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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN MEXICO

-- 2005 --

This report is submitted by the Mexican Delegation to the Competition Committee FOR INFORMATION at its forthcoming meeting to be held on 8-9 June 2006.

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1. Changes to competition laws and policies, proposed or adopted

1.1 Summary of new legal provisions of competition law and related legislation

1. In 2005, legislators of Mexico's two biggest parties presented a bill to the House of Representatives to amend the Federal Law of Economic Competition (FLEC). This proposal was the result of a joint effort among the promoting legislators and the Federal Competition Commission (CFC), aimed at strengthening competition policy and enforcement in Mexico. The proposed amendments do not change the core analytical principles of the FLEC. They do, however, enhance the CFC's operative tools and provide higher sanctions for anticompetitive behaviour.

2. The bill addresses the recommendations contained in the OCDE's 2004 peer review of "Competition Law and Policy in Mexico" and is generally based on international best practices.

3. After 8 months of discussion and analysis of the main elements the bill was unanimously approved by both Houses of Congress. In particular, the amendments passed into law include:

- *Strengthening and simplifying the CFC's procedures relating to:*

  a) *Efficiencies:* the reform includes specific economic concepts for a firm to argue that there are efficiency gains that offset a practice's anticompetitive effects.

  b) *Merger Notification*: thresholds increase by 50%, in order to focus on transactions most likely to raise competitive issues in Mexican markets. The amendments also contemplate early termination of merger reviews in cases that clearly raise no competitive concerns.

  c) *Relative practices:* five additional conducts that may constitute relative monopolistic practices are specified: predatory pricing, exclusive dealing, cross subsidization, price discrimination and raising rivals' costs.

  d) *Verification visits:* the CFC acquires powers to conduct searches for specific information in the course of law enforcement investigations.

  e) *Leniency Program:* the CFC is given authority to grant leniency to cartel members that cooperate with the agency.

- *Binding Opinions*

  f) The bill empowers the CFC to issue binding opinions on secondary regulation by other public agencies that could have anticompetitive effects.

- *Sanctions*

  g) Main changes in this section are:

  (i) Higher economic sanctions;

  (ii) New language providing that an agent who violates the law more than once may be fined up to twice the applicable monetary amount, or up to 10% of annual sales, or of total assets, whichever is bigger.

  (iii) A provision stipulating that the CFC may order the divestiture of assets to eliminate market power, if an agent has been fined more than two times.

4. In addition, legislators introduced 5 draft amendments to specific articles of the Federal Law of Economic Competition (FLEC): (1) two amendments related to articles 14 and 15, to strengthen and make effective the CFC's powers to fight inter-state trade barriers; (2) two amendments related to article 10, section VII, to create new specific relative practices; and (3) one bill relating to article 3, to redefine the concept of economic agent. The proposed amendments to articles 10, 14 and 15 were motivated by the Supreme Court (SCJN) declaration of unconstitutionality of these articles (further details are included below). The Federal Competition Commission issued opinions on all five proposals, which led to their rejection or inclusion in the comprehensive reform discussed earlier.

5. In 2005, after four judicial procedures in lower courts, the SCJN studied and resolved on the constitutionality of article 10 paragraph VII in the following terms: The SCJN judged that this paragraph was unconstitutional, since it only includes general criteria on conducts that can hinder free market access and economic competition, and fails to establish the parameters that the CFC must follow in order to sanction the relative monopolistic practices involved.[1]

1.2 Government proposals for new legislation

6. In 2005, the CFC issued opinions on several proposals to amend the following sectoral regulations (only the most relevant are listed):

- Telecommunications Law and Radio and Television Law: proposal to redefine the structure of the Federal Telecommunications Commission (COFETEL), to extend its powers to radio and TV regulation and to establish a new concession-granting procedure for TV and radio concessions. The law was passed, amendments addressing the CFC's concerns are currently before Congress;

- Law to Promote the Book and Reading: proposal to allow editors and importers to fix a single retail price for books. The law was passed;

- Commercial Practices Law: proposal to regulate retailers, including minimum distances (geographic market segmentation) as a mandatory requirement for the establishment of commercial stores. The law was rejected;

- Airport Law, proposal to establish new criteria in concession-granting procedure and considering the CFC's favourable opinion. Decision is pending.

2. Enforcement of competition laws and policies

2.1 Action against anticompetitive practices, including agreements and abuses of dominant positions

a) Summary of activities

7. In the period under review, 92 investigations registered activity, 59 of which had been initiated in previous years, with the remaining 33 initiated during 2005. The CFC concluded 66 files and imposed sanctions in 5 cases involving absolute monopolistic practices (hard core cartels) and in 6 investigations on relative monopolistic practices (vertical agreements). See Annex 1 for further details.

[1] CFC vs. Embotelladora Argos, SA de CV (DE-06-2000 which includes complaints against other firms belonging to Grupo Coca Cola in Mexico).

b) Description of significant cases, including those with international implications

Food industry: Tortilla case in Berriozabal, Chiapas[2]

8. In 2005, corn dough and tortilla producers brought a complaint against the Union of Tortilla Producers of Berriozabal, Chiapas (Union) and the municipality's Technical Consultative Council (Council), regarding the closing of five out of eight tortilleria establishments property of the claimants, as a sanction for failing to apply the "official" corn dough and tortilla price.

9. The Commission initiated an investigation and determined that the closing of the establishments was due to the lack of licenses to operate the tortillerias. However, the Commission determined that the Union was guilty of an absolute monopolistic practice foreseen in article 9 of the FLEC, consisting in price fixing.

10. The CFC ordered to the Union to suppress its anticompetitive practices and to implement the following corrective measures: 1) to avoid leading his associates to commit conducts which violate the FLEC and its code of regulations, and taking part in the process of concession of licenses for the opening of tortillerias; 2) to publish a guide aimed at preventing anticompetitive practices and promoting competition and free market access in the production, distribution and selling of corn tortillas in the state of Chiapas; 3) to issue and deliver a circular letter to all Union members communicating the right to freely set their prices and compete; 4) to distribute the CFC's resolution among Union members and 5) to provide a mechanism that would allow verification of their compliance with the corrective measures.

11. In relation to the actions carried out by the Council, since the Commission does not have the power to sanction an authority, the CFC only issued an explicit opinion in which reference was made to the anticompetitive effects of its acts.

Pharmaceutic Industry: Landsteiner and PIHCSA v. Merck[3]

12. In 2004, Landsteiner and PIHCSA opened a complaint against Merck, alleging that it had misleadingly been claiming to be the holder of a patent for active pharmaceutical ingredient (API) Alendronate. According to the complainants, Merck had been using various patents protecting certain processes to bar others from producing drugs using the substance Alendronate, which is not protected by a patent. Landsteiner and Pihcsa noted that Alendronate is a substance marketed in Mexico since 1994 and generally known since 1981.

13. Landsteiner and PIHCSA argued that Merck had challenged the health sector's public procurement processes involving Alendronate. Merck had also used the amparo procedure to bar Landsteiner from manufacturing and marketing this product and used the resulting ruling to bar competitors from participating in public sector auctions for this API.

14. Despite a statement by the Mexican Institute for Industrial Property (IMPI) to the effect that the chemical compound Alendronate was not protected by a patent and there was no exclusive right associated with its production, Merck argued that the patents mentioned in the complaint are under legal dispute, which means that, until a verdict is reached, it retains the rights for their use and exploitation.

15. In light of the evidence, and because determining the property rights for patent licenses lies outside of the realm of the Commission's powers, it resolved to close the case. Nonetheless, the case

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2 File DE-08-2004.

3 Files DE-13-2004 (Landsteiner), DE-18-2004 (Pihcsa) and RA-01-2005.

exemplifies how patent owners are using ambiguities in the government acquisition law to pressure health authorities not to hold conventional auction processes, thus barring entry and shielding themselves from competition. The CFC sees its subsequent role in similar cases as one of advocacy with the government agencies involved.

Transportation sector: Boatage and piloting in Tampico port

16. In July 2004, the Commission opened an ex-officio investigation for presumed relative monopolistic practices in the market of boatage and piloting services in the port of Tampico, Tamaulipas.

17. The port of Tampico handles 14 percent of Mexico's total commercial load. As in all other Mexican ports, ships intending to dock at a port must hire piloting services. Pilots, in turn, have to be conveyed to the ship by boat. In Tampico, the local division of the National Union of Port Pilots (Union) set up a boatage firm to jointly provide both services.

18. In the course of the investigation, the Commission defined the relevant market as piloting services in the port of Tampico, and as a complementary market the service of boatage. The CFC found out that the Union had market power due to the existence of normative barriers and the lack of competitors.

19. Furthermore, the Commission concluded that there were enough elements to determine that the Union forced shipping agencies to acquire boatage services from the Union as a condition to provide piloting, and not (as the Union argued) as result of efficiency gains.

20. Based on these findings, the CFC imposed a sanction of 2.3 million pesos and ordered the Union to suppress the practice.

2.2 Mergers and acquisitions

a) Statistics on number, size and type of mergers notified and/or controlled under competition laws

21. In 2005, the CFC reviewed 232 merger files, including notifications, complaints and ex-officio investigations of alleged anticompetitive transactions. Out of the 220 cases concluded, one horizontal merger and one vertical merger were blocked, six horizontal mergers were authorized subject to conditions, and one vertical merger was conditioned.

b) Summary of significant cases.

Grupo Bimbo / El Globo[4]

22. In 2005, Grupo Bimbo, S.A. de C.V. (Grupo Bimbo) notified its intention to acquire Controladora y Administradora de Pastelerías, S.A. de C.V., a firm which controls a group of companies dedicated to the production and selling of bread and cakes, and which operates a group of cake shops under the commercial name of "El Globo".

23. Grupo Bimbo participates in the production, distribution and sale of packaged bread, cakes, cookies, candies, chocolates, snacks, tortillas and other products in Mexico, the US, Central and South America and Europe.

4 File CNT-87-2005.

24. The parties participate in two segments of bread-making: i) industrial market (Grupo Bimbo); and ii) fresh market (El Globo).

25. The CFC authorized the merger given the fact that the goods produced by Grupo Bimbo and El Globo belong to separate markets (because of the differences in production process, distribution channels and retail prices) and the transaction would not affect the competition process.

Bachoco / Sanjor[5]

26. Industrias Bachoco, S.A. de C.V. (Bachoco) notified the acquisition of assets of the poultry business owned by Aviproductos Sanjor, S.A. de C.V., Empacadora Dorantes, S.A. de C.V. and Vías y Construcciones del Milenio, S.A. de C.V. (Grupo Sanjor).

27. The parties concurred in commercial chicken and egg production and sale. The relevant markets have a national dimension, since there is an important movement of both products across the country; chicken and egg imports are not significant; and, in the case of chicken, there is a safeguard against importing chicken legs from the US.

28. The post-transaction concentration indexes indicated low risk of negative effects on competition. In addition, the CFC identified other important market competitors like Pilgrim's and Tyson.

29. The Commission authorized the transaction and concluded that the merger would allow Bachoco to increase its presence in Mexico, to exploit economies of scale and scope and to reduce its production and commercialization costs.

El Paso Energy International Company / Pemex Gas y Petroquímica Básica[6]

30. TDF, S. de R.L. de C.V. notified a joint venture between El Paso Energy International Company (EPEIC) and Pemex Gas y Petroquímica Básica (PGPB) to build a pipeline to transport liquefied petroleum gas.

31. The pipeline, which would have an approximate length of 185 kms and would include facilities to receive the molecule, would communicate the gas processing complex in Burgos, Tamaulipas with the city of Monterrey, Nuevo León.

32. The CFC determined that the relevant market was the transportation service of LP gas, with the project's area of influence covering the cities of Monterrey, Saltillo and La Laguna.

33. According to TDF, the volume of gas transported by truck along the Reynosa-Monterrey federal highway would foreseeably show a significant increase during 2006. The importance of the pipeline project laid in avoiding accidents both inside the Complex and during transport to the area of influence.

34. However, the project raised serious difficulties from the competition point of view. Since PGPB participates in the LP gas market as a provider, transporter and seller, its activities could represent a significant barrier to entry for potential private entrants to the LP gas transportation and commercialization markets.

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5 File CNT-14-2005.

6 File CNT-54-2005

35. In order to encourage competition in an area not protected by the constitutional ban on private participation, the CFC conditioned PGPB to sell its share in the joint venture in a period no longer than 3 years.

Procter & Gamble / Gillette [7]

36. Compañía Procter & Gamble México, S. de R.L. de C.V. (P&G Mexico) notified the intention of The Procter & Gamble Company (P&G) to acquire capital stock of The Gillette Company (Gillette) in different countries.

37. In Mexico, the parties concurred in the relevant markets of deodorants/antitranspirants for both men and women, mouthwashes, toothpastes, and electric/battery-operated toothbrushes.

38. The geographic dimension of the relevant markets was national because producers sell their goods through a national distribution network and imports are carried out by companies that have a well-established national distribution channel and well-known brands in Mexico.

39. The concentration indexes exceeded the thresholds in the case of electric/battery-operated toothbrushes, but the CFC judged this situation represented no risk because this is an incipient market, there were significant changes in market shares in the last years, and the brand controlled by P&G has been losing share. Consequently, it authorized the transaction.

Grupo Comercial Chedraui / Grupo Carrefour[8]

40. Grupo Comercial Chedraui, S.A. de C.V. (Chedraui) notified the acquisition of controlling stock in Grupo Carrefour, S.A. de C.V. (Carrefour) and subsidiaries.

41. Chedraui operates supermarkets in 39 cities mainly located in the south-east of the country. Carrefour operated supermarkets in 25 cities mainly located in the center of the country. The objective of the transaction was to improve Chedraui's national presence in the relevant markets of wholesale and retail sales.

42. The CFC considered that the transaction could help Chedraui to provide its services to a larger number of consumers at a lower cost. Based on this consideration, the CFC approved the concentration.

SBC Communications / AT&T[9]

43. SBC Communications Inc. (SBC) notified the acquisition of stock in AT&T Corporation (AT&T), a transaction that had effects in different countries. In Mexico, SBC would acquire stocks of Alestra, S. de R.L. de C.V., Alestra Telecomunicaciones Inalámbricas, S. de R.L. de C.V., Servicios Alestra, S.A. de C.V., Conectividad Inalámbrica 7GHZ, S. de R.L. de C.V., AT&T de México, S.A. de C.V. and AT&T Global Network Services México, S. de R.L. de C.V. (Alestra and subsidiaries).

44. SBC is a public company that participates in activities related to consumer and business voice and data services. SBC has shares in different Mexican companies: Southwestern Bell Internacional Holdings, S.A. de C.V., Sterling Commerce (México), S.A. de C.V., Claricom de México, S.A. de C.V., Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil, S.A. de C.V. (América Móvil).

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7 File CNT-45-2005.

8 File CNT-16-2005.

9 File CNT-36-2005.

45. AT&T is a public company that provides consumer and business voice and data services. In Mexico AT&T had shares of Alestra and subsidiaries.

46. Because of the corporate rights SBC has in Telmex and América Móvil, and those that would be acquired in Alestra and its subsidiaries as a result of the transaction, SBC could be in a position to influence the operative decisions of Telmex, América Móvil, Alestra and its subsidiaries. Another risk was the possibility of interchange of relevant information that could lead to coordinated actions.

47. The CFC approved the merger subject to a set of conditions to maintain the operative independence of Telmex and Alestra. Besides that, SBC committed to establishing commercial agreements to improve Alestra's market position.

3. The role of competition authorities in the formulation and implementation of other policies, e.g. regulatory reform, trade and industrial policies

3.1 Regulatory framework

48. In 2005, the CFC issued opinions on two projects to reduce entry barriers in the market of gasoline retail sale. Both projects were to modify the procedure to join the Pemex franchise. The first project's object was to allow service stations to market other lubricant brands in addition to that of Pemex. Furthermore, the project prevented franchise applicants from proposing service station locations inside shopping malls and established minimum quality standards for lubricants. The second project was aimed at modifying two requirements for leased property proposed to build a service station. First, it established that the validity of leasing contracts would be for a fixed period of 15 years, instead of a minimal and compulsory 5 years period. Second, it required the property owner to be Mexican or, in the case of firms, to have a clause excluding foreigners in its bylaws.

49. The CFC also issued three opinions related to the telecommunications sector. The first opinion was issued regarding a resolution of the Federal Telecommunications Commission (COFETEL) to promote competition in long-distance phone service. The resolution's object was to establish the "calling party pays" scheme for long distance calls to a local mobile service user.

50. The second opinion was issued regarding a project of the Ministry of Communications and Transportation destined to reduce entry barriers for broadband services and other wireless uses. The third opinion was issued regarding the competitive effects of telecom network convergence.

51. The CFC also signed two collaboration agreements with the Federal Commission for Regulatory Improvement (COFEMER) and the Office of the Federal Attorney for Consumer Protection (PROFECO) to integrate and coordinate competition, regulatory and consumer protection policies.

52. Regarding its enforcement activities arising from the powers granted to the competition authority by sectoral regulations, the CFC concluded 118 files related to procedures to allocate licenses, permits or public contracts, either through public auctions or through direct allocation procedures. All the opinions issued were favourable for the interested parties. In addition, the CFC processed 450 notifications of economic agents interested in obtaining permits to undertake activities in the LP gas industry.

3.2 Privatisations, licenses and permits granted by the Federal Government in regulated sectors

3.2.1 Opinions on the auctioning process to sell Aeroméxico and Mexicana[10]

Cintra, SA de CV, informed the Commission about auctions to sell its shares in Grupo Aeroméxico and Grupo Mexicana to independent buyers.

53. The Commission received five requests for a favourable opinion from parties participating in the auction for Grupo Mexicana, and four requests in the auction for Grupo Aeroméxico. Four economic agents took part in both auctions: Infraestructura y Transportes México, SA de CV; Grupo Posadas, SA de CV; Grupo Xtra, SA de CV; and a consortium comprised of Grupo Empresarial Ángeles, SA de CV and Globalia, SA. One agent participated only in the auction for Grupo Aeroméxico.

54. The relevant markets were defined as: i) public air passenger transportation service on national routes; ii) public air passenger transportation service on international routes; iii) national and international public air freight transportation service; iv) terrestrial airport services to airlines; and v) technology services for managing domestic reservation systems.

55. The Commission took into account that selling Grupo Aeroméxico and Grupo Mexicana to independent economic agents would cause an important decrease of the concentration levels in the national public air passenger transportation market. In all other markets there would be no important structural effects, mainly because the parties participating in the auction would be new entrants to those markets. The Commission issued a favourable opinion to all participants.

3.2.2 Opinions on the granting of concessions for the provision of railroad passenger services[11]

56. The Commission received two requests for a favourable opinion from parties participating in the auction of a concession to provide the suburban railroad passenger transportation service on the route from Cuautitlán, State of Mexico to Buenavista, Mexico City. The concession also includes the possibility of extending the service coverage to three additional routes within the Valley of Mexico urban area.

57. The participants were two groups of firms. One group was composed of Alstom Transport, SA; Alstom Transporte, SA de CV; Ingenieros Civiles Asociados, SA de CV; Controladora de Operaciones de Infraestructura, SA de CV; Inverse, SA de CV; and Grupo Hermes, SA de CV. The second group was composed of Construcciones y Auxiliar de Ferrocarriles, SA; Inversiones en Concesiones Ferroviarias, SA and Autobuses Estrella Blanca.

58. The relevant market was defined as the railroad passenger transportation service on the route Cuautitlán, State of Mexico-Buenavista, Mexico City, covering the expected additional routes.

59. The CFC took into account that the current transport service providers within the relevant area (bus and minibus) would be possible competitors for the suburban railroad in short segments for passengers not placing a premium on time. However, at the same time there would be some complementarity among both kinds of transport services.

60. The Commission also considered that any possible market power of the auction winner would be counteracted by two factors: competition for the market and specific measures included in the concession

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10 Files LI-12-2005 and LI-16-2005.

11 File LI-06-2004.

title to limit freedom in pricing and restrict the service supply. The Commission issued a favourable opinion to both participants.

4. Resources of competition authorities

4.1 Resources overall (current numbers and change over previous year):

a) Annual budget (in your currency and USD)

61. The annual budget exercised by the CFC in 2005 was 162.9 million Mexican pesos, equivalent to US$14.9 million[12]. It represented a 1.3 percent nominal decrease with respect to its 2004 budget.

62. 70.6 percent of the annual budget was allocated to wages.

b) Number of employees (person-years)

63. At the end of 2005, the CFC employed 149 people: 112 of them worked in the enforcement divisions (18 lawyers, 24 economists, 9 engineers and 61 from other professions), and 37 provided administrative support.

64. The average tenure for the Commission's personnel is five years and the productivity index was 6.2 cases concluded per person. The average age for the Commission's personnel was 39 years.

4.2 Human resources (person-years) applied to: enforcement against anticompetitive practices, merger review and enforcement, and advocacy efforts

65. In enforcing activities, the staff was distributed as follows: 18.8% worked on mergers; 43.6% were involved in investigations of anticompetitive practices; and 37.6% worked on enforcing sectoral dispositions.

66. Approximately one third of the CFC's staff undertakes advocacy activities along with enforcement activities.

4.3 Period covered by the above information: January through December 2005

5. Summaries of or references to new reports and studies on competition policy issues

67. In 2005, the CFC published its 2004 Annual Economic Competition Report describing its activities and evaluating its performance during that year. The report is divided into three chapters, which summarise selected CFC decisions and illustrate their impact on the markets, providing elements that guided the final resolutions. The Report also includes a Statistical Appendix with detail information on the CFC's activities and a complete list of cases resolved during the year.

68. Additionally, during 2005, three issues of the Gazette (numbers 18, 19 and 20) were published including final resolutions issued from January 2004 through December 2004.

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12 2005 average exchange rate published by Banco de México.

Annex 1

FEDERAL COMPETITION COMMISSION

Files Processed 2004-2005[1]

	2004	2005
MERGERS		
Cases filed and *ex officio* investigations initiated	**193**	**232**
Notifications	188	230
Ex officio investigations	1	0
Complaints	4	2
Concluded	**194**	**218**
No objection	181	202
Conditions imposed	4	8
Opposed	1	2
Others [2/]	8	6
In process	**28**	**42**
PRIVATISATIONS, CONCESSIONS AND PERMITS		
Cases filed	**599**	**528**
Concluded	**563**	**568**
No objection	26	77
Conditions imposed	0	0
Opposed	0	0
Others [2/]	537	491
In Process	**80**	**40**
MONOPOLISTIC PRACTICES AND OTHER RESCTRICTIONS TO COMPETITION		
Cases filed and *ex officio* investigations initiated	**44**	**33**
Ex officio investigations	3	2
Complaints	41	31
Concluded	**42**	**66**
Penalty or recommendation	8	11
Concluded in advance, based on Art.41 of the RLFCE	3	0
Others [2/]	31	55
In Process	**59**	**26**
CONSULTATIONS		
Filed	35	26
Concluded	32	26
In process	5	5
MARKET POWER AND COMPETITION CONDITIONS		
Filed	0	0
Concluded	2	0
In process	1	1

FEDERAL COMPETITION COMMISSION
Files Processed 2004-2005[1]

	2004	**2005**
APPEALS FOR REVIEW		
Filed	34	53
Concluded	33	56
In process	6	3
TOTAL		
Cases filed	905	872
Concluded	866	934
In process	179	117

1. Figures only include administrative proceedings concluded by the CFC.
2. It includes closed, withdrawn and dismissed proceedings.