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Barriers in the Mexican  
Economic Competition Regime

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# Essential Inputs and Antitrust Barriers in the Mexican Economic Competition Regime

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## I. INTRODUCTION

On July 7, 2014 the new Mexican Economic Competition Law (“MECL”) came into force; this is a legislation that replaces the antitrust law enacted in 1992 as one of the commitments made by the Mexican Government to sign the North America Free Trade Agreement with the United States and Canada. The new MECL embodies significant changes with respect to the previous competition regime, including, among others: (i) the creation of a new competition authority (“COFECE”), fully independent from the central government; (ii) a significant expansion of the antitrust authorities’ powers to intervene “ex ante” in particular markets; and (iii) the enforcement of a tougher regime of sanctions for antitrust violations.

This article briefly discusses the virtues and risks associated with the two main economic concepts that have been introduced into the new MECL; namely, the notion of “barriers to competition and free entry” and the concept of essential inputs.

## II. “BARRIERS TO COMPETITION AND FREE ENTRY”

The Mexican reform introduced into the MECL a new economic concept associated with the notion of barriers: the so-called “barriers to competition and free entry.” The definition of barriers to competition and free entry is better understood in two dimensions: one legal and one economic. Let’s discuss each of them in turn.

From a legal perspective, a barrier to competition and free entry is defined as any regulation or legal enactment that, having been issued by any municipal, state, or federal level of government, distorts unjustifiably the process of competition and free entry in a particular market. This conception, at least from its legal perspective, seems reasonable, since including the word “unjustifiably” explicitly recognizes that the implementation of some regulations and legal framings, even when they are able to distort the process of competition and free entry in a particular market, can be justified in terms of their impact on social welfare.

An example of this “justifiable” type of barrier are normatives that force specialized professions to pass highly demanding entry examinations and requirements in order to have the legal right to exercise that profession. Notwithstanding that this type of normative, in fact, restricts competition and free entry, its existence is considered to promote social welfare since it

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guarantees minimum levels of quality of service in highly specialized and socially relevant professions as medical or notary services.

From an economic point of view, a barrier to competition and free entry is defined as any “structural condition” of the market, fact, or market behavior having as a purpose, or having as an effect: (i) imposing restrictions on competitors to accessing the market or (ii) limiting their capacity to effectively compete in the market. According to the new law, a barrier to competition and free entry is also, literally, **anything** that limits or distorts the process of competition and free entry. Unfortunately, the economic dimension of this definition is at odds with standard economic antitrust thinking, for the following reasons.

First, the definition of barriers to competition and free entry embedded into the MECL provides, from an economic perspective, no real guidance about what a barrier of this type is. To say that anything that limits or distorts the process of competition and free entry is a barrier is of little practical use. Similarly, establishing that a barrier to competition and free entry is any structural condition of the market, fact, or market behavior that limits market access or the ability of competitors to compete is far too general to provide a functional conceptualization of the scope of this concept.

Second, when the definition of barriers to competition and free entry first appeared in the drafts of the new law, some economists argued that the definition should be linked with the notion of economic efficiency in order to provide a more precise and meaningful conceptualization.<sup>2</sup> The rationale of this proposal was that, in some cases, it is possible to identify barriers that, in principle, should not be seen as anticompetitive by themselves.

A basic but important example of this type of barrier is the presence of “economies of scale.” Beyond the debate of whether economies of scale should be considered (or not) as a barrier from a dynamic point of view, it has been common to argue that economies of scale represent a barrier because they disincentive market entry. However, given the enormous efficiencies arising from the existence of these economies, it is absolutely clear that this type of “barrier” cannot be prohibited or punished by antitrust enforcement. Since the definition of barriers to competition and free entry contained in the new MECL has not been directly associated with the concept of economic efficiency, the new language leaves the general impression that all barriers, including ones such as economies of scale that are socially efficient, may be prosecuted.

Third, attempting to define “barriers to competition and free entry” also raises the question of whether this type of barrier should be understood as different from the more standard antitrust concept of “barriers to entry.” Two interpretations are possible. The first is that “barriers to entry” and “barriers to competition and free entry” are understood to be equivalent. In this case, the new MECL seems to be conceptually inconsistent, since the same economic concept would then be sometimes referred to as a “barrier to competition and free entry” and other times only as a “barrier to entry.” For example, the competitive analysis leading

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<sup>2</sup> V. Pavón-Villamayor, *Analytical Contributions to the Federal Economic Competition Law*, Discussion Paper presented at the public hearings for the analysis of the Federal Economic Competition Law, Mexican Senate (April 2, 2014). Available at [http://works.bepress.com/victor\\_pavon\\_villamayor](http://works.bepress.com/victor_pavon_villamayor).

to the determination of market power uses the notion of “barrier to entry” (MECL, Article 59), whereas in other parts of the law the notion of “barrier to competition” prevails (MECL, Article 94).

The second interpretation is that “barriers to entry” and “barriers to competition and free entry” are indeed different concepts. A first observation is that the simultaneous, but different, use of these two concepts makes the Mexican competition regime unique in the international arena, since there is no competition regime in the world in which these two concepts are simultaneously used. From this perspective, the Mexican competition regime departs from best international practices for the conceptualization and treatment of barriers for antitrust purposes.

And, as a second observation, if “barriers to competition and free entry” is a concept far more general than “barriers to entry,” it is highly probable that the concept of barriers to competition and free entry will be used by COFECE as a primary tool for “ex ante” market interventions—in other words, there is a risk that COFECE will be regularly intervening in markets in order to break down obstacles that may represent a barrier to competition and free entry.

On the positive side, however, it is worth noting that the enforcement of measures to eliminate barriers to competition and free entry will always be subject to pass an “efficiency test.” Indeed, according to Article 94 of the new law, COFECE is obligated to verify that the measures proposed to eliminate barriers lead, in all cases, to higher market efficiency. In other words, COFECE will be forbidden to implement any measure leading to the elimination of any barrier in cases where undertakings are able to provide evidence that the so-called barriers are the source of efficiency gains leading to an increase in consumer welfare.

Notwithstanding that the implementation of measures to eliminate barriers to competition and free entry requires satisfying an efficiency test, uncertainty still remains regarding how these new legal powers will be used in practice. As noted above, the fact that barriers to competition and free entry is a more general concept than barriers to entry significantly increases the risk of having more frequent market interventions by COFECE. Additionally, Article 94 of the MECL establishes that the burden of proof regarding the efficiency gains necessary to deter the implementation of measures that eliminate barriers should be provided by undertakings. Thus, undertakings face a two-fold risk: first, the possibility that COFECE rejects the (absolute or relative) existence of efficiency gains in the market analyzed and, second, the risk that undertakings may deal with complexities in the measurement of the impact of the different sources of efficiencies in the performance of the market.

In this sense, undertakings operating in Mexico are strongly recommended to start to develop economic methodologies that allow them to identify, classify, and quantify the economic efficiencies that may exist in the different stages of production, distribution, and commercialization where they operate.

### III. ESSENTIAL INPUTS

From an economic perspective, the second substantial change implemented in the new MECL is the introduction of the concept of “essential inputs” in the national competition framework. According to the new competition law, COFECE should take into account the following elements in order to identify the presence of an essential input in a particular market:

1. Whether the input is controlled by one or more undertakings either having market power or being a “preponderant” undertaking in terms of the new *Federal Telecommunications and Broadcasting Law*.<sup>3</sup>
2. Whether the replication of the input is unfeasible from a technical, economic, or legal point of view by any other undertaking.
3. Whether the input is indispensable for the provision of goods and services in one or more markets and whether that input doesn’t have close substitutes.
4. Whether the circumstances under which the undertaking ended up controlling the input were the result of risk-taking behavior or not.

Regarding the definition of essential inputs, it is worth noting that to identify essential inputs, undertakings should have market power, but it is unclear whether such market power should necessarily be observed in the relevant market to which the essential input belongs. Economic intuition dictates that this must be the case, but the law is ambiguous regarding this issue since it can also be interpreted that any undertaking having market power in **any** relevant market, and not necessarily in the relevant market in which the essential input belongs, satisfies the first condition. In this case, for example, a telecommunications operator having market power in the relevant market for mobile call termination may satisfy the first condition even when the essential input is identified in a totally different market as, let’s say, passive infrastructure.

Even when this last interpretation does not make much economic sense, it cannot be ruled out since the same (first) condition also states that an essential input can be identified when the input is controlled by a “preponderant” undertaking—a conceptual framework that only applies to the telecommunications and broadcasting industries. A preponderant undertaking is identified exclusively by the basis of its national market share either in the telecommunications or in the broadcasting sector. This implies that an essential input controlled by an undertaking having “significant presence” in a whole sector satisfies automatically the first condition which, by a logical extension, implies that in order to identify an essential input, it is not necessary to determine market power in the relevant market to which this input belongs to.

It is also worth discussing the implications of the last condition of the definition of essential inputs. This condition mandates COFECE to take into account the “circumstances” under which the undertaking ended up controlling the essential input. The Mexican Senate justified the addition of this fourth condition as a means to differentiate between different cases of input ownership. The idea is that ownership of essential inputs that derive from commercial risk-taking behavior should be treated differently from ownership that derive from other “circumstances”—although these other circumstances are not specified.

Regardless of the fact that this fourth condition still requires a more precise meaning, this condition is considered a positive feature of the new law, since it forces COFECE to treat

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<sup>3</sup> In terms of the Federal Telecommunications and Broadcasting Law, officially enacted on July 14, 2014, a “preponderant” undertaking in Mexico is any firm that directly or indirectly controls, at least, 50 percent of the national market of the telecommunications or broadcasting “sectors.”

ownership of essential inputs in a differentiated way. This may have positive effects on the deployment and investment of infrastructure, facilities, and distribution channels and can also be instrumental in fostering innovation in the production and commercialization of inputs in the whole economy.

Another important implication of introducing the concept of essential inputs in the Mexican competition regime relates to the characterization of two new unilateral conducts. First, according to the new MECL: (i) the refusal to give access, (ii) the imposition of restrictions to provide access, or (iii) the implementation of discriminatory access to essential inputs, may represent a unilateral conduct that violates competition law (MECL, Article 56). The second market conduct now intrinsically linked to the concept of essential input, and characterized as a unilateral conduct, is “margin squeeze,” a subject that has been the source of intense debates in the context of the telecommunications sector in Mexico.<sup>4</sup>

The concept of essential inputs embodied into the MECL is not exempt from implementation risks. In the new Mexican competition regime, COFECE not only has legal powers to identify essential inputs in the whole economy—the exemption being the telecommunications and broadcasting sectors, where the Federal Institute for Telecommunications has exclusive powers to identify and to regulate essential inputs in these sector—but also has the power to regulate them (MECL, Article 12). To provide powers to a competition authority in order to identify and to determine essential inputs is hardly surprising, but to provide powers to COFECE to unilaterally determine tariffs and conditions of access to those essential inputs is controversial.

This controversial power is particularly evident in the case of network industries, which typically are regulated industries. According to the new MECL, COFECE has the power to determine tariffs, terms, and conditions of access to those essential inputs in **any** sector of the economy. And, most importantly, this power does not need take into account the technical opinion that a sector-specific regulator may have regarding the regulation proposed by the competition authority. COFECE’s design of access regulation to an essential input in a regulated sector may take into account the technical opinion of the sector-specific regulator, but following this expert opinion is optional—not compulsory.

The fact that COFECE may mandate access regulation to essential inputs without necessarily taking into account expert advice of sector-specific regulators creates enormous risk since the social costs of implementing regulatory measures ill-designed for sector-specific needs can be significant. A main source of risk is pricing. As has been discussed extensively in the antitrust literature, any debate pretending to discuss terms of access is forced to debate the extent to which access pricing should derive from the “intrinsic” or the “market” value of access. This discussion is particularly complex and is a real conundrum when the entity in charge of determining optimal prices is a competition authority ill-prepared to address this kind of issue.

As some authors have mentioned, engaging in access regulation is not a simple task since it implies that the competition authority should be prepared:

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<sup>4</sup> V. Pavón-Villamayor, *Margin Squeeze in Mexican Mobile Telecommunications*, 8(2) CPI ANTITRUST CHRON. (August, 2011).

...(1) to command that access be provided by others, to regulate the prices, terms, and conditions for the provision of such access, (3) to command the capacity expansion required to make such access feasible, and (4) to command that the service of the facility—as expanded to make access feasible—actually be provided to those who demand it.<sup>5</sup>

Since all these tasks are real challenges for any sector-specific regulator, it is not surprising that expectations for the implementation of optimal access regulation by a competition authority as COFECE are quite low.

#### IV. FINAL REMARKS

The introduction of new concepts as barriers to competition and free entry, and essential inputs, in the Mexican competition regime imposes important challenges. From the perspective of antitrust authorities, the “ex ante” and “ex post” powers to intervene in markets need to be used intelligently and responsibly to guarantee maximizing social welfare.

And from the perspective of undertakings, there is an urgent need to fully understand the scope of the new competition law and, most importantly, to work out the economics of the industry-specific efficiencies that, in most cases, will be the only answer to antitrust concerns deriving from the new competition framework in Mexico.

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<sup>5</sup> A. Lipsky & G. Sidak, *Essential Facilities*, 51 STANFORD L. REV. 1187-1249 (1999).