



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ROUNDTABLE ON COMPETITION IN BIDDING MARKETS

-- Note by Mexico --

This note is submitted by the Mexican Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 18-19 October 2006.

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1. Introduction

1. This note summarises Mexico's experience in two types of bidding markets: public procurement contracts and the allocation of radiospectrum. Section 2 outlines the regulatory framework for public procurement contracts, identifies competition concerns derived from this regulation, and presents some bid rigging cases. Section 3 briefly describes the framework that regulates the allocation of radiospectrum and identifies the challenges the Federal Competition Commission (CFC) faces to promote procompetitive radiospectrum auctions. This is further illustrated by a recent case associated with a broadband PCS auction in which the CFC recommended rules to prevent excessive spectrum concentration and facilitate the participation of new entrants. Finally, section 4 contains some concluding remarks.

2. Public procurement contracts

2. According to the electronic system for government contracts (Compranet), during the first semester of 2006, the federal government organised 15,495 public auctions to purchase goods and services worth over US\$8.9 billion.¹ The great majority of these auctions are called by public health institutions and state-owned petroleum and electricity firms.

2.1 Regulatory framework

3. Federal government procurement is regulated by the Law of Public Sector Acquisitions, Leasing and Services (Acquisition Law or AL), its Regulations (ALR), and associated provisions under free trade agreements (FTAs).

4. The AL establishes that, as a general rule, acquisitions, leasing and services must be allocated through public auctions and that all providers must face similar terms and conditions.²

5. The AL and its Regulations set out the following general auction rules:

- *Lowest-price sealed-bid auctions.* Bids are secret and contracts are awarded to the lowest bids.³
- *Multiple provision.* Contracts may be granted to two or more bidders if their bids do not differ by more than 5% with respect to the lowest bid. The winning bidder would be awarded a 50% share or more of the contract and the other participants would be granted shares previously specified in the auction rules.
- *Joint bids.* Two or more persons or firms may offer joint bids without needing to incorporate into a single firm.
- *Reference prices.* Government entities may set a maximum price, as a reference for bidders to offer discount percentages.

¹ Secretaría de la Función Pública, Informe de labores, 2006.

² Under special circumstances, contracts may be directly conferred or granted by contest through invitation to at least three persons.

³ In the procurement of services, multiple criteria may be used (e.g. price and quality), by applying an index where price has a 50% weight.

- *Prohibition of price bids below costs.* Entities calling auctions must verify that prices offered are not below costs, and may dismiss tenders on insolvency grounds.
- *Domestic auctions.* Most public procurement contracts are reserved for Mexican nationals and goods with a minimum domestic content of 50 percent.
- *International auctions.* This type of auctions may only be called if: mandated under FTAs (except for reserves);⁴ domestic supply is not available in terms of quality, quantity or at convenient prices; no participants turned out or qualified in a previous domestic auction; and if it is so stated in foreign financing contracts granted to the federal government. In these auctions, economic proposals of domestic products are granted a 10% preferential margin, while bids of handicapped (or firms that employ them) are also favored.

2.2 *Competition concerns arising from procurement regulations*

6. The CFC has issued several opinions concerning particular features of the regulatory framework that foster collusive conduct, as explained below.

- The multiple provision feature limits price competition and lays the groundwork for agreements (implicit or explicit) on market sharing. In extreme cases, bids are identical and the procurement contract is allocated among the lowest bidders in equal parts. See illustrative cases presented below.
- Joint bids may be a simple mechanism to collude. These bids should be allowed to the extent they do not have a negative effect on the competitive process.
- Maximum prices may be used as an easy reference for bidders to collude on prices. See illustrative cases presented below.
- The prohibition of bids below cost may eliminate competition from low price bidders, and limits the power of auctions as an efficient mechanism to discover market information. This prohibition entails a more stringent approach than the predatory price prohibition envisaged under the competition legislation, which is subject to a rule of reason analysis.

2.3 *Competition legislation*

7. The Acquisitions Law states that bidders may be disqualified from the auction if they are found to have agreed to increase prices or to attain any kind of advantage over the remaining bidders.

8. The Federal Law of Economic Competition (FLEC) typifies bid rigging as a *per se* prohibited anticompetitive conduct. Recent reforms to this law⁵ strengthened the powers of the CFC to investigate and sanction this type of conduct in the following ways:

- The CFC is now empowered to undertake on-site investigations and to implement a leniency program.
- Maximum sanctions increased from \$1.7 to \$6.6 million US dollars.

⁴ Mexican reserves under FTAs apply mainly to purchases by state-owned energy enterprises.

⁵ These reforms entered into force on June 28, 2006.

- Recidivists are now subject to a double sanction or to a sanction equivalent to 10 percent of their assets or annual sales.

2.4 *Bid rigging cases*

9. The CFC has identified two types of problems in investigating public procurement auctions. First, as described above, there are several provisions in the Acquisition Law and its Regulations that facilitate collusive conduct. Second, government entities tend to organise very frequent auctions to allocate small contracts instead of aggregating them into fewer auctions and larger contracts. Additionally, in many instances, government entities divide the national market into several regional markets and hold a series of regional auctions instead of having a single auction for the whole market. These practices turn what could be a one-shot game into a series of games, which facilitate collusive (implicit or explicit) pricing and market segmentation.

10. These problems seem to persist, notably in the health sector, and have prompted the CFC to initiate several investigations into the markets for medicine and medical supplies. The following bid rigging cases illustrate previous CFC findings in the health sector and energy industry.

2.4.1 *Purchasing of surgical sutures by the health sector*⁶

11. Following a complaint filed by Grupo Sutinmex challenging Internacional Farmacéutica, Serral, Le Mare Internacional de México and Matcur with the alleged collusion in public auctions to purchase surgical sutures, the CFC analysed two public auctions called by the General Hospital of Mexico and the Social Security Institute for Government Employees (ISSSTE). In both cases, a bid pattern among the participants was identified. One of the most important pieces of evidence considered in the investigation was that the prices bid by these companies were practically the same. In addition, evidence of coordination was derived from proceedings initiated by the alleged violators regarding the auctions. During the investigation, the defendants recognised that their conduct could be interpreted as a violation to the FLEC. They agreed to pay fines and to refrain from infringing the FLEC in the future.

2.4.2 *Purchasing of x-ray material by the health sector*⁷

12. Reliable de México filed a complaint against Kodak, GPP and Juama⁸ for alleged collusion in public auctions called by public health care institutions for the purchase of x-ray material. Most of the auctions were called by the Mexican Social Security Institute (IMSS). The CFC analysed the participation of these companies in 35 public auctions from 1997 to 2000, and found indications of collusion in 21 of those auctions.

13. These three firms had a 93% share in the market for x-ray film. The CFC found that in 11 auctions they offered identical tenders and obtained equal shares of the supply contracts. Further, the CFC observed that the defendants bid the same prices for several product codes whenever two or the three of them participated in an auction. The defendants contended that reference prices issued by the bid-takers caused their tenders to be similar, but they were unable to prove this assertion. Thus, the CFC found Juama and GPP responsible for violating the FLEC, ordered suspension of the practice, and fined both of them. The proceeding against Kodak was terminated in advance based on commitments proposed by this firm. Notwithstanding, the CFC also fined Kodak for its conduct.

⁶ DE-03-2000

⁷ DE-57-2000; RA-81-2002 and RA-82-2002

⁸ Kodak Mexicana, SA de CV (Kodak), GPP Mexicana, SA de CV (GPP) and Juama, SA de CV (Juama)

2.4.3 *Purchasing of chemical developers for x-ray material by the health sector*⁹

14. Following a complaint filed by Back Quality & Co., SA de CV charging GPP and Juama with the alleged collusion in national auctions for the acquisition of chemicals used to develop x-ray plates, the CFC investigated auctions called by the ISSSTE and the IMSS from 1997 to 2001. The defendants were the only participants in all auctions, except for three, and in 17 of these 18 auctions, Juama and GPP presented identical price bids. The defendants tried to justify this behaviour based on the reference prices provided by the bid-takers. In 2001 the IMSS started to publish the winning price-bids on the Internet after each auction. However, the IMSS did not identify these prices as the maximum prices it was willing to pay. The CFC concluded that this price information did not justify identical tenders and that these prices were a requirement to win the auction. The CFC fined GPP and Juama and ordered them to suppress the illegal practice.

2.4.4 *Purchasing of auto tanks by Pemex*¹⁰

15. In the investigation into an auction called by Pemex (the state-owned petroleum company) to acquire forty 20,000 litre auto tanks, the CFC found that three bidders, namely Carrocerías y Adaptaciones Automotrices, Dinamundo and Vanguardia Industrias, offered identical tenders. The CFC also showed that these firms had common shareholders and members of their boards of directors. Although the defendants were not successful in obtaining the contract, the CFC found them responsible for absolute monopolistic practices because they engaged in conduct having the aim of coordinating tenders. They were consequently sanctioned.

3. **Allocation of radioelectric spectrum**

3.1 *Legal framework*

16. The Federal Law of Telecommunications (FLT) and the Federal Law of Radio and Television (FLRTV) establish that the radiospectrum for telecommunication and broadcasting services, respectively, must be allocated through public auctions.¹¹ However, these laws do not specify the auction rules or the criteria to choose the winner. They also state that bidders need a favorable opinion from the CFC to participate in these auctions.¹² The need for this opinion may help the CFC to prevent excessive concentration of spectrum, but, as illustrated by the relevant case described below, it is not sufficient to assure pro-competitive auctions and facilitate entry, because the laws do not specify auction rules and sector regulators have not involved the CFC in their design.

3.2 *Case study: auction to allocate radiospectrum for broadband Personal Communication Services (PCS)*

17. On July 12, 2004 the Federal Telecommunications Commission (Cofetel), the telecommunications regulator, called for a multiple round, simultaneous, and ascending auction to allocate broadband PCS spectrum. The spectrum offered comprised four 2x5 paired Mhz blocks in each of the 9

⁹ DE-10-2001 y RA-04-2003 y RA-05-2003

¹⁰ IO-65-97 y RA-06-98; RA-08-98; RA-09-98

¹¹ The requirement to use public auctions to allocate radiospectrum for broadcasting was introduced in the FLRTV by a set of reforms that entered into force on April 12, 2006

¹² In the case of the FLT, the text of law clearly states that prospective bidders need to obtain a favorable opinion from the CFC before participating in an auction. However, in the case of the FLRTV, the text of the law only states that prospective bidders need to “apply” for this opinion.

regions covering the national territory and one 2x15 paired Mhz block in two of them. The auction rules imposed a 65 MHz spectrum cap on the combined cellular (824-849/869-894 Mhz) and PCS (1850-1910/1939-1990 Mhz) frequencies held by each licensee (new or incumbent).

18. Pursuant to the FLT, the auction call required prospective bidders to obtain a favorable opinion from the CFC, as a necessary condition for Cofotel to accept their bids. The CFC assessed 7 different economic agents, including four incumbents¹³ and three new entrants.¹⁴

19. Based on the attributes of broadband PCS, the CFC defined the relevant service as that of mobile telephony services, which also included cellular and digital trunking (push-to-talk over cellular). The geographic dimension corresponded to the footprint of each of the 9 regions. In practice, mobile carriers seek to create nationwide footprints via spectrum trading in secondary markets and, to a limited extent, by subscribing roaming agreements with other carriers.

20. The CFC found that the market was highly concentrated in terms of subscribers and firm turnovers, both nationally and regionally. Only four carriers provided mobile telephony services: Telcel, Telefonica, Unefon and Iusacell.¹⁵ The first two had a nationwide spectrum network in both cellular and PCS bands. Unefon had licenses for PCS in all regions, whereas Iusacell had cellular and PCS licenses in all but regions 2 and 3.

21. The sum of intended spectrum acquisitions revealed by the prospective bidders exceeded the available spectrum. Moreover, the intended spectrum acquisitions of the incumbents, within the spectrum cap of 65 Mhz, exceeded the spectrum auctioned. Therefore, according to the auction rules, incumbent operators could win 100% of the available spectrum and they could deter new entry by pushing spectrum prices up.

22. The CFC considered that, since spectrum is a scarce resource, incumbents had incentives to deter the entry of new competitors by acquiring as much spectrum as possible. Incumbent carriers had significant sunk costs and the deepest pockets, so the CFC anticipated they would win the auctions.

23. The CFC sought to hinder spectrum concentration which would: (a) impede the entry of new carriers and diminish the prospects of long-term competition among incumbents, and (b) underscore the asymmetries in spectrum bandwidth among carriers, hindering the growth possibilities of some smaller incumbents.

24. To encourage entry, the CFC conditioned clearance to prospective bidders to acquire no more than 35 Mhz at the 1.9 Ghz band in all regions. This decision was intended to make more spectrum frequencies available to new entrants, and to increase competitive pressure on incumbents. The spectrum caps imposed by the CFC had the following effects: (a) Telefonica and Grupo Salinas would be blocked from bidding for spectrum in several regions; (b) Telcel would be able to acquire a maximum of 10 Mhz in all regions; and (c) at least 210 Mhz would be available for new entrants, independent of any incumbent bids.

25. The incumbent firms, except for Nextel (who withdrew from the auction) challenged the CFC 35 Mhz cap before judicial authorities on the grounds of unconstitutionality and obtained suspensions regarding the auctions of certain lots. The regulator held the auction following the original rules (a

¹³ Telecel (+At&T wireless), Telefónica, Grupo Salinas and Nextel.

¹⁴ Axtel, Cingular and Maxcom.

¹⁵ Unefon and Iusacell belong to Grupo Salinas.

spectrum cap of 65 MHz), and, as foreseen by the CFC, incumbent operators Telcel, Telefónica and Grupo Salinas won all available spectrum.¹⁶ However, the CFC reversed the judicial decision against the 35 Mhz cap and Cofetel will not be able to allocate spectrum above this cap.

4. Concluding remarks

26. The CFC's experience illustrates that competition law and policy can play a key role in promoting efficient bidding markets. In the case of public procurement contracts, inadequate regulations and poor auction designs have facilitated collusive pricing and market segmentation, which has increased prices paid by the government. Regarding the allocation of radiospectrum, the lack of pro-competitive auction rules has facilitated behavior by incumbent operators to successfully deter entry and keep monopolist rents in the telecom markets.

27. The CFC faces important challenges to promote efficiency in these markets, and has begun an aggressive strategy to overcome them. First, it recently created a specialised cartel division, which, together with its recently enhanced powers to investigate and sanction anticompetitive conducts, will allow the implementation of an effective program to fight collusive agreements with a special focus on bid rigging. Second, it is constantly advocating for regulations that promote competitive bidding markets. For example, it recently issued an opinion on a proposal to reform the Regulations of the Acquisition Law, where it recommended eliminating auctions rules that facilitate collusive agreements. Also, in December, 2005, it issued a public opinion on a proposal to reform the FLRTV, where it pointed out the need for pro-competitive auction rules to prevent an excessive concentration of radiospectrum for broadcasting services. Third, the CFC is actively collaborating with government entities that regularly allocate procurement contracts through public auctions (e.g. IMSS and Pemex) to promote auction designs that prevent collusive behavior. This collaboration is also helping the CFC to gather information to identify potential bid rigging practices.

¹⁶ In practice, incumbents did not need to push prices up to deter entry, because the auction rules discouraged the participation of new entrants: none of them participated in the auction. When the auction rules were published, some non incumbent operators expressed interest in participating and presented the required documentation, but they withdraw before the auction took place.