolute Monopolistic Practices

An absolute monopolistic practice is any contract, covenant, agreement or combination among competitors with the object or effect of: (I) fixing, raising, agreeing upon or manipulating the sale or purchase price of goods and services or exchanging information with the same objective or effect (price fixing);[51] (II) restricting or limiting the supply of goods and services;[52] (III) dividing, distributing, allocating or apportioning segments of an actual or potential market (allocating market shares);[53] establishing, fixing or co-ordinating bids or agreeing to abstain from participating in public bids or auctions (rigging public bidding).[54]

[51] LFCE, Article 9(I).
[52] LFCE, Article 9(II).
[53] LFCE, Article 9(III).
[54] LFCE, Article 9(IV).

These horizontal practices are defined by the absence of productive rationalisation or integration, thereby failing to generate any gains in efficiency; their sole purpose is to monopolise markets and they invariably have a direct and negative impact on consumers and the economy in general. Absolute monopolistic practices will have no legal force and are severely punished.[55] The single practice is punished without inquiry of the substantial power over the relevant market or any other criteria.

An international case

The CFC initiated an investigation for an agreement between competitors, presumably violating Article 9, paragraph I of the LFCE. The allegedly firms involved in this price fixing agreement were Archer Daniels Midland Co., Ajinomoto Co. Inc., Kyowa Hakko Kogyo Co. Ltd. and Sewon America Inc. All this economic agents plead guilty before the U.S. Courts. The CFC conclude that the market was the lysine for which the price was agreed. The foreign firms put into effect the agreement in Mexico through its subsidiaries ADM Bio Productos, S.A. de C.V. and Fermentaciones Mexicanas, S.A. de C.V. In this market the product is substantially homogeneous, there are few producers at either world or national level, and the markets are easily divided. This being the case, and since it had already been proved that both ADM's foreign shareholders (Archer Daniels Midland of the United States) and Kyowa Hakko (of Japan) had entered into agreements to fix prices and divide markets in the United

55 Presidential Bill, p. XIII.

States and other countries, the Commission ruled that the firms were responsible of the absolute monopolistic practices.[56]

Relative Monopolistic Practices

Relative monopolistic practices are those acts, contracts, agreements or cartels, whose purpose or effect is, or could be, to unfairly drive other economic agents from the market, substantially impede their access thereto or to establish exclusive advantages in favour of one or several persons.[57] The practices deemed as relative are: (I) the fixing, imposition or establishment of exclusive distribution of goods or services by subject, geography or time period, including the division, distribution or assignment of clients or suppliers (vertical division of markets);[58] (II) the imposition of price or other conditions which a distributor or supplier must comply with, when selling or distributing goods or offering services (price and other restrictions);[59] (III) the sale or transaction subject to the condition to buy or acquire, sell or supply other goods or services, normally distinct and distinguishable, or on a reciprocal basis (tied sales);[60] (IV) the sale or transaction based on the condition of not using or acquiring, selling or supplying goods or services produced, distributed or marketed by a third party (exclusive dealing);[61] (V) a unilateral action of consistently refusing to sell, to

[56] Comisión Federal de Competencia. *Gaceta de Competencia Económica.* Año 1, núm. 2. Septiembre-diciembre, 1998. pp. 373-376.
[57] LFCE, Article 10.
[58] LFCE, Article 10 (I).
[59] LFCE, Article 10 (II).
[60] LFCE, Article 10 (III).
[61] LFCE, Article 10 (IV).

certain persons, goods or services normally offered to third parties (refusal to deal);[62] (VI) the agreement to exert pressure against specific client or supplier, with the purpose of dissuasion from certain conduct, to retaliate or force it to act in a certain manner (boycott);[63] (VII) any act that unduly impairs or impedes the process of competition and free participation in the production, processing, distribution and marketing of goods and services (catch-all provision).[64] such as predatory pricing, cross subsidies, raising competitor's costs. [65]

In all cases of relative monopolistic practices, the LFCE establishes two necessary qualifications before the Commission can sanction them: first, to identify the relevant market in which the practice is taking place; and second, to show that the alleged violator has substantial power in the relevant market.[66]

The relevant market is determined by grouping goods or services that can be substituted in terms of use and price. For this purpose, product characteristics, transport costs, geographic location, access to the product and its substitutes (either domestic or imported), and competitor's accesses to the inputs in order to produce the substitute's products, are taken into account.[67]

---

[62] LFCE, Article 10 (V).
[63] LFCE, Article 10 (VI).
[64] LFCE, Article 10 (VII).
[65] Regulations of the LFCE, Article 7.
[66] LFCE, Article 11.
[67] LFCE, Article 12; *Report-94*, p. 27. See also Pascual García Alba Iduñate. Federal Competition Commission. *Economic Bases of the Federal Competition Commission's Decisions*. Second Semester Annual Report 1996, p.112-133.

Once the Commission identifies the relevant market, it has to ascertain that there is substantial power in the market; that is, it must establish whether the economic agent has power to engage in anticompetitive behaviour, such as set prices or restrict supply, without the competing agents being able, at present or potentially, to offset such power.[68] To determine substantial power, the Commission should take into consideration the existence of barriers to enter[69], import conditions, transport costs, the existence and power of present and potential competitors, the recent conduct of the economic agent and other criteria established by the regulations of the law,[70] which are the degree of positioning of the goods or services in the relevant market; the lack of access to imports or the existence of high importation costs; and the existence of high cost differentials which could face consumers on turning to other suppliers.[71] It is important to emphasize that an economic agent may provide evidence before the Commission in order to show that there are efficiency gains deriving from a relative monopoly practice that have a favorable influence on the process of competition and free participation in the market.[72]

An international case

American Express Travel Related Services Company, Inc. and American Express Company Mexico, S.A. de C.V., (AMEX), in 1996 filed a complaint against Visa International Service Association and Visa International Mexico, S.A. de C.V. (VISA).

[68] LFCE, Article 13(I).
[69] See Rulings of the LFCE, Article 11.
[70] LFCE, Article 13 (I-VI).
[71] Rulings of the LFCE, Article 12.

The issue of the complaint was an attempt by VISA to impose a clause which prohibited the banks operating in national territory to issue cards of Amex, under a menace that those who violated the agreement will loose the VISA membership. According to the AMEX, VISA's intent to obstruct the expansion of AMEX in those countries and regions in which AMEX could represent a threat to VISA's market share. AMEX state that other complains were filed against VISA in jurisdictions such as the European Community, U.S.A., and Latin América, among others, arguing that this conduct was globally impeding the growth and expansion of AMEX as a card system with global scope.

According to AMEX the board of directors of VISA International was the authorized body that determines the general and regional applicable strategies and criteria, and VISA intention to impose the prohibition includes Mexican banks.

Due to this statements and in order to maintain things the way they were at the moment the complaint was filed by AMEX, the CFC first admitted the complaint and summoned both Visas companies and required both companies to inform immediately regarding the veracity of the instruction to not issue AMEX cards, under a warn that in case of not responding such conducts would be considered as certain. The CFC also warned both VISAS companies to abstain to enter into any exclusivity contracts or execute any acts imposing others the obligation of not producing or distributing goods or services for a certain period of time which have or could have as

[72] Rulings of the LFCE, Article 6.

object or effect the displacement of other agents from the market and substantially impede their access thereto such as any impositions of statutory Bylaw, contractual or any similar acts which could pressure or invite any card issuer to operate exclusively with VISA or stop operating with other economic agents.

In response to all the above, VISA declared the had not approved in any time and did not intend to approve a that point or in the future any instruction which impose or prohibit the banks to issue cards of AMEX under a clause which implied loosing the VISA membership to those who did not respect such decision.

Due to the response and considering that the summoned parties informed and presented evidence that the Regional Board of Directors of Latin America declared that had no intent, now or in the future, to perform such conducts against AMEX and had not imposed any Bylaw clause which prohibited the banks to issue cards of AMEX, the CFC resolved to terminate in an anticipated way the investigation procedure. The CFC also ruled that if in the future the allegedly relative monopolistic practices take place at any time, it could be considered as an element for responsibility in accordance with the Mexican antitrust law.

3.6. CONCENTRATIONS

Chapter III of the LFCE regulates concentrations' issues (mergers and acquisitions).[73] A concentration is a merger, acquisition of control or any act whereby companies, partnerships, shares, equity, trust or assets in general are concentrated among competitors, suppliers, customers or any other economic agent.[74]

The Commission shall challenge and penalise those concentrations whose purpose or effect is to diminish, harm or impede competition or free market participation with regard to equal, similar or substantially related goods or services.[75] When investigation takes place the Commission must interpret as evidence that the merger or acquisition may diminish, impair, or impede competition when, as a result of the merger, the newly-formed economic agent: (I) could fix prices unilaterally or substantially restrict the stock or supply in the relevant market, without the competing economic agent being able, at present or potentially, to offset that power;[76] (II) intends or may intend to wrongfully displace other economic agents or to prevent their access to the relevant market;[77] and, (III) intends or has the effect of substantially facilitating the participants in the act or attempt in question, to engage in monopolistic practices.[78] The sole evidence of one of this indicia is enough to challenge the

[73] We use the term concentration, mergers or acquisitions interchangeably. For an analysis of the merger chapter see Martín Moguel Gloria. Análisis del Capítulo de Concentraciones en la Ley Federal de Competencia Económica Mexicana. Boletín Latinoamericano de Competencia, número 10. Junio 2000.
[74] LFCE, Article 16.
[75] LFCE, Article 16.
[76] LFCE, Article 17 (I).
[77] LFCE, Article 17 (II).
[78] LFCE, Article 17 (III).

merger,[79] which means that not all those three criteria have to be met in order to challenge the merger or acquisition. The Commission must define the relevant market or markets on which the merger will have effect, the existence of substantial power and the degree of concentration in the relevant market, and other criteria prescribed in the regulations of the law.[80] It is worth noting that the Regulations of the LFCE allows an economic agent involved in the merger to prove the efficiency gains of the transaction, but the CFC can not be compelled to investigate this efficiencies; the burden of proof is upon the economic agents.[81]

The Commission has power to impose conditions or order the partial or total divestiture or the elimination of the act in question, if the concentration is likely to harm competition.[82]

3.7. PRE-MERGER NOTIFICATION

The LFCE provides that concentrations must be notified prior to closing to the Commission when they meet one of the statutes three threshold tests.[83] (I) If the single transaction or a series of transactions amounts to over 12 million times the minimum general wage prevailing in the Federal District (FD wage);[84] (II) If the single transaction or series of transactions would lead to an accumulation by the acquiring

[79] *Presidential Bill*, p. XX.
[80] LFCE, Article 18. Regulations of the LFCE, Article 15.
[81] Regulations of the LFCE, Article 15, par. I. See also Article 6 of the same statute.
[82] LFCE, Article 19(I-II). Regulations of the LFCE, Article 16.
[83] The Commission has held that "parties may engage in negotiations before making the notification, provided that suspensive conditions are set which must be fulfilled after filing the notification." *Report-94*, p. 25.

economic agent of 35 per cent or more of the assets or shares of the target economic agent with assets or annual sales in excess of 12 million times the FD wage;[85] (III) If all the economic agents to the transaction have assets or annual sales in excess of 48 million times the FD wage, and the transaction would lead to an additional accumulation of assets or capital stock in excess of 4.8 million times the FD wage.[86]

The concentrations that take place abroad that have effects on the Mexican territory, it is compulsory to notify when the transaction in Mexico exceed the thresholds established of the first two paragraphs of Article 20, except for the rule set in paragraph III of Article 20 that has international dimension.[87] In international merges is should be stressed that prior to closing means that the merger must be notified before the transaction have legal or material effects on Mexican territory.[88]

The aim of the pre-merger notification is to prevent the concentration of market power.

The notification must include a draft of the agreement to merge, the names of the economic agents involved, the financial statements for the latest fiscal year, market share data and other data relevant to evaluate the operation. To facilitate the

---

[84] LFCE, Article 20(I).
[85] LFCE, Article 20(II).
[86] LFCE, Article 20(III).
[87] Comisión Federal de Competencia, *Informe de Competencia Económica*, segundo semestre de 1996, p. 53 e *Informe de Competencia Económica 1997,* p. 30.
[88] Rulings of the LFCE, Article 17, *in fine*.

notification the CFC issued a questionnaire to be requested by the parties involved in the transaction.[89]

The Commission has twenty days in which to request additional information from the parties and the latter have fifteen days from the date of the request to respond; the latter time period can be extended on the parties request in cases ‘duly justified’. The Commission must reach a decision within 45 calendar days from the date of the response to the request for additional information. If no additional information is requested, a decision must be made 45 days from the day the notification is filed. The Commission may extend the ordinary period or 45 days for up to 60 additional days in ‘exceptionally complex cases’. If the Commission within the ordinary period or extraordinary period has not reached a decision it shall be understood that it has no objection to the concentration.[90]

A concentration may no longer be challenged when it has received a favourable ruling by the Commission, except when such ruling was based on false information, or in the case of mergers not requiring pre-merger notification, a year after their ‘consummation’ or ‘closing’ date.

The LFCE has no mandatory waiting periods during which the parties may not ‘close’ a proposed transaction and begin joint operations; therefore, is not clear form the statute if the transaction may be closed just after the notification is made. In order to

[89] *Report-94*, p. 25.
[90] LFCE, Article 21(III).

avoid the associated cost and uncertainty to all parties involved in a future order of divestiture by the Commission, the Commission may issue an order to the parties involved to preclude from closing the proposed merger, and to refrain from making any payments, exchanging any information other than that required for due diligence, or taking over the management of the company involved in the merger.[91]

Another form of pre-merger notification has been settled in the case of privatisation of state-owned enterprises. In these cases the regulations on specific sectors impose these obligation.

In international transactions there is an exemption in the compulsory pre-merger notification, therefore is shall not be necessary to notify pursuant to Article 21. The exception is when a merger is taking place between foreign companies and meet the following: (i) the firms involved in the transactions do not thereby acquire the control of Mexican companies; (ii) nor accumulate in the national territory shares, partners' capital contributions, shares in trusts or assets in general, additional to those which, directly or indirectly, they possess prior to the transaction.[92]

There is also an exemption to notify the merger only if there is a written declaration within five working days following the closing date, when an economic agent has had in property or possession, directly or indirectly, over a period of at least three years,

[91] *Report-94*, p. 27.
[92] Rulings of the LFCE, Article 21.

98% of the shares or partner's capital contribution within itself or the economic agents involved in the transaction.

3.8. PROCEEDINGS

The proceedings before the Commission can be initiated by the Commission itself or on request of an interested party.

3.8.1. Ex-Officio Investigation

The Commission has the power to request any necessary information or documents as well as to summon whomever may be involved in the cases in question.[93] The proceedings before the Commission are two: first, investigating the unlawful conduct; second, issuing a resolution before the due process take place.

3.8.2. Private Investigation

Any economic agent may submit a written denunciation against the alleged guilty party in the case of absolute monopolistic practices. In the case of relative monopolistic practices or mergers, only the affected party may denounce. In the latter case, the complainant must include the elements that constitute the practice and must explain

[93] LFCE, Article 31.

when it was carried out and which factors show that the complainant has sustained or may sustain substantial damage or loss.[94]

Once the denunciation is submitted before the Commission, it initiated the investigations. If there is evidence of a violation of the law the party presumed guilty is served with a summons, stating the nature of the investigation and, if applicable, a copy of the accusation.[95] The party so summoned shall have thirty calendar days to submit its defence and to attach evidence.[96] Once the file is completed, the Commission must reach a decision within 60 calendar days.[97]

3.9. APPEAL FOR REVIEW

The parties may submit an appeal against the decisions of the Commission. The appeal must be filed before the Commission within 30 working days after the date of notification of any decision. The purpose of the appeal is to reverse, amend or confirm the decision appealed.[98] The Commission shall reach its resolution within 60 days following the reception of the appeal. The silence of the Commission should mean confirmation of the act.[99] The Commission has overturn its own resolutions. Notwithstanding, if the appealed resolution is confirmed or only amended partially, parties may file an administrative adversary proceeding before the Federal Tax Court

[94] LFCE, Article 32.
[95] LFCE, Article 33(I).
[96] LFCE, Article 33(II).
[97] LFCE, Article 33(IV).
[98] LFCE, Article 39.
[99] LFCE, Article 39.

where the decision of the Commission involves fines. When the decision affects constitutional rights, the parties may file an amparo demand before the District Court Judges.[100]

3.10. PENALTIES

Chapter VI of the LFCE empowers the Commission to impose diverse sanctions. It may order the suspension, correction or termination of the practice or concentration in question, or order the divestiture of an unlawful concentration. The Commission may also impose high fines. A fine up to 100,000 times the FD wage, for failing to notify a merger that meets the size requirements of Article 20 of the LFCE or for violations of Article 10(VII);[101] up to 225,000 times the FD wage for taking part in any prohibited merger or any relative monopolistic practice;[102] and up to 375,000 times the FD wage for having engaged in absolute monopolistic practice.[103] These fines may be doubled in the case of repeated violations.[104] Moreover, for violations that the Commission deems "particularly serious", it may impose a fine of up to 10% of the offender's annual sales or assets, whichever is greater,[105] instead of the fines stated in sections IV to VII of Article 35 of the LFCE.

---

[100] *Report-94*, p 13-14. The amparo is a Constitutional proceeding to protect individuals from laws or acts of the authorities that violate individual guarantees. See Article 103 and 107 of the Constitution.
[101] LFCE, Article 35(V and VI).
[102] LFCE, Article 35(V and VI).
[103] LFCE, Article 35(IV).
[104] LFCE, Article 35.
[105] LFCE, Article 37.

The Commission must take into account the seriousness of the violation, the damage caused, the degree of intention, the violators' market share, the size of the market affected, the duration of the practice, the violators' antecedents, as well as its financial capacity in order to impose the fine.[106]

Finally, the LFCE permits those who demonstrate that they have suffered injury as a result of monopolistic activity or an unlawful concentration to recover the amount of the damage they have sustained through judicial proceedings.[107] The judicial authority may take into consideration the damage or loss as estimated by the Commission.[108]

IV. AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED MEXICAN STATES

Under chapter 15 of the North American Free Trade Agreement, the Federal Competition Commission and the Department of Justice and the Federal Trade Commission, signed an agreement that strengthened the chapter on economic competition. The competition authorities of Mexico and the United States will seek to work together to ensure effective enforcement of each country's laws on competition and to seek technical cooperation, coordination and to avoid conflicts arising form the application of competition laws.

[106] LFCE, Article 36.
[107] LFCE, Article 38.
[108] LFCE, Article 38.

The main issues of this agreement are:

Notification: The parties resolve to notify acts of enforcement of the competition laws of one of the parties that affect the interests of the other. Such is the case with merger operations and anti-competitive practices carried out by the economic agents of one of the countries which have a bearing on the economy of the other country, or when involve remedies that expressly require or prohibit conduct in the territory of the other Party.

Enforcement Cooperation: The parties recognizes their common interest to work together in the detection of anticompetitive practices and to support each other to ensure compliance of their respective competition laws. This, subject to compatibility with the legislation of each country and to the availability of resources of each of the parties. The parties will exchange the information required and obtaining evidence to ensure compliance of competition law, as long as said exchanges are compatible with each country's legislation.

Coordination regarding related matters: The parties may coordinate their activities concerning enforcement of their laws when it is an issue of mutual interest, making use of mutual assistance arrangements.

Cooperation regarding anti-competitive activities in one country that affect the other: This will enable a Party to initiate investigation activities at the request of the other if there are anticompetitive activities carried out in the territory of the latter.

Avoidance of Conflicts. The parties should bear in mind to what extent the decisions taken by the competition authority of one country affect the interests of the other country, when they promote and apply the mechanisms necessary to avoid disputes.

Technical cooperation: The parties agree that it is in their common interest to work in technical cooperation activities, such as exchange of information, personnel training, training courses, among others.

Consultation: Either party may request consultations regarding any matter relating the agreement.

Periodic Meetings: The parties shall meet periodically to exchange information regarding its enforcement efforts, on economic sectors of common interest.

Confidentiality of information: One party is not obliged to provide information that is prohibited by legislation or that is incompatible with the important interests of the other party and the parties will maintain the confidentiality of any information communicated to it in confidence by the other Party under the agreement.

Existing Laws. The agreement does not means that a Party should take action to amend the laws of the contracting party.

Entry into force and termination. The agreement enter into force in July 12, 2000 and will remain in force until 60 days after the date on which either Party notifies that it wishes to terminate the Agreement.

MEXICAN ANTITRUST LAW

ACCA-SAN DIEGO
October 2001

Legal Framework

- Article 28 of the Mexican Constitution
- Federal Law on Economic Competition (December 24, 1992) (FLEC)
- Regulations of the Federal Competition Commission (August 28, 1998)
- Regulations of the Federal Law on Economic Competition (March 4, 1998)
- Federal Civil Procedures Code

FCC and objective of the FLEC

- **The Commission is an administrative body of the Ministry of Economy. The Commission is a self governing agency, with its own budget and with autonomy to prescribe its resolutions. The Commission consists of five members including its chairperson, and has broad powers to enforce the law.**
- **To protect the process of competition and free market participation, through the prevention of monopolies, monopolistic practices and other restrictions that deter the efficient operation of the market for goods and services.**

The FLEC characteristics

- **Foster economic efficiency.**
- **Do not protect competitors**
- **The proceeding is of public interest**
- **The FCC is the only enforcer of competition**
- **No criminal offences**

FLEC scope of application

- Mexican Territory and in all sectors of business activity, by:
  - Mexican or foreign economic agents
  - Substantial effects

Forbidden conducts

- Monopolies
- Absolute monopolistic practices
- Relative monopolistic practices
- Prohibited concentrations

Absolute monopolistic practices

- **Agreements between competitors whose aim or object is:**
  - **Price Fixing**
  - **Output restrictions or quotas**
  - **Allocating market shares**
  - **Rigging public bidding**

▪Archer Daniels Midland Co., Ajinomoto Co. Inc., Kyowa Hakko Kogyo Co. Ltd.

Foreign shareholders Archer Daniels Midland (US) and Kyowa Hakko (Japan) entered into agreements to fix prices and divide markets in the United States and other countries in the lysine market. All plead guilty before the U.S. Courts

The foreign firms put into effect the agreement in Mexico through its subsidiaries in Mexico

The Commission ruled firms were responsible of the absolute monopolistic practices

Relative monopolistic practices

- **Unduly excercise of market power with the object of:**
  - **Unfairly displace other agents from the market**
  - **Impede the access to the market**
  - **Establish exclusive advantages in favor of one or several entities or individuals**

Relative monopolistic practices

- **Exclusive Dealing**
- **Resale price maintenance**
- **Tied sales**
- **Refusal to deal**
- **Boycott**
- **Predatory pricing**
- **Tied discounts**
- **Cross subsidies**
- **Discrimination**

Substantial power in the relevant market

- **Relevant market is determined by grouping goods or services that can be substituted (use and price)**
- **Product characteristics, transport costs, geographic location, access to the product and its substitutes, and to the inputs in order to produce the substitute's products, are taken into account.**
- **Substantial power.- Power to engage in anticompetitive behaviour. Barriers to enter, import conditions, transport costs, the existence and power of competitors, among others.**

▪American Express (AMEX), Visa International Service Association and Visa International Mexico (VISA).

VISA prohibited banks operating in Mexico to issue cards of Amex. Those who violated the agreement will loose the VISA membership.

CFC summoned VISA and required to inform immediately the veracity of the instruction.

Summoned parties informed and presented evidence that the Regional Board of Directors of Latin America declared that had no intent, now or in the future, to perform such conducts

CFC ruled to terminate an anticipated way the investigation

Absolute MP (per se)	**Relvative MP (Rule of reason)**
▪ **Between competitors** ▪ **An agreement** ▪ **Absence of productive rationalization. Purpose monopolization**	▪ **Any economic agent** ▪ **Imposition of conduct** ▪ **Efficiency gains** ▪ **Sustantial Power in the relevant market**

Prohibited concentrations

- **Mergers or acquisitions with the purpose or effect to diminish, harm or impede competition or free market participation with regard to equal, similar or substantially related goods or services.**

    - **Pre-merger notification**
    - **Investigation**

Procedure

- **First stage:**
  - **Integration of the investigation**
  - **Ex officio**
  - **By complain**

Absolute monopolistic practices any economic agent.
Relative monopolisticpractices and in prohibited concentrations only the affected parties may file a written complaint before the Commission.

- **Second stage:**
  - **Summon-writ of alleged responsibility (due process)**

Rulings

- **The FCC can rule in two ways:**
  - **No violation of the act (i.e. efficiencies).**
  - **Impose administrative sanctions (fines, divestiture, elimination of the monopolistic practices)**
  - **Sanctionscan be imposedwhen a consent agreement is reached**
  - **Damages in court but CFC can estimate those**

Appeal for review

Economic agents may file an appeal against FCC resolutions with the porpose to revoke or ammend the decision appealed

Federal Courts

- **The FCC rulings can be reviewed by the Administrative Courts or Federal Courts :**
  - **In both instances they review the legality of the Commission's decision**
  - **In the Amparo Trial (Constitutional control procedure) also the constitutionality of the antitrust legislation is reviewed**

Agreement USA-Mexico

- **NAFTA-Chapter 15**
- **Notify acts of enforcement of competition laws**
- **Exchange information or obtaining evidence to ensure compliance of competition law**
- **Coordinate activities concerning enforcement**
- **Cooperation regarding anticompetitive activities carried out in the territory of one Party**
- **Avoidance of Conflicts**
- **Technical cooperation**
- **Confidentiality of information**

International economic agents

- Conducts that have effects in Mexico (absolute or relative monopolistic practices)
- Pre merger notification only if the part of the transaction in Mexico exceed the thresholds
- Can file any consultation
- Electronic files