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By: Alvaro Sánchez-González. Economic consultant
at Valdes Abascal & Brito Anderson, Attorneys-at-law

Amendments to the Federal Law on Economic Competition

Does the consumer matter?

1. Mexican Constitution (Federation's Charter) and Competition Law

The Federal Law on Economic Competition ("FLEC") has been designed to enforce Article 28 of the Constitution as it prohibits monopolies and associated abusive conducts.¹

Such article establishes protection for both competition and consumers, however competition law has been oriented to protect the competition process. Under this approach by fostering competition markets expected outcome will be better prices, supply and quality of goods and services thus furthering consumer's welfare. Recently the FLEC underwent some modifications one of them being a specific place given to consumer's welfare protection. This note will comment on this item.

2. FLEC's amendments

In June 28, 2006 amendments to the FLEC were published in Federation's Official Gazette.

Some modifications address procedural aspects whereas others address substantial topics.² Amendments are intended to clarify aspects which had been subjected to intense court proceedings and to provide the authority, Comision Federal de Competencia, with more tools to evaluate anticompetitive practices and concentrations.

3. FLEC's substantive matter

FLEC's substantive matter is to deal with anticompetitive practices (e.g. cartels and vertical restraints or abuse of dominance) and concentrations (e.g. mergers and acquisitions).

4. A consumer' welfare standard

¹ The Federal Law on Economic Competition was first published in December 24, 1992, being enforceable six months thereafter. The FLEC is available at: <http://www.cfc.gob.mx>
The FLEC is aimed to enforce Constitution's Article 28 whereby monopolies are prohibited, large economic concentrations should be prevented and abusive prices should be sanctioned. Some activities as carried out exclusively by the State are exempted and not considered monopolies (e.g. Oil extraction).

² A thorough review of the amendments from a legal perspective can be found in "Reformas a la Ley Federal de Competencia Económica". Valdes Abascal y Brito Anderson, S.C. June 2006. See it at: <http://www.vb.com.mx>. English translation forthcoming.

This article will comment on the inclusion of consumer's welfare as an amendment to the section on vertical restraints which, from the author's point of view, will provoke a totally new set of economic discussions.

5. FLEC's treatment of Vertical restraints/ Abuse of dominance.

It is worth mentioning that cases of exploitative power are practically absent from the FLEC; by contrast the law establishes in some detail what types of vertical restraints could be considered cases of abuse of dominance.

5.1. "Exploitative" aspects, such as charging monopolistic prices, are succinctly dealt with by the FLEC.

FLEC's article 7th establishes that the Ministry of Economy is enabled to set "prices" for goods or services as long as there is a formal opinion by the Comision Federal de Competencia concluding the absence of "effective competition" in the relevant market. This article conveys a couple of caveats. First, Constitution's article 28 considers only the imposition of maximum (ceiling) prices, thus establishing minimum (floor) prices would turn controversial at least. Second, neither the FLEC nor its Code of regulations defines what is meant by "effective competition", concept becoming a likely source of disputes.³

5.2. FLEC's article 10 deals with vertical restraints under a rule of reason approach. The article may be viewed as composed of three parts. The first one corresponds to the first paragraph wherein "parameters" to be assessed in order to conclude if a commercial practice is contrary to the competition process. The second part is a list of eleven sections identifying the type of vertical restraints of the exclusionary type, which could translate into abuse of dominance (e.g. (exclusivity agreements, boycott, predation by price or costs, etc.). The third part is a final paragraph instructing analysis of efficiencies supposedly brought along by the restraint or conduct as well as their effects on consumer' welfare.

Specifically article 10 establishes in its first paragraph that a commercial practice could be sanctioned if its intended purpose or resulting effect:

- i. unduly excludes from the market a competitor;
- ii. hinders in a substantial way his/her access to the market; or
- iii. grants exclusive advantages to some persons.

Notice that out of the above mentioned items, two of them are quite contentious. Concepts such as undue exclusion or substantial impediments to entrance are issues open to heated discussion because apart from any material quantification they convey

³ Some laws or regulations in "regulated" sectors require the authority to have an opinion by the Comision Federal de Competencia on the competition conditions in a given market, prior to establishing regulated tariffs to economic agents. Different laws call for opinions regarding different –but analogous concepts, such as "effective competition" or "reasonable competition conditions" (for the first concept see Civil Aviation Law and Law ruling railroad services; for the second one see Law on Airports. The Federal Law on Telecommunications will regulate a concessionaire having "substantial power in the relevant market").

discretionary or subjective assessments. In fact we could think of them as immerse within the perennial discussion on how to distinguish competition on the merits from anticompetitive conducts.⁴

5.3. The authority can investigate a vertical restraint provided such practice is carried out by an economic agent with substantial power in the relevant market. This prerequisite is stated in FLEC's article 11.

The amended article 10, Sections I to XI include vertical restraints such as: exclusivity agreements, refusal to deal, tying, boycott, predation by price or costs, loyalty rebates, discrimination. In particular Sections VII to XI incorporate conducts which were formerly stated in the Code of regulations and had been outlaw by court.

Notice that the FLEC does not address conducts oriented to acquire substantial power (i.e. "monopolization conducts"). This approach was not amended.

5.4. This Note focus in the final paragraph of article 10 whereby it is established that the analysis of a commercial practice should take account of its net effects on consumer's welfare. This being a "new evaluation standard".

Such paragraph reads:

"To determine whether those practices referred to herein should be sanctioned by this Law, the Commission will analyze efficiency gains accruing from the conduct as supported by the economic agents, such gains should favor both the competition process and freedom to access markets...[and] proofs should be given that they advance net consumer' welfare in spite of anticompetitive effects". (Own translation).

Before going any further it should be pointed out that previously to the amendments efficiency considerations for vertical restraints appeared only in FLEC's Code of regulations, article 6. By contrast the study of efficiencies is now directly considered in law, a fact that facilitates its enforcement.

5.5. Some comments follow.

5.5.1. To begin with notice that the discussion on whether antitrust law should aim to protect consumer welfare or total welfare (i.e. consumer plus producer welfare), seems to be settled favoring consumers.

Whereas article 28 of the Constitution states that *the law shall protect consumers*, this objective is served indirectly as the FLEC's design aims to protect the competition process. The only explicit mention to consumers is in FLEC's article 10 as amended.⁵

⁴ See "What is competition on the merits"? Policy brief. OECD. June 2006. Available at <http://www.oecd.org/dataoecd/10/27/37082099.pdf>
"Competition on the merits". DAF/COMP(2005)27. OECD. March 30, 2006. Available at <http://www.oecd.org/dataoecd/7/13/35911017.pdf>

⁵ Protection to consumers' rights is provided by the Federal Law on Consumer's Protection, enforced by the Consumer's Federal Attorney. However this law does not deal with issues rising out of sellers charging monopolistic prices, although some surveillance duties would arise in case a price ceiling for a good or service is set by the authority according to FLEC's article 7th.

5.5.2. The “new standard” for vertical restraints analysis is challenging for an economist, since he/she has to work out net effects on consumer’ welfare as the final step in the process of distinguishing competition on the merits and anticompetitive conducts and the role played by economic efficiencies.⁶

5.5.3. An example. FLEC’s article 10 is comprised of eleven sections, each one referring to a commercial practice or conduct which could be investigated by the authority as a likely anticompetitive vertical restraint.

For an example take a price-predation case.

Section VII of article 10 establishes as a price-predation case:

“Systematic sales of goods or services at prices below their average total cost or their occasional sale below their average variable cost, whenever there are elements to think that such losses will be recouped by future price increases...” (Own translation).

Yet observe that according to FLEC’s articles 13 and 17 an agent has substantial power if he/she can set prices unilaterally. Thus the presumption that a predator can increase prices is fulfilled automatically as the agent under investigation has to have substantial market power to start with. Further complexity arises if a predatory case involves associated practices such as cross-subsidies and price discrimination.

The authority could conclude that the practice is an infringement to competition law only if consumer’s welfare deteriorates. Whether that is the case turns thorny since a balance should be made between current and short run benefits for consumers arising of lower prices, which are a tangible effect v. medium or long run price increases, which is an expected but uncertain outcome. In any case it seems that purposes or effects of a conduct as stated in the first paragraph of FLEC’s article 10 (see 5.2 above) lack substance when contrasted with the “net” effects on consumer’ welfare.

Although the FLEC does not identify what is meant for net effects on consumer’ welfare, lets say as a working proposition that it is better price or supply or quality of a good or service or some combination thereof.

That is any vertical restraint which is found to deteriorate consumer’ welfare should be sanctioned. To this effect care should be taken of deriving measurements against well-defined benchmarks and within a reasonable time horizon.

5.5.4. Cartels. FLEC deals with cartels as a per se law infringement, thus an economic evaluation of the sort just discussed is not needed (cf. Article 9th).

5.5.5. Merger control. The FLEC establishes the definition of concentration (i.e. merger) and points out that a merger transaction has to be challenged by the antitrust authority if as a result the merging firm shall acquire substantial power in the relevant

⁶ See Rey, P., and Tirole, J. (January 2006). “A Primer on foreclosure”. Handbook of Industrial Organization, III. Eds. M. Armstrong and R. Porter, (forthcoming). Available at: <http://idei.fr/doc/by/tirole/primer.pdf>

Also see Whinston, M.D. (2006). “Lectures on Antitrust Economics. The Cairolti Lectures”. The MIT Press, Cambridge, Massachusetts. Chapter 4.

market (i.e. the capacity to unilaterally impose the price or supply of a good or service) and thus it is enabled to carry out anticompetitive practices. (cf. Articles 16 and 17).

The FLEC and its Code of regulations instruct steps needed to determine the relevant market and its characteristics (level of concentration, entry barriers, and the like) and evaluate the transaction effects on it. It is clarified also that efficiency gains should be analyzed. However, there is no mention to effects on consumers. Thus it should be understood that “net” effects on consumer’s welfare accruing from a proposed merger should not be accounted for by the authority.

From this author point of view that approach keeps as fundamental criterion to challenge a proposed merger whenever its likely result is the acquisition of substantial power in the relevant market by the merging party (ref. FLEC’s articles 16 and 17).⁷

Nevertheless there may be other interpretations. For instance FLEC’s article 18 lists elements to analyze in order to determine when a merger should be challenged. Among them, Section V requires an analysis of “efficiencies” to be brought along by the transaction and to assess if such efficiencies are favorable to the competition process.

For instance in a market where network externalities arise a case could be made that efficiencies of a merger will further consumer’s welfare in spite of a high level of concentration and high entry barriers in the relevant market.⁸

Even though a final decision shall be taken on a case by case basis the issue at stake is if as a general rule effects on the consumer’s welfare are going to be taken into account by the authority in its merger analysis.

6. Concluding remarks

6.1. FLEC has been designed to protect competition process and free access to markets under the well founded assumption that in the end the more competition the more benefits to the consumer.

6.2. FLEC’s amendments bring explicitly the consumer to the forefront. A change in the evaluation of abuse of dominance has taken place. Consumer’ welfare is explicitly stated as the ultimate test to conclude if a vertical restraint should be sanctioned thus superseding any other consideration. The consumer does matter!

⁷ See “Concentraciones. Apuntes para el análisis económico”. CFC’s web page: <http://www.cfc.gob.mx>

⁸ In such a market the more consumers belonging to the producer network the better (effect known as demand-side economies of scale).