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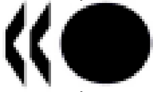

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OECD Global Forum on Competition

CONTRIBUTION FROM MEXICO

-- Merger enforcement in Mexico (Session V) --

This contribution was submitted by Mexico as a background material for the first meeting of the Global Forum on Competition (Session V) to be held on 17 and 18 October.

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MERGER ENFORCEMENT IN MEXICO

I. STATUTES' BACKGROUND

Article 28 of the Constitution of Mexico (Constitution) prohibits monopolies, barriers to trade, and other monopolistic practices that limit or restrict competition and free market access.

During decades this remarkable vision was neither taken advantage of nor put into practice by those responsible for applying the constitutional mandate. The failure to apply this constitutional provision had undesirable consequences for Mexico's well-being and national economic progress. Among other examples are the well known episodes of financial uncertainty experienced in Mexico since the late 70's, episodes produced by series of internal economic and political situations, which along with non-favorable international events, negatively affected growth and promoted macro and micro economic imbalance. In this scenario high concentration of productive activities, investment and savings, affected also the economic cycle, not to mention its effects on income distribution.

As a result of the aforementioned experiences, since the early 90's Mexico has been involved in a deep process of structural reforms with the aim to change the functioning and operation of its economic system from a state controlled, closed and over-regulated economy to one privatized and open to trade and competition.

The economic model that Mexico chose, relies significantly on market forces. Trade liberalization and regulatory reform have a central position in economic policy aimed at strengthening the role of market forces and the incentives for private investment. It was recognized that in competitive markets, production and quality of goods and services is larger than in monopolized or highly concentrated markets; prices are lower and that economic inefficiencies not only restrict the competitiveness of our companies but also hamper social and consumer well-being.

Mexico widely recognized the benefits of market economies and the positive effects of competition. However it was considered that the operation of free market principles does not imply the elimination of all participation of the authority in economic activities. From our perspective, free market principles imply some supervision in order to preserve market mechanisms.

The promotion of competition and efficient market structures needed a specific institutional arrangement, and thus in 1993 the Federal Law of Economic Competition (FLEC) [1] was enacted, and a specialized and autonomous agency, the Federal Competition Commission (FCC), was created to enforce it.

Currently, competition policy is an indispensable and effective element of economic policy. Together with trade liberalization and regulatory reform, the application of a competition legal framework has contributed to enhance economic activity, create investment opportunities and foster market efficiency.

Competition policy reduces entry barriers to private investment and induces better market structures. It promotes the permanence of efficient investors and the development of smaller companies, by

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[1] The FLEC and the Regulation for the implementation of the FLEC can be consulted at the FCC's homepage http://www.cfc.gob.mx. Other relevant information regarding the enforcement of the FLEC are also available at that website.

removing anticompetitive conduct carried out by agents with market power in order to monopolize markets. These outcomes emphasize the need to persist in promoting competition and eliminating the restrictions which still prevail.

Companies merge for different reasons: to adapt to economic environment, to enhance their efficiency or financial position, to diversify their activities or to control vertically integrated activities, among other causes. Most of this transactions are neutral or beneficial from a competition perspective. However some transactions may imply a risk for the markets and competition processes.

The possibility to prevent anticompetitive mergers is undoubtedly a valuable tool aimed to promote attractive market structures for new investments and to foster industrial and commercial efficiency.

The strict application of the FLEC occupies a key place in the economic strategy and policy of the Mexican government since 1995

II. THE FEDERAL LAW OF ECONOMIC COMPETITION

In 1993 the FLEC was issued to enforce article 28 of the Constitution. The FLEC expresses the permanent goal of competition policy, to safeguard and promote competition and free market access, in order to help raise the efficiency and productivity of the Mexican economy and to expand the options available to economic agents for using their resources and choosing satisfiers.

The FLEC applies to almost every economic activity carried out within the Mexican territory. Only strategic economic areas reserved to the State, labor unions, intellectual property rights and some kind of export cooperatives are not considered monopolies and therefore, are not prohibited by the FLEC. However, even these exclusions from the monopoly prohibition do not apply when it comes to anti-competitive conducts and business combinations. In other words, even state companies operating in strategic areas are compelled to refrain from anticompetitive behavior carried out in related markets.

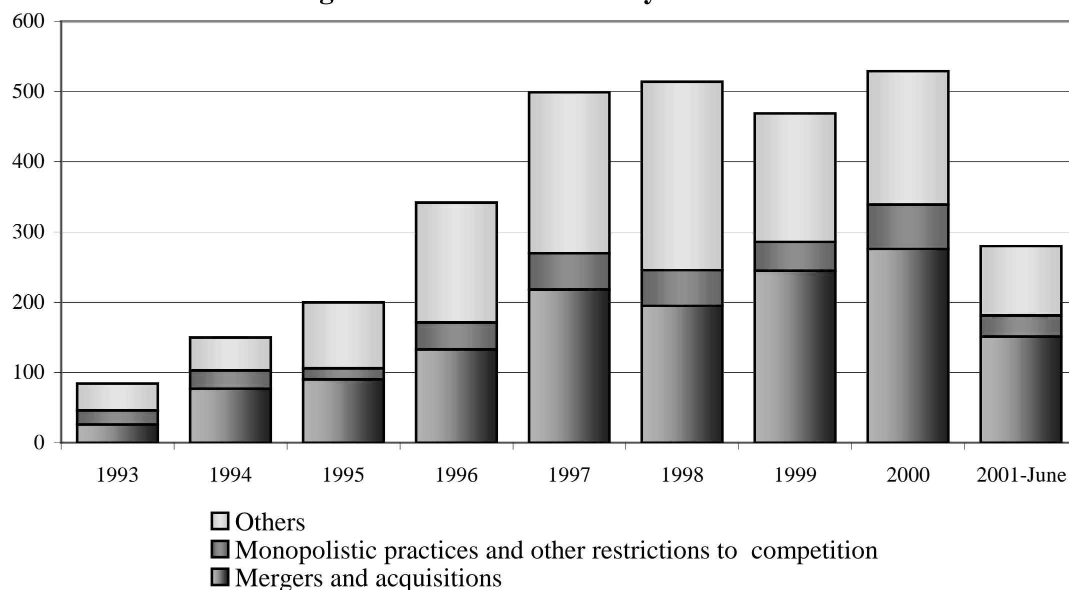
According to the FLEC, the FCC was set up to protect competition and freedom of access and to promote the establishment of free markets in every economic activity.

In march 1998, the Regulations to the FLEC (RFLEC) came into effect enhancing transparency and guidance in the enforcement of the Mexican competition legislation. The RFLEC characterizes relative monopolistic practices; develops in a greater detail the procedures provided for in the FLEC, simplifies proceedings for certain types of mergers (the so-called corporative restructuring), and establishes a tighter discipline on the diffusion of the FCC decisions and rulings. No additional changes or new provisions concerning competition legislation have been proposed since.

III. ENFORCEMENT OF COMPETITION LAW AND POLICIES. MERGERS AND ACQUISITIONS

The FLEC gives exclusive powers to the FCC to assess competition effects regarding mergers in all economic sectors in Mexico. Since its creation, the FCC has concluded more than 3,000 cases (see figure 1). Most of them were about mergers and acquisitions.

Figure 1. Cases concluded by the FCC



In 1993, the FCC reviewed 26 mergers; in 2000 this figure increased to 276, and to 151 in the first six months of 2001

Economic liberalization, the increasing number of transactions with international scope, the effects of revised regulatory framework and the divestiture of state companies largely explain the modifications in market structures and the consequent increase in the number of mergers notified to the FCC. For this reason, merger review constitutes one of the best mechanisms to prevent excessive market concentration that result in the creation of market power that can induce higher prices or insufficient supply of goods and services; and inhibit new investments and technological innovation.

Fundamentals of mergers and acquisitions procedure

Pursuant to Article 20 of the FLEC, mergers meeting the legal thresholds[2] shall be notified before the FCC. According to the FLEC and the RFLEC, merger notification must take place before one of the following events occur: a) the transaction has taken place; b) control is exerted over the acquired company; c) a merger agreement is signed, and, d) if the merger is a sequence of events, when the single event exceeding the legal thresholds is accomplished. Mergers that take place abroad must be notified before they produce "legal or material effects" in the Mexican territory.

Both merging and merged parties are compelled to notify the transaction, when required by the FLEC. Even though the buyer is the first party required to file the notification, the seller may as well

2 Mergers should be notified to the FCC whenever the transaction's value exceeds $50.4 million, or accumulation of 35% of the companies assets is worth $50.4 million or having sales of this amount; or involve two or more firms with individual or joint sales of approximately $201.7 million or more and the additional acquired assets exceed $20.2 million understood as only the portion corresponding to the Mexican subsidiary.

comply with this obligation[3].. Regarding mergers aimed to reorganize a corporate company all parties are obliged to notify[4]

The FLEC empowers the FCC to request information and data from competitors and other parties when analyzing the corresponding transaction, although such firms or individuals do not become involved parties in the merger notification process. Strict confidentiality clauses protect all information submitted to the FCC from disclosure.

The FCC must issue its decision regarding mergers within 45 days following reception of notification[5],. If no decision is issued within said term, authorization from the FCC is granted to the notified merger.

To determine market effects and implications of a merger[6], notified transactions are subjected to a rule of reason test. The FCC analyses which markets are affected by the transaction (relevant markets) and to what extent the merged entity will have the power to restrict output or supply of goods or services or have the possibility to increase or manipulate prices without its competitors being able to offset such actions.

The actions adopted by the FCC can be either preventive or corrective.

Article 16 of the FLEC empowers the FCC to challenge mergers which aim or effect is to reduce, harm, or hinder competition and free access to the markets.

As mentioned above, in order to prevent the possible anti-competitive effects of mergers, individuals are obliged to provide prior notification of such operations whenever the amount of the transaction exceeds the limits set forth in the FLEC. To the same end, the FCC can require economic agents to give notice of future mergers or transactions, even if the amounts involved do not exceed the established thresholds.

Corrective measures apply to mergers for which compulsory notification has been omitted or falsified, and to those transactions for which prior notification is not required but which do reduce or hinder competition and free access. In such cases, the FCC is empowered to apply rulings, impose fines, or the annulment of the merger.

3 Once the FCC receives notification of a merger, it: (i) requires basic information of the transaction through a preliminary questionnaire, which is available to the public through the FCC's correspondence office, and can be mailed upon request to any interested party; (ii) verifies that the documentation provided is complete and, if necessary, requests, additional information on one or more occasions. The FCC does not acknowledge receipt of the merger notification if these requirements have not been met, and (iii) decides if it orders the parties involved to refrain from closing the proposed merger, and 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. This orders are issued by the FCC only when it considers that the merger involved is analytically complex. Moreover, these orders are issued only for preventive purposes. If the merger is deemed to the anticompetitive and the parties close the merger before it is approved, the FCC can order divestiture, with the associated costs and uncertainty to all parties involved.

4 See Annex 1 for additional information regarding Corporate restructuring.

5 Pursuant to the provisions of Article 21 of the FLEC.

6 As well as in the so called “relative monopolistic practices” which include vertical restraints, and abusive conducts.

In addition, the FLEC also empowers the FCC to open ex-officio investigations regarding mergers that have not been notified. The ex-officio inquiries must be initiated during a period of twelve months following the transaction. Based on the results of such investigations the FCC may order the dissolution of the transaction. These powers may apply both when the investigation relates to mergers for which notification is not required or for those which have not been notified even in spite of the legal obligation to do so.

IV. ILLUSTRATIVE CASES

In order to illustrate the criteria used by the FCC in the review of mergers some of the most representative cases are briefly described below.

The Cintra Case

On September 1, 2000, the main share-holders of Cintra presented a written consultation before the FCC regarding their intention to sell their shares. Cintra is a holding company that controls the two largest airlines in Mexico: *Aerovías de México (Aeromexico)* and *Mexicana de Aviación (Mexicana)*. The FCC's Plenum resolved that the sale of the two airlines should be made separately and to independent owners. The decision of selling these assets is of great importance as described below. This case also offers a clear example of the negative effects derived from the lack of a merger enforcement mechanism and the importance of preventive rather than ex-post actions.

Background

In the 80's, Aeromexico was privatized as a company free of financial or labor liabilities, emerged from the bankruptcy of Aeronaves de Mexico. Aeromexico was sold to a group of national investors. On the other hand, Mexicana was capitalized through resources provided by a group of new private investors who acquired control of the airline through the acquisition of two thirds of the shares, while the Federal Government kept 34%.

Aeromexico and Mexicana had a market share of 80%[7]. Several small companies operated also in the airlines' market.

At the beginning of the 90's, inadequate decisions brought both enterprises to a difficult financial position characterized by excessive indebtedness due to the leasing and acquisition of equipments at highly unfavorable conditions and the excessive hiring of personnel. The high operation costs and indebtedness brought Aeromexico and Mexicana to a bankruptcy limit.

Before the FLEC entered into force, in 1993, the Federal Government authorized Aeromexico, the airline with a better financial situation, to acquire control of Mexicana, its main competitor in the market at that moment. The Transportation and Communications Secretariat (SCT) imposed several conditions to maintain competition in the market. The conditions imposed included that both airlines should keep an independent operation, in other words, although Aeromexico controlled the shares of Mexicana, each of them had to continue defining its own operational and market policies (including airfares, routes, schedules, strategic commercial planning, among other). Thus, Mexicana was under the control of Aeromexico, but its operations and assets remained unmerged.

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[7] Figure corresponds to January 2000

However, efforts carried out by the SCT could not prevent the creditor banks of both air companies assume the control of both from September 1994. The coincidence of an unsuitable management, together with an inadequate supervision of the new enterprises, created the false perception that the airlines would have failed due to market competition.

In May 1995, the banking institutions managing Aeromexico and Mexicana requested the FCC authorization as required by the FLEC in order to constitute a holding company to control the shares of both airlines. The holding called Cintra would operate as a "temporal financial vehicle" aimed to allow the banking institutions to capitalize the liabilities of the airlines. In this scheme, Aeromexico would no longer control Mexicana. They would operate as "sister companies", controlled by both by Cintra. Former shareholders of Aeromexico and Mexicana would become shareholders of Cintra.

The main purpose of such operation was: (i) to achieve the recovery and economic survival of the airlines through the capitalization of the banking debt; (ii) to enhance their operation through new investments, and (iii) to eventually sell each of the companies under **independent selling schemes**, once their financial solvency was re-established.

On August 1995, the FCC resolved to authorize the creation of Cintra subject to a series of measures aimed to avoid market power abuses and **to maintain the separate operation of the airlines** so that after a three year period, the companies could be sold separately. The scheme included elements aimed to prevent the "effective concentration" of the companies, while allowing to enhance their financial position. In other word, both airlines were to keep operating independently, thus, although they were controlled by a single company the two airlines shouldn't be considered as one agent for purposes of their operation and thus for antitrust enforcement.

Through an appeal for review presented by the shareholders before the FCC, the former resolution was modified by the Plenum of the FCC. It resolved that the divestiture of Aeromexico and Mexicana would take place once the financial and operative restructuring process of the companies ended. This decision implied the substitution of the previous three year period for a flexible non-restricted period.

Notwithstanding, the FCC kept the power to order the partial or total divestiture of the airlines, as well as to impose other fines and sanctions foreseen by the FLEC. Cintra agreed to those conditions.

Due to the banking crisis in 1995, part of the assets that banks held in Cintra, became property of the Banking Fund for the Savings Protection (Fobaproa)[8] In 1999, credit banks and Fobaproa transferred their Cintra's shares to the Institute for the Banking Savings Protection[9] (IPAB), meaning that the majority

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8 Trust Fund established according to the article 122 of the Credit Institutions Law, to protect the savers interests.

9 Decentralised organisation from the Federal Public Administration, with juridical personality and shareholders' equity, created through the Banking Savings Protection Law (published in the Official Gazette on January 19, 1999). This institute has the following objectives:

a) Provide Multiple Banking Institutions with a system to protect the banking savings that guarantee payments, through the Institute's assumption, in a subsidiary and limited way, of certain obligations of such Institutions.

b) To manage programs of financial reorganization that conducts in benefit of the savers and users of the institutions and in the payments national system safeguard.

According to the law, the IPAB assumes the responsibility for the reorganization programs conducted by Fobaproa, while the Federal Government through the Treasury Secretariat (SHCP) and the Bank of

of Cintra's shares were in hands of governmental organizations again. These transactions were authorised by the FCC, subject to the accomplishment of the conditions imposed in the previous resolution.

Since 1996 both airlines enhanced their operative incomes, reduced their financial expenses and stabilized their operations' costs.

Cintra's anticompetitive conducts

After Aeromexico and Mexicana were put under the control of Cintra, the competition process in the air transportation market and other markets related to it (tourism for example) experienced negative effects. A clear example, is the agreed reduction by Aeromexico and Mexicana of the percentage paid to the travel agencies for the air tickets sold by them, which meant to reduce from 10% to 7%.

Regarding air transportation, fares reached excessive levels in 26 commercial routes compared to fares offered in routes served also by other airlines. The FCC found agreements between the two airlines which included non competition clauses, market segmentation and price fixing. Furthermore, it learned that Aeromexico and Mexicana were transferring assets between each other without previously notifying to the FCC.

Cintra had undoubtedly infringed the FCC's resolution. The airlines were operating in some degree as a merged agent, affecting the competition process in several routes and related markets.

Consultation regarding Cintra's sale

In spite of the 1995 resolution and the agreement to sell Mexicana and Aeromexico separately, the shareholders integrated by the Federal Government, the IPAB and bank owners, presented on September 2000 a consultation before the FCC expressing their doubts about the feasibility of the resolution. From their point of view the separate operation of the airlines was not feasible nor economically reasonable.

The joint sale of the companies is equivalent to a merger and thus was reviewed under a traditional merger analysis. Based on the FLEC and its Rulings the FCC determined that:

- The merger of Aeromexico and Mexicana would increase concentration index to a very high level in all of the most important routes in the country. Each route is considered a relevant market. Although the airlines had already started to coordinate or "merge" their operations, such a process would become definitive and irreversible.
- Important economic and legal barriers hinder the access of both national and foreign competitors and strengthen the involved enterprises' market power;
- Since1995, Aeromexico and Mexicana had shown anticompetitive practices related to: substantial increase of air fares; collusion, agreed reduction of percentages paid to travel agencies. All of them revealed their market power.

Mexico, should carry out the necessary acts for the Fobaproa expiration. This way the IPAB acquired the largest property of Cintra's shares.

On October 2nd 2000, the FCC confirmed its previous resolution concluding that the concentration of Aeromexico and Mexicana, would permanently harm competition, since it would provide the merged agent with market power allowing it to unilaterally fix prices in most of the national routes. Moreover, in the long term, nothing would prevent the merged agent from establishing higher fares, reducing flights frequencies and lower service quality.

Based on these results, the FCC informed the petitioners that the joint sale of Aeromexico and Mexicana would be harmful for the markets and would violate the FLEC and article 28 of the Constitution. On the other hand, separating Aeromexico and Mexicana would foster greater competition in the air transportation service. This would in turn be an important factor in reducing fares, expanding the markets and offering better services to users without sacrificing safety. It would likewise enable sound development of the industry and technological progress based on new investments, and thus air transportation would contribute to the country's development.

The FCC challenged the arguments presented by the SCT, which basically consisted in three points:

a) Splitting up Cintra would promote a destructive competition behavior among airlines which would lead one of them to leave the market.

The FLEC, the Civil Aviation Law (CAL) and its rulings, empower the FCC and the sector regulator to act against collusive acts, predatory conduct or any other form of unlawful competition that may force one or both companies, or any other national airline, to bankruptcy. Articles 53(a) and (b) of the Regulations of the CAL empower the SCT to establish price regulation in the provision of air transport services under two situations. First, when the FCC declares that reasonable conditions of competition do not exist in terms of the FLEC. Second, on the basis of public interest, the FCC may request the regulator to impose a price regulation scheme before it actually issues such declaration. Thus, in Mexico's case, it is very unlikely that national airlines of a similar size and with financial resources alike, would become involved in a self-destructive price war.

b) the companies would not be large enough to be profitable in order to face market competition.

In this regard, petitioners put forward two arguments in support of the joint sale of the companies. First, in case of the creation of a hub, the resultant economies of scale would allow one of the companies to displace the other from the market. Second, the size of a separated air fleet would be inferior to that of other big companies operating at international level, thereby creating profitability problems. Both arguments where discarded on the following basis:

- No Mexican airport offers the characteristics and cost savings associated to a hub. Moreover, both companies presently operate networks based on the airport of Mexico City, which is the biggest airport in the country and there is no reason to believe this practice will not continue. Likewise, they may continue with their joint policies or other commercial strategies which, even if separately organized, would allow them to attain efficiency profits.

- Even a joint fleet of both companies would be smaller than its international competitors, but this situation does not set forth any profitability problems regarding their operation in the domestic market. This is demonstrated by the fact that other relatively smaller companies operate in the country. Besides, according to the economic literature on the air industry, scale economies go off rapidly, so that a company may be profitable and compete on prices

and quality with a reduced number of homogeneous airships. As international experience demonstrates, the most profitable companies of the world are not the bigger ones, nor those with large fleets, radial centrals or greater number of destinies.

Additionally, a small national airline can attain many of the efficiencies of size by a code sharing arrangement with an international carrier.

Thus, cross subsidising international operations with excessive profits obtained in the domestic markets would result against the nation interests. On the contrary, such competition should be carried out on efficient operation basis.

c) Sales value reduction

Pursuant to its legal mandate, one of the core objectives of the IPAB, the deposit guarantee agency and Cintra's main shareholder, consists in obtaining the highest possible recovery value from the sale of its assets. It has been argued, that maximum recovery value would be guaranteed if the companies were sold as part of a "package".

It is important to note that the value of a monopoly or a company with clear market power, if unregulated by the authorities, is always higher than that of companies operating in a free market environment. Excess profits and benefits that a monopoly can generate at the expense of consumers explain this outcome.

If Cintra was 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. If such regulations were correctly anticipated by investors, the value of the company would be much lower than if the companies were sold separately. If they were not anticipated, investors would be willing to pay more, for they would be acquiring a company with market power (or even a monopoly in certain routes), and they would complain that they were the victim of ex-post opportunistic behaviour on the part of the government, and future investments might be discouraged. Under such circumstances, the value of the company would be much lower than if the companies were sold separately.

Conclusions to the Cintra Case

Pursuant to articles 16 and 20 of the FLEC the FCC is empowered to review, block or authorise mergers. Merger review constitutes a tool aimed to preserve and ensure effective competition conditions in the markets, and thus better prices and quality of services and goods.

The activity of the FCC is based on the legal mandate to protect the competition process and free entry to markets, which serves as a counterbalance to other authority's acts, including regulatory authorities, whose approaches are different.

The Cintra example shows the difficulties related to revert the harmful effects of acts carried out by authorities on the basis of protectionist principles non compatible to competition and efficiency. This case is a clear example of the harm caused to consumers well-being under situations where market power can be exerted and the damage to reverting it.

The Aeromexico and Mexicana sale has not occurred yet. Consumers have been seriously affected over these years facing excessive tariff increase and lack of efficiency of the two companies controlling large part of the domestic routes.

Considering the aforementioned facts, a complex situation has developed. No agreement has been reached and there is no consensus regarding the Aeromexico and Mexicana sale, which has to be re-evaluated due to the precarious situation of the air industry, affected by unfortunate acts of terrorism suffered by the USA recently.

Mergers in the Financial Sector

The Mexican financial sector has experienced deep transformations, particularly after the *peso* crisis of 1994. Such transformation has encouraged a continuous growth in the number and scale of cross-border horizontal mergers and acquisitions in the sector. Behind such growth, there is a strong interest to achieve scale economies to cope with the remaining effects of the 1994 financial breakdown, increasing cross-border competition, deregulation and advance on information technology. Therefore, the number of participants in the financial markets have been decreasing.

This trend has demanded an active merger review by the FCC, specially regarding banking, insurance and pension funds' markets. The FCC's actions have aimed to prevent that the resulting agent acquires substantial power in relevant markets or that the concentration degree in such markets increase beyond convenient thresholds. Examples abound.

Conglomerate concentrations that substantially change the structure of financial markets

In 2000, *Grupo Financiero Bancomer (Bancomer)* and *Grupo Financiero Serfin (Serfin)*, the second and third financial institutions in Mexico, were acquired by *Banco Bilbao Vizcaya Argentaria (BBVA)* and *Santander Mexicano (Santander)* respectively, two of the major players in the Spanish financial system.

The analysis carried out by the FCC focused on those activities affected by each transaction, which included commercial banking, insurance and pensions funds' management. These markets have a national geographic dimension, since the branch infrastructure of the financial institutions enables consumers to use offices throughout the country to make their transactions. Other financial and non-financial markets that could be affected by the transactions were also analysed.

The enquiry showed that: *(i)* the participation of other national and international competitors is large enough to prevent anticompetitive conduct of the resulting party; *(ii)* the existence of legal and economic restrictions on entry (limits on foreign investment or the availability of bank branches and positioning of brands) do not impede national or foreign firms participation in Mexican financial markets.

Commercial banking

In this sector, the registered operations tend to enhance the consolidation of financial groups. These services are relevant to the financial system since they constitute the mean through which customers may access several services mainly savings, investment and credits.

The FCC's analysis to evaluate whether concentrations of banking financial agents could affect competition conditions and the variety of alternatives for bank users in Mexico, includes the assessment of economic and legal barriers to entry, as well as efficiency gains.

An other aspect to be considered for the assessment of the impact of banking concentrations is the variety of banking services provided by the institutions. These may include immediate demand deposits, fixed term deposits, banking bonus, inter-banking loans, saving accounts, commercial credits, credits to financial intermediaries, housing credits, consumer credits (through credit cards), governmental credits, fiduciary services and foreign currency exchange.

Likewise, the number and location of banking branches for the provision of services at specific geographic regions is relevant. Even when diverse financial companies have nationwide operations, special attention has to be paid to prevent the creation of agents with substantial market power. Thus, the number of branches of a banking institution to provide service in specific geographic regions was adopted as a measure to estimate the concentration indexes in a location.

Insurance

The impact of the proposed transactions in the insurance market was assessed by grouping insurance policies regarding: life, accident, medical care and damages. Since each insurance involves different risks, it may be concluded that different kind of insurances are complementary, this means, they are not substitutes among themselves, and therefore, represent different markets. Thus, the portfolio content of each insurance should be analyzed in order to detect the effects on competition.

Accordingly, each kind of policy was considered a separate relevant market. In none of them, the proposed acquisitions involved competition concerns, because the involved parties were not major players in such markets.

Afores

In 1995, the reform of the pension system took place with the aim to improve the Mexican society's capacity to increase its domestic savings. Such reform consisted in the adoption of a retirement system managed by *retirement fund management companies* (afores). Afores receive financial resources by means of compulsory and voluntary contributions from workers affiliated to the Mexican Social Security Institute (IMSS), which are placed at their disposal after their retirement.

As part of this reform, a sector-specific regulator and regulations were established[10], to promote the development of the pension system and to facilitate channelling pensions funds to productive investments such as infrastructure projects. To this end, the regulator was empowered to establish mechanisms to prevent anticompetive practices, including the FCC's participation when necessary. Likewise, the reform highlights the necessity that the afores notify to the FCC their intention to participate in such market.

Nowadays, 13 companies participate in the afores market, which shows regulatory limits on participation, in terms of the number of affiliates that each management company can register. Even when each worker may freely choose the afore that will manage its individual retirement savings account, they face economic barriers that obstruct free change among afores including, among others, the payment of a

10 National Commission on the Retirement Savings System (Consar) and the Law on Retirement Savings Systems, respectively.

substantial commission when a worker changes the afore managing his/her account more than once in a year. As result of such features, the market structure is highly concentrated.

Concerning market structure, the FCC has adopted as a guideline, to impede the presence of one agent in two afores, which would give rise to a situation of competitive disadvantage for the other participants in the market. The *BBVA/ Bancomer* acquisition falls in the latter assumption.

Resolutions

Once the FCC analysed all the relevant markets, it resolved to authorize the *BBVA/ Bancomer* and *Santander/Serfin* acquisitions. However, in the *BBVA/ Bancomer* case the FCC ordered the divestment of BBVA's afore in order to preserve Bancomer's afore, which is one of the largest in the market.

By evaluating the concentration effects in each involved financial market, the FCC prevented the creation of an agent with substantial market power, which would affect competition conditions and would damage users and customers of these services. Moreover, the financial entities in Mexico, became healthier and stronger without affecting competition and free entry to the markets or consumers.

ABB Vecto Gray Inc/ FIP, SA de CV

On March 7, 2001, the FCC was notified of the intention of ABB Vector Gray Inc (ABB) to purchase 100% of the stock of FIP, SA de CV (FIP), owned by Walworth de Mexico, SA de CV. ABB produces tools and systems used in maritime and terrestrial perforation and has no presence in Mexico. FIP is a company that produces, distributes and commercializes devices to interconnect petroleum pipelines and only carries out exports to Mexico. Thus, the transaction would not affect the structure of any of them.

However, in the stock purchase contract a non-competition clause was established so that neither Walworth nor its current shareholders, could for a ten-year period carry out directly or indirectly, the following acts: i) participate with more of 10% of the total stock as shareholders in any of the so-called "restricted operation"; ii) take active charge on restricted operation businesses in Mexico; and iii) request, foster or seek business related to any "restricted operation". The term "restricted operations" included the design, manufacture, marketing, sale, exportation, installation, repair and maintenance and service of the following products: casing heads, casing hangers, casing spools, tubing spools, tubing hangers, tubing bonnets and adapters, other well-head components, casting patterns and forged dies owned by FIP, and all drawing and intellectual property associated with the above.

To justify the scope of the non competition clause, ABB claimed the following defenses:

- The ten year non-competition agreement is only for certain FIP products, some of which have little or no restrictions on Walworth. FIP is a failing firm according to the seller.

- FIP products included under the non-competition clause, are related to valuable drawings and intellectual property rights.

- As a consequence of the concentration, the customers would enjoy broader product supply with superior quality resulting from better machine tools and engineering process, as well as a more reliable aftermarket service.

In the FCC's opinion, the ten-year period of the non competition clause was excessive because products under such clause were on a mature stage of their product-cycle. On June 18, 2000, the FCC

authorised the proposed concentration but conditioned it by reducing the non-competition episode to no more than five years.

The establishment of a non-competition clause to protect the rights acquired by an agent, should strictly correspond to the transaction scope, in order to avoid the creation of artificial access barriers into the market. This way competition is protected to benefit industry and consumers.

Mergers in utility sectors

Concessions and permits granted by the authorities may also have competition effects in the markets, and thus, are reviewed by the FCC under the same criteria applied to mergers. Additionally, several mergers are taking place among utilities –water, electricity generation[11] and natural gas- as a result of deregulation.

On March 31, 2000, Sempra Energy notified to the FCC its intention to obtain a permit to transport natural gas in the north of the State of Baja California, including the provision of gas to the distribution zone of Mexicali. On August 31, 2000, the FCC blocked the transaction, because it would imply the vertical integration of Sempra in two activities: transportation and distribution of natural gas. Sempra already held a permit to distribute natural gas in Mexicali. The integration of transport and distribution would give incentives to Sempra to carry out discrimination and other anticompetitive practices against other distributors On October 24, the defendant parties challenged the FCC's resolution by appealing for review before this authority. Finally, on November 29, 2000, the FCC reversed the appealed resolution. Nevertheless, its favorable opinion was subject to the condition applied to Sempra to divest the distribution permit in the geographical area of Mexicali.

V. BENEFITS DERIVED FROM MERGER AND ACQUISITION'S REVIEW

While mergers frequently lead to significant cost savings and other benefits, they may also be anticompetitive. Thus, merger and acquisitions review carried out by the FCC, allows the identification and prevention of potentially harmful transactions, thereby benefiting consumers and the development of economic activity. In this way, the FCC can prevent market damage, avoiding the widely acknowledged difficulties that accompany attempts to restore competition after anticompetitive transactions have been completed.

The efficient processing of filings has allowed competition to be protected without hindering business development or market dynamics. These results reflect the priority given to administrative measures intended to reduce costs associated with enforcing and observing the competition law.

The FCC has persevered with its policy of administrative enhancement, reducing response times, cutting back on formalities, and streamlining its paperwork. In addition, it has established internal procedures that substantially expedite resolutions on operations that are merely administrative restructurings. Thanks to these measures, greater resources can now be channeled into solving the more complex cases.

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11 Despite the national electricity industry is still a public monopoly, the regulatory framework allows private agents to participate in electricity generation market.

VI. PENDING CHALLENGES

After its almost eight years of existence and hard work, the following issues remain as the major challenges for the FCC:

(i) **Lack of full societal understanding of the competition legislation**, which blocks its timely application. To this end, advocacy becomes a basic instrument to enhance competition policy, having the following objectives:

- *Broader diffusion of competition legislation,* will promote a better understanding of the competition's principles among regulators, economic agents and society. Public knowledge of the FLEC is important because complaints are an important source of information to the FCC.

- *Foster coordination with other regulatory bodies* concerning actions involving market behavior and regulation, granting concessions and permits; government procurement and public auctions.

(ii) **Lack of legal capacity to impose an effective mandatory request of information to merging parties outside the Mexican borders**.

The number of international transactions that have an effect on the Mexican markets increases gradually in absolute numbers and relatively, as part of the total cases filed.

The FCC has promoted coordination with other countries' competition authorities to exchange experiences and apply techniques of analysis of competition in a global context. This coordination has led to the negotiation and subscription of international treaties[12] and agreements Similarly, there has been active and prominent participation in international fora in which the topics of competition and best practices are discussed, among them are the OECD, WTO, UNCTAD and EFTA. This actions provide the FCC with better tools to protect Mexican interests.

(iii) **Cope with economic dynamism and technological progress**. Competition fosters the efficient reallocation of production inputs and resources from les profitably activities to those with higher rates of growth and returns. The FCC's task is to facilitate that reallocation process by preventing barriers of entry and excessive concentration in a given market, which create the possibility for the accomplishment of anticompetitive conducts and abusive pricing behavior. Research has shown that national champions and monopolies do not tend to be dynamic; their protection allows them to be lazy and thus stagnant.

12 The chapter on competition in the Free Trade Agreements with the European Union and the G3 (group including), and the bilateral agreement on competition with the authorities of the United States of America are examples of cooperation mechanisms aimed to strengthen competition law enforcement.

ANNEX 1. - Corporate reorganizations vs. Mergers and acquisitions

There is only one exemption to the compulsory notification provided in Article 20 of the FLEC. The RFLEC establish that transactions among companies controlled by the same holding company[13] , should not be considered mergers under the terms of the FLEC if they are:

- legal acts regarding shares or partners' capital contributions of foreign companies, when the economic agents involved in the said acts do not thereby acquire the control of Mexican companies, nor accumulate in the national territory shares, partners' capital contributions, shares in trusts or assets in general, additional to those which, they directly or indirectly possess prior to the transaction, or

- transactions in which an economic agent has had in property or possession, directly or indirectly, over a period of at least three years, 98% of the shares or partner's capital contribution within itself or the economic agents involved in the transaction. In this case, the economic agents are compelled to notify to the FCC, within five days following the day on which they carry out the transaction.

To determine whether the transaction is a corporate reorganization or a merger of a different nature, the FCC considers that a transaction entails a corporate reorganization when the reasons for carrying out the transaction are simply operational, and whenever they do not imply any change in the actual control of the companies involved. In these cases, the FCC studies the equity structure before and after the merger plus the extent of control that the parties to the transaction have. Therefore, the analysis is kept simple, thus allowing the FCC to issue a ruling promptly. If more than a corporate reorganization is involved, a second stage to assess the effects of the merger is carried out. For this purpose, the FCC defines the relevant market or markets on which the merger will have effect, and on a case-by-case analysis, it assesses the associated competition effects.

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13 based on criteria similar to those established by the Income Tax Law

ANNEX II. - Fundamentals of merger and acquisition analysis

The relevant market definition

The relevant market is defined by grouping goods (or services) that can substitute each other, in terms of use and price. For this purpose, the FCC takes into consideration product characteristics, their geographic location and the ease of conditions to the product or service and its substitutes.

Market Power.

Once the FCC defines the relevant market, it applies concentration indices in order to determine whether market concentration is significant. A firm which accounts for a large percentage of the sales in the relevant market may have the power to raise price above the competitive level. This is termed market power.

The danger of accumulation of market power is customarily assessed indirectly by measuring the level of concentration in a market, to do so the FCC have stated an arithmetical test to measure the degree of concentration of a relevant market based on the Herfindahl Index and the Dominance Index, the second was developed by a FCC's Commissioner and both rates measure the level of concentration on a scale of 0 to 10,000.

Thresholds are the following:

- the Herfindahl rate must be below 2,000 units and its increase must not exceed 75 units, and
- the dominance rate must stand below 2,500 units and its value must decrease after consolidation.

If the concentration degree in the relevant market does not exceed the thresholds established by the FCC, the transaction is not challenged. The FCC does not challenge a transaction whenever it finds it unfeasible to obtain substantial market power as a consequence of the transaction.

Market structure

The FCC also takes into consideration the existence of barriers to entry, import conditions, transport costs, the existence and power of present and potential competitors, and the recent conduct of the economic agents that participate in the merger, among other elements legally required.

Defenses (Efficiency gains)

If the conclusions reached in the above stages show that substantial power in the relevant market exists or would be acquired, the FCC assesses the possible efficiency gains derived from the merger, as compared to the costs it entails. The assessment contemplates the relevant elements, such as all effects on consumers and producers. If the FCC determines that the anticompetitive effects do not outweigh the efficiency gains, the merger is not challenged, although on occasions it may subject it to conditions that eliminate the possible anticompetitive effects. If the FCC determines that the anticompetitive effects of the merger are significant, and cannot be eliminated through specific conditions, it blocks the merger.