

Ministry of Economy of Mexico-OECD Co-operation to Strengthen Competitiveness in Mexico



Market Examinations in Mexico

A manual by the OECD Secretariat



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**Ministry of Economy of Mexico-OECD Co-operation
to Strengthen Competitiveness in Mexico**

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Foreword

In December 2014 the OECD signed an Agreement with the Mexican Ministry of Economy to strengthen Mexico's competitiveness through economic competition. The support provided by the OECD through this agreement aims to help the Ministry to promote competition in Mexico, by identifying restrictions or distortions that unduly limit competition in its markets.

Mexico established a new Federal Economic Competition Law in May 2014 in accordance with the constitutional reform on telecommunications, broadcasting and competition of June 2013. The new legal framework endows the Federal Executive Branch, directly or through the Ministry of Economy, with the capacity to request the Federal Economic Competition Commission or the Federal Telecommunications Institute to issue opinions or to initiate investigations.¹ The Ministry's requests can be made to issue opinions about the restrictions to competition that could result from public policies or regulatory changes; to open investigations of anti-competitive conduct, unlawful concentrations, barriers to competition, and essential facilities; to issue resolutions or opinions on market conditions; to issue opinions on the granting of concessions, permits and licences; or to open a market study.²

In order to fulfil its mandate on economic competition, the Ministry of Economy may conduct, or commission to external consultants, inquiries in the markets where there is a suspicion or an indication that the market is not functioning well.³ In this context, this manual supports the Ministry or its external consultants in the examination of markets by explaining what market examinations are, including their purposes, intended outcomes and substantive content. The manual provides guidance on the content of a formal request, the procedure for its submission to the competition authorities and the process it will go through within the corresponding authority.

This manual could also guide other public entities empowered by the new legal framework to make requests to the competition authorities. In addition, it could help competition authorities, business and consumer groups to understand how markets will be examined by the Ministry.

With this manual the Ministry of Economy seeks to provide transparency and certainty to the analytical procedures used when conducting market examinations that could derive in a request to the competition authorities, or to other public bodies.

The Ministry can make a request when the conditions set up by the corresponding statutory provisions appear to be met. Moreover, it is not necessary that the Ministry conducts a market examination in order to submit a request to a public authority, nor public authorities require the Ministry

¹ The Constitutional reform created the Federal Economic Competition Commission as an autonomous entity with enforcement and advocacy competition powers in all sector of the economy, with the exception of telecommunications and broadcasting, where the Federal Telecommunications Institute, also created as an autonomous entity by the aforementioned reform, is the competent authority.

² See Subsection XXIII of Article 12 of the FECL. Any other Mexican public authority may also submit a market study request.

³ Because of competition concerns or due to other industrial or consumer policy issues.

to conduct such an examination in order to receive a request from it.⁴ It is worth to highlight that this manual is not a legal nor a binding document, neither for the Ministry nor for any other public entity, but rather a tool intended to provide a general framework to conduct case-specific market examinations, which can be updated in light of experience and developments in competition law and practice in Mexico.

⁴ *See* Sections 5 and 6 of this manual. The FECL does not establish as a requirement a market examination in order to submit a request to the competition authorities. For example, analogously in the international arena, in the United Kingdom the Enterprise Act of 2002 and the Enterprise and Regulatory Reform Act of 2013 do not require that the Secretary of State or other Ministries submit to the Competition and Markets Authority in the terms of reference for a market investigation the results of an a prior market examination. *See* Provision 131 of the Enterprise Act of 2002 and Provision 141 A of the Enterprise and Regulatory Reform Act of 2013.

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Acronyms and abbreviations

| | |
|------------------|--|
| COFECE | Federal Economic Competition Commission Comisión Federal de Competencia Económica |
| COFEMER | Federal Regulatory Improvement Commission Comisión Federal de Mejora Regulatoria |
| DOF | Federal Official Gazette Diario Oficial de la Federación |
| FECL | Federal Economic Competition Law |
| FECLRP | Federal Economic Competition Law Regulatory Provisions |
| FPAOL | Federal Public Administration Organic Law |
| FTAPIL | Federal Transparency and Access to Public Governmental Information Law |
| FTBL | Federal Telecommunications and Broadcasting Law |
| ICN | International Competition Network |
| IFT | Federal Telecommunications Institute Instituto Federal de Telecomunicaciones |
| IMPI | Mexican Industrial Property Institute Instituto Mexicano de la Propiedad Industrial |
| INADEM | National Entrepreneurship Institute Instituto Nacional del Emprendedor |
| OECD | Organisation for Economic Co-operation and Development |
| PGR | Office of the Attorney-General Procuraduría General de la República |
| PROMEXICO | Mexican Trust to Promote Trade and Investment in Mexico |
| RIA | Regulatory Impact Assessment |
| PROFECO | Federal Attorney's Office of Consumers Procuraduría Federal del Consumidor |

Key definitions and terminology

| | |
|---------------------------------------|---|
| Board of Commissioners | The Board is the governing body of the competition authority; it is composed by members named Commissioners, including its President. |
| Competition | Rivalry between market suppliers to obtain customers by offering products that have desirable price-quality characteristics. |
| Contact details | Address, telephone, electronic mail address, and any other data that allows for the contact of authorised personnel. |
| Customers | End consumers ⁵ or buyers, or both. |
| Harm | An adverse effect on competition caused by structural, regulatory, conduct, or a combination of these features of the market. This effect may appear in the market as prevention, restriction or distortion to competition. |
| Market participants | Business, individuals, profit or non-profit, or government involved in supplying or buying goods or services. ⁶ |
| Product | Applies to goods, services, or both. |
| Public authority | Any public authority of the Federation, the States, Mexico City, and of the Municipalities, their entities and agencies, and the management of their State and Municipal Enterprises, public trusts, autonomous institutions and entities, as well as any other public entity. ⁷ |
| Procedural oversight authority | The unit within the competition authority that reports to the Board of Commissioners. This refers to the Technical Secretariat, as established in Subsection VIII of Article 2 and Article 18 of the Organic Statute of COFECE, or the Economic Competition Unit, as established in Article 46 of the Organic Statute of the IFT. |

⁵ Or end users.

⁶ See Section I of Article 3 of the FECL. In Mexico, the term “economic agent” may also refer to a market participant who could be any natural or legal person, either for profit or non-profit, Federal, State or Municipal public administration agencies and entities, associations, business chambers and professional associations, trusts, or any other form of participation in economic activity.

⁷ See Subsection III of Article 3 of the FECL.

| | |
|---------------------------------|---|
| Reasonable ground | Any indication of the existence of monopolistic practices or unlawful mergers, also denoted as objective cause. ⁸ |
| Request | A petition made by the Ministry of Economy to any of the competition authorities based on the statutory provisions of the Federal Economic Competition Law (FECL), its regulatory provisions, organic statutes of the competition authorities, and the internal regulation of the Ministry of Economy. A request can be made for enforcement or advocacy action by the corresponding competition authority. |
| Regulation | Refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-government or self-regulatory bodies to which governments have delegated regulatory powers. |
| Substantial market power | A degree of market power of one or several market participants that could be determined considering elements such as their market shares and ability to unilaterally fix prices or restrict supply in the examined market, without competitors being actually or potentially able to counter balance such power. It is used to denote a significant market power or a dominant market participant. ⁹ |
| Well-functioning market | Refers to a market where there is vigorous competition and where there is effective interaction between suppliers and its buyers. It is understood as a market without structural, conduct or regulatory features that detract it from a desired competitive process |

⁸ See Article 71 of the FECL. The competition authorities “*In order to initiate an investigation for monopolistic practices or unlawful concentrations an objective cause is required. An objective cause is any indication of the existence of monopolistic practices or unlawful concentrations. [...]*”

⁹ This is a general definition, thus the specific conditions for substantial market power should exhaust the assumptions provided by the FECL, being the competition authorities (IFT and COFECE) the autonomous entities entitled to interpret this law.

Executive summary

The economy as a whole benefits when markets are competitive, when buyers have the option to choose between different suppliers and when there is competition between suppliers. More competition in the markets translates into higher productivity and more economic growth. Introducing or strengthening competition in markets that do not function well is imperative for higher productivity.¹⁰

The Ministry of Economy has the mandate to formulate and conduct public policies on industry, foreign and national trade, on national supply and prices, as well as to regulate, promote and monitor the commercialisation, distribution and consumption of goods and services. Furthermore, the Ministry is responsible for establishing the policies for the industrialisation, distribution and consumption of agricultural products, livestock, forestry goods, minerals and fishery products, this in co-ordination with the corresponding regulators. It also regulates, directs and stimulates consumer protection measures, registers industrial and business ownership, sets and monitors standards for commercial and industrial activity, advises businesses, and promotes and organises technical-industrial research, among other mandates,¹¹ with the aim of promoting productivity and competitiveness of the Mexican economy in the benefit of consumers, a better business environment, to strengthen Mexico's internal market, and to attract national and international investment.¹²

The Ministry may conduct a market examination to effectively implement the aforementioned legal functions and use its findings to make recommendations to other public authorities when concerns about policy issues, different from competition, are found.¹³ The Ministry may also act within the scope of its statutory powers to solve identified market problems.

Moreover, the enactment of the new Federal Economic Competition Law (FECL) grants the Ministry better tools to accomplish its mission. When the Ministry suspects or finds an indication that a market is not working well, or when there is a cross-cutting issue negatively affecting several markets, it is empowered to request the Federal Economic Competition Commission (COFECE) or the Federal Telecommunications Institute (IFT), hereinafter referred to as the competition authorities, to initiate an investigation. If the competition authority decides it is necessary, it may open such an investigation or, under Article 94 of the FECL, order a remedy to the identified competition problems. In such complaints, the Ministry receives priority treatment in its evaluation compared to third party complaints.

¹⁰ See OECD (2014).

¹¹ See Article 34 of the FPAOL.

¹² See the mission of the Ministry of Economy, www.gob.mx/se/que-hacemos

¹³ See Foreword of this manual. It shall not be understood that the Ministry requires conducting a market examination in order to submit a request to any public authority, nor that public authorities require the Ministry to conduct such an examination in order to receive a request.

1. Introduction to market examinations and to this manual

Competition promotes efficiency by helping to ensure that products offered to consumers better match their preferences, producing benefits such as lower prices, improved quality, increased variety, innovation and, ultimately, higher productivity and economic growth. When markets are not working well they will not deliver products with price and quality characteristics that most closely match customers' needs, which has a negative effect on the economy as a whole.

Identifying the markets that are not functioning well, as well as their specific problems and their causes, is imperative for the Ministry of Economy in order to take action directly, or to refer the matter to the competent body.

This manual provides guidance, based on international best practices, to the Ministry of Economy when it carries out market examinations. The manual is not a legal nor a binding document, neither for the Ministry nor for any other public entity, but rather a flexible tool, that is intended to provide a general framework to conduct case-specific market examinations, and that can be updated in light of experience and developments in competition law and practice in Mexico.

A market examination is defined in this manual as an inquiry into a particular market or sector of the economy, or into a particular cross-cutting issue present in various markets, when there is a suspicion or indication of distortions or restrictions that cannot be assigned to a particular market participant.¹⁴ This is an instrument that has the purpose of identifying structures, regulation and conduct that affect market performance, harm consumers and that shall be eliminated. It is considered a proactive and flexible tool available for the Ministry's application on a case-by-case basis.¹⁵

Market distortions that have adverse effects on competition may be caused by the structure of the market, its regulation and by business or consumer conduct. Thus, market examinations often have the purpose to look into these causes and their specific effects, with the aim of identifying remedial action. However, a market examination may also be initiated to improve knowledge of markets (to look at developing markets), to respond to unusual market events, or to identify potential risks to consumers (and can include an ex post analysis of a previous intervention in the market).

Competition agencies may also conduct market inquiries, often known as market studies or investigations.

Market studies or investigations conducted by competition agencies should not be confused with market examinations conducted by other government bodies, such as the Ministry of Economy. In this

¹⁴ See OECD (2008). This definition may be similar to that agreed by the European Competition Network (ECN) for a sector inquiry.

¹⁵ Therefore, when using this manual the Ministry may justifiably depart from its guidance.

manual, market studies are regarded as a competition advocacy action¹⁶ conducted by competition agencies. These are more in-depth research reports, that incorporate information that competition authorities have the power to request when deemed necessary to exercise their powers, and that contain a detailed analysis of the market studied with the aim of identifying and confirming root causes that restrict competition in order to eliminate them and remedy their adverse effects on competition.

International organisations such as the OECD and the International Competition Network (ICN) have discussed international good practices¹⁷ by competition agencies when conducting these studies.¹⁸ This manual considers these international good practices.

The Ministry may request to the competition authorities the opening of a market study or to investigate the existence of essential facilities, barriers to competition or the lack of competition conditions in a given market.¹⁹ This request may be an outcome obtained from the findings of a market examination.

Other outcomes of a market examination include, *inter alia*:

- requests for enforcement and advocacy campaigns on competition issues;
- action in other public policy areas, such as: enforcement action on consumer protection issues, recommendations to market participants (such as trade or professional associations), recommendations to the government to modify the law and regulatory framework, and on better regulatory practice issues;
- improved knowledge of a market;
- building of technical capacity;
- development of public policy; or
- no action where markets are found to be working well (in a particular period).

In the context of the attributions granted by the Federal Economic Competition Law (FECL) to the Ministry, this manual has the purpose to provide it with guidance, as well as to any other public bodies, when carrying out market examinations, when identifying and selecting outcomes of the examination, and for presenting and following up requests to the Mexican competition authorities, where there are reasonable grounds for suspecting that competition in a market is distorted or restricted by its structure, regulation, conduct or a combination of all.

It offers a standardised and flexible framework that seeks to provide greater clarity to the Ministry's procedures for market analysis. It also has the aim to serve the competition authorities, business and consumer groups to gain understanding on how the markets are being examined by the Ministry.

¹⁶ See Section 2.2 of this manual.

¹⁷ See ICN (2012). Good practices generally refer to the “*practices which work well in the jurisdiction(s) where they are applied, but which may or may not work well in the legal context of another jurisdiction, [...]*”.

¹⁸ See OECD (2008), OECD (2015a), and ICN (2012).

¹⁹ See Section 2 of this manual.

The manual is structured in six sections, plus seven appendices and bibliography:

- *Section 2* describes the possible outcomes of market examinations, such as the use of statutory powers of the Ministry of Economy on: industrial policy issues, requests to the competition authorities, requests to other public authorities – like the Federal Attorney’s Office of Consumers (PROFECO), the Federal Regulatory Improvement Commission (COFEMER), and other outcomes – such as recommendations to sub-national governments or businesses.
- *Section 3* describes the Ministry’s powers to make requests to the competition authorities for issuing opinions about public policy restrictions to competition; opening investigations of anti-competitive conduct, unlawful concentrations, barriers to competition, and essential facilities; for deciding on market conditions, on the granting of concessions and equivalent exclusivity rights; and for opening a market study.
- *Section 4* provides the framework for carrying out market examinations based on economic theory and international best practice. This section begins with a description of activities for gathering and handling information; it also provides guidance on the range and depth of analysis to cover relevant aspects of competition, such as the definition of the market to be examined, description of the market characteristics and its outcomes, exploration of possible market power, examination of conduct, regulatory and structural features that can harm competition, and development of possible theories of harm.
- *Section 5* provides guidance on the content of requests made to the competition authorities.
- Lastly, *section 6* presents the process each request will face within the competition authorities and its key procedural aspects.

2. Outcomes of the market examination

Market examinations are a robust tool that allow to gain insight into the analysis of markets – at a specific point in time – to identify and understand what is working well (or not) and why. The examination of structural, regulatory and conduct features of the market may lead to the development of possible theories of harm to competition, and in other public policy areas, that can trigger government action to solve market problems.

The Ministry of Economy has an important role in ensuring well-functioning markets. Based on the statutory powers of the Ministry to fulfil this role, this section presents an array of possible results of a market examination that may trigger the direct action by the Ministry, or from other public authorities. Then, the section focuses on the powers provided by the Federal Economic Competition Law (FECL), such as the faculty to submit requests to the competition authorities, and describes other types of results that would require action by the Ministry, such as recommendations to government on consumer protection and regulatory issues, to sub-national governments and to the private sector.

Notwithstanding the above, international good practice demonstrates that there are other kinds of results, no less important:²⁰

- The finding that markets are working well in a particular period;²¹ or that there are no suitable remedies available.
- A better understanding of the functioning of a market.
- Building technical expertise on the market.²²

Moreover, transparency along the elaboration process of the market examinations is important. When applicable, (i) making a public announcement at the beginning of the examination, (ii) allowing for consultations of its results, and (iii) the publication of the public version of the examination may improve its robustness and effectiveness.²³ Also, the publication of the market examination, in itself, is an important outcome that facilitates knowledge of the market among the general public.²⁴

²⁰ See OECD (2008) and ICN (2012).

²¹ See Office of Fair Trading (2010). For example, in the United Kingdom this action is known as a “clean bill of health” for the market. See Competition Commission (2013), p. 78. See also Office of Fair Trading (2010), p. 3.

²² Improving the knowledge on markets that work well could be useful for the Ministry because this can be used as a benchmark for comparing with those that do not function well.

²³ Transparency along the elaboration process of the market examinations is a priority of the Ministry of Economy. However, special care must be taken with confidential information held by the Ministry of Economy. This type of information shall be treated according to the Federal Transparency and Access to Public Information Law (FTAPIL).

²⁴ The government of the United Kingdom stands out for its transparency in the publication of its market studies. In this jurisdiction the Competition and Markets Authority has competition concurrent powers with the regulators established in the provision 52(4) of the Enterprise and Regulatory Reform Act of

2.1 Use of statutory powers and public policy development

The Ministry of Economy has the mandate to promote productivity and competitiveness of the Mexican economy by way of industrial public policy for the benefit of consumers and a better business environment, to strengthen Mexico's internal market, and to attract national and international investment.²⁵

Industrial public policy developed and enforced by the Ministry is founded in the pillars of:²⁶

- Competition.
- Consumer protection.
- Regulatory improvement.
- Protection of industrial property rights.
- Innovation.
- Increased foreign trade and investment.
- Fair international commercial practices.
- Small, medium, and micro business development.
- Warranty of a national content quota in public procurement.
- Effective measurement and standardisation.
- Effective business regulation.
- Registry of, as well as, effective co-ordination with trade and professional associations.
- Efficient national trade and services.

In addition, the Ministry oversees and co-ordinates economic activity related to: light-industry,²⁷ heavy and high-technology industries,²⁸ and mining.

To effectively implement its mandate, the Ministry has de-concentrated or subordinated bodies – such as the National Entrepreneurship Institute (INADEM), and the Federal Regulatory Improvement Commission (COFEMER); and the Ministry directly co-ordinates with other public authorities – such as the Federal Attorney's Office of Consumers (PROFECO), the Mexican Industrial Property Institute (IMPI), and PROMEXICO.

2013. These regulators also have the power to conduct market studies, which are published. *See* example of the Financial Conduct Authority of this country, www.fca.org.uk/about/what/promoting-competition

²⁵ *See supra* 11.

²⁶ *See* Internal Rules of the Ministry of Economy, www.economia.gob.mx/files/reglamentointeriordelase.pdf

²⁷ *See Ibid.* Refers to agricultural and agro-industrial, textile-clothing, leather-tanning-footwear, wood-cellulose-fibre, secondary-paper-editorial industry and printing, wood-furniture, oil-petrochemical-chemical, pharmaceutical-pharm chemical, and industries of rubber, plastics, cosmetics, soaps, detergents, cleaning products, equipment and medical equipment, toys, games and sporting recreational goods, precursor technologies related to these industries, including biotechnology.

²⁸ *See Ibid.* Refers to automotive, aerospace, electronic, electrical, and steel sectors, metallurgy, metalworking, equipment and machinery, and non-metal industries such as glass, ceramics and cement.

Given its statutory powers, the Ministry may develop public policy related to the pillars mentioned above. Thus, market examinations may produce public policy changes in any of them, and may trigger enforcement and advocacy action, by the Ministry, alone or in co-ordination with other public authorities, and by other authorities at the request of the Ministry.

Another statutory power of the Ministry directly related to economic competition is the imposition of prices. A competition authority's decision on market conditions may be requested by the Federal Executive Branch, by itself or through the Ministry of Economy, with the aim of identifying competition conditions that call for the imposition of maximum or minimum prices of goods or services that are necessary for the national economy or for consumption of low-income households. The Ministry of Economy, based on the decision of the competition authority, will establish the corresponding price.²⁹ When establishing prices, the Ministry may agree and co-ordinate action with suppliers and distributors, always trying to minimise impact on competition. The Ministry will co-ordinate with PROFECO – the institution responsible for the compliance of the established prices.³⁰

2.2 Competition requests

A market examination conducted by the Ministry of Economy may result in a request to a competition authority to call for enforcement or advocacy action.

Enforcement is understood as the action taken by a competition authority when there is a suspicion of anti-competitive conduct. Enforcement action may result in a settlement with the presumed offender, or an order to eliminate the imposed restrictions on competition, or an administrative sanction, or in criminal prosecution in the case of cartel conduct.

Requests that call for enforcement action are:³¹

- Opening of investigations of anti-competitive conduct.

Advocacy is referred to “those activities conducted by the competition authority related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms, mainly through its relationships with other governmental entities and by increasing public awareness of the benefits of competition.”³²

Requests that call for advocacy action are:

- Issuance of opinions about public policy restrictions to competition.
- Opening of an investigation of barriers to competition and essential facilities.³³
- Issuance of a decision on market conditions.
- Issuance of a decision on the granting of licences, concessions, permits and equivalents.
- Opening of a market study.

²⁹ After careful considerations that will prevent a shortage in the supply.

³⁰ See Article 9 of the FECL.

³¹ See Section 3 of this manual for a description of the statutory powers of the Ministry of Economy for making these requests.

³² See ICN (2002), p.i.

³³ See Article 94 of the FECL. A resolution related to a divestiture of assets does not constitute a sanction as provided in Article 131 of the FECL.

2.3 Other types of outcomes

Market examinations are good for obtaining knowledge and expertise on a market and the sharing of this knowledge has spill-over benefits to other public authorities, businesses, consumers, and the general public.

In particular, this is true for other public authorities that may not be aware of a market problem. Therefore, the Ministry's market examinations may recommend action to policymakers when it is needed to correct a market problem. In this case, the Ministry may facilitate the necessary information for such purpose.³⁴

2.3.1 Recommendations to government and the private sector

Recommendations derived from the findings of a market examination may include different policy issues. As mentioned above, competition enforcement and advocacy issues are assessed by competition authorities, and industrial policy issues, including the wide range of topics mentioned above in section 2.1, are addressed directly by the Ministry.

Describing the wide variety of possible results of a market examination is out of the scope of this document, therefore the remaining part of this section focuses on explaining results related to consumer protection, and regulatory policy, in order to illustrate some which may arise from a market examination. Lastly, other results – such as the issuance of recommendations to sub-national governments (states and municipalities) and to trade and professional associations will be described in general terms.

Consumer protection recommendations

Besides identifying competition problems that result in a consumer detriment, market examinations are also useful to assess if markets may not be working well because of consumer protection problems, or because of both.

International good practice considers that market examinations “[...] are a good way to develop a link between consumer policy and competition policy. In a number of countries, market studies are used both for competition and for consumer policy and these two uses are often intertwined [...]”³⁵ This is because market examinations also take an overview of patterns of consumer behaviour. Thus, another possible outcome of a market examination is consumer-focused remedies (e.g. improved consumer information).

Therefore, market examinations are one tool available to the Ministry of Economy for addressing competition or consumer protection problems, or both. If enforcement action is needed on the consumer protection side, the Ministry may request action by PROFECO.³⁶ If policy change is needed in this

³⁴ Sharing of information between public authorities often takes place under the framework of an inter-institutional agreement or a memorandum of understanding.

³⁵ See OECD (2008), p.7.

³⁶ PROFECO is a decentralised body that co-ordinates with the Ministry of Economy in consumer protection related issues. It is the institution responsible for the promotion and protection of consumers' rights and interests, by providing legal certainty and fairness between suppliers and consumers. On the other hand, the Ministry is responsible for establishing the national consumer protection policy and is vested with the faculty to adopt the measures needed to promote that markets work well to benefit consumers and to foster economic growth. In addition, the Ministry is responsible for standard-setting for consumer protection.

matter, the Ministry is the public authority vested with the statutory power to do it. Lastly, if advocacy action is needed to address consumer protection problems, both PROFECO and the Ministry may carry out advocacy activities.

Regulatory policy recommendations

“Regulatory policy is about achieving government’s objectives through the use of regulations, laws and other instruments to deliver better economic and social outcomes and thus enhance the life of citizens and business.”³⁷ Regulatory policy is fundamental to ensure public order, therefore it should be designed and implemented in a way that maximises benefits and minimises costs for market participants. Public policy is one type of intervention by which governments act to promote economic prosperity, enhance welfare and pursue public interest. Therefore, the OECD recommends setting out measures that governments can and should take to support the implementation and advancement of systematic regulatory review to deliver public policy that meets its objectives while having a positive impact on the economy.³⁸

COFEMER is a body of the Ministry of Economy that carries out the aforementioned systematic regulatory review of national public policy, in an *ex ante* and *ex post* manner.

COFEMER is responsible for applying the Regulatory Impact Assessment (RIA) tool, an *ex ante* assessment of the public policy issued at the federal level, which incorporates a Competition Assessment section.³⁹ When the results of the RIA indicate a medium or high negative impact to competition, they shall be sent to the corresponding competition authority for the issuance of an opinion that provides alternatives to eliminate or lessen the impact.⁴⁰

On the *ex post* assessment side, market examinations carried out by the Ministry are an important source for identifying regulatory problems on any of the industrial policy issues mentioned above, as well as for identifying recommendations that will trigger action by the Ministry and COFEMER to eliminate them or to lessen their negative impact on the market.⁴¹

Sub-national governments

The Ministry of Economy has offices located in all of the Mexican states. This allows the Ministry to co-ordinate with the local governments. Thus, when industrial policy concerns are found by a market examination in local markets, the Ministry may make recommendations at this level and advocate for its implementation.

³⁷ See OECD Regulatory Policy. www.oecd.org/gov/regulatory-policy/. See also OECD (2012b). OECD Regulatory Policy. www.oecd.org/gov/regulatory-policy/. See also OECD (2012b).

³⁸ See OECD (2012b).

³⁹ See OECD (2011a), OECD (2011b) and OECD (2015d).

⁴⁰ See Agreement that modifies only Annex of the Manual of Regulatory Impact Assessment, published in the DOF on 28 November 2012, www.dof.gob.mx/nota_detalle.php?codigo=5279503&fecha=28/11/2012. See also Collaboration Agreement between COFECE and COFEMER to implement co-ordinated actions that allow for effective competition and better regulation law enforcement, as well as the exchange of information that facilitates the implementation of their powers, www.cofece.mx/cofece/index.php/normateca/category/21-autoridades-publicas?download=299:convenio-cfce-cofemer-del-23-de-septiembre-de-2013

⁴¹ See Agreement for the implementation of the Ex post Regulatory Impact Assessment, published in the DOF on 28 November 2012, http://dof.gob.mx/nota_detalle.php?codigo=5279502&fecha=28/11/2012.

Private sector: trade and professional associations

The Ministry of Economy maintains open channels of communication and consultation with the business community. When market examinations indicate business conduct poses a risk to market efficiency, or if a change in its conduct may enhance it, the Ministry may issue recommendations for such purposes.

3. Statutory powers for making requests

The Ministry of Economy has a statutory mandate to submit requests to Mexico's competition authorities. This section describes the specific provisions in the Federal Economic Competition Law (FECL) that enable the Ministry to submit such requests.

Ministry's requests may seek the:⁴²

- Issuance of opinions about public policy restrictions to competition.
- Opening of investigations of anti-competitive conduct.⁴³
- Opening of an investigation of barriers to competition and essential facilities.
- Issuance of a decision on market conditions.
- Issuance of a decision on the granting of licences, concessions, permits and equivalents.
- Opening of a market study.

Based on the findings of a market examination the Ministry might send any of the requests mentioned in the preceding paragraph to the corresponding competition authority. However, a market examination is not necessarily followed by a request; neither a request requires the conduction of a previous market examination. Therefore, the findings of a market examination are only one of the possible sources that could initiate a request to a competition authority.

The remaining part of this section describes each of the requests of paragraph 43.

3.1 Opinion about public policy restrictions to competition

At times government legislation, regulation and policies (public policy),⁴⁴ intentionally or unintentionally, may impose undue restrictions to competition, even when they are not focused on economic regulation and not intended to affect competition.

Public policies that unduly restrict competition may often be reformed in a way to promote market competition while achieving the public policy objectives. However these changes usually require a detailed competition assessment of the likely effects.⁴⁵

⁴² See Article 61 of the FECLRP. Regardless of the Ministry's statutory powers to make a request, it - like any other public authority having information on the investigated object or effect - can collaborate with the authority by submitting information.

⁴³ See COFECE (2015a) and COFECE (2015b).

⁴⁴ Including international agreements entered with other nations or international organisations.

⁴⁵ See OECD (2009a).

The FECL grants the competition authorities with the power to issue opinions when public policy restrictions have been identified. These opinions analyse an existing or proposed public policy that unduly restricts competition, identify the elements that generate competition problems and provide non-binding recommendations for government action to adopt pro-competitive alternatives.⁴⁶ In addition, public policies may impose barriers to competition; therefore the FECL also empowers the competition authorities to assess them as such. Section 3.3 of this manual describes the investigatory power of the competition authorities on barriers to competition.

When the Federal Executive Branch identifies a public policy that unduly restricts competition it can request, directly or through the Ministry of Economy, the issuance of opinions related to:⁴⁷

- Modification of programs and public policies carried out by government.⁴⁸
- Draft regulation, rules, agreements, directives or any other administrative document that government intends to issue.⁴⁹
- Legislative bills and draft bylaws and decrees.⁵⁰
- Laws, bylaws, agreements, directives or any other administrative acts.⁵¹
- Competition provisions included in the negotiation of international treaties.⁵²

3.2 Investigation of anti-competitive conduct⁵³

When there is suspicion of possible violations of the FECL by market participants (individually or collectively) the competition authorities shall enforce the law.

An enforcement tool available to the competition authorities is the investigation of anti-competitive conduct.

The investigation procedure of anti-competitive conduct is carried out by the investigation authority, created by the FECL, as a body within each competition authority, responsible for the investigation phase and participating as a party in the trial-like procedure.

When the Ministry has reasonable grounds,⁵⁴ for suspecting anti-competitive conduct, the FECL empowers the Ministry, on behalf of the Federal Executive Branch, to submit a request to the

⁴⁶ The FECL establishes that all opinions issued by the competition authorities shall be made public.

⁴⁷ See Paragraph 7 of Article 18 of the FECL. These opinions shall be issued by the Board of the corresponding competition authority.

⁴⁸ See Subsection XII of Article 12 of the FECL.

⁴⁹ See Subsection XIII of Article 12 of the FECL.

⁵⁰ See Subsection XIV of Article 12 of the FECL.

⁵¹ See Subsection XV of Article 12 of the FECL.

⁵² See Subsection XVIII of Article 12 of the FECL.

⁵³ Market examinations conducted by the Ministry do not constitute a mean to obtain information about anti-competitive activity. This is in line with international best practice when conducting market studies. See ICN (2012) and OECD (2008).

corresponding competition authority, which shall decide whether or not to initiate an investigation. Such requests have a priority nature.⁵⁵

The FECL establishes three types of anti-competitive conduct: Absolute monopolistic practices (“cartels”), relative monopolistic practices (“abuse of dominance”),⁵⁶ and unlawful concentrations.

3.2.1 Cartels

Cartels, considered *per se*⁵⁷ violations under the FECL, are contracts, agreements, arrangements, or a combination of these, between market competitors with the object or effect of:⁵⁸

- *Fixing/Manipulating prices*: Fixing, rising, agreeing or manipulating the sale or purchase price of products supplied or purchased.
- *Supply constraint*: Setting an obligation for not producing, processing, distributing, selling, buying but only a restricted or limited quantity of products; or for offering a limited number, volume or frequency of services.
- *Market segmentation*: Dividing, distributing, allocating or imposing segments of an actual or potential market, through customers, suppliers, periods or determinable spaces.
- *Bid-rigging*: Setting, agreeing, co-ordinating bid proposals or refraining from tenders or auctions.⁵⁹
- *Exchanging information*: With the object or effect of the aforementioned conduct.

The following conduct are considered an indication of presumed cartel activity.⁶⁰

- Invitation or recommendation addressed to one or several competitors to co-ordinate prices, supply, production, marketing or distribution conditions, or exchange information with the same object or effect.
- Sale price of two or more competitors is considerable superior or inferior to an international reference price. Or, price trends are significantly different to international price evolution in the same period, except when the trend in Mexico is derived from fiscal policy, transportation or distribution costs.

⁵⁴ See Article 71 of the FECL. The opening of an investigation of anti-competitive conduct requires an objective or reasonable cause. These reasons may or may not be based on the information obtained from a market examination.

⁵⁵ See Article 66 of the FECL. See also COFECE (2015b)

⁵⁶ Relative monopolistic practices is a concept used in Mexico that refers to vertical restraints and other business practices that when are carried out by market participants with substantial market power, individual or joint, can violate the FECL.

⁵⁷ See COFECE (2015c), p. 8.

⁵⁸ See *Idem*, p.11 and Article 53 of the FECL.

⁵⁹ See OECD (2009b), for guidance about fighting bid-rigging among competitors in public procurement.

⁶⁰ See Article 3 of the FECLRP.

- Trade or professional associations' instructions, recommendations or commercial standards for the co-ordination of prices, supply, or production, marketing or distribution conditions; or for the exchange of information with the same object or effect.
- Two or more competitors establish the same maximum or minimum sale price, or adhere to the sale or purchase price issued by a business chamber or association, or any other competitor.

Cartel conduct may be criminally prosecuted, aside from the administrative sanction imposed by the competition authority.⁶¹

3.2.2 Abuse of dominance⁶²

The FECL provides that conduct of individual or collective business with substantial market power, in a relevant market, under any of the assumptions listed below, with the object or effect of unduly displacing other market participants or preventing access or granting exclusive advantages to one or several market participants is unlawful,⁶³ unless demonstrated efficiency gains⁶⁴ supersede the anti-competitive effects of the conduct.⁶⁵

Assumptions are:⁶⁶

- Vertical market segmentation.
- Vertical price restraint.
- Tying sales or purchases.
- Exclusive dealing.
- Refusal to deal.
- Boycott.
- Predatory pricing.⁶⁷

⁶¹ See Subsection IV of Article 127 of the FECL.

⁶² See *supra* 52.

⁶³ See COFECE (2015a), p. 11. Besides the confirmation of substantial market power in the relevant market the conduct shall impose a decrease, harm or restriction to the competition conditions in the market.

⁶⁴ See Article 55 of the FECL. The efficiency gains that could be considered are the (i) *introduction of new products*; (ii) *utilisation of carryovers, defective or perishable products*; (iii) *cost reductions resulting from the creation of new techniques and methods of production of products or different services with the same factors of production*; (iv) *introduction of technological advantages that produce new or improved products*; (v) *combination of productive assets or investments and recovery to improve the quality or expand the attributes of products*; (vi) *quality improvements, investment and recovery, timing and opportunity that favourably impact the distribution chain*, and (vii) *other that demonstrate that net contributions to consumer welfare arising from these practices outweighs their anti-competitive effects*.

⁶⁵ See Article 54 of the FECL.

⁶⁶ See Article 56 of the FECL.

- Loyalty discounts.
- Cross-subsidies.
- Discrimination.
- Rising rivals costs.
- Denial or discriminatory access to an essential facility.
- Margin squeeze in relation to an essential facility.

This type of conduct, considered in the FECL as relative monopolistic practices, includes the acts, contracts agreements, procedures or combinations of the aforementioned conduct, by one or several market participants, that fits any of the assumptions mentioned above.⁶⁸

3.2.3 *Unlawful concentrations*

According to the FECL a merger or concentration transaction takes place when two or more market participants, that are competitors, suppliers, customers or any other, concentrate, acquire control or carry out an act by which companies or associations join, or in which shares, social parts, trusts or assets in general are acquired.⁶⁹

Unlawful concentrations are those concentration transactions that have the object or effect of preventing, reducing or harming competition.^{70 71} The following criteria are considered an indication of an unlawful concentration (or intention to merge):⁷²

- Confers or may confer the merged or acquiring party with increased or significant market power to impede, reduce, harm or restrict competition.
- May have the object or effect of imposing barriers to entry, impede access to third parties into the relevant market, or related markets or essential facilities, or foreclose other market participants.
- Has the object or effect to significantly facilitate merging parties to conduct anti-competitive conduct or breach the FECL.

To determine if a merger is unlawful the competition authority shall take into account the elements, that may be provided by the market participants, of how the presumed illicit transaction may generate efficiency gains that affect in a favourable manner the process of competition superseding its possible anti-competitive effects in the analysed market, and therefore resulting in improved consumer welfare.⁷³

⁶⁷ See Article 4 of the FECLRP.

⁶⁸ See Article 54 of the FECL.

⁶⁹ See Article 61 of the FECL.

⁷⁰ See Article 62 of the FECL. Merger thresholds are established in Article 86 of the FECL.

⁷¹ Mergers solved by the competition authorities and non-notified mergers transitions of one year or more of completion cannot be analysed. In the first case, if false information was provided the competition authority may reopen the investigation.

⁷² See Article 64 of the FECL.

⁷³ See COFECE (2015a), p. 13.

3.3 Investigation of barriers to competition and essential facilities

The FECL establishes a special investigation procedure for the determination of barriers to competition and of essential facilities.⁷⁴

Barriers to competition are any structural, regulatory or conduct feature of the market, with the object or effect of preventing or distorting competition in the relevant market.⁷⁵

Essential facilities are determined considering the following criteria:⁷⁶

- Controlled by one or more market participants declared with substantial market power⁷⁷ by any of the competition authorities.
- Not technically, legally nor economically feasible to replicate the input.
- Indispensable for the provision of products in one or more markets, and does not have near substitutes.
- Circumstances under which the market participant acquired control of the input.
- Criteria established in the FECLRP.

The special procedure for determining essential facilities is different from that of the investigation procedure for denial or discriminatory access to essential facilities. Moreover, competition authorities may opt to determine the existence of essential facilities when investigating anti-competitive conduct without initiating a special procedure.⁷⁸

The competition authorities may initiate a procedure to investigate barriers to competition and essential facilities at the request of the Federal Executive Branch, through itself or by the Ministry of Economy.

3.4 Decision on market conditions

The competition authorities are granted the power to analyse markets when there is a suspicion that competition in a market may be restricted in different forms, or a combination of forms.⁷⁹ For example, when the market exhibits different kinds and several barriers to entry and expansion giving market participants an advantage over potential entrants, or when the market is highly concentrated and one or more market participants appear to have substantial market power, or when competition could be

⁷⁴ See Article 94 of the FECL. In this manual essential facility and essential input will be considered as synonyms.

⁷⁵ See Subsection IV of Article 3 of the FECL.

⁷⁶ See Article 60 of the FECL and Articles 10 and 12 of the FECLRP. The latter articles, respectively, establish the obligation of the investigation authority to evaluate if access regulation of the essential input would produce efficiencies in the market, and the obligation of the Board to evaluate if any remedial action imposed eliminates the essential input's competition problems and if this action is the least intrusive for businesses.

⁷⁷ Also refers to a preponderant participant as defined in Article 262 of the Federal Telecommunications and Broadcasting Law (FTBL).

⁷⁸ See Article 56 of the FECL.

⁷⁹ See Article 96 of the FECL.

impeded by co-ordinated approaches of market participants, or when customers lack the information necessary to make decisions about products or are unable to switch from suppliers.

When using this power, competition authorities will decide if effective competition conditions exist, including the existence and declaration of dominant market participants. This ability may only be exercised when established in the laws or in Presidential Decrees, and may be triggered by the Federal Executive Branch, through itself or the Ministry of Economy, or by sectoral regulators.

3.5 Decision on the granting of concessions, licences, permits and equivalents

Government may grant exclusive rights to produce a certain product or operate an infrastructure to provide a service and receive revenues deriving from it. The impact of these types of rights should be carefully considered because they may create barriers to entry and may result in monopoly pricing or other competition problems associated with the use of market power.⁸⁰

Governments may grant licences and permits, for example in the form of minimum standards or tests, to demonstrate the qualifications of a product or service provider in order to protect consumers. However, these may also restrict entry so it is important to carefully assess the need for them, as well as how strict these are in order to avoid reducing consumer choices and creating artificial scarcity that raises prices.⁸¹

Therefore, the FECL empowers competition authorities to analyse and issue decisions on the call for tenders of concessions, licences, permits and equivalents.⁸² The authorities may issue a decision when the sectoral regulation establishes this requirement, by a Presidential Decree, or when the Federal Executive Branch, through itself or by the Ministry of Economy, requests it.

The types of cases that may be analysed by the competition authorities involve:⁸³

- Tenders issued by state owned enterprises or productive state companies, as well as for public assets that are under divestiture process.
- Tenders of instruments that represent equity of a commercial corporation owned, directly or indirectly, by the federal government in more than 10 per cent.
- Tenders for granting contracts, concessions and permits, when the corresponding authority substantiates the reasons for the intervention of the competition authority.
- Transfer of contracts, concessions or permits, as well as acquisition and sale of instruments that represent equity of a commercial corporation that owns a concession or a permit.
- Granting of concessions for the provision of public services, including amongst other, comprehensive port administrators, maritime ports and harbour, airport, railroad, domestic air transport facilities, as well as transfer of the rights of such concessions.

⁸⁰ See OECD (2011a), OECD (2011b) and OECD (2015d).

⁸¹ See *Ibid.*

⁸² See Article 98 of the FECL.

⁸³ See Article 111 of the FECLRP.

- Granting of transportation, storage and distribution permits of natural gas, as well as for the pipeline transportation of liquefied petroleum gas.
- Tenders of contracts of electrical energy purchase and sale, as well as for generation capacity commitments related to productive state companies, its subsidiaries and affiliates.
- Any other equivalent issue when the corresponding authority substantiates the intervention of the competition authority.

3.6 Opening of a market study

Market studies are an advocacy tool that competition authorities can use to identify restrictions to competition. As mentioned in the previous section, the Ministry of Economy, as well as any other government body, may request the competition authorities to carry out a market study.⁸⁴

⁸⁴ See Subsection XXIII of Article 12 of the FECL.

4. Framework for a market examination

The manual is neither a legal nor a binding document, neither for the Ministry nor for any other public entity, but rather a tool intended to provide a general framework to conduct case-specific market examinations, to obtain any of the outcomes described in section 2.⁸⁵

This section provides the general methodological and theoretical guidance for making market examinations. It draws on the experience of international best practices and relies on economic theory to provide a framework that allows understanding a market and for explaining and giving meaning to suspected problems – for example, anti-competitive effects caused by government action or market participants' conduct.

Economics is at the root of all market examinations, providing the conceptual framework to analyse the functioning of markets.

The framework provided in this manual does not represent a comprehensive list of all economic theories or qualitative and quantitative tools that may be used in market examinations.

Since this framework has the aim to serve economists and lawyers involved in market examinations, it tries to avoid technical language, and detailed mathematical aspects are referred to in the appendices of this manual.

Moreover, the types of markets examined by the Ministry may be very different, making it impossible to cover in this manual all issues that may be encountered during an examination. Therefore, it is recommended that these examinations are conducted on a case-by-case basis applying only the guidance of this manual that may be applicable.

When there is a suspicion that a market is not functioning well the origin of the problem may lie in structural, conduct or regulatory features, or a combination of all, affecting its performance.⁸⁶

Structural features of a market refer to the environment in which market participants operate. In this manual, such features include the level of market concentration, the degree of differentiation, vertical integration, conditions of entry, exit and expansion, economies of scale and scope, information asymmetries, switching costs and the degree of buying power.⁸⁷

⁸⁵ Market examinations may support the work of the Ministry in the enforcement of the regulatory framework related to industrial policy. For example, markets assessed may result in the identification of regulation or standards that restrict competition or features that restrict small, medium and micro business development.

⁸⁶ This section provides the relevant features to be considered when conducting a market examination. These features shall not be taken as an exhaustive list. The use of these and other factors shall be carefully assessed on a case-by-case basis.

⁸⁷ See Competition Commission (2013), p. 36 and see Bain (1962) for product differentiation as a structural feature. This information is based on the international experience of the United Kingdom and does not

Conduct refers to the behaviour and practices of market participants. The conduct that may harm competition, intentionally or inadvertently, is related to, but not exhaustively, that exerted by oligopolists, or facilitation of horizontal co-ordination, or involvement in vertical agreements (downstream or upstream), or industry or consumer practices or strategic reaction to regulation.⁸⁸

*Regulatory features*⁸⁹ of a market refer to the diverse set of instruments which governments at all levels implement. Regulation affects industry structure making it more concentrated by imposing barriers to entry; affects the conduct of market participants by creating incentives for acting strategically, for example by facilitating co-ordination; and regulation may also affect the behaviour of consumers by creating switching costs from one supplier to another.

When market examinations suggest that adverse effects on competition exist, this manual offers assistance in developing theories of harm that state the circumstances in which the adverse effects originate in the market. Theories of harm may, or may not, be included in a request of the Ministry of Economy supporting the need of a competition authority, or other public authority, to intervene in a market that appears not to be functioning well.

Before presenting the methodological and theoretical guidance for conducting market examinations it is important to highlight that for initiating an examination a market (or markets) shall be selected. The manual's framework does not focus on selection issues. For such purpose it is recommended to consult international best practice in this matter.⁹⁰

4.1 Gathering and handling of information

A market examination depends, to a great extent, on the type, amount and quality of the data and information obtained on the market (or related markets) and its participants.⁹¹

The manual's methodological framework begins by explaining ways in which data and information may be gathered and handled.

constitute an exhaustive list. Other features that could be assessed are the existence of multiple sided markets or network effects, which are not covered in this edition of the manual.

⁸⁸ See Competition Commission (2013), p. 36 and 37. This information is based on the international experience of the United Kingdom and does not constitute an exhaustive list.

⁸⁹ See Section of key definitions and terminology of this manual. Regulation includes laws, formal or informal orders and subordinate rules, and rules issued by non-government or self-regulatory bodies.

⁹⁰ See OECD (2015a), and ICN (2012).

⁹¹ See Competition Commission (2003), for international best practices on the general principles that apply across a range of submissions of technical economic analysis from parties to the Competition Authority. These general principles are: clarity and transparency, completeness, and replication of results. This information is based on the international experience of the United Kingdom and does not constitute an exhaustive list.

Data and information may be obtained from many different sources:⁹²

- Internal (e.g. administrative information generated or in possession by the Ministry of Economy).
- Public (e.g. specialised literature, webpages, pamphlets, information of public authorities, etc.).
- Specific of business and professional associations (e.g. sector or industry data produced by these associations or by public authorities – such as sectoral regulators and Ministries).
- Specific of consumer organisations (e.g. complaints, sector or industry data produced by these organisations).
- International organisations (e.g. from the OECD, World Bank, ICN, etc.).
- Other public authorities, national or international (e.g. public information, administrative data generated or in possession by these authorities).
- External experts, national or international (e.g. academia or industry consultants).

Some means for obtaining data and information are:⁹³

- Desk research (e.g. literature review, internet search, telephone calls, statistical analysis, etc.).
- Questionnaires (e.g. applied to market participants, external experts, etc.).
- Workshops (e.g. for discussing market issues with market participants, public officials and external experts).
- Meetings or interviews (e.g. with market participants, investors, public officials, external experts, consumers, etc.).
- Commissioning of surveys and focused groups (e.g. to specialised market consultants).

Obtained data and information may be classified as:⁹⁴

- *Empirical* – which is highly desired due to its evidential rigour, whenever feasible to obtain.
- *Anecdotal* – which is useful but less reliable than empirical data.

Stakeholder engagement during the data and information gathering stage, when feasible, may provide good anecdotal and empirical data.⁹⁵

Handling of data and information by the Ministry of Economy when conducting a market examination shall be based on its internal rules for handling information, as well as on the Federal Transparency and Access to Public Information Law (FTAPIL). Particular care must be taken with confidential or reserved information classified by the Ministry of Economy according to the FTAPIL and its internal rules.

⁹² See ICN (2012), for international good practice on information collection and analysis.

⁹³ See *Ibid.*

⁹⁴ See *Ibid.*

⁹⁵ See *Ibid.*

Market data and information is crucial to produce robust findings on any market problem and its possible remedies. The following sections provide guidance on the use of this information to delineate the market to be examined, determine its market characteristics, analyse in general terms its competitive process and its outcomes, and to develop possible theories of harm.

4.2 Examined market

Market means a closely interrelated group of suppliers and buyers, defined as a set of suppliers of close-substitute output who sell to a common group of buyers situated in a geographical area.⁹⁶ Therefore, when delineating a market, it is important to describe it in at least two dimensions, the product market and the geographic market.

Market definition is one of the most important analytical tools available to the competition authorities to examine and evaluate the competitive constraints that a market participant faces and the impact of its behaviour on competition.⁹⁷ Therefore, the methodological and theoretical guidance provided in this manual is based on the principles of this definition. However, this guidance does not have the aim to define markets but rather to support in the establishment of the product and geographical dimensions of the market that will be examined.⁹⁸

Examined markets will be defined in a way such that the competitive constraints a market participant faces, e.g. demand and supply side substitution, are captured as accurately as possible.⁹⁹

As mentioned above, product and geographic dimensions shall be identified when delineating markets.¹⁰⁰ In addition, the market participants of the market to be examined shall be as clearly as possible identified.

It is common practices to start with product market delineation and then continue with its geographic demarcation.

Temporal dimensions may also be considered when defining markets. This dimension may be included when customers are not able to substitute products between periods.¹⁰¹

⁹⁶ See Bain (1962), pp. 7-8.

⁹⁷ See Article 58 of the FECL for the criteria that must be considered for determining the relevant market. See OECD (2012a) for international best practice on the use of this analytical tool.

⁹⁸ References made hereinafter in the manual to the FECL and its FECLRP related to relevant market definition are intended to illustrate that the methodological and analytical framework used by the Ministry, or any other public authority, or market participant, when conducting market examinations that may lead to a request to a competition authority, is aligned to these legal provisions. Moreover, public authorities or market participants may propose a market definition but the legal definition of a market may only be carried out by the competition authorities.

⁹⁹ See *Ibid.*, and OECD (2012a). Article 5 of the FECLRP establishes that relevant markets shall be analysed based on the particular circumstances of each case. See also Davis and Garcés (2009), p. 161, the use of any of the analytical tools presented in this section to delineate markets shall be analysed on a case-by-case basis.

¹⁰⁰ See OECD (2012a) and Competition Commission (2013).

¹⁰¹ For example in services with schedules as may be the case of air transport services, or as in the provision of electricity.

4.2.1 *Product dimension*¹⁰²

- *Product markets* are determined by the empirical question of substitutability¹⁰³ of products, as well as on relative price levels.¹⁰⁴
- *Demand substitutability* considers the degree in which customers respond to a change in relative prices (or quality or availability or other characteristics) by substituting away to alternative products.¹⁰⁵ See a hypothetical example of demand substitutability in Appendix A.
- *Supply substitutability* considers the degree in which suppliers of alternative products could switch their production facilities in response to a change in relative prices (demand or other market conditions).¹⁰⁶ See a hypothetical example of supply substitutability in Appendix A.

Substitutability may be different in the short and long run.¹⁰⁷

- *Short run* analysis is based on substitutability between existing products (or areas).
- *Long run* considers an improvement in market participants' product portfolio (or extending the geographical scope of their operations). This analysis includes the identification of market participants that are capable to introduce substitutes (or open new areas).

Sometimes the existence of an aftermarket (or secondary market) shall be considered when delineating a market. Aftermarkets are those in which the secondary product is purchased only because a buyer has purchased a primary product. Secondary and primary products may be considered in the same market when buyers purchase a primary product after considering the cost of the secondary product.¹⁰⁸

¹⁰² See Article 5 of the FECLRP, which establishes that produced, distributed, sold or offered products and services, as well as their substitutes or likely substitutes, shall be determined when defining a relevant market.

¹⁰³ See Subsection I of Article 58 of the FECL that states that substitutability may consider products or services of national or foreign origin, considering the technological capabilities, which consumers may count as substitutes, and the time required to substitute them. See also Davis and Garcés (2009), for treatment of potential entrants as a source of supply substitutability for market definition purposes.

¹⁰⁴ See ICN (2006).

¹⁰⁵ Or alternative locations in the case of geographic market definition. See Article 58 of the FECL; this law places an emphasis on demand substitutability.

¹⁰⁶ A supply substitutability approach may be used with care in order to avoid altering market shares as a result of overestimating productive capacity. See also European Commission (1997). When supply substitutability entails the need to adjust significantly existing tangible assets, additional investments, strategic decisions or time delays, the European Commission will not consider this type of substitutability at the stage of market definition. In these cases, the effects of supply substitutability are examined at a later stage.

¹⁰⁷ See Competition Commission (2013), p. 31. See *Nestlé/Perrier case* example in Appendix A for a brief illustration of short and long run considerations.

¹⁰⁸ See *Ibid.* See short example in Appendix A.

Box 1 provides an example of the information that may be used when determining the product dimension.¹⁰⁹

Box 1. Information that may be considered when determining the product dimension

- Product characteristics (e.g. physical properties, intended use which can indicate similarities between different products).¹¹⁰
- Relative price levels of products (of the candidate markets).¹¹¹
- Prices and sales volumes over time or across areas that allow for the analysis of the ways customers can respond to price changes or for the entrance or exit of suppliers into the market.
- Information about customer behaviour (e.g. obtained from customers, competitors and third parties).
- Suppliers' views of the products (e.g. obtained from internal documents, such as marketing studies, consumer surveys, market analysis for investors, internal business analysis, etc.).

There are several, qualitative and quantitative, methods and tests for identifying substitutes. The application of any method requires the identification of the effective substitutes of the product.

Qualitative methods include interviews to suppliers who claim knowing their customers as well as their potential competitors in other markets, and the assessment of the extent to which customers' view products as functional substitutes, the latter often carried out through a survey.¹¹²

Quantitative methods, when possible to use, shall be a supplement to qualitative methods.¹¹³ Several quantitative methods use price information for market definition.¹¹⁴ Some commonly used quantitative methods focus on: cross-price elasticity, price correlations, diversion ratios, and the critical loss analysis.¹¹⁵

¹⁰⁹ See *Ibid.* This is the information that the competition authority of the United Kingdom may use when defining a product market.

¹¹⁰ Other characteristics may be the production process, commercialisation channels, physical and chemical properties as well as intended use and function.

¹¹¹ Determination of a candidate market is explained in Appendix D.

¹¹² See Davis and Garcés (2009), p. 167. Qualitative assessments include the evaluation of various product characteristics and the uses to which consumers put the product.

¹¹³ These methods are mainly based on numerical data or nominal or ordinal variables that can be used in descriptive and inferential statistics, multivariate analysis or significance tests.

¹¹⁴ However it is important to note that suppliers may also compete in other dimensions, such as quality, quantity, service, marketing, or innovation. So it is recommended that markets are analysed in those terms also, rather than on price alone.

¹¹⁵ See OECD (2012a), for information about other types of quantitative methods, e.g. pricing pressure indices such as Upward Pricing Pressure (UPP), Gross Upward Price Pressure Index (GUPPI) and Illustrative Price Rise (IPR) and tests (e.g. FERM test). See also Motta (2004) for other type of tools (e.g. own price elasticity and price differences) and other type of (e.g. temporal, seasonal, multiple or secondary (or after)) markets.

Tests such as the hypothetical monopolist test and the (Small but Significant and Non-transitory Increase in Prices) SSNIP are theoretical approaches, typically known for guiding the analysis of market definition in both the product and geographic dimensions.¹¹⁶

When setting the boundaries of the markets to be examined, special consideration is needed to avoid the risk of delineating markets, either too narrowly or too broadly. In some cases, if the market is delineated too narrowly, the assessor may incorrectly view a market participant as holding substantial market power, whereas in some cases of broadly defined markets, the assessor may view market participants as holding less market power than they actually have.¹¹⁷

Cross-price elasticity represents the percentage change in quantity demanded for a product in response to a certain change in the price of another product. See how to calculate this elasticity in Appendix B.

Price correlation between substitutes is a statistical measure that examines how closely their prices move together, across time or space.¹¹⁸ For a hypothetical example of an interpretation of this tool see Appendix B.

Diversion ratios are used to identify the effects of a price increase of a product. Expected effects are the loss of sales of the product and the increase of sales of another product.¹¹⁹ For further detail of this method see Appendix C.

Another analytical method often used¹²⁰ for analysing substitutability considers the narrowest candidate market definition by assuming a hypothetical monopoly supplier.

The *Hypothetical monopolist test* analyses the degree to which customers could and would switch among substitutes if a (hypothetical) monopoly supplier, not subject to price regulation, maximises its profits by consistently charging higher prices. The test is described in terms of price, because it tests whether the aforementioned supplier would be able to exploit its market power, that is, to raise prices of products inside the candidate market by a small but significant amount. The *SSNIP* is a methodological tool of the hypothetical monopolist test, where substitution by customers would prevent the hypothetical monopolist from imposing the small, but significant non-transitory increase in price. A common benchmark used for the size of the small but significant non-transitory increase in price is 5 – 10 per cent.¹²¹ See Appendix D for further detail about the hypothetical monopolist test and SSNIP and Appendix E for caveats of this tool when assessing market power.

¹¹⁶ See Motta (2004), p. 102.

¹¹⁷ See Cellophane Fallacy in Appendix E.

¹¹⁸ See Davis and Garcés (2009), pp. 170-184. Correlation methods have several limitations (e.g. false positives or negatives, spurious correlations and non-stationarity, which may lead to wrong conclusions. See also Carlton and Perloff (1994), p. 108. There are no correlation standards that determine if two products are in the same market. Also, high correlations may not imply that two products are in the same market.

¹¹⁹ See OECD (2012a), p 12. International experience illustrates the difficulties of competition authorities in collecting robust and accurate information on diversion ratios. Nonetheless, the limited empirical literature available indicates that this measurement, as an indication of pricing pressure, performs reasonably well.

¹²⁰ See OECD (2012a) and ICN (2006). Often used by most of the competition authorities around the world.

¹²¹ See *Ibid.*

It is useful to rely on qualitative and quantitative information when applying the hypothetical monopolist test and the SSNIP. See Box 2 for an example of the information used when considering customers' likely responses to higher prices.¹²²

Box 2. Information that may be considered when applying the hypothetical monopolist test and the SSNIP

The information considered includes but is not limited to:

- Information on how customers have switched in the past in response to price changes (or other terms and conditions).
- Information from buyers related to how they would respond to price changes (e.g. from surveys).
- Industry participants' conduct, such as:
 - Business documents or decisions concerning knowledge or belief about consumers' response to price changes.
 - Tracking and response of price changes by some or all competitors.
- Objective information about product characteristics and switching costs, especially from switching within the candidate market and outside it.
- Information of sales lost by one product in the candidate market.
- Evidence from other industry participants (e.g. aftermarket products).
- Legal or regulatory requirements.

Critical loss analysis is a break-even analysis that focuses on answering if imposing at least a SSNIP on one or more of the products in the candidate markets would raise or lower the hypothetical monopolists' profits. It considers the volume of demand that has to be lost in response to an increase in price in order for this price increase to be unprofitable. Therefore, the critical elasticity indicates the maximum value of the price elasticity of demand that induces a hypothetical profit-maximising monopolists to increase the price.¹²³ This analysis complements the hypothetical monopolist test with an assessment of the profit margin made by the monopolists. See Appendix E for further detail about this analytical tool.

4.2.2 *Geographic dimension*¹²⁴

Most of the tools and considerations presented in section 4.2.1 hold good for delineating geographic markets because they too consider the degree of substitutability.

¹²² See US DOJ and FTC (2010), this is the information that the US competition authorities may consider when applying this test.

¹²³ See OECD (2012a), p. 36.

¹²⁴ See Article 5 of the FECLRP, which establishes that the geographic area in which goods or services are demanded or supplied, as well as the identification of other suppliers and customers in the same region (without significant cost to reach them within the area) shall be determined when defining a relevant market.

Geographic markets are delineated by the willingness or ability of consumers to substitute a product in another geographic location, or when geography limits suppliers' willingness or ability to serve customers. Geographic markets may be local, regional, national or international.

The boundaries of geographic markets are often a function of transportation costs, and other factors such as regulation, tariff and non-tariff trade barriers, reputation, familiarity, traditions, service availability and language.^{125 126}

Box 3 provides an example of the information that may be used when delineating geographic markets.¹²⁷

Box 3. Information that may be considered for delineating geographic markets

Supplier-based markets:

- Catchment areas from which the majority of suppliers' customers are caught.
- Differences in pricing, sales, advertising, and marketing strategies by candidate market area.
- Suppliers that customers consider to be substitutes for each other.
- Natural experiments that show the effect on a supplier's sales due to entry, exit or expansion of a nearby supplier.

Customer-based markets:

- Product characteristics (e.g. perishability).
- Differences in pricing, sales, advertising and marketing strategies by area.
- Information that allows for the estimation of switching costs that customers may incur when changing to products from other geographic areas.
- Flows of products between regions or into the country, and barriers to entry.
- Price correlation among catchment areas.

¹²⁵ See Subsection II of Article 58 of the FECL, which establishes that when defining relevant markets the following transportation costs shall be considered: of the good itself, its relevant inputs, its complements and substitutes from other regions and from abroad, considering freight, insurance, tariffs and non-tariff restrictions, restrictions imposed by market participants or their trade associations and the time required to supply the market from these regions. Subsection IV of the same Article establishes that federal, local or international normative restrictions that limit access by customers to alternative suppliers, or access of suppliers to alternative customers shall be considered in the analysis of product and geographic market definition.

¹²⁶ See US DOJ and FTC. (2010), for international best practices in the delineation of geographic markets.

¹²⁷ See Competition Commission (2013), this is the information that the competition authority of the United Kingdom may consider when defining geographic markets.

Shipment test may be used for delineating a geographic market based on shipment data.¹²⁸ This test is divided in two components. The first component considers a candidate market area in which nearly all purchases come from within the candidate market and a very small part comes from imports. This test is known as the LIFO, *little in from outside*. The second test is known as LOFI, *little out from inside*, and considers a candidate market area in which nearly all local production goes to the area, and only a small part is exported. The combined test, LIFO plus LOFI, has the purpose of expanding the candidate market area until the supply (LOFI) and the demand (LIFO) sides of the test are satisfied, that is, until there is little movement of the product from and to other geographical areas.¹²⁹ See Appendix F for details on the implementation of this test.

Geographic markets may also be delineated in the absence or presence of price discrimination.

- *Absence of price discrimination based on the location of suppliers* applies when customers receive products at the suppliers' locations. In this case, customers of these suppliers may be located outside the boundaries of the geographic market. Hypothetical monopolist test and the SSNIP are also used to delineate the geographic market. These require a monopolist who is the only present and future supplier of the product(s) located in the region that would impose at least a SSNIP in it.
- *Price discrimination based on customer location* is assessed when suppliers deliver their products to customers' locations. Therefore, the suppliers that sell in the determined geographic market may be located outside it. Hypothetical monopolist test and the SSNIP are also useful in these cases. These tests require a monopolist who is the only present and future supplier of the product(s) located in the region that would impose at least a SSNIP to some customers in the region.

See Box 4 for an example of the information used when considering customers' likely responses to higher prices in the geographic market.¹³⁰

The delineation of a market allows the analysis of its structural, regulatory and conduct features, as well as the effects of these features on competition.¹³¹ When these features are present in a similar way across different markets, grouping these markets together, and analysing them as a whole, may be considered. Also, it may be worth to analyse downstream or upstream markets (neighbouring markets) when effects in them are suspected as a result of harm to competition in the examined market.¹³²

¹²⁸ See Elzinga and Hogarty (1973) and Davis and Garcés (2009).

¹²⁹ See Motta (2004). It is suggested to carefully interpret the results of this test as they could be biased. See Davis and Garcés (2009).

¹³⁰ See US DOJ and FTC (2010), this is the information that the US competition authorities may consider.

¹³¹ However, when conducting this analysis, competition restrictions coming from outside the examined market may also be assessed.

¹³² Upstream markets refer to the wholesale markets or to the suppliers of inputs, downstream markets refer to distributors and retailers.

Box 4. Information that may be considered when delineating a geographic market

The information considered includes but is not limited to:

- Information that shows how in response to a price increase, customers have shifted in the past between different geographic locations.
- The costs a customer faces when traveling to a supplier's location in relation to the price of the product.
- The costs of transporting the product in relation to its price.
- The costs a customer faces when switching from suppliers within and outside the geographic market.¹³³
- If suppliers need a presence near the customer to provide support or service.
- Information about the suppliers' knowledge on the likely of customers switching between geographic locations in response to a change in price.
- Effect of downstream competition faced by customers in their output markets.

4.3 Market characteristics

The examination of the delineated market may start with an overview of the market characteristics that determine the relations among suppliers (actual and potential), among buyers, and between suppliers and buyers.¹³⁴

Market characteristics help to understand how a market operates and provide an indication of how competitive it is. Market characteristics commonly analysed are market participants, market power and market outcomes.¹³⁵

Other characteristics used on a case-by-case basis are:¹³⁶

- Nature and characteristics of the product, and those of any (potential) substitutes.
- Nature of customer base (buyers of other market participants or end/consumers, their demographic profile, and the extent to which they are informed about the product in question).
- Industry practice (e.g. how prices are set, marketing practices, etc.).
- History of the market and its recent competitive developments.

Market participants of the examined market are those that earn (or potentially earn) revenues in it.¹³⁷ Suppliers of the same product in other geographic markets that may be rapid entrants, and not

¹³³ See *Ibid.* Also, Subsection III of Article 58 of the FECL establishes that the costs and likelihood of customers to switch to other markets shall be assessed also.

¹³⁴ Market characteristics are understood as indicators and shall be complemented with the analysis of structural, regulatory and conduct features of the market(s) examined.

¹³⁵ See Competition Commission (2013) and US DOJ and FTC (2010) for further guidance.

¹³⁶ See Competition Commission (2013), for other characteristics that may be analysed by the competition authority of the United Kingdom.

current producers in the examined market, but who are likely to provide a rapid supply, without incurring in significant costs, in response of a SSNIP, are also considered market participants of the examined market. Recent behaviour of the market participants shall be analysed.¹³⁸

4.3.1 *Market power*¹³⁹

The delineation of a market allows conducting a focalised examination of its structural and regulatory features. This examination could include a general evaluation of the possible existence, creation or strengthening of *market power* – of one or several market participants, which could be determined through their market shares and their ability to unilaterally fix prices or restrict supply, without competitors being actually or potentially able to counter balance such power – in the market examined.¹⁴⁰

Characteristics that may be commonly used for analysing single or joint market power are market shares, conditions of entry and expansion, concentration, buyer power, and the similar conduct of a group of firms.¹⁴¹

Market shares give a picture of the relative competitive positions of market participants. It would be expected that a monopoly that has 100 per cent of the market has the highest possible market power. Conversely, it would be expected that a small firm that has a minor share of the market will not be able to have and exercise market power. However, having a high market share is not enough to conclude that a market participant has substantial market power, since it may be restrained on its ability of setting high prices, for example – if entry in the industry were very easy or if there were strong buyer power.¹⁴²

¹³⁷ Near future potential entrants are included. Also, when relevant, vertically integrated market participants may be included.

¹³⁸ See Subsection V of Article 59 of the FECL.

¹³⁹ See Article 8 of the FECLRP; for establishing if one or more market participants have substantial market power in the relevant market the following criteria may be considered: (i) positioning level of the good or service in the relevant market; (ii) lack of access to imports or the existence of high internalisation costs; and (iii) the existence of differential high costs that consumers may face when going to other suppliers. For establishing if two or more market participants have joint dominance the competition authorities may consider the following: (i) if market participants are distinguished from the rest in the relevant market, considering factors that facilitate common incentives or independent strategic behaviour; or (ii) market participants show similar behaviour.

¹⁴⁰ See Subsection I of Article 59 of the FECL.

¹⁴¹ See Motta (2004) and Carlton and Perloff (1994). These characteristics are an indirect approach of assessing market power. Direct quantitative techniques to assess market power involve the estimation of residual demand elasticities and the use of logit demand models. These techniques are not described in this manual but can be reviewed in Motta (2004). See also Article 9 of the FECLRP, which provides the considerations that must be covered for determining if two or more independent market participants between them have joint market power, as provided in Subsection VI of Article 59 of the FECL.

¹⁴² See Motta (2004). See OECD (1996), on the joint market power or joint dominance applied in the European Union, Canada, Australia and other jurisdictions. It is assumed to be different from an agreement and is intended to deal with the “oligopoly problem,” e.g., independent firms’ strategic interaction. In this case, the market share indicia of joint dominance may not be the same as the market share indicia of a single firm dominance.

There are several sources that can be used to derive market shares. “In practice, market shares, in particular for heterogeneous products, are most often defined in value terms, expressed by turnover.”¹⁴³ Data periods are determined on a case-by-case basis (usually annual data or for longer periods), for the purposes of measuring market shares.¹⁴⁴

The following considerations may be kept in mind when analysing market shares:¹⁴⁵

- *Existing reserves* of crucial inputs that may limit production.¹⁴⁶ Market shares will need to be carefully assessed when existing reserves are limited. For example – when analysing a mining industry in which a market participant has a market share of 30 per cent, but will exhaust its mining reserves in the near future.
- *Unlikely future significance* of a relevant market participant may happen when it uses older or less efficient technology or for other reasons (e.g. expiration of patents). Therefore, as in the previous case, the inclusion of such a market participant in the market power analysis shall be carefully assessed.
- *Capacity* of each market participant over the total industry capacity may be relevant information. For example, when a market participant’s capacity is just enough to satisfy its current sales, its ability to react to an increase in prices is very low. Conversely, when a market participant has excess of capacity it may reduce the market power of another participant.
- *Supply substitution* may be estimated based on the capacity of market participants to supply the market not currently selling their products in the examined market.
- *Infrequent (large) orders* made by a small number of buyers, for example in bidding markets where government places one or few large orders that might represent a considerable portion of the period’s sales of an industry. In these cases there may be a large variance in market shares over a small period. Therefore market shares shall be calculated over a relatively long period of three to five years.
- *Patterns* of sales that persist over time give a strong indication of an industry’s competitive situation.
- *Recognition* of the product in the market.¹⁴⁷

Conditions of entry and expansion provide information on the significance of the ability of actual or potential competitors to constrain the ability of a market participant to raise prices. Even if a market

¹⁴³ See ICN (2006-2007), and Subsection II of Article 59 of the FECL establishes that market shares may be determined through sales, number of clients and productive capacity, as well as any other indicator deemed useful. See COFECE (2015d) which provides that market shares are understood as the percentages that market participants have in the relevant market, considering data of sales, number of clients, productive capacity and other variables deemed pertinent by COFECE.

¹⁴⁴ See Competition Commission (2013), for reference of the United Kingdom’s experience.

¹⁴⁵ See Motta (2004) for further explanation about these considerations.

¹⁴⁶ See Subsection IV of Article 59, which provides the analysis of possible access of market participants to input sources.

¹⁴⁷ See Subsection I of Article 8 of the FECLRP.

participant has a high market share, this may not be an indicative of a durable market power if entry or expansion may be rapid, profitable and barriers were low.¹⁴⁸

Entry analysis provides information on the likely impact of potential entrants that may constrain the ability of a market participant to raise prices.

Expansion analysis provides information on the likely impact of the growth of active market participants.

The conditions of entry and expansion are commonly assessed in light of:¹⁴⁹

- Economies of scope or scale, or both.¹⁵⁰
- Scarce natural resources that are necessary inputs.
- Technical capability.
- Historical reputation of market participants.¹⁵¹
- Investment in excess capacity.
- Duration, termination, and renewal provisions in existing contracts.
- Restrictions of public policy or regulation that may limit the number or range of suppliers, limit the ability of suppliers to compete, reduce the incentive of suppliers to compete, and limit the choices and information available to consumers.¹⁵²
- Whether entry or expansion may occur in a timely manner or eventually.¹⁵³
- The scope and scale of entry or expansion.
- Access to and cost of imports.¹⁵⁴

Concentration is often measured as a function of market shares of the market participants.

¹⁴⁸ See ICN (2006-2007) and Subsection II of the Article 59 of the FECL, which establish that the existence of entry barriers and any other elements that may modify such barriers and the supply of other market participants shall be considered when assessing market power.

¹⁴⁹ See *Ibid.*

¹⁵⁰ See OECD (2011b), p. 25. Economies of scale arise when the overhead costs are high. This allows for greater scale of production leading to lower average costs per unit produced. Economies of scope are those in which it is less costly for one firm to produce different products or services as compared to the products being produced by separate specialised market participants.

¹⁵¹ See Motta (2004), for example, when a market leader has consistently priced aggressively whenever new competitors have entered the industry.

¹⁵² See OECD (2011a), OECD (2011b) and OECD (2015d).

¹⁵³ See OECD (2005). In general, the international benchmark for the timeliness is flexible, but the ordinary criterion is that entry must occur within two years to be considered timely.

¹⁵⁴ See Subsection II of Article 8 of the FECLRP.

Concentration ratio (CR) is a parameter that measures the share of industry sales accounted for by the selected number of largest market participants.¹⁵⁵ This measure is the sum of the market shares of the selected (four, five, etc.) number of largest market participants and does not provide information on the relative size of the market participant nor give any information about smaller market participants.¹⁵⁶ Other concentration ratios include the Lerner Index and the Herfindahl-Hirschman Index (HHI).¹⁵⁷ The Lerner Index can be calculated as a measure of market power; it indicates that the margin of a market participant will be greater as the price elasticity of the demand is smaller.¹⁵⁸ See Appendix G for further details.¹⁵⁹

The *Herfindahl-Hirschman Index* of concentration equals the sum of the squared market shares of each firm in the industry. The index is useful to the extent there is a direct relationship between the degree of industrial concentration and the average degree of market power.¹⁶⁰ See Appendix G for further details.

Buyer power occurs when buyers can offset the power of suppliers.¹⁶¹ A market participant may easily exert market power when it faces a large and atomistic demand and customers face high switching

¹⁵⁵ See Carlton and Perloff (1994) for further explanation about the CR.

¹⁵⁶ See COFECE (2015d). Based on the merger cases assessed by COFECE, this authority has considered adequate the use of this parameter in cases where the absolute value of the HHI is between 2,000 and 2,500 points and its variation falls within 100 and 150 points.

¹⁵⁷ See COFECE (2015d). COFECE considers that a merger will have a small likelihood to restrict, diminish, damage or impede competition in the relevant market when the HHI is less than 2000 points and the variation is less than 100 points; or when the HHI is between 2000 and 2500 points, its variation is between 100 and 150 points, and the market participant is not among the four market participants with the highest market shares.

¹⁵⁸ See Ibid. COFECE agreed to abandon the use of this index because it is a measure of asymmetry between market participants that does not have a clear link with economic theory, because it may underestimate risks that may harm competition in cases where transactions may increase in an important manner the levels of concentration in a market and reduce the number of competitors.

¹⁵⁹ See Motta (2004). See paragraph 140, the HHI and the sum of weighted Lerner indexes, assuming cost linearity, are two sides of the same condition. The HHI is a weighted measure of market power in an industry. The Lerner index, analysed individually is a measure of the market power of a market participant and depends on its participation in the market together with the elasticity of the market demand. The ratio of the market share and the elasticity of demand is called the elasticity of the residual demand.

¹⁶⁰ See OECD (2007c). The HHI is motivated by the Cournot model. “*The Cournot model of oligopoly assumes that rival firms produce a homogenous product, and each attempts to maximise profits by choosing how much to produce. All firms choose output (quantity) simultaneously. The basic Cournot assumption is that each firm chooses its quantity taking as given the quantity of its rivals. The resulting equilibrium in quantities is called a Cournot equilibrium. The degree to which each firm’s price exceeds marginal cost is directly proportional to the firm’s market share and inversely proportional to the market elasticity of demand. If the oligopoly is symmetric, that is, all firms have identical products and cost conditions, then the degree to which price exceeds marginal cost is inversely related to the number of firms. Thus, as the number of firms increases, the equilibrium approaches what it would be under perfect competition. More generally, it can be shown that for the industry the degree to which price exceeds marginal cost is directly proportional to the Herfindahl-Hirschman Index of concentration. As concentration rises, industry performance deviates more from the norm of perfect competition.*”

¹⁶¹ See Carlton and Perloff (1994)

costs. Conversely, a strong buyer can make use of its bargaining power to promote competition among suppliers, for example by sponsoring entry of a new supplier.¹⁶²

Joint market power occurs when at least two market participants stand out from other participants in the examined market. Criteria for identifying such participants include common incentives or strategic or interdependent behaviour that displays similar action.¹⁶³

4.3.2 Market outcomes

Market outcomes are indicators that provide evidence about how the market is functioning. This section of the manual will focus in explaining some useful indicators of the competitive process – these are competition itself, price, profitability, quality and innovation.¹⁶⁴

Under perfect *competition* market participants produce homogeneous, perfectly divisible output, there is free entry and exit from the market, there is a large number of suppliers and consumers, suppliers and customers have full information, incur in no transaction costs, are price takers, and there are no externalities. Even though this type of market outcome is rarely seen in the real world, it provides the theoretical benchmark against which markets can be compared.¹⁶⁵

In perfectly competitive markets efficiency comes from within the market through its market participants, from participants that could readily enter the market, and from customers. In these markets, no market participant can charge a price above the market price without losing all its customers. Therefore, price is also a market outcome that helps reflect the nature of competition in the market. Economic profit is commonly examined in such a market as a quantitative indicator described in this section as profitability. Qualitative indicators may also be assessed as market outcomes; in this manual only quality and innovation are briefly described.¹⁶⁶

These quantitative and qualitative indicators need to be carefully analysed on a case-by-case basis since they may vary according to the particular circumstances of the industry.

Prices in the examined market are observable and measurable outcomes that may be useful for analysing the extent of competition in a market.¹⁶⁷ Under competition conditions, market participants may try to win customers by, among other strategies, improving prices. Therefore, patterns of price overtime may indicate the nature of competition in the market. In the absence of other explanatory factors, such as external shocks or cost increases, price patterns can help to identify if a market is a well-functioning market or conversely, if there is a lack of competition in it.¹⁶⁸

¹⁶² See Motta (2004) for further explanation about buying power.

¹⁶³ See Subsections I and II of Article 9 of the FECLRP.

¹⁶⁴ See Competition Commission (2003). This information is based on the international experience of the United Kingdom and does not constitute an exhaustive list.

¹⁶⁵ See Carlton and Perloff (1994)

¹⁶⁶ See Competition Commission (2013), for other qualitative outcomes that may be assessed.

¹⁶⁷ See OECD (2011d), for international best practice when assessing prices.

¹⁶⁸ See Competition Commission (2013) p. 26.

Usually prices and costs are analysed together because these explain price changes over time or in different geographic markets.¹⁶⁹ A measure that associates both variables is the price-cost margin or Lerner Index.¹⁷⁰ Since vigorous competition may induce market participants to price towards marginal cost, patterns of Lerner Index across time, geographic markets and customer segments may, for example – indicate (un)willingness or (in)ability of customers to switch.

Price comparisons with other markets of identical or similar products in other countries may be a useful hint to understand how a market is functioning.

The extent to which prices respond to changes in costs, and if these costs are in an efficient level, has a direct effect on market participants' profits.

Profitability is the objective of any market participant. Profitability is often measured in terms of rate of return on capital. However, this measure greatly depends on data availability of the market participants – accounting data is often used for this measure. Also, the profitability measure may be informed by data produced by industry participants, analysts, or investors for the purpose of monitoring and reporting performance. The type of information used will also depend on the nature of the industry, as well as its growth over a period.¹⁷¹

Economic theory suggests that under perfect competition, an efficient market participant will only be able to earn a *normal-economic profit*. That is, its rate of return on invested capital for a particular business activity shall be equal to its cost of capital for that activity. Evenly, in perfectly competitive markets, prices should be equal to the marginal cost of production of an efficient firm leaving rightful economic rents to more efficient ones.¹⁷²

Profitability analysis may indicate restrictions to competition in the market when there is a large difference between the level of profitability and the cost of capital.

- When the size of the difference has grown over a period, this may be an indication that competitive conditions in the market are diminishing. However, *supra-economic profits* need to be carefully analysed since these may have been acquired due to a superior efficiency, investment, or innovation. Thus, these profits may encourage the entry and trigger effective competition in the market.
- When the gap is reducing, competitive conditions may be improving. However, *low-economic profits* may not be an indication of a well-functioning market. Sometimes a period of low profitability may occur after a downturn in trading conditions, regardless of the state of competition. Also, market participants with market power may not be profitable despite being protected from new entry simply because they are operating with high cost – because they are inefficient. There may be weak competition because customers are not responding effectively to other competitive offers.

¹⁶⁹ High prices may be found after analysing demand elasticities and variable profit margins (which are sales revenues minus costs of sales). It is important, when looking at price changes, to analyse movements in costs. Consideration of changes in variable costs alongside price movement may indicate potential concerns about co-ordination between market participants.

¹⁷⁰ See Appendix G.

¹⁷¹ See Competition Commission (2013).

¹⁷² See OECD (2011d), p. 389.

Competitive markets are expected to have significant variations in profit levels between firms over time because supply and demand conditions are constantly changing. Where profitability of a market participant is persistently above the competitive level this may be an indication of limitations to competition, for example – like the presence of entry barriers or significant market power, or both. When profitability levels have remained persistently high and stable over time among several market participants this may be an indication of co-ordinated conduct.¹⁷³

Quality is a qualitative indicator that is usually obtained from surveys, questionnaires, or interviews with market participants, customers, and market observers about the perception of a product.¹⁷⁴

Innovation and competition are related in the sense that the former preserves the dynamism of markets and the latter promotes it. Innovation by market participants can provide a number of desirable outcomes such as increased production efficiency that may lead to decreased costs, improvements in product quality, wider product variety, and improvements in product safety.¹⁷⁵

4.4 Market features that can harm competition

Market features that may affect competition can include its regulation, the conduct of market participants, and other features related to the intrinsic structure of the market.

This subsection provides a general description of the structural, conduct and regulatory features that could be analysed in a market examination. These features shall not be taken as an exhaustive array of aspects to be covered in an examination since careful analysis on a case-by-case basis is needed on what gives rise to the competition restriction in the relevant market.

4.4.1 Structural features

The structure of a particular market encompasses certain aspects that provide the context in which market participants operate. A common aspect analysed in any market is concentration. However there are other structural dimensions that can give rise to a competition concern – such as product differentiation, vertical integration, conditions of entry, exit and expansion, information asymmetries, switching costs, and buyer power.

¹⁷³ See OECD (2007b). In contrast a “*Monopoly is a situation where there is a single seller in the market. In conventional economic analysis, the monopoly case is taken as the polar opposite of perfect competition. By definition, the demand curve facing the monopolist is the industry demand curve which is downward sloping. Thus, the monopolist has significant power over the price it charges, i.e. is a price setter rather than a price taker. Comparison of monopoly and perfectly competitive outcomes reveals that the monopolist will set a higher price, produce a lower output and earn above normal profits (sometimes referred to as monopoly rents). This suggests that consumers will face a higher price, leading to a deadweight welfare loss. In addition, income will be transferred from consumers to the monopoly firm. Monopoly should be distinguished from market power. The latter is a term which refers to all situations in which firms face downward sloping demand curves and can profitably raise price above the competitive level. Market power may arise not only when there is a monopoly, but also when there is oligopoly, monopolistic competition, or a dominant firm.*”

¹⁷⁴ See Competition Commission (2013).

¹⁷⁵ See OECD (2011b), p. 24.

Concentration

As explained above, market concentration provides an indication of market power. It is generally accepted that the larger the proportion of some aggregates of economic resources by a market participant, the greater the market power it is likely to have. Particularly, if high market shares have persisted over a period of time relatively stable, this applies to both suppliers and buyers.¹⁷⁶

Even though market shares may be used as a proxy of market power there are limitations in this analysis alone. For example, where high market shares are present in a market, it is likely that it has high entry barriers. Thus when assessing the degree of concentration it is necessary to consider other factors besides market shares alone, such as:¹⁷⁷

- The existence of *economies of scale*.
- The existence of substantial barriers to entry.
- The *homogeneity* of products.
- *Symmetry* in market shares, cost structures, timing of decisions, and business strategies.
- *Stability* of market conditions (demand and cost side).
- Degree of excess capacity.
- Market *transparency* (of prices, outputs, market shares) that facilitates knowing the behaviour of other market participants.
- *Awareness of the ability of competitors* to respond quickly and effectively to any price change.
- The structure of the demand side (where *buyer power* is significant or buyers may co-ordinate their behaviour).
- The extent of any multi-market contracts.
- The existence of essential facilities.¹⁷⁸

Differentiation¹⁷⁹

Where all the products in the relevant market are regarded as perfect substitutes, or identical, by buyers, who have no preferences for one as compared to the other, the products are referred to as *homogeneous*. In this case, suppliers will be able to sell only at a single, identical price. No supplier will be able to raise its price above the general market level and hold its buyers (unless competitors also raise prices to the same level). Also, advertising and other sales promotions will be generally ineffective in attracting customers. Market shares often will not be determined by buyer preferences but perhaps as a random event or because of historical developments in the establishment, growth or disappearance of market participants.

¹⁷⁶ See Office of Fair Trading (2003).

¹⁷⁷ See *Ibid.* This information is based on the international experience of the United Kingdom and does not constitute an exhaustive list.

¹⁷⁸ See paragraph 68 of this manual.

¹⁷⁹ See Bain (1962), this section is based on Chapter 7.

Conversely, when substitutability is not perfect, products will be *differentiated* according to the various buyers' preferences. In this case, buyers will be willing to pay at least slightly more for a preferred product in order to obtain it. Therefore, product differentiation refers to the extent to which buyers distinguish or have specific preferences among the competing products of the suppliers established in the relevant market – for example among various brands of toothpaste, breakfast cereals or drinks.

The sources of product differentiation are:

- *Quality or design* of competing products.
- *Unawareness by buyers* of essential characteristics and qualities of the products.
- *Persuasive sale-promotion* by suppliers, and advertising (intrinsically connected with brands, trademarks, or company names, and other sale promotion).

In presence of product differentiation suppliers are no longer necessarily bound to sell at a common price. Price differentials reflect the preferences of buyers and non-price dimensions of sales promotions and advertising are added to the selling costs, quality level, design and variety of the products. Market shares in these markets can differ significantly through time, with an impact on the degree of supplier concentration and the nature of competition.

Moreover, practitioners often maintain that it is easier to reach collusion in markets where the degree of differentiation is low or non-existent as in the case of homogenous products.

Conditions of entry, expansion and exit

Entry conditions as a structural feature of the market refer to the advantage that suppliers already established have over potential additional suppliers who may wish to enter the market. When established suppliers have an advantage over potential entrants, they will be able persistently to set prices at least somewhat above the indicated competitive cost level without making it attractive for others to enter, since they are disadvantaged because are unable to make a profit at such prices. These prices are often called *entry-forestalling*. This supplier's advantage reflects the existence of some type of barrier to entry.

In general terms, the concept of barriers to entry may be understood as an impediment that makes it more difficult for a market participant to enter a market,¹⁸⁰ and which allows an incumbent market participant to earn above normal-economic profits without the threat of entry.¹⁸¹

In this manual, barriers to entry are understood as the following impediments:¹⁸²

- Financial costs and costs related to the development of alternative channels and access to limited financing, technology and efficient distribution channels.
- Amount, indivisibility and required investment recoupment period, as well as the absence of or scarce profitability of alternative use of equipment and infrastructure.

¹⁸⁰ See OECD (2005), p. 10. Since there is no consensus upon a precise definition of barriers to entry it is necessary to analyse such impediments on a cases-by-case basis.

¹⁸¹ See MacAfee, Mialon, and Williams (2003), p. 1. Definition provided by Joe S. Bain in "Barriers to New Competition" of 1956.

¹⁸² See Bain (1962), p. 237. These impediments shall not be considered an exhaustive list.

- Need to have a concession, licence, permit or any other government authorisation, as well as use or exploitation rights protected by intellectual and industrial property rights registration.¹⁸³
- Advertising investment required for the brand or commercial name to acquire a presence in the market that enables competition with established brands or names.
- Limits to competition in international markets.
- Restrictions imposed by market participants' conduct in the relevant market.
- Action or public policy issued by public authorities that discriminate in the granting of incentives, subsidies or grants to certain producers, sellers, distributors or service providers.

These barriers may also be classified as natural, intrinsic, strategic, or regulatory.¹⁸⁴

Natural or intrinsic barriers are those unavoidable costs born when entering a market. These include:

- *Sunk costs* are those that cannot be recovered by the market participant when exiting the market. These often include set-up costs (research and development, finding a location, getting planning permissions, attracting and training staff, etc.), investment in specific assets as well as advertising and promotion costs.¹⁸⁵
- *Economies of large-scale distribution and production* are such that in order to attain lowest-cost scale, the entrant must supply a significant fraction of the total industry output.
- *Network effects* occur when a market participant provides services over a network or through a platform. In this case, customers value the network more highly when it is used by a greater number of customers.¹⁸⁶
- *Access to a scarce input* providing an absolute advantage. This input may be an essential facility or input, or the acquisition of any necessary intellectual property rights.¹⁸⁷

Strategic barriers are actions by market participants that can have detrimental effects on competition. For example:

- *Product differentiation advantage* over potential entrants exists when buyers prefer products of established market participants when compared to new ones. To enter a market a new entrant would have to incur sales promotion costs per unit greater than those of the established market participants, making its profit margin less favourable. Possible sources of this type of barrier are:

¹⁸³ See Section 4.4.3 of this manual.

¹⁸⁴ See Article 7 of the FECLRP.

¹⁸⁵ See Office of Fair Trading (2003).

¹⁸⁶ See Competition Commission (2013), p. 40. This is the same case for two-sided markets (or multiple-sided), where market participants interact through a platform in which clients served in one side of the platform value the product in relation to the number of clients served in the other side or sides of the platform.

¹⁸⁷ See OECD (2004) for examples.

- Accumulated preference of buyers (because of long-sustained advertising, loyalty to brand names, company reputation, etc.).
- Exclusive control of superior product designs by established market participants, through patent protection.
- Ownership or control of favoured systems of distribution outlets.
- Superiority in production and distribution costs due to:
 - Control of superior production techniques, either by patent or secrecy.
 - Inability of an entrant to acquire necessary factors of production (management services, labour, equipment, materials), on terms as favourable as those enjoyed by established market participants.¹⁸⁸
 - Less favourable liquid funds for investment.¹⁸⁹
- *Switching costs* for customers imposed strategically by market participants, for example by offering fidelity discounts or long term-contracts.
- *Locked-in consumers* is a term that refers to the behaviour of consumers. If for whatever reason consumers find it costly to switch from one service provider to another, and prefer long-term relationships with an existing service supplier, this supplier can gain a measure of market power over customers and some protection against rival providers. In extreme cases where consumers are reluctant to switch, competition of new firms focuses only on new customers. Consumers are less interested in conducting a search for other suppliers where brand loyalty and trust is perceived as important, or for inertia owing to a lack of sufficient knowledge and understanding of the services and products, or because of network effects, or given the importance of the customer – supplier relationship relative to the products themselves.¹⁹⁰
- *Signal of an aggressive response* by market participants to deter entry, for example by overinvesting in spare capacity.
- *First movers' advantage* of a market participant's established position, through its reputation, experience or closeness with customers.

Laws, regulations and government interventions restrict competition in the marketplace. These are also structural features of a market that will be explained in the next section 4.4.3.

Markets may have one or more types of barriers to entry and aggregate barriers to entry will determine the condition of entry, or the degree to which established market participants could elevate their prices above minimum average costs while still forestalling entry.

¹⁸⁸ See OECD (2005), p. 114. Case example of difficulty in new entry of new airlines in the Haneda Airport (Tokyo International Airport), in this case the difficulty to acquire slots.

¹⁸⁹ See Prudential Regulation Authority (2014), for examples of regulation that aims to reduce this type of strategic barrier.

¹⁹⁰ See OECD (2011e), pp. 20-21.

Expansion conditions are determined by how easy is for an entrant to grow when entering the market, in terms of gaining customers and market shares. Since the latter implies customer switching, information asymmetry is a key factor that may prevent switching and therefore expansion.¹⁹¹

Exit conditions are related to the cost of exiting a market if market participants are not performing as expected. These conditions are directly related to the sunk costs needed to enter the market. High exit barriers may lead to tacit co-ordination as a survival strategy of market participants unable to exit the market.¹⁹²

Vertical integration

A market participant that partakes in more than one successive stage of production or distribution of goods is vertically integrated. Some participants choose to vertically integrate and perform all production and distribution activities themselves and others integrate only partially.¹⁹³ There are various reasons for vertical integration; some of them are reducing the risk of relying on incomplete contracts, eliminating freeriding problems, protecting specific investments, eliminating double marginalisation problems, and in general reducing transaction costs.¹⁹⁴

Vertical integration may also be a result of a *vertical merger* where a firm obtains the ownership and complete control over neighbouring stages of production and distribution.¹⁹⁵ These types of mergers are typically a source of considerable price and non-price efficiencies. *Non-price efficiencies* may arise from increased co-ordination often realised by the merger. *Price efficiencies* are achieved through lower prices because of the elimination of double marginalisation when there was market power in the upstream and downstream markets before the merger take place.¹⁹⁶ This gives it an incentive to increase output downstream, to the benefit of consumers.

When the downstream market is perfectly competitive, the single profit result indicates that a monopolist upstream cannot increase its profits by integrating downstream. By charging the appropriate wholesale price it can extract all of its monopoly profits. This suggests vertical integration in these circumstances is motivated by efficiency considerations that lead to lower costs and greater output.¹⁹⁷

However, vertically integrated firms and vertical mergers can result in anti-competitive effects if they either foreclose competitors or enhance co-ordination among competitors. The difficult challenge in examining these mergers is precisely to distinguish anti-competitive from competitive transactions. Competition policy enforcement should deal with this challenge.

¹⁹¹ See Office of Fair Trading (2003).

¹⁹² See *Ibid.*

¹⁹³ See Carlton and Perloff (1994), based on Chapter 13.

¹⁹⁴ See Joskow (2010).

¹⁹⁵ See OECD (2007c), p. 19.

¹⁹⁶ See OECD (2007c), p. 7. Double marginalisation is eliminated because instead of paying a wholesale price that includes a mark-up over marginal cost, the integrated market participant will be able to access the input at its marginal cost.

¹⁹⁷ However, there may be exceptions; for example even when a downstream market is competitive, certain regulations may favour the establishment of high prices. See also OECD (2007c), p. 16.

Information asymmetries

The *principal-agent problem* occurs when the agent (supplier), acting on behalf of the principal (customer), is better informed (asymmetry) than the latter about how it is providing a product or a service; therefore, the principal may be prevented from exerting an effective decision or choice. Another characteristic of the problem is that interests of the agent and the principal are not aligned; therefore, the agent may act against the interests of the principal, where the latter may not detect such actions given the existence of information asymmetries. The greater the asymmetry of information the more harmful the effect of such actions may be.¹⁹⁸

Asymmetries of information may be caused because of *barriers to access information*. These barriers may be caused by impediments or costs¹⁹⁹ that hinder the search or comparison of alternative products.

Impediments may be caused by the product's own (complex) characteristics, or imposed by market participants in order to obtain market power. The latter may be carried out through:

- Charging different prices for the same product at various geographic areas, or under different brand names, making it difficult to find the low price brand.
- Referring to some prices or offers which are not available to all consumers.
- Fail to provide (intentionally or unintentionally) all or some of the product's information needed for customers to make informed choices.

Information asymmetries may add to customers switching costs, a situation that may foreclose entry of new participants.

Switching costs

Switching costs are borne by customers when moving from one supplier to another. These may have pro-competitive effects by intensifying competition for new customers, particularly if there is scope to charge different prices to new consumers as opposed to existing consumers. Also, limited constraints on switching may enable suppliers to recoup upfront investment costs for supplying a customer and may facilitate customer specific investments.²⁰⁰

Switching costs may be caused by:

- *Customer's lack of information* about alternative products (possibly because of the lack of access to information or high search costs).
- *Administrative obstacles* that may impose costs on customers wishing to switch.
- *Network effects* that give rise to collective switching costs, locking consumers into firms that control them.
- *Substantial new investments* by customers required when acquiring a new product or obtaining new skills for using the product.
- Contractual terms or marketing devices.

¹⁹⁸ See Competition Commission (2013), p. 63.

¹⁹⁹ Including opportunity costs of customers' time.

²⁰⁰ See Competition Commission (2013) p. 67.

*Effectiveness of buying power*²⁰¹

Buyer power is often discussed in the context of *monopsony power* as the ability to profitably set input prices below competitive levels.²⁰² The usual illustration of monopsony power is a competitive upstream supply sector selling to a single buyer (or a small number of buyers in the case of an oligopsony). Such a buyer would have a profit incentive to reduce its purchases in order to reduce the market price of goods purchased.²⁰³

The key to identifying monopsony power in practice is recognising that it is the existence of alternatives for the sellers that determines the extent of a buyer's monopsony power. If the sellers can easily find other buyers who use the input for a different use, other buyers in different geographic areas who use the input for a similar use, or other buyers for whom the assets can be used to make a different input, then a buyer will have limited monopsony power. The relevant market for the purpose of identifying monopsony power is the smallest set of products in the smallest geographic area such that a hypothetical monopsonist of those products in that area would be able to depress prices by a small but significant and non-transitory amount.

Another form of buying power is *bargaining power*, defined as the strength of a buyer in its negotiations with sellers. This power is useful to understand the nature of trade between input suppliers and downstream firms when the interface or framework between trading partners involves bilateral negotiations, assuming there are relatively few upstream and downstream firms and firms negotiate bilaterally over terms and conditions of supply.

The greater the effectiveness of a buyer at bargaining, the larger the buyer's outside option, and the smaller the outside option of the seller. The value of the buyer's outside option depends on its ability and willingness to substitute to alternative suppliers. Similarly, the value of the seller's outside option depends on its ability and willingness to substitute to alternative buyers.

A buyer will have substantial buying power if it:

- Can easily switch to alternative suppliers, sponsor new entry or self-supply without incurring substantial sunk costs.
- Is a gateway to the downstream market.

Identifying buyer power requires precise and careful market definition of the relevant downstream product and geographic markets to identify market power in distribution services provided by the buyer.

Both types of buyer power result in lower prices, though the lower price obtained from monopsony power is achieved through the act of purchasing less, whereas the lower price obtained from bargaining power is achieved through the threat of purchasing less. A key difference is that the exercise of monopsony power results in prices being depressed below competitive levels, whereas the exercise of

²⁰¹ See OECD (2008a).

²⁰² See Carlton and Perloff (1994), p. 116.

²⁰³ See OECD (2008), p. 9. Note that "A firm with monopsony power will behave in the output market as if it had higher marginal costs than a firm that does not have monopsony power. As a result, prices downstream will be higher and downstream consumers are harmed even though input prices are lower. This is true even if the monopsonist is a competitive firm in the downstream market and supply from competing suppliers is perfectly elastic. If the monopsonist also has market power in the downstream market, the harm to efficiency and consumers is greater than if it does not."

bargaining power might countervail seller market power and push prices toward competitive levels. Moreover, when the input market is competitive, monopsony power operates because the suppliers do not have bargaining power. Therefore, it is not possible to push suppliers to price below marginal cost. Bargaining power can only be exercised when suppliers and buyers have certain relative market power.

4.4.2 Conduct features

Market participants' behaviour, intentional (strategic) or unintentional, that may harm competition shall be considered as a conduct feature of the relevant market.²⁰⁴

Conduct of oligopolists

Oligopolies are markets characterised by a small number of competitors and barriers to entry such that market participants are interdependent because their strategic decisions have a meaningful impact on one another. Therefore, *profit-maximising market participants in oligopoly markets* will rationally take into account their rivals' behaviour and anticipated reactions when setting prices.²⁰⁵

However, oligopoly interdependence can also foster anti-competitive conduct. When there is repeated interaction over time, oligopolists may, in certain circumstances, be able to co-ordinate their actions and sustain supra-competitive prices to the detriment of consumer welfare and economic efficiency.

In addition to recognised interdependence, there appears to be another precondition which must be satisfied before there is a good probability that co-ordination will replace competition in oligopoly markets. It is that barriers to entry and expansion be sufficiently high to make it profitable for leading market participants to raise price by cutting back quantity supplied.²⁰⁶

However, even if a market is characterised by both high concentration and high barriers to entry and expansion, this is far from sufficient to justify predicting that market participants will engage in co-ordinated interaction.²⁰⁷ Whether oligopolists engage in co-ordination depends on the market conditions that facilitate such co-ordination. These conditions are explained in the section of facilitating practices.

*Vertical agreements*²⁰⁸

Vertical agreements are an essential element of market economy. These contractual agreements, usually in the form of long-term contracts with complex pricing clauses and several obligations imposed on the contracting parties, are common when the vertical relationship is between a manufacturer and its distributor.²⁰⁹

²⁰⁴ Suspected or actual violations, intentional or unintentional, carried out by market participants in other policy areas may also be considered as conduct features. As stated above, this section will not cover such violations as it focuses only in features that may harm competition in the relevant market.

²⁰⁵ See OECD (2015b), p. 3.

²⁰⁶ See OECD (1999), p. 20.

²⁰⁷ See *Ibid.*

²⁰⁸ See Carlton and Perloff (1994), p. 522. Economists describe the relationship between a manufacture and a distributor as a principal-agent relationship.

²⁰⁹ See OECD (2013), p. 10.

Thus, non-vertically integrated market participants buy inputs they need for their production or distribution processes from other firms.²¹⁰ Therefore, a non-integrated market participant may enter into a contract in specified terms, including the price, other terms, or forms of behaviour between them.²¹¹

Usually, vertical agreements take place when its signature represents less transaction costs than a vertical integration (understanding these transaction costs as the anticipation of contingencies and possible opportunistic behaviour of parties) and when the transaction costs of legally enforcing contracts are not high (efficient judicial system).²¹² These agreements can solve problems in distribution such as:²¹³

- Double monopoly mark-up by successive monopolies in manufacturing and distribution.
- Free riding by some distributors (not do their share in promotion activities) on other distributors.
- Free riding by some manufacturers on other manufacturers.
- Lack of co-ordination among distributors that leads to externalities.

These types of agreements have pro-competitive implications. “Vertical agreements which simply determine the price and quantity for a specific sale and purchase transaction do not normally restrict competition.”²¹⁴ Nevertheless, when agreements impose restraints on the supplier or the buyer, these types of agreements are considered as vertical restraints.²¹⁵

For example – vertical restraints may in some cases make it difficult for an entrant to gain sufficient distribution outlets, because existing distributors are largely tied up with existing suppliers, or to gain access to vital components.

There are a wide variety of vertical agreements; among the most prominent are exclusive purchasing, tying and bundling, franchising, selective distribution systems, and pricing arrangements.²¹⁶

Facilitating practices

Facilitating practices are those that may promote co-ordination among market participants. *Co-ordination* typically involves repeated interaction among competing market participants, with the aim of increasing or protecting profits. Explicit and tacit collusion are among the common types of co-ordinated conduct.

²¹⁰ See European Commission (2012), p. 9. Non-vertically integrated market participants are those that operate in different levels of the production or distribution chain.

²¹¹ See Carlton and Perloff (1994), p. 499.

²¹² For example, when there is a judiciary system that can enforce contracts, it could be less risky to sign vertical contracts. In this case, firms do not need to undertake the management of a vertical unit.

²¹³ See Carlton and Perloff (1994), p. 523. See also Tirole (1991), Chapter 3.

²¹⁴ See European Commission (2012).

²¹⁵ See Carlton and Perloff (1994).

²¹⁶ See Competition Commission (2013), p. 57.

Explicit collusion takes place when market participants directly communicate to carry out this practice.²¹⁷ And *tacit collusion* occurs when markets are stable and market participants have the opportunity to interact repeatedly, which gives them the opportunity to anticipate each other's future actions, and to tacitly establish co-ordinated course of action without communicating directly.²¹⁸

Increased transparency between market participants allows them to have readily available information or exchange information, which in turn provides them with the ability to interpret the choices their competitors have made. Co-ordination can be facilitated by information availability that:²¹⁹

- Generates mutually consistent expectations of competitors' conduct and beliefs, thus making it easier for them to reach understanding (co-ordination).
- Provides past and present indication of competitors' conduct, thus allows monitoring compliance or deviation from the understanding.
- Provides information on new entrants.

Direct communication is the most common mean of obtaining information that facilitates co-ordinated conduct. Other direct means are:²²⁰

- Voluntary publications of information.
- Price announcements.
- Information sharing through trade associations.
- Most-favoured customer clauses.²²¹
- Relationships through: joint ventures,²²² cross-directorships, joint marketing and supplier-buyer relationships.
- Practices promoted by trade or professional associations such as: adoption of rules of conduct, ethics codes, product standardisation, regulatory disclosures, and price computation manuals.²²³

²¹⁷ See OECD (2011b), p. 16. Cartels are a type of business conduct deemed likely to be the most harmful to competition. Cartels, via their collusive or co-ordinated behaviour, result in higher prices, lower quantities and potentially lower variety and innovation with a clear loss of welfare.

²¹⁸ See Competition Commission (2013), p. 51.

²¹⁹ See *Idem*, p. 55.

²²⁰ See *Ibid.* Assessed on a case-by-case basis.

²²¹ Provision in a sales contract under which the supplier agrees to give the buyer the benefit of more favourable contract terms it may later negotiate with another buyer.

²²² See Carlton and Perloff (1994), p. 539.

²²³ These conducts may take place among market participants outside trade and professional associations.

There are three conditions that must be met for co-ordination to be sustainable in a market:²²⁴

- Market participants need to *reach an understanding and monitor* compliance with the terms of co-ordination.
- Co-ordination needs to be *internally sustainable* among market participants of the group (there must be an incentive for a market participant to join the group).
- Co-ordination needs to be *externally sustainable* (from other market participants outside of the group or by reactions of customers).

Industry practice

Industry practice may be adopted and accepted with no apparent co-ordination between market participants. However, even when the conduct of market participants is co-ordinated, through trade or professional associations, it can still be pro-competitive.²²⁵

Trade and professional associations play valuable and fundamental roles as forums for the discussion and exchange of views on many important issues of common interest for the industry sector which they represent. Their activities benefit their members – especially the smaller members.²²⁶

Most professional and trade associations take an active role in shaping the way of their industry structure and how it works. They promote product standards and best practices, and they define and promote standard terms and conditions of sale. They publish and enforce codes of ethics, and in some cases they formulate and enforce industry self-regulation. They issue recommendations and guidelines to their members on a variety of commercial and non-commercial issues.²²⁷ Trade associations can also educate members about proper compliance with competition laws.²²⁸

In addition, these associations can promote information exchanges among its members with potential benefits:²²⁹

- Better understanding of the market and of the demand structure, which enables suppliers to develop more effective marketing strategies, and efficient distribution systems. Increased

²²⁴ See Competition Commission (2013), pp. 52-53.

²²⁵ See OECD (2007a), p. 15. “*Collective or collaborative efforts made within trade and professional associations may produce benefits such as product standardisation, harmonisation and promotion of good business practices, support of business interests before governments and public agencies, the determination of ethical rules for professions, etc.*”

²²⁶ See OECD (2007a), p. 7.

²²⁷ See *Ibid.*

²²⁸ See *Idem*, p. 15.

²²⁹ See OECD (2010), p. 10. For example “*The sharing of information enables certain markets to function effectively. This is the case, for example, in retail credit markets, where the sharing of data on the creditworthiness of borrowers amongst banks results in better access to credit for good customers. Similarly, in the insurance sector the sharing of certain information such as tables, calculations and studies allows for a better risk assessment of individual companies. In this context the sharing of information may not only lead to increased competition among insurers but may also facilitate entry if such information is readily available to potential entrants.*”

market transparency may also facilitate entry into the market for new competitors in that it allows potential entrants to better evaluate business opportunities in a given sector.

- In markets with high fluctuations in demand, where suppliers have to maintain high inventory levels to satisfy demand peaks, information exchanges can lead to better demand forecasting resulting in inventory optimisation.
- The sharing of information on costs enables companies to compare their performance to that of their competitors (benchmarking), which can lead them to adopt productive efficiency increasing initiatives.
- Information exchanges may also have beneficial effects on technology innovation markets characterised by high investment costs, where any uncertainty as to future developments of demand may stymie investment into new products. This may take place in the context of a broader efficiency enhancing co-operation agreements such as joint venture, standardisation or R&D agreements.

However, trade and professional associations can create risks of anti-competitive co-ordination, despite their many pro-competitive aspects. Participation in trade and professional associations' activities provide ample opportunities for market participants in the same line of business to meet regularly and to discuss business matters of common interest. Such meetings and discussions, even if meant to pursue legitimate association objectives, bring together direct competitors and provide them with regular opportunities for exchanges of views on the market, which could easily spill over into illegal co-ordination. Formal or casual discussions of prices, quantities and future business strategies can lead to agreements or illegal understandings. It is for this reason that professional and trade associations and their activities are subject to close scrutiny.²³⁰

Conduct of customers

Suppliers compete with each other to attract customers, and consumers make decisions to buy a particular product based on factors such as their personal preferences, income, prices and attributes of the product. As noted above, when making their decisions customers may not have sufficient information and may face costs in switching from one product to another or from one supplier to another.²³¹

The ability to choose products depends on customers' behaviour – meaning their willingness and capability to access information about offers available in the market, to evaluate these offers, to identify the best value offer of products for them, and to act on this evaluation by switching between alternatives of supply.

Customers may face difficulties in acquiring knowledge about products and their substitutes, in terms of price, quality and offer because of:²³²

- opportunity costs;
- incomplete, asymmetric and variable information;

²³⁰ See *Idem*, p. 8. See also COFECE. (2015e).

²³¹ See OECD (2011b), p. 74.

²³² See Competition Commission (2013), p. 65.

- imprecise knowledge of their own requirements;
- degree of their ability to remember information, which may limit their capabilities to search for and compare alternatives;
- sensitivity or embarrassment about the product they are searching; and
- behavioural biases such as:²³³
 - *Processing power*, a bias triggered when customers are overloaded or faced with too many choices, which makes it difficult for them to make a purchasing decision. *Representational bias* may occur when customers use visible information thought reliable but that may hide valuable information, or when customers use rules of thumb to make choices.
 - *Framing responses* made after a past experience with a product, when adopting a default decision for a product, or when customer select a product based on its position in a list (usually choosing among the first options).
 - *Time inconsistencies* in the customers' future projections about a product.

These difficulties are called *search costs*. When these costs are perceived to be high, it is likely that searching will be curtailed.²³⁴

4.4.3 Regulatory features

“Government action routinely is designed to promote and protect important public policy goals.”²³⁵ Government often intervenes in markets to regulate the behaviour of market participants to correct market failures rising from externalities, the existence of public goods, or incomplete and asymmetric information, or to limit market power. Government also regulates this behaviour to promote valuable goals in the areas of health, safety and environmental quality.²³⁶

While laws, rules and regulations are adopted in response to various social and economic objectives pursued by government, they affect competition by influencing the structure of the market, the conduct of market participants, or both through:²³⁷

- Imposing barriers to entry, expansion or to the flow of products across regions and states.
- Facilitating co-ordination of prices and production among market participants.

²³³ See *Ibid.* Customers can learn from their experiences and own biases, becoming more sophisticated. Consumer organisations, advisers, intermediaries, and media can catalyse consumer sophistication.

²³⁴ See Office of Fair Trading (2003), p. 41.

²³⁵ See OECD (2011b), p. 9 and pp. 27-31.

²³⁶ See *Ibid.*, for a thorough explanation.

²³⁷ To develop full understanding of different types of rules and regulations and their potential consequences on competition it is strongly recommended to complement this manual with the OECD Competition Assessment Toolkit, see OECD (2011a), OECD (2011b) and OECD (2015d).

- Impose higher costs on entrants and small market participants as opposed to actual market participants and large firms.
- Partially or completely sheltering firms from national competition laws.

The OECD recommends giving particular attention to laws, regulations and government policies that:²³⁸

- Limit the number or range of suppliers.
- Limit the ability of suppliers to compete.
- Reduce the incentives of suppliers to compete.
- Limit the choices and information available to consumers.

Rules and regulation created within the private sector for self-regulation or co-regulation may have potential advantages such as better co-ordination by market participants in setting standards related to product comparability, quality and safety, among others.²³⁹ However, an important concern may rise from the enhanced co-ordination of market participants, as it may facilitate the implementation of collusive strategies and the setting of standards and their compliance – that may impose barriers to entry.²⁴⁰ Therefore, these rules need also to be carefully assessed in light of their effect on competition.

4.5 Developing theories of harm

Harm is understood as an adverse effect on competition caused by structural, regulatory or conduct features of the market. This effect may appear in the market as prevention, restriction or distortion to competition.

Market examinations may indicate that one or several of such features appear individually or collectively and may have adverse effects on competition.²⁴¹

The theory of harm considers one or several hypothesis of how the structural, regulatory and conduct features or characteristics of the market interact, causing adverse effects on competition and thus affecting consumers in a negative manner. If theories of harm are proven, these may be an important part of the outcome of market examinations since these can provide a rationale for the Ministry's action – which can be the promotion of public policies, proposal of changes in regulation or the submission of requests to the competition authorities.²⁴²

Different theories may be developed during a market examination. These are not mutually exclusive and some may be dropped over the course of the examination. Moreover, these theories shall not be understood as prejudgement of an adverse effect of competition in a given market.

²³⁸ See OECD (2009a). See Appendix H.

²³⁹ See OECD (2007a), p. 28.

²⁴⁰ See OECD (2011b), p 31.

²⁴¹ See OECD (2011c).

²⁴² See Section 2 of the manual to see the different outcomes that a market examination may have.

Developing theories of harm requires the analysis of the market characteristics, its outcomes, the structural, regulatory and conduct features that may be affecting the competitive process, as well as the consideration of aspects that may benefit competition.

Therefore, the key issue in developing these theories is to grapple with whether structural, regulatory or conduct features, or a combination thereof, can lead to the following effects:

- A decrease of competition in the market, with implications in its outcomes (prices, profitability, quality, innovation, etc.).
- Public policy or regulatory issues.
- Consumer protection concerns.

The process of developing theories of harm, typically, is based in the following criteria:²⁴³

- Requires a well-defined empirical question.
- Presents consistency between the underlying assumptions of the analysis with the observed features of the market.
- Uses a reliable dataset.
- Is presented in a clear and coherent manner.

A well-defined empirical question is the hypothesis of how relevant and harmful are the effects caused by structural, regulatory, or conduct features of a market and how these affect consumers.²⁴⁴ This question may articulate how the market examined is harmed relative to an appropriately defined counterfactual.²⁴⁵ See Appendix I for hypothetical examples.

The hypothesis shall be consistent with the underlying assumptions made during the examination of the market and should fit reasonably well the features and facts of the market in question. This is also true for the methodology chosen for answering the question.²⁴⁶ See Appendix I.

Reliable data is an essential requirement to develop and prove a theory of harm. Thus the information gathered during the examination is critical; therefore it is imperative to recognise any limitations in the data used for developing and proving the theory. Evidence or data about possible efficiencies related to the prevalent structure, regulation or conduct in the market shall be taken into account at this stage.

²⁴³ See ICN (2013), p. 45.

²⁴⁴ See *Idem*, p. 46.

²⁴⁵ See *Idem*, p. 36 and See OECD (2011c), p. 39 and 43. A counterfactual is a created scene that would have taken place during the alleged period absent the structural, regulatory or conduct feature affecting the market.

²⁴⁶ See ICN (2013), pp. 46-47.

The process of developing a theory shall be transparent, replicable and intuitive to allow other stakeholders to fully understand the analysis. The key underlying assumptions shall be explicit and based on the information used during the examination.²⁴⁷

Appendix I provides international experiences on how these theories have been developed in other jurisdictions.

²⁴⁷

See Idem, p. 49.

5. Content of a request

This section provides guidance on the information that shall be included in a formal request made to a competition authority. This information is based on the requirements established by the Federal Economic Competition Law (FECL), its regulatory provisions, and the organic statute of each of the competition authorities. It is recommended to review the aforementioned statutory provisions to obtain further detail on the requirements.

Depending on the type of request, complaints or letters shall be addressed either to the investigation authority or to the procedural oversight authority of the corresponding competition authority. Requests shall be presented at the parties' registry office, within business hours of the working days established in the official calendar of the respective competition authority.²⁴⁸

Request letters or complaints shall be formulated in a practical and respectful manner.²⁴⁹

5.1 Public policy

Box 5 provides the minimum information required in requests made for the issuance of opinions about public policy restrictions to competition. The letter shall be addressed to the head of the procedural oversight authority.

Box 5. Elements of a request letter for the issuance of an opinion about public policy restrictions²⁵⁰

- Legal name and accreditation of the applicant.
- Name and localisation information²⁵¹ of the public policy or international treaty, including the name of the public authority issuing it.
- Description of the identified risks or issues that affect competition and the grounds that substantiate the need for the opinion of the competition authority.
- Any information deemed useful to the competition authority.

²⁴⁸ See Chapter III Title V of the FECL for obtaining the specific requisites for filing requests at the competition authorities, as well as Section Fifteenth of the regulatory provisions of the FECL.

²⁴⁹ See Article 32 of the FECLRP.

²⁵⁰ See Article 148 of the FECLRP. Inter-institutional agreements with a public authority may require additional or different information.

²⁵¹ Shall include the publication date in the DOF, or Parliamentary Gazette, or electronic source, or any other mean used by public authorities; if applicable a photocopy of the public policy shall be submitted.

5.2 Anti-competitive conduct

A request from the Ministry of Economy to request the opening of an investigation of anti-competitive conduct is no different to a complaint letter that any individual can submit to a competition authority when violations to the FECL are suspected or known.

Box 6 provides the minimum information of a complaint letter. The letter shall be addressed to the investigation authority.

Box 6. Elements of a complaint letter for the investigation of anti-competitive conduct ²⁵²

- If applicable, name of the legal representative, accreditation, legal address, and authorised personnel to hear about the case, as well as their contact details.
- Legal name and, if available, the contact details of the presumed offender.
- A brief description of the facts that originate the accusation, including the arguments that reasonably show the existence of an anti-competitive conduct and its possible effects.
- In case of cartels:²⁵³
 - Any indication that leads to suspect the existence of this conduct.
- In case of abuse of dominance or unlawful concentrations:²⁵⁴
 - The reasonable grounds that lead to suspect the existence of this conduct.
 - Description of the main products, specifying their use in the market.²⁵⁵
 - If available, a list of possible substitutes (related to the presumed offender and main market participants).
- List of documents and evidence that substantiate the complaint.
- Other evidence, including its location or filing, deemed pertinent by the complainant.

5.3 Barriers to competition and essential facilities

Requests of this nature made by the Federal Executive Branch, through itself or the Ministry of Economy, include the elements that lead to suspect an absence of effective competition in a market and with the aim that competition authorities determine the existence of barriers to competition and essential facilities that can generate adverse effects on competition.

²⁵² See Articles 67, 68 and 71 of the FECL, 56 of the FECLRP and COFECE (2015a), (2015b), and (2015c) for further guidance on the specific information that shall be submitted for the particular conduct (cartels, abuse of dominance or unlawful concentration).

²⁵³ See Article 3 of the FECLRP and COFECE (2015b) and (2015c).

²⁵⁴ See Article 71 of the FECL and COFECE (2015b) and (2015c).

²⁵⁵ See Article 4 of the FECLRP. In case of presumed predatory pricing conduct, the request shall include elements that support the cost estimation presented in the complaint.

Box 7 provides the minimum information of a request letter for an investigation of barriers to competition and essential facilities. The request shall be addressed to the investigation authority.

Box 7. Elements of a request letter for the investigation of barriers to competition and essential facilities²⁵⁶

- Identification of the public official responsible for following up the procedure with the competition authority.
- Available elements that allow for the determination of the relevant market.
- If available, the name of the individual that controls the input.
- In the case of essential facilities, provide:
 - A description of the input, including its use and usefulness.
 - Productive process through which it is obtained.
 - Estimated costs and period to build or generate an identical or similar input, and the period for recoupment of the investment.
 - Main components, difficulties to obtain them, as well as the technical, economical and legal possibility of providing such components separately.
 - Technical, economical and legal possibility of customers of the input to obtain a similar good or service in a different geographic area.
 - Technological developments in the production of the input or the goods or services obtained from it.
- In the case of barriers to competition, provide:
 - A description of the barrier to competition, and the way in which it distorts the competition process.
 - In case of a legal barrier, the name of the public authority that issued it, along with the information by which it can be checked, including date and publication source, and in case it is not public, provide a photocopy.
 - In case it is a fact or conduct of one or several market participants, the corresponding individual or individuals shall be identified.
- Any element deemed important for the investigation.

5.4 Market conditions

When a request letter of this nature is sent by the Federal Executive Branch, through itself or the Ministry of Economy, it shall include information that leads to the identification of the relevant market and market participants with substantial market power.²⁵⁷

Box 8 provides the minimum information required in a request of this nature. The request shall be addressed to the corresponding investigation authority.

²⁵⁶ See Article 104 of the FECLRP.

²⁵⁷ See Subsection I of Article 96 of the FECL.

Box 8. Elements of a request for the analysis of market conditions²⁵⁸

- Legal name and accreditation²⁵⁹ of the public authority or complainant.
- Affected complainants are those:
 - Users or consumers of the corresponding good or service; or
 - Market participants are subject to regulation on prices, tariffs, quality, compensations or information, among other aspects; or
 - Any other market participant that claims harm from the lack of effective competition or the existence of substantial market power.
- Complainant market participants with legal interest are those:
 - Affected; or
 - Subject to the corresponding regulation (that will be removed or implemented); or
 - Consumers subject to the corresponding regulation (that will be removed or implemented); or
 - Any other market participant that claims harm from the lack of effective competition or the existence of substantial market power
- Address where notifications will be sent, as well as the authorised personnel to receive the notification; contact details of the personnel shall be provided.
- Elements or grounds that support the need for a decision of this nature and the available elements that allow the competition authority to analyse the relevant market and substantial market power, or the competition conditions, along with the information collected during the investigation stage.
- Identification of participants in the relevant market, related markets, and its market shares.

5.5 Granting of concessions, licences, permits and equivalents

A request letter of this nature made by the Federal Executive Branch, through itself or the Ministry of Economy, shall specify the information presented in Box 9. The request shall be addressed to the procedural oversight authority.

²⁵⁸ See Article 110 of the FECLRP.

²⁵⁹ Accreditation shall be fulfilled with original or certified photocopy of a legal document or instrument.

Box 9. Elements of a request letter about decisions on the granting of concessions, licences, permits and equivalents²⁶⁰

- Legal name of the applicant or name of the market participants that belong to the group that takes part in the tender or name of the applicant seeking a favourable opinion from the competition authority.
- Name of the legal representative of the group, including original and certified photocopy of its accreditation, its notification address, and contact details of its authorised personnel.
- Photocopy of the constitutive deed (latest version) of each market participant.
- Description of the equity structure of the applicant market participant, and if applicable, of each market participant of the group, stating nationality, and identifying the share of each shareholder, direct or indirect, as well as the individuals that have control.
- Information that allows the competition authority to determine the relevant market, related markets and substantial market power.
- A description of the activities carried out by the individuals mentioned in point 4, including the concession and permits they own that are related to the issue analysed.
- A description of the equity participation of individuals and market participants mentioned in point , in other organisations, including their social objective, the activities these perform and the concessions and permits granted by the federal government they own and that are related to the issue analysed.
- Elements or grounds that support the need for a decision of this nature and the available elements that allow the competition authority to analyse the relevant market and substantial market power, or the competition conditions, along with the information collected during the investigation stage.
- Identification of participants in the relevant market, related markets, and their market shares;
- The corresponding authority shall include in the request the draft tender call, draft contract and any document deemed relevant for the analysis of the issue.²⁶¹
- Parties shall consult if the corresponding competition authority has issued instructive brochures for filing this type of request.

5.6 Market studies

A request letter made by the Federal Executive Branch, through itself or the Ministry of Economy, for a market study shall specify the information presented in Box 10. The request shall be addressed to the corresponding procedural oversight authority.

²⁶⁰ See Article 112 of the FECLRP.

²⁶¹ See Article 98 of the FECL.

Box 10. Elements of a request letter for market studies²⁶²

- Name of the applicant.
- Information and documents required to give credit that the applicant has the legal faculty to request a market study.
- The elements and grounds that substantiate the need for carrying out a market study.
- The relevant information in possession of the applicant, and required to open a market study.

²⁶²

See Article 151 of the FECLRP.

6. Request process and key procedural aspects

Specific information and the periods set forth in the statutory provisions for each stage of each of the processes can be consulted in the Federal Economic Competition Law (FECL), its regulatory provisions (FECLRP) and any guidance issued by the competition authorities.

6.1 Public policy opinions

The procedure to issue opinions about public policy restrictions to competition is the responsibility of the procedural oversight authority.²⁶³

Figure 1 shows the general process through which requests of this type are assessed and solved within the competition authorities.²⁶⁴

Key procedural aspects of the process in relation to the admittance and opening, submission to the Board and issuance of the opinion are described below.

Admittance and opening: Shall take place if the request letter or the notice fulfils the requirements established in the statutory provisions.

Requests will be dismissed when:²⁶⁵

- Focus on issues not related to the faculties of the corresponding competition authority.
- Deal with public policy or international agreement negotiations do not exist.
- Relate to other provision different to the issuance of opinions about public policy.
- Competition authority has already issued a prior opinion on the same topic.

Submission to the Board: When the request focuses on modification of programs and public policies carried out by government,²⁶⁶ draft regulation, rules, agreements, directives or any other administrative document that government intends to issue,²⁶⁷ and legislative bills and draft bylaws and decrees²⁶⁸ the procedural oversight authority will submit the case-file to the President Commissioner and will provide a summary with key data and information to the rest of the Commissioners. After analysing the file, the

²⁶³ See Article 149 of the FECLRP.

²⁶⁴ See Article 149 of the FECLRP.

²⁶⁵ See Article 150 of the FECLRP.

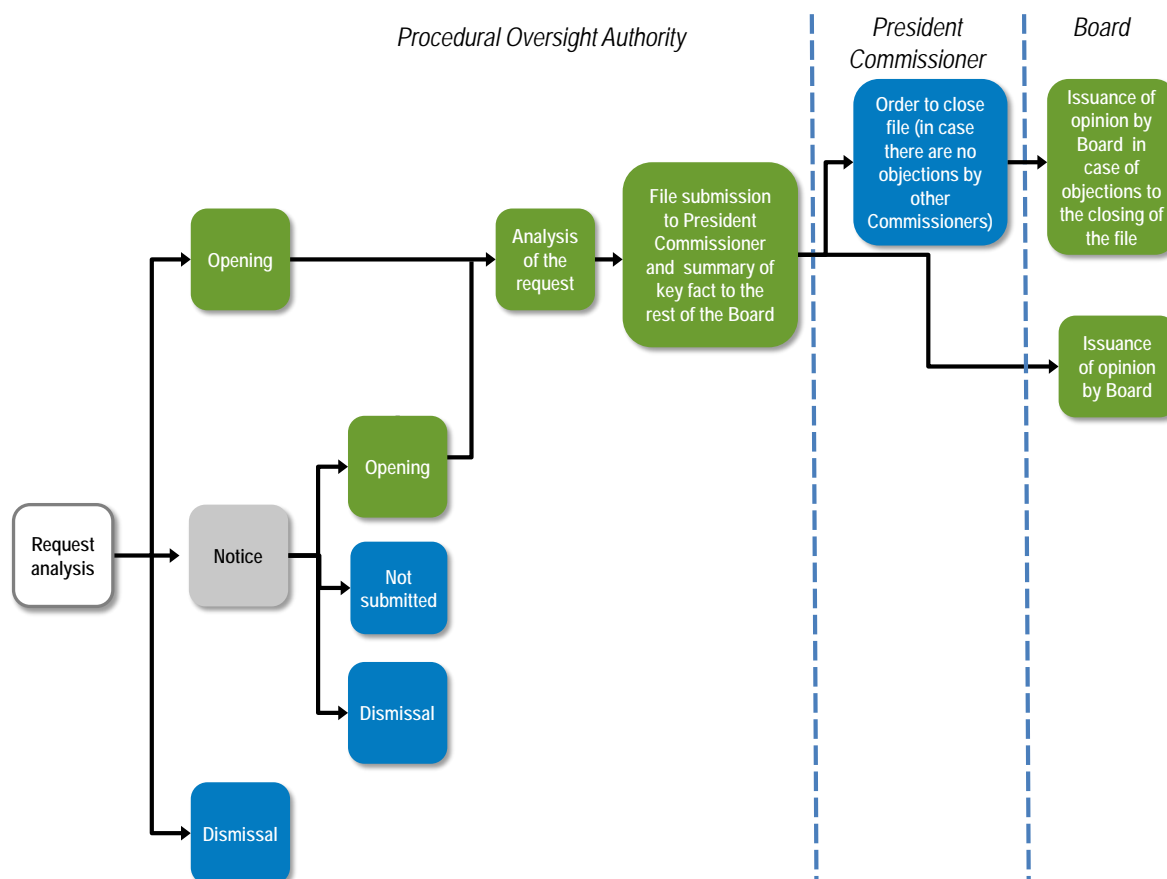
²⁶⁶ See Subsection XII of Article 12 of the FECL.

²⁶⁷ See Subsection XIII of Article 12 of the FECL.

²⁶⁸ See Subsection XIV of Article 12 of the FECL.

President Commissioner may close the procedure if it is concluded that no competition concerns exist, otherwise the file will be discussed and the Board will issue the requested opinion. If at least one Commissioner expresses that the procedure should not be closed, the case will be discussed and decided by the Board.²⁶⁹

Figure 1. Process for the issuance of public policy opinions



Issuance of the opinion: The issuance will follow the process described in Figure 1 unless stated differently in an interinstitutional agreement signed between the competition authority with other public authority.

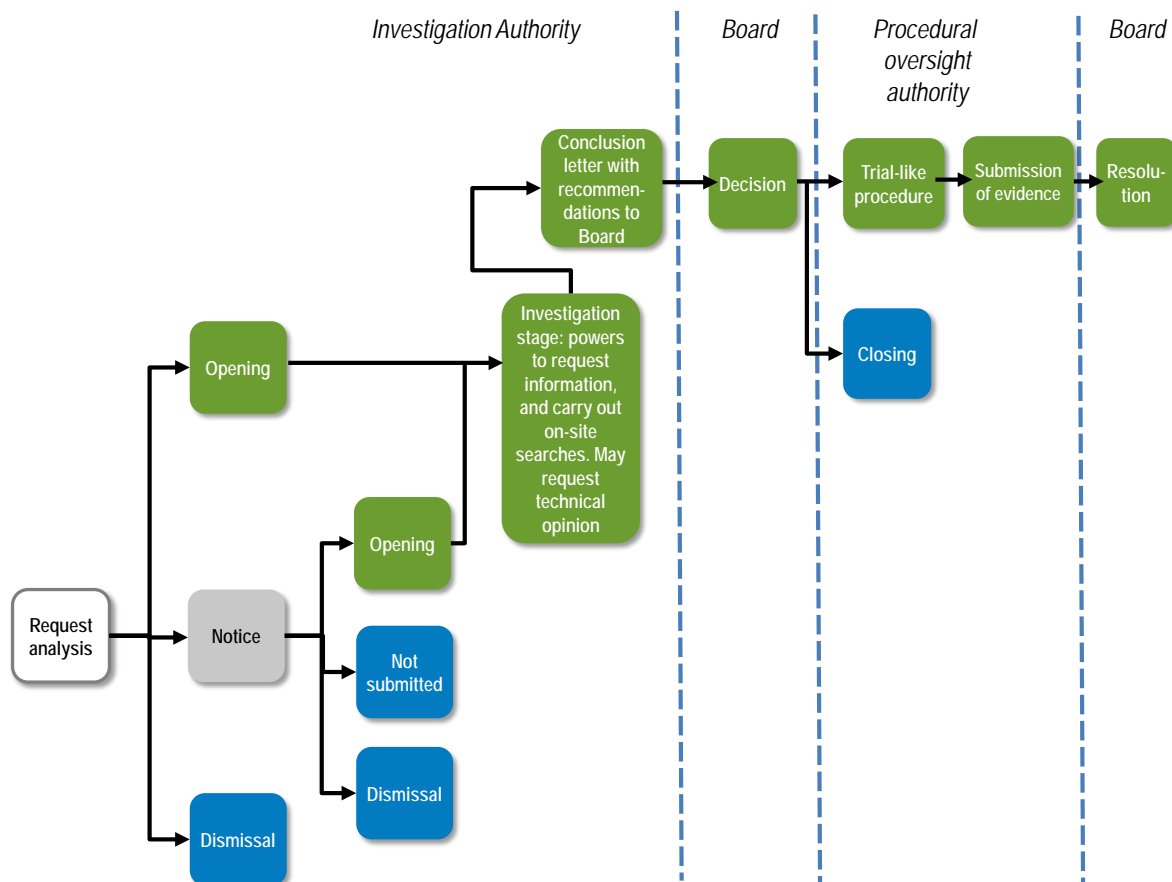
6.2 Anti-competitive conduct investigations

Requests submitted by the Federal Executive Branch, through itself or the Ministry of Economy, or by the Federal Attorney's Office of Consumers (PROFECO), will follow the same process of any complaint of anti-competitive conduct. However, these requests will be considered as preferential.

The process is shown in Figure 2.

²⁶⁹ See Subsection IV of Article 149 of the FECLRP.

Figure 2. Process for dealing with presumed anti-competitive conduct



The analysis of a complaint by the investigation authority has three possible outcomes.²⁷⁰

- Opening of an investigation.
 - There must be reasonable grounds for opening an investigations of anti-competitive conduct.²⁷¹
 - Investigations officially open with the issuance of an initiation decision.²⁷² A notice of the investigation is published in the competition authority’s webpage during the first period of the investigation stage. The notice shall contain the sections of the FECL presumed to have been violated, the market investigated and the case-file number.²⁷³
- *Notice for only one occasion.* When the complainant’s letter does not comply with any of the requirements established in the FECL or it is incomplete, the complainant is given the possibility of an extension to respond the notice. If no response received, the complaint will be considered as not submitted.

²⁷⁰ See Article 69 of the FECL.

²⁷¹ See Article 71 of the FECL, Article 3 of the FECLR and COFECE (2015b) and (2015c).

²⁷² An initiation decision must include the market investigated with the purpose of informing market participants in case they would like to provide information.

²⁷³ See Article 55 of the FECLRP.

- *Dismissal.* When the complaint is notoriously inadmissible because of the following reasons.²⁷⁴
 - The alleged facts do not constitute infringements to this FECL.
 - It is evident that the market participant(s) involved do not have substantial power in the relevant market, regarding relative monopolistic practices or unlawful concentrations complaints.
 - The defendant market participant and the stated facts and conditions in the relevant market have been the subject matter of a previous resolution in terms of articles 83, 90 and 92 of the FECL, except for the cases of false information or noncompliance with conditions or remedies set forth in said resolution.
 - There is a pending procedure before the competition authority concerning the same relevant market's facts and conditions, after the alleged offender has been notified.
 - The claimed facts concern a concentration notified pursuant to article 86 of the FECL, which is pending for resolution by the competition authority. Nevertheless, market participants may collaborate with the competition authority by providing such data and documents they deemed pertinent so these are taken into account when issuing the resolution. The complainant shall not be granted access to the concentration file or documents and may not challenge the procedure; however, the decision incorporating the provided information into the concentration file must be notified.

Key procedural aspects are described below, related to the powers of investigation, its conclusion, the trial-like procedure, and resolution.²⁷⁵

Investigation powers. Once the procedure is opened, the investigation authority has powers to request testimony to any person, as well as to require documents and information to individuals or public authorities.²⁷⁶ This authority also has the power to carry out on-site searches.²⁷⁷ Moreover, the investigation authority may present a criminal case to the Office of the Attorney-General (PGR) and co-operate with it during its criminal investigation.²⁷⁸

Conclusion. The investigation phase will conclude with a conclusion letter²⁷⁹ that shall propose the Board either to initiate a trial-like procedure or the closing of the case.²⁸⁰ If Board decides to initiate the aforementioned procedure, a statement of objections will be issued and notified to the presumed offender(s).

²⁷⁴ See Article 70 of the FECL.

²⁷⁵ See COFECE (2015a), (2015b) and (2015c).

²⁷⁶ See Article 73 of the FECL.

²⁷⁷ See Article 75 of the FECL.

²⁷⁸ See Article 77 of the FECL.

²⁷⁹ The dictum must establish the presumed offender(s), the facts investigated, and the breaches to the FECL, the presumed effects in the market, evidence and its analysis, and the elements that substantiate the recommendation of the dictum.

²⁸⁰ See Article 102 of the FECL. The presumed offender(s) may ask for leniency during the investigation phase of cartel conduct (Article 103 of the FECL). In cases of abuse of dominance and unlawful concentrations, the presumed offender(s) and the corresponding competition authority may, in only one occasion, settle a case during any time of the investigation phase and before a statement of objections is issued. (Article 100 of the FECL) The settlement resolution issued by the Board shall establish the waiver benefit of reduction of a sanction, as well as any commitment agreed to restore the competition in the market.

Trial-like procedure. The procedural oversight authority is responsible of the trial-like procedure and the aforementioned notification.²⁸¹ The investigation authority and the presumed offender(s) are parties of the trial-like procedure. When the case was initiated at the request of the Ministry of Economy, statutory provisions establish that it could provide support to the investigation authority.²⁸² In addition, the Ministry, as any other complainant and with the approval of the competition authority, may add an interrogation or a questionnaire for pericial or testimonial evidence.²⁸³ Also, as any other complainant, the Ministry may request an oral hearing and, if ordered by the competition authority, it may participate in oral hearings and may make further arguments.²⁸⁴

Resolution. Once the submission of evidence in the trial-like procedure is concluded, a designated Commissioner will present the case for review of the Board.²⁸⁵ Before this presentation, an oral hearing may be requested by the complainant or the presumed offender.²⁸⁶ The final resolution or decision of the Board shall include at least:

- Analysis of the evidence that leads to finding the anti-competitive conduct.
- In case of abuse of dominance, the offender shall be accredited with substantial market power in the relevant market.
- Determination of remedies and the terms to fulfill them.
- Determination of sanctions.²⁸⁷

6.3 Barriers to competition and essential facilities investigations

These types of investigations are denoted in the FECL as special procedures.²⁸⁸ The process can start at the request of the Federal Executive Branch, through itself or the Ministry of Economy, when having reasonable grounds for suspecting the absence of effective competition in the market due to barriers to competition or essential facilities.

Figure 3 shows the general process through which requests of this type are assessed and solved within the competition authorities.

²⁸¹ See Article 78 of the FECL and Subsection XXIII of Article 5 of the Organic Statute of COFECE.

²⁸² See Article 82 of the FECL and Subsection XXIV of Article 17 of the Organic Statute of COFECE.

²⁸³ See Article 85 of the FECLRP. When evidence is required the fact or facts shall be clearly expressed in the request letter or complaint. See Article 83 of the FECLRP. Confessional or testimonial evidence provided by public authorities is not admissible in any case. See Article 87 of the FECLRP. The competition authority may reject evidence when it is illegally obtained, has no relation to the issues analysed, or is unnecessary.

²⁸⁴ See Article 80 of the FECLRP.

²⁸⁵ See Subsections V and VI of Article 83 of the FECL.

²⁸⁶ See Subsection VI of article 83 of the FECL.

²⁸⁷ See Chapter II of Title VII of the FECL.

²⁸⁸ See Article 94 of Chapter I of Title IV of the FECL.

Key procedural aspects of this process are related to the notice, opening, investigation powers, co-ordination with sectoral regulators or other public authorities, procedural fairness during the investigation phase, and resolution or decision.

Notice: When a request fails to provide the elements required by the investigation authority a notice will be issued. When the prevention is not answered the request will be considered not submitted.²⁸⁹

Opening: The investigation will commence with the publication in the DOF of a summary of the initiation decision issued by the investigation authority.

Investigation powers: The investigation authority may use the same powers provided for the investigation of anti-competitive conduct. It may call for testimony, require documents and information, and carry out on-site searches.

Co-ordination with other public authorities: The preliminary decision issued by the investigation authority shall include the necessary remedies to eliminate the restrictions to competition in the investigated market; the authority may co-ordinate with the corresponding sectoral regulator or public authority to request a non-binding opinion on the proposed remedies.²⁹⁰

Procedural fairness during the investigation phase: The preliminary decision will be notified to all market participants likely affected by the proposed remedies. Market participants that demonstrate a legal interest in the case may offer evidence to the authority. The procedural oversight authority conducts this stage of the process.

Resolution: When the case-file is completed and before the issuance of a decision by the Board, the market participant involved may propose, at one time, measures which are effective and feasible to eliminate the identified competition concerns. Remedies proposed by the market participant shall include an implementation plan and schedule of achievable and effective corrective measures, the verifiable monitoring mechanisms, and evidence that shows that measures set take place and are sufficient for the elimination of the identified competition problems.²⁹¹ The Board may or may not accept the remedies proposed by the market participant. In case these are not presented, or accepted, the Board will issue a public resolution that may include the following remedies:^{292 293}

²⁸⁹ See Article 104 of the FECLRP. When the applicant does not have the information required in the statutory provisions this shall be clearly justified in the first request.

²⁹⁰ See Article 10 of the FECLRP. The preliminary dictum shall assess if regulation of access to an input, or allowing its use by third parties, generates efficiency in the market.

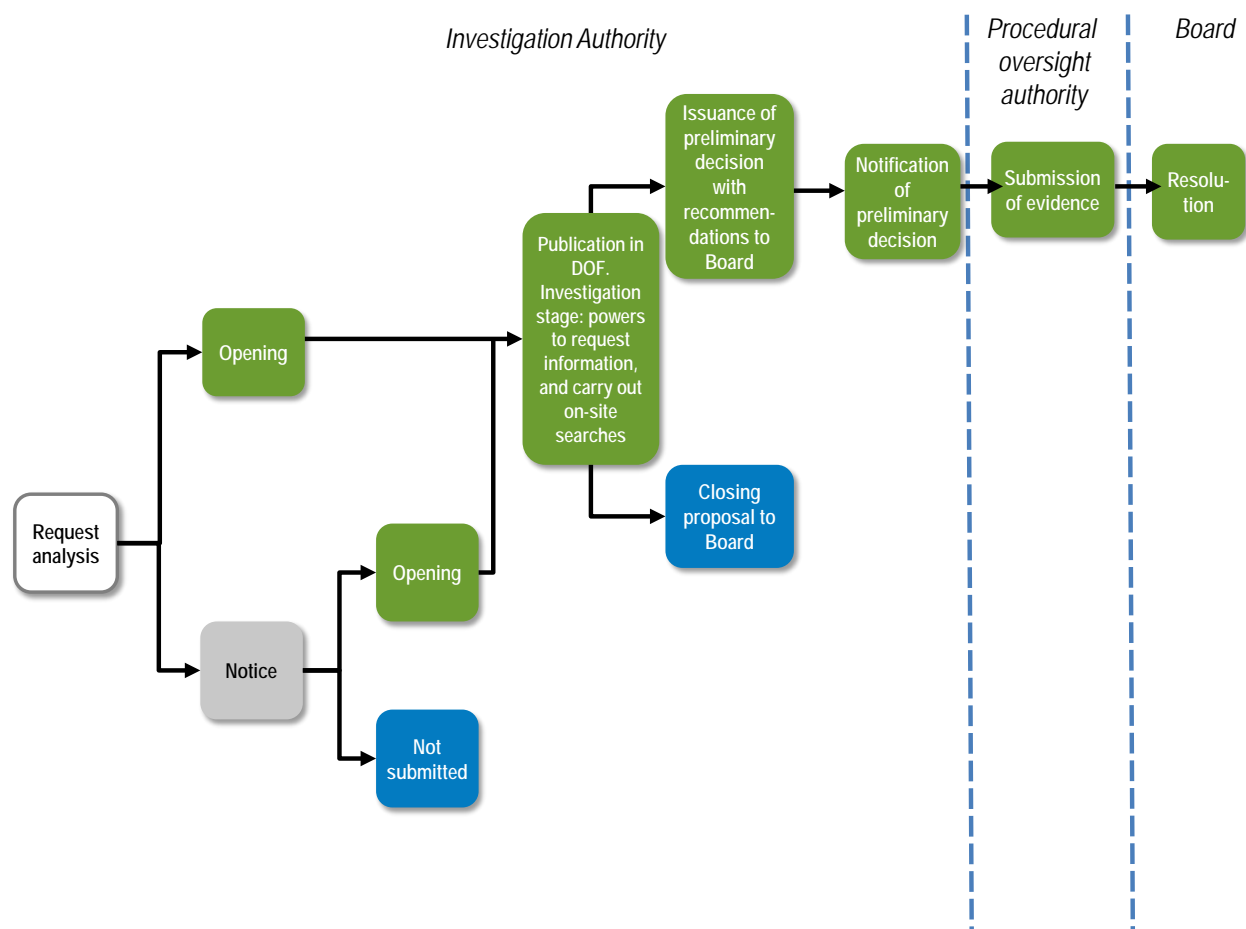
²⁹¹ See Article 107 of the FECLRP.

²⁹² See Subsection II of Article 12 of the FECL. The imposition of such measures has to be approved by the affirmative vote of at least 5 (of 7) Commissioners.

²⁹³ See Article 187 and 189 of the FECLRP. Remedies considered in the preliminary dictum and ultimately imposed by the Board shall accredit: (i) these eliminate the competition concerns; and (ii) are imposed with the least possible costs or restrictions to the market participant (Article 12 of the FECLRP). When the competition authority decides to impose a divestiture of assets the affected market participant may present to the Board alternative divestiture programs. The proposed program(s) shall address the identified anti-competitive effect and substantiate the measures to address them in the least costly manner. See Article 94 of the FECL. Remedies will not be imposed when involved market participants demonstrate efficiency gains that exceed adverse effects on competition and increase consumer welfare. Efficiency gains may be the result of innovation in production, distribution and marketing processes. See

- Recommendations to public authorities.²⁹⁴
- Order to eliminate the barrier to competition.
- Determination of an essential input, its regulation (access, price or tariffs, technical and quality standards, etc.) and the calendar for its application.
- Divestiture of assets, rights, stock or social parts of the market participant, in the necessary proportions needed to eliminate the adverse effects on competition.

Figure 3. Process for dealing with presumed barriers to competition and essential facilities



Article 95 of the FECL. Resolution shall be notified, accordingly, to the Federal Executive Branch, the public authority or sectoral regulator, and the affected market participants.

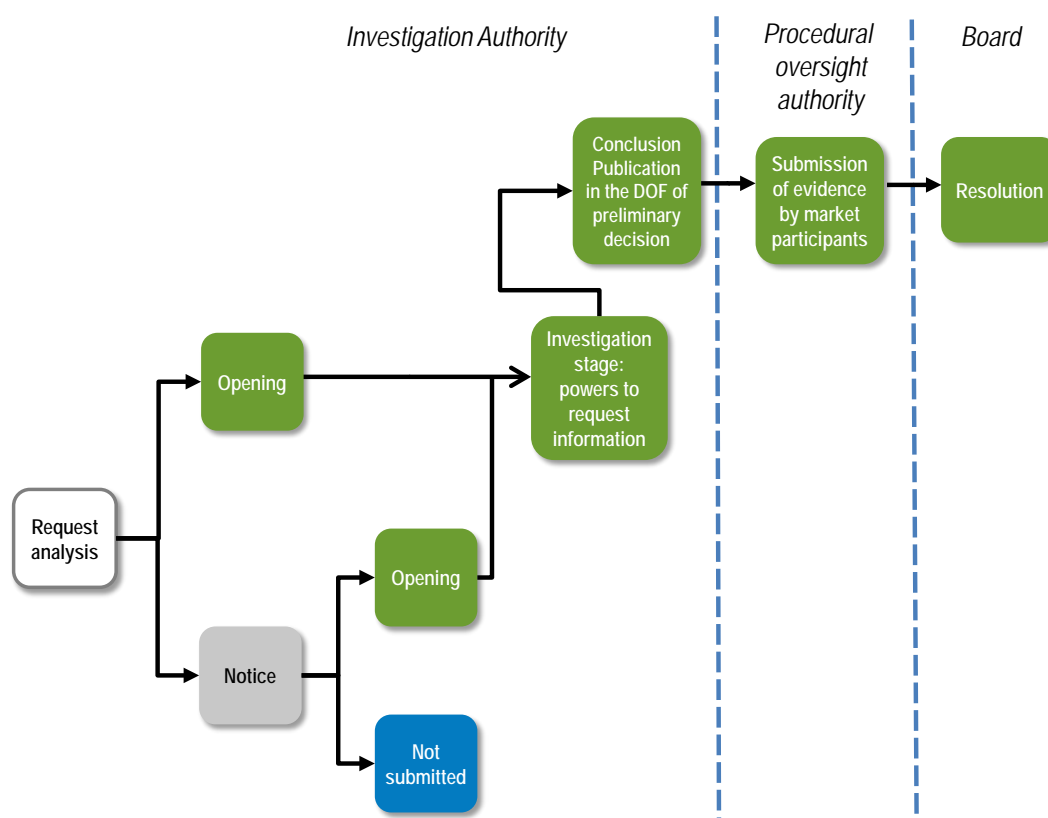
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When the competition authority is aware of public policy issued by a State or Mexico City, or a Municipality that may cause adverse effects on competition or invade the powers of the Federation, it will notify the Federal Executive Branch in order to consider the presentation of an unconstitutionality action. In case the Executive or Legislative Federal Executive Branch issues this public policy, the competition authority may initiate the constitutional action.

6.4 Decisions on market conditions

The procedure for deciding on market conditions is also considered a special investigation procedure.²⁹⁵ Figure 4 shows the general process through which requests of this type are assessed and solved within the competition authorities.

Figure 4. Process for deciding on market conditions



Key procedural aspects of this process are related to the opening of the special investigation procedure, procedural fairness, and decision.

Opening: The investigation will commence with the publication in the DOF of a summary of the initiation decision issued by the investigation authority.

Investigation procedure: The investigation authority will carry out the investigation phase. This authority has the power to request information and documents required for the investigation and may call for testimony of those related to the procedure. If during the investigation phase there are found elements to concluding the existence of substantial market power or insistence of effective competition conditions, the authority will issue a preliminary decision,²⁹⁶ otherwise the case will be closed.

Procedural fairness: Relevant data of the preliminary decision will be published in the DOF. After the publication of the preliminary decision the market participants that demonstrate interest in the

²⁹⁵ See Article 96 of Chapter II of Title IV of the FECL.

²⁹⁶ See Subsection V of Article 96 of the FECL.

investigation may present evidence. The procedure related to the submission of evidence is the responsibility of the procedural oversight authority.²⁹⁷

Resolution: Once the case-file is integrated with the admitted evidence the Board will issue a resolution or opinion that shall be notified to the corresponding market participant(s) for the implementation of the identified remedies.²⁹⁸ The decision or opinion shall be published in the DOF.²⁹⁹

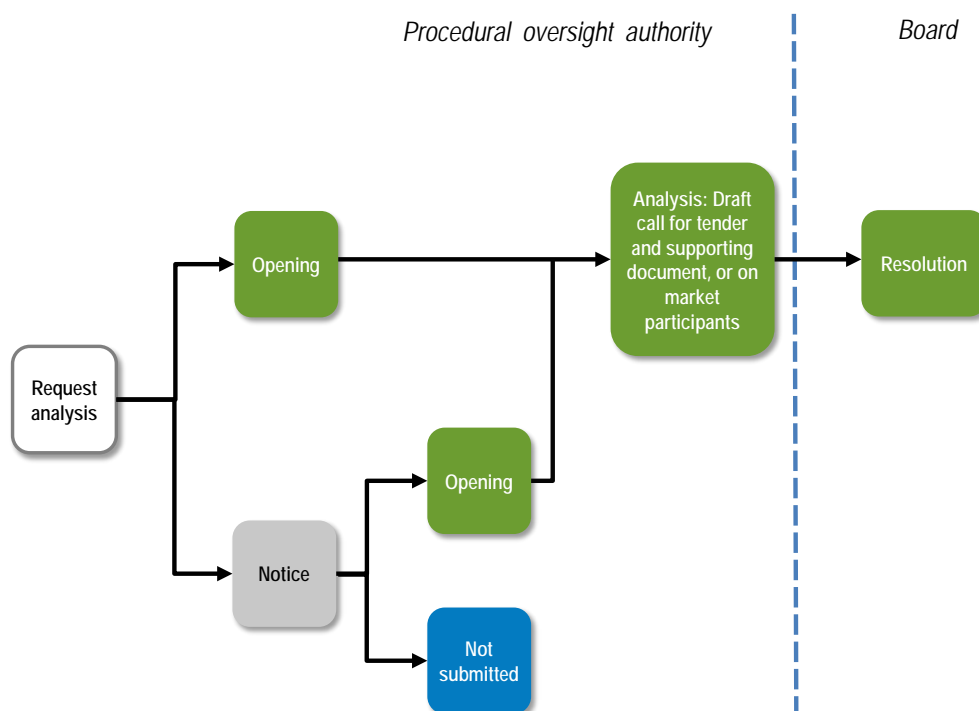
6.5 Decisions on concessions, licences, permits and equivalents

The procedure for deciding on the granting of concessions, licences, permits or equivalents is also considered a special investigation procedure.³⁰⁰ Figure 5 shows the general process through which requests of this type are assessed and solved by the competition authorities.

Key procedural aspects of this process are related to the opening, analysis, investigation powers and decision.

Opening: The investigation procedure will be opened when market participants have submitted the information required by the competition authority and the opening agreement has been issued.

Figure 5. Process for deciding on the granting of concessions, licences and equivalents



²⁹⁷ See Subsection V of Article 110 of the FECLRP.

²⁹⁸ The corresponding authority may request a non-binding opinion of the competition authority on issues related to the proposed remedies.

²⁹⁹ Resolution shall be notified, accordingly, to the Federal Executive Branch, the public authority or sectoral regulator. When regulation is needed to counter act adverse effects on competition a non-binding opinion of the competition authorities may be requested by the aforementioned government actors.

³⁰⁰ See Article 98 of Chapter III of Title IV of the FECL.

Analysis: The request shall be presented in the date specified in the draft tender call and shall be sent to the competition authority before the tender call is released to the public. When there is no tender process, market participants shall obtain a favourable opinion from the competition authority before the transaction or granting is carried out. During this stage the authority may request additional information to the public authority issuing the call for tender or to the market participants involved in the granting process.

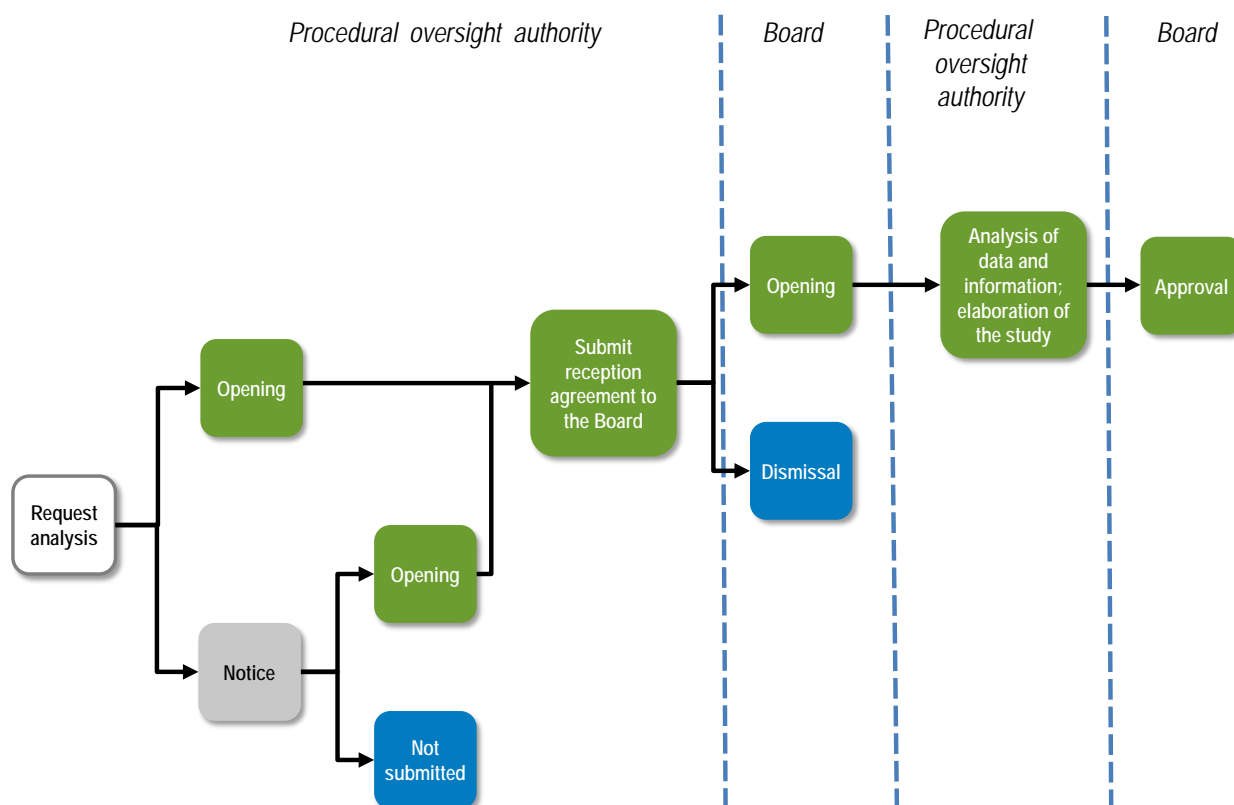
Investigation powers: The procedural oversight authority has some of the faculties provided for the investigation of anti-competitive conduct. It may call for testimony and require documents and information. In this type of investigations it is not possible to carry out on-site searches.

Resolution: The Board will issue a decision with its opinion on the draft call for tender or on the market participants involved in the granting transaction.

6.6 Market studies

Figure 6 shows the general process through which requests for a market study are assessed and solved by the competition authorities.³⁰¹

Figure 6. Process for issuing a market study



Key procedural aspects of this process are related to the opening, analysis and approval of the study.

³⁰¹

See Article 152 of the FECLRP.

Opening: Similar to all procedures described in this manual, a market study will be opened when requests are presented according to the statutory provisions and if information provided is found sufficient by the competition authority. If requests for market studies do not provide the necessary information, the procedural oversight authority may notify the applicant in order to complete the information. If there is no response to the notification request the procedure will not be opened and the request will be dismissed. A market study will start by opening a procedure when the procedural oversight authority issues a Reception Agreement that will be analysed by the Board. Only when the Board approves the market study will it be completely opened through the issuance of an initiation decision, and a summary of this agreement may be published in the webpage of the competition authority.

Analysis: The procedural oversight authority has the power to obtain information and data deemed pertinent for the study and may request information to or subpoena the market participants.

Approval: The final version of the market study is submitted to the Board for the approval of its conclusions, recommendations and, when applicable, liberalisation, deregulation and public policy modification proposals. The results of the study will be notified to the corresponding public authorities, and the public version of the study will be published in the authority's webpage.

Appendix A. Substitutability

Hypothetical example 1– Suppose product A and product B are bicycles, produced by two leading brands. Demand substitutability could be approached by understanding what could happen if the price of product A is raised and some customers make a substitution to product B, and some others substitute it with motorcycles. In this example it is important to assess the competitive significance of motorcycles and of product B in constraining product A's raised price. Since, including motorcycles in the substitution analysis will imply that the market of bicycles is expanded, it is important to consider that motorcycles substitution may be overestimated.³⁰²

Hypothetical example 2– Suppose that product A and motorcycles are no substitutes in demand but are forced into the same product market because the producer of motorcycles could easily and quickly change production from motorcycles to bicycles, in response to a price increase of product A. This may result in an unintuitive product market comprising products that are not demand substitutes, therefore considering the case of supply substitutability.

Hypothetical example 3– Consider printer cartridges as the secondary market of printers. Typically, the consumer buys a printer – the primary product – and subsequently purchases printer cartridges – the secondary product without which the primary product is of little or no use. In this case the printer and its cartridges are viewed as complements and form a system that works properly if it is comprised by both products. Sometimes secondary products are only compatible with the primary product, for example, because of intellectual property rights, and as a result consumers are locked in. However, the supplier of the of the primary product will not increase the price of the secondary product if consumers' choice of the primary product also depends on the price of the secondary product and a higher price would encourage them to purchase a different primary product. Therefore, the primary and the secondary products shall be considered as a system. A different situation arises if for each primary product there are several secondary products available. In this case the primary and secondary products should not be analysed as a system but separately.³⁰³

*Example 4 – Nestlé/Perrier case.*³⁰⁴ This case exemplifies how substitutability may be different in the short and long run, even when technology for producing a different product is simple in principles. For example, the technology for producing cola is simple and some firms operating in other markets (e.g. mineral water and other carbonated drinks) might have this technology. However, success in the cola market is greatly determined by advertising campaigns which entail sunk costs that make entry difficult and risky. In this case, the European Commission found that producers of soft drinks could have started to produce and sell still water immediately. However, for such product to compete with sparkling water, producers would have to incur in large advertising outlays. For this reason, supply substitution was not invoked to include soft drinks in the same market as mineral waters. Moreover, this investigation showed that still water would not imply a competitive constrain to sparkling water producers even in the long run horizon.

³⁰² See US DOJ and FTC (2010), pp.8, OECD (2012a) and Competition Commission (1997) for more examples.

³⁰³ See OECD (2012a), p. 45.

³⁰⁴ See Motta (2004), p. 104.

Appendix B. Cross-price elasticity and price correlation

Cross price-elasticity is an economic concept used in defining markets. Cross-price elasticity is the percentage change in quantity demanded for product B in response to a percentage change in the price of product A. Equation 1 defines this elasticity:³⁰⁵

$$\varepsilon_{BA} = \frac{\partial Q_B}{\partial p_A} \frac{p_A}{Q_B} \quad \text{Equation 1}$$

where p_A is the price of product A and Q_B is demand for product B. In the case of substitutes, this elasticity is positive. The cross-price elasticity between products A and B, ε_{BA} , of 1.5 implies that a 1% increase in the price of product A leads to an increase in the demand of B by 1.5%.

Price correlations are illustrated in the following hypothetical example.

Hypothetical example 5– Suppose there is the question of whether a product market is for still water, or for sparkling water, or for non-alcoholic drinks. The following table presents correlations of prices of eight individual brands.³⁰⁶

Table 1. Correlations between prices

| | A | B | C | D | E | F | G | H |
|---|-------|-------|-------|-------|-------|-------|-------|---|
| A | 1 | | | | | | | |
| B | 0.99 | 1 | | | | | | |
| C | 0.94 | 0.92 | 1 | | | | | |
| D | 0.92 | 0.91 | 0.89 | 1 | | | | |
| E | 0.88 | 0.93 | 0.92 | 0.87 | 1 | | | |
| F | 0.21 | -0.05 | -0.21 | -0.01 | 0.12 | 1 | | |
| G | 0.01 | 0.05 | 0.11 | -0.05 | -0.12 | 0.14 | 1 | |
| H | -0.22 | -0.44 | -0.50 | -0.01 | -0.49 | -0.07 | -0.22 | 1 |

Note1: For calculation of correlations review statistics and causality literature.

Note2: A – C are brands of still water, D – E of sparkling water, F – G of soft drinks, and H of bottled juices.

Note 3: Hypothetical data based on example *Nestlé – Perrier* of Davis and Garcés (2009), pp. 170-171.

³⁰⁵ See OECD (2012a), p35 and Motta (2004), p. 106.

³⁰⁶ See Motta (2004), pp. 107 – 109.

The results suggest that the product market is the market of water, still and sparkling, with positive correlations around 0.9, thus close to 1. In contrast, soft drinks and bottle juices have small positive and negative correlation values. Negative values indicate that as the price of water increases the prices of soft drinks and bottle juices decreases. However, all negative values are below 0.50, indicating a relatively weak correlation. The latter results also indicate that soft drinks and bottled juices may have separate markets of their own.

High price-correlations do not, on their own, demonstrate that products constitute a product market. For example, steel beams and steel cutlery might have high price-correlations but would not be substitutable products.

Appendix C. Diversion ratios³⁰⁷

Products A and B are substitutes if the “product B is a demand substitute for A if an increase in the price for A causes consumers to use more B instead. Product B is a supply substitute for A if, in response to an increase in the price of A, suppliers of B switch some of their production facilities to the production of A. In both cases the presence of B significantly constrains the pricing of A, provided that an increase in the supply of A would result in either a significant decline in the quantity of A consumed as consumers switch from A to B or a significant increase in the supply of A as firms switch production from B to A. [...] The degree of substitution between products depends upon the current prices of the two products.”³⁰⁸

The diversion ratio tries to answer the following question: if the price of a product A increases, what fraction of the lost sales will go to product B?

Therefore, a diversion ratio between product A and B shall establish how much the demand reduction of product A caused by an increase in its price is diverted to product B. Equations 2 and 3 show the product demand curves of A and B.³⁰⁹

$$q_A(p_A, p_B) = a_A - b_{AA}p_A + b_{AB}p_B \quad \text{Equation 2}$$

$$q_B(p_A, p_B) = a_B - b_{BB}p_B + b_{BA}p_A \quad \text{Equation 3}$$

Loss in sales of product A is represented by coefficient b_{AA} caused by an increase in p_A by one unit. The increase in sales of product B is represented by coefficient b_{BA} caused by that same price increase. The diversion ratio between B and A is shown below:³¹⁰

$$D_{AB} = \frac{b_{BA}}{b_{AA}} = \frac{\partial Q_B / \partial p_A}{-\partial Q_A / \partial p_A} = \frac{\varepsilon_{BA} Q_B}{-\varepsilon_A Q_A} \quad \text{Equation 4}$$

Hypothetical example 6 – The own- price elasticity ε_A is -3, the cross-price elasticity ε_{BA} is 1.5, and the quantities for the products are 2000 units for product A and 1500 for product B, the diversion ratio for an increase of 5% in price of product A is 37.5% as shown below.³¹¹

$$D_{AB} = \frac{(1.5)(1500)(0.05)}{-(-3)(2000)(0.05)} = \frac{2250}{6000} = 0.375$$

³⁰⁷ See *supra* 114. International experience illustrates the difficulties that competition authorities face when collecting robust and accurate information on diversion ratios.

³⁰⁸ See Carlton and Perloff (1994), p. 804.

³⁰⁹ See Davis and Garcés (2009), p. 192.

³¹⁰ See OECD (2012a), p. 35.

³¹¹ See *Ibid.*

Appendix D. Hypothetical monopolist test and the SSNIP

Hypothetical example 7– A hypothetical monopolist test would try to answer if the monopolist of still water could increase its price without losing profits because consumers’ switching to (or substituting with) sparkling water. The two possible answers to this question are:³¹²

- Yes, indicating that sparkling water is not a substitute of still water, thus sparkling water shall not be included in the product market of still water.
- No, indicating that sparkling water shall be included in the product market.

This hypothetical test process starts with the narrowest product market delineation which is often call “focal product”. Then it is analysed if the hypothetical monopoly could profitably raise its price for a year on a range of 5 – 10 per cent. If the response to this question is yes, then the product market will be that of the “focal product”. If the answer is no, then the nearest substitute shall be included in the market, resulting in an expanded market that is called “candidate market”, and the aforementioned question will be applied now to this market. The process can be expanded with other substitutes until the last expanded “candidate market” renders a reply of yes to the question.³¹³

In answering the aforementioned questions, the SSNIP looks at whether a small but significant non-transitory price increase would be profitable for the hypothetical monopoly.

SSNIP assumptions are:³¹⁴

- A price increase is regarded as non-transitory if it lasts for one year.
- Firms outside the candidate market will not react and change the prices of their products. Thus, elasticity of supply of firms outside the candidate market is assumed infinite.
- The test does not require a uniform increase in the prices of all products in the market.
- A uniform price is a reasonable assumption in a symmetric situation with similar margins and demand structures.

Hypothetical example 8 – Consider that product A (still water) is tested as a focal market. Price of A is \$1.5 per unit, its sales are 1,000,000 units and its variable cost per unit is \$0.7. In this case the profit equals \$800,000. If supplier of A decides to increase its price by 10 per cent, the new price would be \$1.65, 200,000 units were lost due the increase in price and the new profit equals \$760,000. Since supplier A is making less profit with this price increase, it seems that there are other substitute products

³¹² See US DOJ and FTC (2010), pp. 9 – 12.

³¹³ See *Ibid*, OECD (2010a), p. 30, and Davis and Garcés (2009), pp. 202 – 204.

³¹⁴ See OECD (2012a), p. 30 and Davis and Garcés (2009), p. 227.

to which consumers are switching and shall be included in the market. Therefore, consider product D (sparkling water) is tested along with A as a candidate market. Price of D is \$1.55, its sales are 500,000 units and its variable cost per unit is \$0.55. In this case the profit made in the candidate market composed by A and B (controlled by the hypothetical monopolist) before the price increase is \$1,300,000. This is the profit of A plus the profit of B. When it is assumed that the monopolist raises 10 per cent the price of A and that the 200,000 units lost by A will be sold by D the new profit in the candidate market is \$1,460,000. Under these conditions the monopolist controlling A and D will profitably increase the price of A by 10 per cent. If D is the only identifiable substitute of A, then A and D satisfy the hypothetical monopolist test using a 10 per cent SSNIP. Thus, the market will be composed by A and D.³¹⁵

When using the hypothetical monopolist test and the SSNIP the following assumption shall be made:³¹⁶

- A single supplier may operate in different geographic markets, even for a single product.
- Terms of sale are held constant for all products produced elsewhere.

³¹⁵ See US DOJ and FTC (2010), pp.9 – 12, for more examples.

³¹⁶ See OECD (2010a), p. 30 – 36.

Appendix E. Critical loss analysis

This analysis is closely related to the hypothetical monopolist test. The question asked in this analysis is how much do sales need to decrease in order to render a certain per cent price increase profitable? This question may be answered using the following equation:³¹⁷

$$\% \text{ Critical loss} = \frac{100(\% \Delta \text{Prices})}{\% \Delta \text{Prices} + \% \text{Initial margin}} \quad \text{Equation 5}$$

Hypothetical example 9 – To illustrate equation 5; consider a 10% increase in prices in a market where the margin at current prices is 60%. If the quantity demanded falls by more than 14.3% after the price increase of 10%, then the price increase is not profitable for the hypothetical monopolist and the candidate market shall be expanded.

$$\% \text{ Critical loss} = \frac{100(10\%)}{10\% + 60\%} = 14.3\%$$

When conducting this analysis it is important to bear in mind the current margins. Since a 60% is already high, it may be a signal of market power exercise. In this case the critical loss may appear smaller as margins increase. This leads to a common fallacy known as the *cellophane fallacy*, which could also affect the conclusions of the SSNIP and hypothetical monopolist test.³¹⁸

Consistently, it is worth noting that a higher margin is associated with a lower critical loss as small increases in price on sales that continue to be made are less important, by definition of high margins, than the loss of profits on the sales foregone. Thus, it is often argued by parties that for a firm with a high margin, the actual loss by a 5% price increase will surely be larger than the small critical loss. Therefore, such a price increase would not be profitable and the market would have to be enlarged. However, it should be taken into account that a high margin at the starting price implies that the price elasticity of demand at this price is low, i.e. consumers are not particularly price sensitive. Thus, a small increase in price should be associated with a small loss in demand. The large margin at the starting price and the large losses caused by a price increase could be an indication that the price has already been raised above the competitive level. If this was the case, the firm already possesses market power and the market should not be enlarged.³¹⁹

³¹⁷ See Davis and Garcés (2009), p. 210-211, and OECD (2012a), pp 36 – 42.

³¹⁸ See OECD. (2012a), p. 40. “*The Cellophane Fallacy is a well-known and generally accepted critique of the SSNIP. Its name is directly linked to the US Supreme Court case in United States v EI du Pont de Nemour and Co, in which the Court accepted an overly broad definition of the relevant market thereby failing to detect du Pont’s market power [...]. The Court’s decision has been subject to extensive criticism because of its failure to recognise that the prices on which the market definition was based were already tainted by the infringement. [...]. As prevailing prices above the competitive level were used, a high degree of substitutability between cellophane and other wrapping materials was found and a larger market definition was erroneously embraced.*” “*The recognition of the problem also stopped the EU Commission from applying the SSNIP in Article 101 MasterCard case. See COMP/C.34.579, MasterCard, 19 December 2007.*”

³¹⁹ See OECD (2012a), p. 38.

Appendix F. Shipment test³²⁰

Since LOFI means nearly all sales are made from within the candidate market area it considers that exports into the area shall be equal or less than 25 per cent of the production in the candidate area. See equation 6, where 25 per cent is an arbitrary number.

$$LOFI = \frac{\textit{Exports}}{\textit{Production in candidate area}} \leq 0.25 \quad \text{Equation 6}$$

The LOFI component can also be computed with the total shipments made from plants in the area to inside, as shown in equation 7.

$$LOFI = 1 - \frac{\textit{Shipments from plants in area to inside}}{\textit{Production in candidate area}} \leq 0.25 \quad \text{Equation 7}$$

If LOFI is equal or less than 25 per cent, then nearly all sales occurred within the area, otherwise the area must be expanded to find an appropriate area where the test is satisfied.

The LIFO test examines demand within the candidate area with respect to the production in this area as shown in equation 8.

$$LIFO = 1 - \frac{\textit{Demand by consumers in area}}{\textit{Production in candidate area}} \leq 0.25 \quad \text{Equation 8}$$

As in the LOFI, the threshold of 25 per cent is arbitrary. But both, LOFI and LIFO must be simultaneously above the given threshold for an area to be deemed a geographic market. Thus, the larger the value of LIFO, the lower the proportion of imports into an area and the larger the value of LOFI, the lower the proportion of exports out of an area. The specific thresholds for both measures recommended are 0.75 for a weak market and 0.90 for a strong market.³²¹

³²⁰ See Davis and Garcés (2009), pp. 198 – 200.

³²¹ See French III, Langenfeld and McCluer (2004), p. 927.

Appendix G. Lerner and Herfindahl-Hirschman indexes³²²

Market power is also known as monopoly power. A monopoly maximises profits when the obtained extra revenue from selling one more unit just equals the extra cost of producing the last unit of output. Profits are maximised where marginal revenue equals marginal costs (MC).

Marginal revenue (MR) is expressed as a function of price and elasticity (ε) of demand. Elasticity is defined as the percentage change in quantity that results from a 1 per cent change in price. See equation 9.

$$MR = p\left(1 + \frac{1}{\varepsilon}\right) \quad \text{Equation 9}$$

The difference between price and marginal costs as a fraction of the price is known as the price-cost mark-up, or price-cost margin, also known as the Lerner Index of market power, so that MR equal to MC may be expressed as a function of the inverse elasticity as shown in equation 10.

$$\frac{p - MC}{p} = -\frac{1}{\varepsilon} \quad \text{Equation 10}$$

The higher the elasticity of demand, the closer the monopoly price will be to the competitive price. The index ranges from 0 to 1 where higher numbers imply greater market power.

Building on the Lerner Index, it is possible to find an aggregate index of market power for an industry as a whole. See equation 11.

$$L = \sum_i m_i L_i = \sum_i \frac{m_i^2}{\varepsilon} = \frac{HHI}{\varepsilon} \quad \text{Equation 11}$$

Where L is the aggregate index of market power for an industry as a whole, L_i is the firm i 's Lerner index, m_i is the market participant i 's market share and the HHI is represented in equation 12.³²³

$$HHI = \sum_i m_i^2 \quad \text{Equation 12}$$

³²² See Carlton and Perloff (1994), pp 133 – 135 and Motta (2004), pp. 123 – 124.

³²³ See Motta (2004), p. 123 and COFECE (2015d). For information on how COFECE assesses the degree of concentration using the HHI in the relevant market that will result from a merger.

Appendix H. OECD Competition Assessment Checklist³²⁴

Competition assessment should be conducted if the proposal has any of the following 4 effects:

(A) Limits the number or range of suppliers

This is likely to be the case if the proposal:

1. Grants exclusive rights for a supplier to provide goods or services
2. Establishes a licence, permit or authorisation process as a requirement of operation
3. Limits the ability of some types of suppliers to provide a good or service
4. Significantly raises cost of entry or exit by a supplier
5. Creates a geographical barrier to the ability of companies to supply goods services or labour, or invest capital

(B) Limits the ability of suppliers to compete

This is likely to be the case if the proposal:

1. Limits sellers' ability to set the prices for goods or services
2. Limits freedom of suppliers to advertise or market their goods or services
3. Sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that some well-informed customers would choose
4. Significantly raises costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants)

(C) Reduces the incentive of suppliers to compete

This may be the case if the proposal:

1. Creates a self-regulatory or co-regulatory regime
2. Requires or encourages information on supplier outputs, prices, sales or costs to be published
3. Exempts the activity of a particular industry or group of suppliers from the operation of general competition law

(D) Limits the choices and information available to customers

This may be the case if the proposal:

1. Limits the ability of consumers to decide from whom they purchase
2. Reduces mobility of customers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers
3. Fundamentally changes information required by buyers to shop effectively.

³²⁴

See OECD (2009a), OECD (2011a), OECD (2011b) and OECD (2015d).

Appendix I. Theories of harm³²⁵

Hypothetical example 10 – For example, when assessing the elimination of a licensing regulation imposing entry restrictions into the market, the proposed theory of harm should question if with the removal of the barrier to entry the quantity and the variety of services on offer in the market would increase and/or their price decrease. One possibility to test the theory is to compare the market characteristics under the licencing regulation with the market conditions that would prevail if the regulatory feature was removed or changed to a less restrictive alternative (the counterfactual). Therefore, when studying the impact of likely entry events in this market after eliminating or changing the regulation, a possible relevant question may be *the entry of a new market participants would result in a significant decrease in the market prices?*

There are several ways in which the effects of the entry of a new entrant on market prices could be estimated. For example, the comparison of the average prices in the examined market over a period of time to assess the impact of entry events. This approach assumes that other factors affecting pricing in the market (costs, shocks, etc.) are presumed to be unchanged over the period of analysis. The market characteristics and methodology used in this analysis shall be selected in light of the data available.

*Hypothetical example 11:*³²⁶ Relevant geographic markets have been considered as point-to-point journeys (flows). The question is to determine whether a change in the structure of the markets, through a concentration (merger) might provide an incentive to increase fares or reduce services.

The factors that may be considered are those related to passenger's choice of mode of travel and their ability to substitute between different modes:

- Cost of the journey.
- Journey time.
- Time spent traveling to the passenger's ultimate destination.
- Frequency and directness of the services available and the ease of interchange.
- Other factors – such as personal preferences (whether passenger is traveling alone or in group, the amount of luggage, etc.).

Private and public transports are considered as substitutes when conducting an analysis on a flow-by-flow basis. Public transports being bus, rail and coach.

It is assumed that transport services that overlap on the same flows may compete. Flows on different transport services overlap if they share the same start and end points.

³²⁵ See ICN (2013), pp. 46 – 49.

³²⁶ This example is based on the United Kingdom's experience in the transport sector. See Collyer, Felet and Kitchen (2014).

Theories of harm derived from the above information could be based on the common ownership of transport services, either of the same, or different, modes of transport on overlapping flows or routes, which could give rise to unilateral effects – the incentive and ability to raise fares and/or reconfigure services post-concentration (including reducing frequencies).

In the analysis, other constraints on the ability of the parties post-merger to raise prices may be examined. These constraints are: regulation of rail fares and service levels, the relationship between regulated and unregulated rail fares, and potential for entry/expansion.

Example 12– Australia – Oligopoly theories of harm ³²⁷ Oligopolistic market structures are a commonplace in Australia. Through their repeated interactions and mutual awareness of each other’s strategies and responses over time, oligopolistic firms can achieve market outcomes that mimic or approach those of explicit collusion without explicit agreement, or even direct communication, between competitors. Like explicit collusion, tacit collusion through oligopolistic interdependence can be detrimental to consumer welfare to the extent that it displaces a more competitive arrangement and results in higher prices, lower levels of service, lower quality goods, less variety of goods and services and/or reduced incentives to innovate.

In recent years the Australian Competition and Consumer Commission (ACCC) has investigated a variety of conduct which potentially increased the likelihood that oligopolistic firms would find it profitable to co-ordinate rather than compete. These include:

- Mergers that reduce the number of firms in the market and/or raise barriers to entry and expansion.
- Facilitating practices in oligopoly, including information exchanges, price/capacity signalling and most favoured nation clauses.
- Applications for authorisation involving airline alliances that significantly reduce the number of airlines operating on a route or set of routes.

Facilitating practices are generally prohibited under Australia competition law only to the extent that they constitute a “contract, arrangement or understanding (CAU)” that has the purpose, effect or likely effect of substantially lessening competition. The law permits an inference of CAU from circumstantial evidence, including behaviour by the parties consistent with the existence of an agreement. However, in practice, Australian Courts to date have been reluctant to infer agreement without direct evidence of commitment by at least one of the parties.

For example, in the *TPC v Email Ltd & Ors (1980) ATPR 40-172* case the only two suppliers of electricity meters (*Email* and *Warburton Franki*) issued identical prices lists, submitted identical tenders, adopted the same price variation clause, sent to each other their respective identical price lists, forwarded to each other new price lists immediately after they changed prices or introduced any new meter or component, and tendered in accordance with their respective price lists. However, the Court found no evidence of commitment, either to exchange the price lists or to charge particular prices, and hence no CAU.

Another practical difficulty faced is to demonstrate that firm behaviour and market outcomes ‘with’ the challenged merger or conduct are, or are likely to be, materially different from those that would prevail ‘without’ them – enough that the Court can be satisfied that they result, or are likely to result, in a substantial lessening of competition.

³²⁷

See OECD (2015c).

Where oligopolistic firms' behaviour 'with the conduct' is observable, the conventional approach is to present a combination of expert economist testimony and, where possible, market evidence to establish that oligopolistic firms' behaviour with the challenged conduct mimics or approaches the behaviours expected with explicit collusion – signalling of how firms should behave followed by punishment for non-compliance – and differs materially from what is likely to be observed in the market without the challenged conduct.

In the *Email* decision cited above, the Court was not convinced that firm behaviour and market outcomes would have been substantially different without the challenged price signalling conduct.

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