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ROUNDTABLE ON CONCESSIONS

Contribution from Mexico

-- Session I --

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ROUNDTABLE ON CONCESSIONS

1. Concessions in Mexico

1. During the 1990's Mexico began a process to modernise and widen its basic services infrastructure, by promoting private investment and efficiency in areas like railroads, telecommunications, ports, and airports.

2. Several legal amendments were necessary to intensify private-sector participation in expanding and operating infrastructure. These legal changes included both amendments to the Constitution and the issuing of new sector-specific laws. The process encompassed the privatisation of infrastructure, the granting of concessions to allow the provision of services through the use and exploitation of infrastructure, and the creation of a specific area in charge of regulations for each transport mode within the Ministry of Communications and Transport (SCT) and, in telecommunications, the creation of the Federal Telecommunications Commission (CFT).

3. In short, during the first years of the Federal Competition Commission (the CFC or Commission), the development of competition in sectors and activities traditionally characterised by a low number of participants—or even dominated by a single firm—was an essential aspect of competition policy and of the CFC's activities.

4. Restructuring in railroads, telecommunications, ports, and airports has shown relative success. However there is a need to develop better regulatory frameworks that favour competition and promote efficiency in such sectors. The CFC has an important role in initiatives to develop, review, or revise sector regulations.

2. The institutional and legal framework

5. Article 28 of the Mexican Constitution establishes as the overall objectives of concessions: i) efficiency in the provision of public services and, ii) the use of state resources by the private sector taking into account social benefits. On these grounds, sector-specific laws ordinarily include the objectives of promoting competition, access rights to essential resources and preventing anticompetitive practices and concentrations, among others.

2.1 *Scope of concessions*

6. The scope of public sector functions and activities is established in the Mexican Constitution and in some sector-specific laws, such as the regulatory law of the oil industry and the electricity public service law. According to such legislation, the following activities can only be performed by the federal government, and therefore the granting of concessions is not allowed:

- Mail services and telegraphs.
- Oil, hydrocarbons and basic petrochemistry. Specifically:

- The exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of oil and products deriving from its refining;
 - The exploration, exploitation, elaboration and first-hand sale of gas, as well as the transportation and storage required to interconnect its exploitation and elaboration, and
 - The elaboration, transportation, storage, distribution and first-hand sale of oil derivatives susceptible of becoming basic industrial raw materials, and gas derivatives used as basic petrochemicals.
- Nuclear energy generation.
 - Public provision of electricity¹.

7. On the other hand, the legal framework does allow the federal government to award concessions to:

- a) establish and operate public telecommunications networks;
- b) use and exploit radio spectrum;
- c) use satellite orbital positions;
- d) construct and operate rail track systems and provide public rail transport services;
- e) construct and operate ports and port terminals;
- f) construct and operate airports.

8. Telecommunications, railroad, port, airport and airline services are completely open to private participation. This policy is firmly established in the corresponding sector-specific laws under the following provisions:

- The government is obliged to grant concessions to establish and operate public telecommunications networks and provide public air transport services to any interested party that fulfils the requirements established in the laws and regulations concerning telecommunications and civil aviation.
- The government should call for a public auction of any of the concessions for radio spectrum, railroads, ports and airports when an interested party requires so. A negative answer from the government must be grounded in law and based on hard facts.
- The government should determine the radio-spectrum frequencies assigned to specific uses and issue a program to concession them.

2.2 Rules governing concessions

9. Under Mexican law, concessions are a legal tool to implement sector-specific law regulations, aimed at promoting private involvement and opening up telecommunications and transport sectors to competition.

10. There is no an specific law on concessions. The sector-specific laws establish the regulatory frameworks and the institutions charged with granting and supervising concessions, as well as the administrative procedures for awarding them.

11. Only the federal government is empowered to grant concessions. The SCT in the case of the transport sector and the Cofetel in telecommunications are in charge of designing and overseeing the allocation and operation of concessions.

12. These government bodies are in charge of handling disputes between the federal government and concession holders through administrative procedures. When not solved at this level, cases are taken to judicial courts.

13. There have been different allocation mechanisms. Concessions to establish and operate public telecommunications networks are granted to any party that fulfils the requirements provided for in sector-specific law. All other concessions are allocated by public competitive auction (sealed-bid auction); which is established as mandatory in the respective sector-specific laws. In the case of radio-spectrum concessions, they are generally allocated through simultaneous auction, in which the bidders are able to take into account the complementarity or substitutability of different band frequencies through successive rounds. So far no concession has been renegotiated or revoked.

3. Competition issues in concessions

3.1 The competition authority's role in concessions

14. The concessioning authority is empowered to allocate concessions and oversee their operation. The CFC has powers to issue opinions on the competition aspects of concessions and even auctions. However, such opinions are non-binding.

15. Additionally, the regulatory schemes established for the telecommunications sector and for rail transportation all contemplate the need for a favourable opinion from the CFC on prospective concession holders, previous to the award of concessions or to authorise the transmission of concession-related rights.

16. The Commission is the sole agency empowered to enforce the Federal Law on Economic Competition (LFCE). The LFCE applies to every economic activity including those developed under federal concessions. Therefore concession holders are subject to all provisions in the competition legislation.

17. Agreements among bidders both on participation in auctions and on prices are considered illegal *per se* by Article 9 of the LFCE, as they are considered absolute monopolistic practices (horizontal agreements).

3.2 Sectoral rules to limit or prevent anticompetitive conduct

18. The sector-specific laws on telecommunications, railroads, ports and airports prohibit discriminatory practices and refusal to deal when access to essential facilities is involved. These regulations are often included in the concession titles themselves.

19. The sector-specific laws also establish price and tariff regulation imposed by the regulator agency if the Competition Commission finds effective competition to be absent in the relevant market or, in telecommunications, when there exists an economic agent possessing substantial market power.

20. Generally, there are no rules on pricing, coverage, and quality standards for services provided by the infrastructure given in concession. However:

- The economic agent interested in obtaining a public telecommunication network concession is required to define the network coverage when submitting his application.

- At present all airport concessions include price-cap rules. This regulation could be removed if the CFC determines the existence of effective competition conditions.
- The telecommunications concession granted to Teléfonos de México (Telmex) during the privatisation process, established price-cap regulation on the telephony services provided by this company. It is important to notice that this regulation considered that Telmex would be the only provider of telephone services, at that time.

21. Rules on pricing and terms of access are enforced by the SCT in the case of railroads, airports, civil aviation and ports. This Ministry and the Cofetel enforce such rules on telecom concessions. In particular, in the railroad sector, the SCT has the right to intervene and impose access rates and conditions if no agreement between private operators is reached within 90 days.

4. Performance of concessions

22. In general terms the concession scheme in the transport sector (ports, airports, railroads) and in telecommunications has promoted investment and the development of infrastructure. New investments have enhanced efficiency and competitiveness and have led to more modern and safe systems.

23. In particular, in the railroad sector, following privatisation, real freight tariffs have fallen and productivity indicators show significant improvement. In spite of these improvements, investments in infrastructure and railroad equipment have remained unchanged; for example, average annual investment for the periods 1990-1996 and 1997-2003 is practically the same. This suggests that productivity enhancements following privatisation cannot be attributed to the elimination of a budget restriction. Rather, investment has been more focused towards increasing productivity by modernising locomotives, acquiring specialised equipment, upgrading operation systems and logistics, strengthening capacity of trunk lines, and improving crossings².

24. However, there are some concerns regarding the implementation of intra-modal competition, particularly in interlinear traffic, derived from a lack of effectiveness of the regulatory framework relating to interconnection fees and access conditions. This has made the problem of interlinear traffic a competition problem, as will be shown in the next section of this contribution.

25. The communications sector³ has registered constant growth. In the last 5 years investments reached almost 18 billion dollars, driving a 15% average growth of telecom GDP⁴.

26. The main feature of the telecommunications sector is the constant introduction of technological innovations. A case in point is cable and microwave television, which can offer internet access since 2003, and is expected to reach more than 16 million users at the end of 2005⁵.

5. Competition cases involving infrastructure concessions

5.1 Relative monopolistic practices in freight railway transportation⁶

27. In November 2001, Transportación Ferroviaria Mexicana (TFM), the holder of the concession for the Northeast Railway, filed a complaint against Ferrocarril Mexicano (Ferromex), the holder of the concession for the North Pacific Railroad, alleging relative monopolistic practices in the interlinear service of freight transport in some of the routes it operated. The alleged conduct consisted in: i) artificially raising tariffs for interlinear traffic and registering them as the Unique Tariff for Express freight (TUCE); and ii) charging car hire services twice to increase TFM's costs and to displace it from the market. The effect of these practices was to leave Ferromex as the sole provider of this service along its exclusive routes.

28. The Commission defined the relevant market as railway lines given in concession to TFM and Ferromex, which, if integrated, created a network that covered a number of cities that had as their interconnection point the City of Celaya, Guanajuato. In October 2003, the Commission determined that Ferromex was guilty of relative monopolistic practices in violation of the LFCE. These consisted of cost increases for interconnection and transport in traffic along several interlinear routes where the origin railway was TFM, as well as duplicate charges for car hire services.

29. Based on these findings, the CFC ordered Ferromex to suppress its practices and implement corrective measures in the relevant market. These measures consisted in setting interlinear traffic service tariffs per kilometer no higher than the minimum tariff charged by Ferromex to its exclusive route customers transporting similar products. The CFC also ordered Ferromex to charge car hire tariffs in traffic along interlinear routes no higher than the minimum tariff charged to its exclusive route customers. In February 2004, the Plenum of the Commission resolved an appeal by Ferromex, which was considered unfounded. Therefore, the Commission confirmed its previous resolution.

5.2 *Absence of competition conditions in airport services*

30. In order to prevent any abuse of dominant position from private concessionaires of Mexican airports, the SCT asked for the CFC's opinion on competition conditions in airport service markets. According to the Airport Law, any tariff regulation imposed by the Ministry has to be based on a CFC decision about the inexistence of competition conditions. Following this procedure, in 1999 the CFC made an assessment of competition conditions in the markets related to airports controlled by Grupo Aeroportuario del Sureste⁷ and Grupo Aeroportuario del Pacífico⁸, and in 2000 for airports controlled by Grupo Aeroportuario del Centro Norte⁹. The following elements were taken into account:

- the existence of legal barriers to entry to build airports and to provide airport services;
- priority granted to the present concession holder for building alternative airports;
- technical and economical difficulties to build new airports.

31. Based on those elements, the CFC determined the inexistence of competition conditions in the relevant markets of airport services, and of leasing of airport areas for the provision of airport-related services. As a result, the SCT imposed price-cap regulation on the airport concessionaires.

6. Concluding remarks

32. The concession scheme in Mexico has had a positive effect on investment and the development of infrastructure. These benefits have promoted efficiency and competitiveness and have led to safer and more modern networks and systems.

33. Competition could be enhanced through amendments to sector-specific laws to facilitate the efficient functioning of infrastructure networks. These amendments should also strengthen the powers of regulatory bodies to effectively enforce the regulatory frameworks. In the CFC's view, its own participation and involvement in this process is necessary.

34. Mexico's experience shows that it is not enough to grant concessions; it is essential to consider competition issues in designing the specific concession scheme to be adopted in each case, in order to prevent anticompetitive conditions and guarantee access to essential facilities. In addition, effective enforcement of the competition law is also needed to guarantee, *ex post*, the efficient functioning of markets related to concessions.

NOTES

1. The private sector is allowed to engage in cogeneration, small production, self-supply generation and electricity generation for sale to the government agency in charge of providing the electricity public service.
2. Mexico's contribution to the Roundtable on Structural Reform of the Rail Industry of Working Party No.2 of the Competition Committee.
3. The communications sector includes telecommunications, postal and telegraph services.
4. Source: Fifth report of activities 2004-2005. SCT.
5. Idem.
6. CFC case numbers DE-57-2001 and RA-50-2003.
7. CFC case number AD-78-98.
8. CFC case number AD-24-99.
9. CFC case number DC-01-2000.

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