Legal Backgrounder

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2009 Massachusetts Avenue, NW
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202.588.0302 wlf.org

Proposed Change To Mexican Antitrust Law: Erecting A Barrier To Competition?

by John Roberti and Meytal McCoy

Mexico is considering a proposal that could transform the nation's competition law regime (the "Law"). The Law, proposed by the Mexican President on February 19, 2014, has the potential to affect many US and other companies in two principal ways:

- First, the Law introduces the concept of "barriers to competition" that may result in a violation based only upon the existence of market dominance or concentration in a critical input and not necessarily the unlawful exercise of that power. This "barriers to competition" concept is not found in competition regimes elsewhere in the world.[1]
- Second, the Law authorizes industry-wide investigations that may be coupled with significant regulatory intervention. Such intervention could include structural remedies and price regulation and could be imposed without any obligation to make company-specific findings of the existence of anticompetitive conduct or agreements.

The Law also may have an international effect. Governments and antitrust authorities around the world are seeking to harmonize their competition laws to allow companies to operate with policies and procedures that apply globally. The new concepts and intervention measures introduced in the Law would be unique to Mexico and thus could undermine the goal of harmonization of international antitrust regimes.

By introducing such measures, the Law also creates potential new antitrust compliance risks for companies operating in Mexico. The Law could be used to regulate companies that have gained a strong market position through innovation, skill, or even luck, and not through anticompetitive conduct. The Law could even be the basis for remedial action against a company with a large market share regardless of whether that company has engaged in exclusionary activity. These features would make the Law unique in the world.

Because the new concepts in the Law may introduce unpredictability and uncertainty into the Mexican antitrust regime, companies may become less willing to make pro-competitive investments involving new

[1] *See* Anne Perrot & Assimakis Komninos, "Mexico's Proposed Reform of Competition Law: A Critique from Europe," Mar. 3, 2014, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2404022.

John Roberti is a partner in the Washington, DC office of the law firm Mayer Brown LLP, where he is one of the leaders of the firm's Antitrust practice. **Meytal McCoy** is an antitrust associate in the Washington, D.C. office of Mayer Brown LLP. The authors gratefully acknowledge the comments received from David Hurtado and Manuel Iglesias of Jáuregui y Del Valle, S.C. in Mexico City. *The views expressed here are those of the authors alone and do not reflect the views of the Washington Legal Foundation, Mayer Brown LLP, or the clients of Mayer Brown LLP. They should not be construed as an attempt to aid or hinder the passage of legislation.*

innovations or quality improvements. Companies may be concerned that such investments could increase competition law risks in Mexico because any increase in the company's market leadership, growth toward a dominant position, or control over an "essential input" could violate the new Law.

This risk is not limited to regulatory proceedings by Mexico's competition authority. Private damages actions may be brought based upon the agency's findings too.

While the final text of the Law is currently being debated, reportedly it is scheduled to move quickly, with final resolution as early as the end of this month.

Key Provisions of the Proposal. The Law includes familiar competition provisions, such as (i) the per se prohibition of horizontal anticompetitive agreements (Article 53), (ii) prohibition of vertical restraints by a dominant market participant if there are no efficiency gains to justify them (Article 54), and (iii) regulations regarding merger control (Article 61 *et seq.*).[2] However, the Law also adds new provisions that are not typically found in other antitrust regimes.

In particular, the Law introduces two new competition law concepts: (i) a ban on "barriers to competition" (and the implementation of measures to eliminate them) and (ii) the regulation of access to an essential input. The Law expressly prohibits "barriers that, according to this law, limit, damage or prevent free participation or economic competition in the production, processing, distribution, or commercialization of goods or services." (Article 52). The Law requires that *Mexico's* Federal *Competition Commission (the "Commission") "**shall establish*** what is essential in order to prevent and eliminate ***any barriers to free competition*** and economic competition using the procedures set forth by this law." (Article 57) (emphasis added). Woven throughout the Law is a concept of "Essential Inputs," which are described as inputs held by a single or small number of economic agents, that are difficult to reproduce by another economic agent and that are indispensable to supply certain goods and for which there are no similar substitutes. (Article 60).

The Law then purports to authorize market-wide investigations to determine whether "there are elements which determine the existence of barriers to free competition of essential inputs" and, if so, to preliminarily order "corrective measures deemed necessary" for the purpose of "eliminating any restrictions for the efficient operation of the market in question and regulate access to essential inputs." (Article 94). The Law authorizes such market-wide investigations through a special procedure initiated by the Commission on its own or by request of the Executive Branch or the Ministry of Economy.

"Barriers to Competition" as a Standard for Competition Law. The apparent prohibition of "barriers to competition" and regulation of "essential inputs" are novel concepts, and if the Law includes them, it would be unique to the Mexican antitrust regime.

One concern is that the Law does not define "barriers to competition." Additionally, the Law's definition of "essential input" appears to be broad and seems to encompass almost any unique product. The concepts in the definition of "essential input"—that the product is difficult to reproduce and has no substitutes—are core concepts in market definition. However, it is unclear whether the definition could be read more broadly to cover inputs that are "essential" to competition but subject to vertical integration and not the subject of commerce (*e.g.*, intermediate chemicals or a method of product or service distribution). Thus, almost any product, service, or process that is deemed essential to making another product might be considered an "essential input."

[2] A Spanish version is available at http://gaceta.diputados.gob.mx/PDF/62/2014/feb/20140220-III.pdf.

The potential breadth of this new "barriers to competition" standard raises compliance issues for companies that have large market shares or are one of a few companies in a concentrated industry. It could be used to enable regulation even in industries not subject to sector-specific regulation. Firms with a large market share could be targeted solely based on that figure or because these firms participate in a market where the structure itself makes it more difficult for other firms to compete or enter. In sum, the Law has the potential to create a status violation based on size alone, which is a concept not traditionally found in other antitrust regimes. If a violation of the "barriers to competition" provision is found, the Law does not authorize fines or other sanctions. The Law does, however, authorize the institution of market regulation, which can be even more harmful than fines or sanctions to competition and market function over the long term.

In the United States, Europe, and virtually every other antitrust regime around the globe, there is nothing that prohibits a company from ***possessing*** a monopoly, unless it has done so through exclusionary conduct. And these other competition authorities may not impose regulatory oversight in the absence of evidence of exclusionary conduct by specific parties.

It should be noted that a separate concept, "barriers to ***entry***," is common in many jurisdictions, but it is not the basis for finding competition law violations. "Barriers to entry" is a well-understood concept used to describe market conditions. However, this concept only serves to identify the potential for market power; the existence of entry barriers alone does not authorize competition authorities to take action to remove barriers to entry in the absence of an actual showing of exclusionary conduct.

Broad Authority for Sector-wide Remedies, Including Divestment. Article 94 of the Law authorizes the Commission to investigate markets to determine the existence of barriers to competition and essential inputs. There is a risk that this language, especially if read in the context of Article 52, could be misinterpreted to authorize the finding of a violation and the imposition of remedies based solely upon an entity's status as a dominant company or as one of a few companies in a concentrated industry. And, if the Commission investigates and determines that a company's assets or products are essential, then Article 94 purports to authorize direct price regulation and other behavioral restrictions, including divestitures, by the government—all of which potentially could be done without regard to whether the company itself is acting in an anticompetitive manner. The purpose of the investigation then is to review and regulate barriers to competition in a given market, and not merely to remedy or prohibit anticompetitive conduct by firms.

In contrast, other jurisdictions, including the US and the EU, do not authorize regulation based on market investigation findings alone. Many competition authorities are authorized to conduct sector-specific investigations, but these investigations are used for guiding enforcement policy or for legislative advocacy and do not lead to sector-wide or company-specific regulation or to the restructuring of an entire industry. In the US, antitrust violations may be prosecuted only on a company-specific basis and remedies obtained only through firm-specific enforcement actions.

Because of this new market investigation provision, the Law could incentivize companies to reduce the intensity of their competiveness or innovation so as to avoid growing too big, which would be to the detriment of Mexican consumers. For example, the fear of mandatory divestitures could introduce an incentive for firms to ***raise*** prices to curtail growth of sales as they approach the market share threshold that would trigger divestitures.

Potential Impact on U.S. Investments and Companies Operating in Mexico. The Law is of general application and could be applied to foreign companies operating in Mexico or considering investments in

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Mexico. If a company's size alone could lead to investigations and result in redistribution of assets through forced divestitures, price regulation, or other remedies, then foreign investment in Mexico may be dampened.

If mandatory divestitures were imposed for any firm reaching a particular market share threshold, the Law could have the effect of penalizing even those firms that grew entirely as a result of pro-competitive behavior. Likewise, a company with a unique or innovative product or asset may find that the threat of that product or asset being deemed essential and subject to price regulation reduces the company's incentives to make its products better or its assets more efficient in the first place.

A policy mandating divestitures for any firm reaching a specified share threshold in a particular market may discourage investments needed to expand output and sales in an efficient manner. A company that is dominant already may decide to hold off on introducing new products or innovations on existing products if either would increase the company's exposure under Mexican law. Beyond competition policy concerns, such a legal regime could raise issues under the North American Free Trade Agreement to the extent US (or Canadian) companies are penalized in order to facilitate the restructuring of the domestic markets in Mexico.

The predecessor Competition Commission has made great advances in the past several years, becoming a leading authority in Latin America and respected globally. Particularly in recent matters, it has demonstrated a willingness to engage in a rational, economically-based analysis that is consistent with other regimes. The predecessor Commission's divestiture orders were generally consistent with its published merger guideline standards, and the current administration may fully intend to use these new powers in only the most extreme circumstances. However, the combination of the broad mandate of the Law and the lack of limitation on its application creates the potential for mischief and generates the future risk that politics or other factors could lead to inefficiencies, protectionism, or results that could harm the Mexican economy.

Conclusion. If enforced as drafted, Mexico's proposed competition law changes are broad. The proposal prohibits undefined "barriers to competition" and allows the competition authority to force divestment by firms for creating a barrier to competition—potentially through dominance alone. The Law could deter firms from engaging in vigorous competition and from making investments in new products and quality improvements, which harm Mexican consumers.

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