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ROUNDTABLE ON CARTELS INVOLVING INTERMEDIATE GOODS

-- Mexico --

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*More documents related to this discussion can be found at:
www.oecd.org/daf/competition/cartels-involving-intermediate-goods.htm*

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– Mexico –

1. Introduction

1. Mexico's Federal Economic Competition Commission (COFECE or the Commission) has investigated international cartels since the 1990s.

2. Notably in 1999 a cartel in the vitamin market was investigated which had been previously discovered and sanctioned in the United States. For COFECE, this case represents a watershed moment in the development of international cartel investigations as the harmfulness of these anticompetitive practices was accurately identified and this translated into a redefinition of efforts for tackling these offenses.

3. Since the vitamin cartel, COFECE has continued to pursue international cartels and very recently has issued a sanction of an international cartel to manufacturers of hermetic refrigeration compressors, the most important input when producing domestic refrigerators and air conditioners, for allegedly participating in an international price-fixing conspiracy affecting the Mexican market.

4. COFECE's determination for pursuing international cartels has not been motivated solely by international inertia, there is a clear recognition of the harmful affectation these conducts have on national markets. Studies show that the average surcharges that international cartels impose upon consumers is around 25%.¹ These studies also show that once an international cartel is created, it tends to be more aggressive in countries with weak enforcement and this is reflected in a rise of exports into those countries.²

5. This means not only that cartels sell more in countries with deficient competition regimes but also that surcharge prices exceed levels seen in countries with experienced competition law enforcement. For these reasons, it is very important for COFECE to send a clear and unequivocal message that international cartels are enforced in Mexico.

6. This submission summarizes COFECE's commitment for pursuing international cartels and analyzes the issues posed by the hypothetical scenario in light of this recent resolution considering Mexico's antitrust law and our enforcement policy.

2. International cartels and their jurisdictional requirement

7. Substantially, the Federal Economic Competition Law (FECL or Law) does not draw distinctions between a national and an international cartel and thus pursues the same objectives whether the conduct is national or international in scope. In this sense, and considering certain jurisdictional requirements which will be detailed throughout this document, under the FECL "Absolute Monopolistic Practices" (in Mexico Cartels are legally defined as *Prácticas Monopólicas Absolutas*) is a term which encompasses cartels both of a national and international dimension.³

¹ Levenstein, Margaret C., y Valerie Y. Suslow., *International Cartels*. Competition Law and Policy (ABA Section of Antitrust Law 2008), p. 1110.

² Clarke, Julian L. y Simon J. Evenett, *The deterrent effects of national anticartel laws: evidence from the international vitamins cartel*, *The Antitrust Bulletin*/Fall 2003, pp. 717-718.

³ James M. Griffin, "An inside look at a cartel at work: Common characteristics of international cartels", available at <http://www.justice.gov/atr/public/speeches/4489.htm>.

8. Pursuant to Article 1 of the FECL its scope of application is as follows, “(...) *applicable to all areas of economic activity and its observance is obligatory in the Mexican Republic.*” Relatedly, Article 2 of the FECL establishes that its purpose is to, “(...) *promote, protect and guarantee free market access and economic competition, as well as to prevent, investigate, combat, prosecute effectively, severely punish and eliminate monopolies, monopolistic practices, unlawful concentrations, barriers to entry and to economic competition, as well as other restrictions to the efficient operation of markets*” [Emphasis added]. These two provisions are essential in the context of international cartels as they allow COFECE to assert jurisdiction over and thus investigate, combat, and prosecute effectively anticompetitive conduct which may have an affectation upon *economic activity in the Mexican Republic*, implying *restrictions to the efficient operation of markets*.

9. In this regard, interpreted in light of these provisions, any contract, agreement, arrangement or combination amongst competing Economic Agents which has an affectation upon economic activity in Mexico would meet the jurisdictional requirement necessary for pursuing enforcement actions. Thus, assertion of jurisdiction by COFECE based upon the FECL is initiated when foreign conduct has a direct or indirect affectation upon any area of economic activity in Mexico.⁴

10. Additionally, article 53 of the FECL⁵ establishes that “Absolute Monopolistic Practices” are considered illegal both for their purpose and effect and as such may be sanctioned for either aspects of the conduct. For cartels with a national scope this means that the illegal purpose or effect for example, of fixing prices does not need to have an affectation upon *economic activity* in order for COFECE to assert jurisdiction. Conversely, regarding international cartels an important distinction needs to be drawn in the sense that an affectation of *economic activity in the Mexican Republic* is a necessary condition for an enforcement action by the Commission, without this element there would be no legal grounds to apply the FECL (mere purpose and effect would not suffice). For further clarity, the difference between effects and affectation in the context of an international cartel is jurisdictional not substantive insofar as the effect translates into a price being fixed, output being restricted or markets being allocated, among others, however, affectation is the material impact upon *economic activity*.

⁴ Another example of how the FECL conceives foreign acts which impact upon *economic activity in the Mexican Republic* is the requirement under the Concentration/Merger Review Regime in Mexico which establishes the following requirement:

Article 87. - “(...) *Concentrations resulting from legal acts executed abroad must be notified before having legal or material effects in Mexican territory*” [Emphasis added].

⁵ “*Absolute monopolistic practices are considered illegal, and these consist of contracts, agreements, arrangements or combinations amongst competing Economic Agents, which have as their purpose or effect any of the following:*

I. To fix, raise, co-ordinate or manipulate the sale or purchase price of goods or services supplied or demanded in the markets;

II. To establish an obligation not to produce, process, distribute, market or acquire but only a restricted or limited amount of goods, or the provision or transaction of a limited or restricted number, volume or frequency of services;

III. To divide, distribute, allocate or impose portions or segments of a current or potential market of goods and services, by a determined or determinable group of customers, suppliers, time spans or spaces;

IV. To establish, arrange or coordinate bids or abstentions from tenders, contests, auctions or purchase calls, and

V. To exchange information with any of the purposes or effects referred to in the previous subsections”

3. Intermediate goods and affectation upon economic activity

11. COFECE's experience has shown that there are clear interdependencies between an investigated market for intermediate goods and the markets for final products. Potential losses in efficiency must also be evaluated in the markets for final products because most probably it is through these markets that *economic activity in the Mexican Republic* was affected as a consequence of a cartel in the intermediate goods market.

12. Affectations between different markets may be conceptualized as the effects between related markets. With the objective of analyzing and determining the magnitude of the affectation the cartel had on the *economic activity*, it is necessary to consider interdependence between both markets. In a recent resolution issued by the Commission the following was stated with regards to interdependence of the intermediate goods involved:⁶

"(...) This interdependence derives from the fact that hermetic refrigeration compressors are one of the most important inputs for producing the final products, insofar as they may constitute anywhere from eight (8%) to thirty percent (30%) of the final cost for refrigerators, an average of fifteen per cent (15%) in different freezers and commercial refrigerators, and in average of fourteen percent (14%) of the total cost for air conditioners. In this sense, it is valid to conclude that an affectation of the compressors market, necessarily impacted upon the final product market.

For example, if it was agreed upon to restrict production of compressors (contraction in supply) with the purpose of raising prices, input costs would increase for the producers of final products and this would entail a reduction in production and an increase in prices for said goods (...)"

4. Intermediate goods and channels of affectation

13. In general terms, for international cartels COFECE considers two sorts of affectation to national markets or some area of economic activity in Mexico pursuant to the following:

- **Direct affectation.** - Consists of the production, merchandising and distribution of a product which has been the subject of an anticompetitive agreement and which enters the country either through subsidiaries of foreign companies or through third parties.
- **Indirect affectation.** - Consists of the merchandising and distribution of a final product containing an input or component which has been the subject of an anticompetitive agreement. Within indirect affectation COFECE also considers exports of integrated products, which have been the subject of an anticompetitive agreement entered into in Mexico or abroad.

14. In accordance with the foregoing and considering the questions posed in the *Hypothetical Scenario*, the channels for indirect affectation regarding intermediate goods that COFECE has analyzed are as follows:

- **National cartel which produces intermediate goods and exports entire production.** Example: A, B and C are companies located in the country and are part of global economic interest groups. These companies enter into anticompetitive agreements, which consist of price fixing and output restriction, however the entirety of their production is exported (in the *Hypothetical Scenario* assuming the position of Country A).

⁶ Resolution number IO-002-2009 issued on February 25th 2014 (available at <https://www.cofece.mx/cofece/index.php/resoluciones-y-opiniones>).

Discussion: This conduct, which is carried out in the country of origin, has an affectation upon exports, which in the case of Mexico, represents an essential activity for the economy. Therefore, this conduct would be subject to the FECL under the affectation upon *economic activity in the Mexican Republic* criteria even if no sales occur in Mexico.

The issue of appropriate sanction determination would be relevant for this example because of the difficulty in determining the cartel's material impact upon the economy. In the recent refrigeration compressor case COFECE stated the following regarding the "severity of the infraction":⁷

"(...) COFECE shall consider the severity of the infraction based upon the corresponding factors for each case ... severity insofar as it consists of an absolute monopolistic practice ... Pursuant to article 28 of the Mexican Constitution absolute monopolistic practices have a high degree of severity "[...] the law shall severely sanction [...] all agreements, procedures or combination among producers, industrials, merchants, or service businessmen that in any manner undertake to avoid free market access and competition among themselves [...]" ... it should be considered that this is the only section of the constitution where the need for "severely" sanctioned is expressed and this emphasizes that these offences are particularly serious ... in this sense, it may be concluded that these offences seriously hinder the competition process and generate severe damages to free market access and competition (...)"

Moreover, the cited resolution also found the following element for determining "*severity of the infraction*":

The nature of the goods which are affected by the anticompetitive agreements, for example, refrigerator hermetic compressors which are included in refrigerators, freezers, supermarket refrigeration systems, commercial refrigerators, ice making machines and air conditioning systems, among others. COFECE found this to be relevant in the following terms, "*(...) in this scenario, if importers of compressors are forced to pay higher prices than under competitive conditions, the excess in prices would be absorbed by the purchasers ... in this case the Mexican companies' income would be affected.... the foregoing without considering the general harm to competition, national producers and exports of national products containing compressors (...)*".

Due to the foregoing elements, COFECE considered that the economic affectation of the anticompetitive agreements was felt by direct consumers of hermetic refrigeration compressors (producers of final products) through certain channels of affectation among which are imports for integration of final products and subsequent exports.

- **Affectation through imports and merchandising of final products into Mexico.** Example: A, B and C are foreign companies that enter into anticompetitive agreements in country Alpha which consist of price fixing and output restriction. These companies sell their products to company D, which then integrates a final product in country Beta. Company E, located in country Gamma, then imports the finalized product into said country. Company E may or may not be a part of the same economic interest group as company D.

Discussion: Assuming that Mexico is country Gamma, this conduct would be subject to the FECL under the affectation upon *economic activity in the Mexican Republic* insofar as sales occurred in Mexico. Companies A, B and C would be subject to the FECL and depending upon D

⁷ Resolution number IO-002-2009 issued on February 25th 2014 (available at <https://www.cofece.mx/cofece/index.php/resoluciones-y-opiniones>).

and E's belonging to the economic interest groups of the companies that participated in the anticompetitive agreement would or would not be liable under the FECL.

This scenario poses two important considerations for enforcement actions, one being the factors for appropriate sanctioning and the other, the legal relationship between companies that undertake the anticompetitive agreements and the implementing entities thereof.

When considering the relevant factors to appropriate sanctioning for the anticompetitive agreements in the hermetic refrigerator compressors case, COFECE considered the importance that the manufacturing industry represents for economic activity in Mexico (17.5% of GDP in 2015 according to the Mexican Institute for Statistics and Geography⁸) and also assessed the affectation upon the alimentary market. This because refrigerators are acquired by consumers for conserving perishable foods and so these agreements have an impact upon the foods industry insofar as they allow firms to offer a greater array of food options:

“... by raising the prices to essential inputs for producing air conditioners and refrigerators ... the economic capacities of Mexican households was also affected as these instruments are important for food preservation and conserving a healthy environment in households...”

The issue of determination of liability for companies involved in anticompetitive practices is one that often comes up in COFECE's investigations of international cartels. Anticompetitive agreements with an international scope are more often than not implemented by entities which are legally distinct from their holding companies however, belong to the same economic interest group⁹ (Fourth Administrative Collegiate Circuit Court from Mexico's First Judicial Circuit, “... although legally distinct, from an economic and functional view point ... constitute a single entity or interest group, formal separation of companies is not a determining factor but rather unity and behavior in the market...”).

In furtherance of the above and considering how these anticompetitive agreements are typically executed (relationship between holding companies and subsidiaries), COFECE stated the following in the hermetic compressor case for arguing the affectation caused by intermediate goods¹⁰:

“(...) in this manner, those subsidiaries acted as agents to the economic interest groups to which they belong to and implemented or executed the agreements and, due to this situation contributed and facilitated illegal contracts, agreements, arrangements, combinations or information exchanges which were carried out by their holding companies who were responsible of determining the common objective or commercial activity to follow by all entities part of the economic interest group. Specifically these companies decided to obtain extraordinary rents for the production, merchandising and distribution of hermetic refrigeration compressors ignoring the economic competition legislation ... these entities participated in these illegal activities by contributing and facilitating the implementation of said collusive agreements.

⁸ Available at: http://www.inegi.org.mx/inegi/contenidos/notasinformativas/pib_preocr/Ni-PIBCR.pdf

⁹ Mexican courts have determined that being part of the same economic interest group is not in itself a determining element for charging liability to an entity for activities carried out by the group. The Supreme Court has established the standard in order to consider liability for a member of a group and these consist of: involvement or knowledge. This means that for considering involvement in the implementation of an anticompetitive agreement, an individual or company has only to perform the action, regardless of knowledge of the illegality or existence of the conduct.

¹⁰ Resolution number IO-002-2009 issued on February 25th 2014 (available at: <https://www.cofece.mx/cofece/index.php/resoluciones-y-opiniones>).

The foregoing, reflects the logic of holding companies of a determined economic interest group which seek common objectives regarding the rest of the entities which compose the group, and these determine a series of commercial policies and business plans that allow these objectives to be attained (legal or illegal). In this manner even if the subsidiaries lacked knowledge of the illegal activities carried out by their holding company, this does not imply that they may not be charged as contributors or facilitators of illegal conduct, even though sales and price negotiations with clients was carried out by the holding company and which was sanctioned in other jurisdictions for anticompetitive conduct (...)"

Conversely, if companies D and E do not belong to the economic interest groups of the companies that participated in the anticompetitive conduct and have no knowledge of the agreements, arrangements of combinations, they would not be liable under the FECL.

- **Affectation through imports of intermediate goods and integration of final products for subsequent exports.** Example: A, B and C are foreign companies that enter into anticompetitive agreements abroad which consist of price fixing and output restriction. These companies import intermediate goods for integration of final products in Mexico which then are exported to third countries.

Discussion: Following on the previous issues for channels of affectation, this conduct would also be subject to the FECL under the affectation upon *economic activity in the Mexican Republic* although no sales occurred in Mexico. This scenario has a double component which comprises affectation through the production process in Mexico as well as affectation through exports resulting from said production.

In cases where the final products are integrated in Mexico and these contain imported intermediate goods subject to cartel activity and are then exported, COFECE has considered this as a significant loss in efficiency (*affectation of economic activity in the Mexican Republic*), insofar as:

- a. The collusive agreements may affect the production levels of the intermediate goods and thus prices;
- b. Higher prices and scarcity of goods increase costs for producers of final products;
- c. Increased costs could lead to decreased production of final products, and
- d. Decreased production could then lead to job loss and shortages for consumers initially willing to purchase a final product.

5. Conclusions

15. Cartels in intermediate goods that feed into a chain of buyers/integrators before reaching the final consumer can be found across a broad range of industries and so for economies with important manufacturing sectors such as Mexico, attention to these issues is of unique importance.

16. Considering the different degrees of affectation to *economic activity*, a case by case analysis of the nature of the goods, the markets involved, the general economic affectation either on consumers or producers, the relative importance of the intermediate goods with regards to the final product (interdependence), market structures, profits, supply and demand elasticities and other issues need to be assessed when competition authorities formulate accusations and establish theories of harm.

17. In Mexico, meeting the jurisdictional requirements for enforcement of international cartels have not been without certain challenges however, COFECE has gathered valuable experience in fulfilling this standard and proving an affectation upon *economic activity in the Mexican Republic* and thus *restrictions to the efficient operation of markets* thereof.

18. Lastly, from COFECE's perspective a clear distinction must be drawn between effects and affectation in the context of an international cartel. Whilst illegal purpose or effect suffice for asserting jurisdiction over a national cartel, affectation upon *economic activity in the Mexican Republic* is a necessary condition for an enforcement action. Legally, affectation encompasses the harm which is caused or the surcharges which consumers must pay for good or product but this element is not part of the normative conditions for constituting an "Absolute Monopolistic Practices" under the FECL. In fact, the sale of a good or product subject of a cartel is not the conduct which is sanctioned in the context of an anticompetitive agreement, the sale of a good or product is not established as an offence under article 53 of the FECL, but rather serves as an element to prove harm when determining the sanction of illegal conduct. Regarding international cartels this implies that COFECE must prove three fold: i) the existence of an illegal contract, agreement, arrangement or combination; ii) that its purpose or effect is illegal under article 53 of the FECL, and iii) affectation of *economic activity in the Mexican Republic* (imports, exports, integration, production, merchandising, sales, etc.).