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Eleanor M. Fox

Gabriel Castaneda Gallardo

Harvey M. Applebaum

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**PART TWO: THE U.S. AND MEXICAN COMPANIES
AGREE UPON SOME VERTICAL RESTRAINTS OF TRADE
IN THEIR CONTRACT**

**MICHAEL W. GORDON,*
GABRIEL CASTAÑEDA GALLARDO,**
HARVEY M. APPLEBAUM,***
ELEANOR M. FOX******

THE PROBLEM

Having resolved issues above relating to the form of the distribution of GROWFAST products in Mexico, the president of GROWFAST has now asked you to prepare the final agreement with AGRICOLAS, S.A. de C.V. GROWFAST is aware that AGRICOLAS is very interested in signing the agreement and will agree to various limitations on activities which GROWFAST believes would be adverse to its concept of AGRICOLAS' role in the distribution of GROWFAST products in North America. The provisions which GROWFAST has included in the draft agreement, and to which AGRICOLAS has raised no objection fearing loss of the prospective distributorship, include the following:

1. AGRICOLAS must restrict its sales of Sollate™ to the Federal District and the State of Mexico.
2. AGRICOLAS must not resell any Sollate™ to retail sellers in the United States, which would compete with GROWFAST's carefully developed distribution channels in the United States.
3. AGRICOLAS must receive approval of GROWFAST before agreeing to distribute any competing products of other manufacturers.
4. All prices of Sollate™ charged by AGRICOLAS in Mexico which deviate from the GROWFAST schedule of prices must be preapproved by GROWFAST.
5. The distributorship does not exclude the possibility of direct sales by GROWFAST to customers in the Federal District of State of Mexico.

These provisions are vertical restrictions on trade. They have been dictated by GROWFAST, without objection by AGRICOLAS (although AGRICOLAS thought they were too restrictive, AGRICOLAS believed it could nevertheless profit selling Sollate™ even with these restraints).

* Partner, Chesterfield & Smith Professor of Law, University of Florida College of Law.

** Partner, Castañeda y Asociados, Mexico, D.F.

*** Partner, Covington & Burling, Washington, D.C.

**** Walter Derenberg Professor of Trade Regulation, New York University School of Law.

THE DISCUSSION

Michael Gordon: Are any of the provisions of the problem in violation of either United States antitrust laws or the Mexican competition law?

Gabriel Castañeda: In the case of the Mexican law, the first issue that arises is what is the relevant market for the fungicide, Sollate™? Is it a Mexican territory relevant market or is it a U.S.-Mexico relevant market? That is the first thing we have to discuss and it is a very touchy thing involving many issues. My view is that while there are some obstacles to entry, such as tariffs, government regulations and so on, we cannot think of a common U.S.-Mexico relevant market, although the Mexican law provides for exactly that. There is no difference between bringing the fungicide from Chihuahua than from Texas. Mexican law says that if we find some obstacles along the way, we will have to carry them over into the analysis of the proper relevant market and ease of entry analysis.

For the purposes of this discussion, let's suppose there are severe obstacles to market entry in the Mexican territory and the relevant market is the Mexican market. We then have to assess the market power of the players. Are we talking about a vertical restriction or what we would call exclusionary practices here? Does our Mexican partner or client have substantial power in the market? Can he or she manipulate prices, that is, push prices up, stabilize prices, or exercise predatory practices? That is the first test to consider.

Next, we have to look at the alternative sources of the product. The case says that the U.S. exporter has absolute power in the United States where there is only one product producer. If there is another kind of fungicide that could be more effective than the one we are addressing, then there is a competitor in that specific relevant market.

A good feature of the Mexican law is that it is very much efficiency oriented. That means, we will have to find an injured party before there will be problems in the antitrust arena of Mexico, either someone who wants to get into the fungicide market or someone who is already in the market and is being threatened by a specific exclusionary practice. From a distribution point of view, the questions to ask are: has the distributor been injured by one of the specific clauses? And is there an abuse of a dominant position in the Mexican territory? If we cannot find an injured party here and AGRICOLAS agrees to the restrictive clauses, there is no problem.

Harvey Applebaum: Could customers or injured parties make the argument that other prices might have been lower but for the vertical price fixing agreement? Under Mexican antitrust law can the customers of the distributor be considered injured parties due to vertical restrictions?

Castañeda: They can be considered injured parties if they can prove actual injury. The key question here is are there alternative products? If there are no alternative products, customers can certainly bring a suit before the Competition Commission and obtain a remedy.

Let me comment about the probabilities of CFC involvement. The way that the law has been drafted, there is the possibility of Commission

involvement on an ex-officio basis, but I would say this is very unlikely unless there is evidence of damage to the competition process. There probably would have to be obvious and considerable evidence of damage in the relevant market.

Applebaum: From the U.S. law standpoint, there are really two questions: one is whether the proposed agreement would only affect competition or commerce in Mexico and the other is whether that would violate the U.S. Sherman Act?

Generally speaking, I think a vertical price fixing or territorial allocation between a U.S. supplier and a foreign distributor, in this instance, a Mexican distributor, ordinarily would not violate the Sherman Act because there is insufficient impact on U.S. commerce. It is not substantial or foreseeable because the impact would ordinarily be only within Mexico. Let's assume that the vertical price fixing, vertical exclusive dealing, and vertical territorial allocations could injure competition within Mexico, either at the manufacturer level, or as I was suggesting in my question, at the level of the customers of the distributor. That would not ordinarily raise any U.S. antitrust law issue. U.S. antitrust law can apply to exports from the United States, but ordinarily does not apply to vertical relations within a foreign country.

Gordon: What if the agreement was entirely in reverse and we had a U.S. distributor serving a Mexican manufacturer?

Applebaum: Then I think we can summarily state that the vertical price fixing is illegal, per se, under the United States antitrust laws. This has been a controversial area for years, but the Supreme Court has never backed off its very clear position that vertical price fixing is, per se, unlawful, and cannot be defended.¹ While the Supreme Court has not reviewed a criminal case in many years, vertical price fixing is subject to criminal prosecution, and state attorney generals have brought criminal actions in recent years.

The other vertical arrangements, territorial restrictions and exclusive restrictions, are not, per se, unlawful. They were unlawful from the 1967 Supreme Court ruling in the *Schwinn* case² until the *Sylvania* case³ in 1977. Now they are governed by the rule of reason. If there is inter-brand competition and the absence of market power, they are ordinarily quite defensible. Since *Sylvania*, only a small handful of private plaintiffs have successfully challenged what we call non-price vertical restraints. So now, there is a very clear dichotomy under U.S. antitrust law between vertical price restraints that remain unlawful, per se, and vertical non-price restraints, which are under the rule of reason.

Eleanor Fox: I agree with my colleagues. Looking at the example of GROWFAST as the U.S. producer and AGRICOLAS the distributor in Mexico, I too was looking to see how that could possibly have any anti-

1. *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988).

2. *United States v. Schwinn*, 388 U.S. 365 (1967).

3. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

competitive effect that would be illegal under U.S. laws. To be illegal under U.S. competition law, you must first have a U.S. consumer that is harmed. Here that is not the case. If there is, for example, retail price maintenance in Mexico, even if it is illegal in Mexico, that certainly doesn't hurt anyone in the United States.

To devise a problem that might hurt someone in the United States, let us suppose that Sollate™ is a monopoly product in Mexico, but not in the United States. Next, let's assume that AGRICOLAS has a well-functioning distribution system, that it is virtually impossible for another American company to set up its own distributorship or to obtain another distributor in Mexico, and that another U.S. producer wants to enter the Mexican market. Finally, imagine that the U.S. producer goes to AGRICOLAS and says, "I want you to distribute my product for me in Mexico and I know you have the facilities to do so," and AGRICOLAS replies, "Oh no, I can't because I've promised GROWFAST that I won't take on any competitors." That exchange creates an interesting problem, one that is being hotly discussed in the United States. Do U.S. laws apply to protect the exports of the U.S. competitor to Sollate™ that wants to get into Mexico? There are two points of view on this. One is that there is no U.S. antitrust problem because, although Mexican customers are hurt, no U.S. consumer is hurt. The other is that there is a U.S. antitrust problem because the exclusion from the Mexican market injures a U.S. producer.

From a global or continental point of view, one would wish, first, that Mexico would enforce its own law, because there is distinct consumer harm in Mexico. If for some reason, not relating to the merits of the case, Mexico could not enforce its own law, there should be a North America remedy. Because the anti-competitive restraint hurts exports and a competitor's opportunities, perhaps the U.S. law ought to be available if the excluded competitor sues.

Gordon: I assume that if a company like Coca-Cola entered into an agreement with a Mexican distributor and then said that the Mexican distributor could not carry Pepsi, and locked Pepsi out of the Mexican market, there could be problems under both U.S. and Mexican anti-competition law.

Applebaum: If Mexico had its own soft drink producers who were blocking Pepsi out in a concerted fashion, with or without the assistance of Coca Cola, then you have something beyond what we have been talking about. This would go beyond competition between U.S. exporters. If the exclusion from the Mexican market is by a group of Mexican companies, both Section 301 of the Trade Act of 1974⁴ and the international antitrust guidelines of the Department of Justice and Federal Trade Commission⁵ could be applicable. Suits by the Department of

4. 19 U.S.C. § 2411 (1994).

5. U.S. Department of Justice and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations (April 1995), *reprinted in* 4 Trade Reg.Rep. (CCH) P 13,107.

Justice, the FTC and by private parties under the Sherman Act⁶ could be considered. This has also been a controversial area: whether the U.S. antitrust laws should be concerned about whether there is vigorous competition within Mexico on the hypothetical soft drinks. At one time the Antitrust Division of the Department of Justice took the position that, since U.S. consumer welfare was not affected, the Sherman Act did not apply. That was reversed a couple of years ago as confirmed in the current Department of Justice international guidelines. At the present time, if the market access exclusion is by a cartel, conspiracy or boycott by potential competitors in the foreign market, the position of the U.S. enforcement agencies is that U.S. antitrust law does apply.

Where the exclusion results from a good deal struck by one U.S. exporter with a foreign distributor, and another U.S. exporter can not get into the market because that distributor is locked up, the issue is more questionable.

Castañeda: Two comments on that. First, in the case of Mexico, being a monopoly is not illegal, per se. The question is one of market entry. It is not illegal for an American company to sell its products on an exclusive basis through an agent in Mexico. The second thing is that the U.S. extra-territorial application of its competition law to Mexico would mean that the relevant geographical dimension of the market would have to be the U.S. territory and the Mexican territory.

Fox: I want to comment on that statement about market definition. He said, that both the United States and Mexico would have to be included as part of the relevant market. I think that he is theoretically correct and maybe Mexico would do it that way, but the United States would not. In its 'market access' claims involving U.S. car companies that want to gain entry into Japan, the United States accepts the framework that is set forth in the international operations guidelines and treats Japan as a separate market.

Let us examine the significance of whether the United States and Mexico are considered a single market or separate markets. Assume again that we have the same vertical restraint and that GROWFAST has appointed AGRICOLAS its sole and exclusive distributor in Mexico. Also, assume that GROWFAST and its U.S. competitor sell 5% of their product in Mexico and the remaining 95% in the United States. If there is a combined U.S.- Mexico relevant market, then the vertical restraint affects only 5% of the market. That is not very much. Alternatively, if you define Mexico as the market, you have a vertical restraint that excludes 100% and that looks much weightier. Under the latter scenario, one is more likely to come to a conclusion that there is an exclusionary restraint serious enough to elicit antitrust enforcement.

Castañeda: Let us assume again the case of two U.S. exporters, one of which has an exclusive distributor agreement in Mexico, and another U.S. company says it has been threatened by this exclusionary practice

6. 15 U.S.C. §§ 1-7 (1994).

and is injured by it. This brings up the issue of export cartels. What is important here is the effect this is this going to have in the Mexican territory. Perhaps those two U.S. exporters get together and say, "I'll sell 50%, you sell 50%; I get half the country, and you get the other half." Is that violating U.S. law?

Fox: No.

Castañeda: It should, but it doesn't.

Applebaum: The U.S. Law doesn't apply only if you have a Webb-Pomerene company,⁷ or a Certificate of Review under the Export Trading Company Act.⁸

Castañeda: The Mexican position would be about the same. The way Mexican law is now drafted, it could accept that the relevant market analysis would cover two U.S. exporters wanting to come into the Mexican market. But I would say that this illustrates the need to develop a uniform position in North America with some sort of reciprocity.

Gordon: As noted above, the U.S. position is that vertical price fixing is illegal, per se. What is the view in Mexico?

Castañeda: Vertical price fixing is not illegal, per se, in Mexico. You have to prove (1) that there is a clear relevant market; (2) that there is substantial market power; and (3) that there is injury to someone wanting to come into the market, or someone who is inside the market that is being threatened to be pushed out of that market. This means that if there is no one who could actually compete in that market and if there is no one injured in that market, there is no injury to the market and no unlawful practice.

Let us look at it the other way around. Let's suppose for a moment there are two large U.S. corporations doing business in Mexico through subsidiaries that have 90% of the relevant Mexican market. The merger of the two subsidiaries is closed in a transaction in the United States. That specific transaction does impinge on the Mexican territory. If the relevant market is the United States plus the Mexican territory, under Mexican competition law, the effect of the transaction is that competition in Mexico will just disappear. There is no violation of competition law in Mexico because the relevant market includes competition that is done or experienced in the United States. Remember, Mexico's economy is about the size of Chicago's economy. It is important for the parties to NAFTA to think about whether NAFTA should be considered a common relevant market for purposes of each parties competition law.

Applebaum: One of the many advantages to U.S. companies of invoking a trade law rather than an antitrust law is that there is not this relevant market concern. Section 301 of the Trade Act of 1974 talks about un-

7. A Webb-Pomerene company is an export trade company, usually composed only of U.S. corporations, which is authorized by the Federal Trade Commission to act as an export cartel with limited immunity from prosecution under the federal antitrust statutes. Webb-Pomerene Export Trade Act of 1918, 15 U.S.C. § 62 (1994).

8. 16 C.F.R. § 1.42 (1995); 15 U.S.C. § 65 (1994).

reasonable burden on United States commerce.⁹ Section 301 was amended in 1988 to add a provision that authorizes the United States Trade Representative to take action if a foreign government is tolerating systematic anti-competitive practices that burden U.S. commerce. That provision remained on the books unused until a few months ago when Eastman Kodak Company, Inc., filed a Section 301 petition alleging that the Japanese government had for many years not only tolerated but assisted Fuji Photo Film Co., Ltd., in exclusionary practices in the Japanese market.¹⁰ In considering this in the context of the Mexican antitrust law, note that the law requires a showing that the foreign government tolerated a violation of its own law.

About a year ago there was an allegation that the Mexican Commerce Department was assisting Mexican sugar producers in preventing high fructose corn syrup produced in the United States from entering Mexico. Corn syrup is a sugar substitute. There was a letter circulated and signed by a number of members of the U.S. Congress, urging the U.S. Trade Representative to invoke Section 301 against Mexico, on the theory that the Mexican government was tolerating systematic anti-competitive practices.¹¹ The foreign government doesn't have to assist or take any affirmative steps, although that's been alleged with regard to film in Japan by Kodak; it simply has to fail to take action. In the context of the NAFTA, it would have been very interesting if the United States had brought a Section 301 action alleging that Mexico was not enforcing its own antitrust law to the detriment of U.S. exports.

Gordon: Who has the right to bring a challenge in these cases? You mentioned before that there has to be some injured party. One would presume the injured party would have the right to bring the challenge, but is the U.S. Trade Representative able on its own to initiate an action if it has a complaint filed before it by the injured party?

Applebaum: Yes, Section 2411 of the United States Code¹² provides that the U.S. Trade Representative has the authority to bring such an action.

Gordon: Mr. Castañeda, would you comment on proceedings by the Mexican Competition Commission to enforce its decision in the courts? What is the capacity of the Mexican judicial system to understand the complexity of these issues?

9. 19 U.S.C. § 2411 (1994).

10. Notice, Office of the United States Trade Representative, 60 Fed. Reg. 35447 (1995).

11. Inside U.S. Trade, June 3, 1994, at 8.

12. Section 301(a) requires the U.S. Trade Representative to bring actions with or without complaint by injured parties where the rights of the United States under any trade agreement are being denied or an act of a foreign country is "unjustifiable and burdens or restricts U.S. commerce." Section 301(b) authorizes discretionary actions by the U.S. Trade Representative if he determines that an act of a foreign country is "unreasonable or discriminatory and burdens or restricts U.S. commerce." Under Section 302, investigations may be commenced by petition of "interested persons" which includes U.S. firms and workers, representatives of consumer interests, U.S. product exporters and certain industrial users of goods and services. Trade Act of 1974, 19 U.S.C. §§ 2411-2495 (1995). *see discussion in Folsom and Gordon, International business Transactions* §§ 14.4-14.9 (1995).

Castañeda: With regard to the interface between the Commission's decisions and the judiciary, I would say that it is only on constitutional rights violations that the federal courts will intervene. In Mexico, we have what we call "the guarantee of legality" which may be raised in an amparo proceeding.¹³ This means that the party which is not satisfied that the Commission has applied the law properly may seek some sort of remedy before the courts. That certainly is going to induce the Commission to get a consent agreement before litigation. What is going to be the outcome if there is litigation? I am quite optimistic about it. There is a group of three or four federal judges I know who have been studying competition laws for some time now. One of them had the opportunity to look at two of the three cases that are subject to amparo proceedings at this time. I am very satisfied that federal judges will have enough interest to go into the details. I think there are checks and balances between the judiciary and the Competition Commission which is very healthy.

Fox: With regard to the interpretation of the Mexican antitrust law by the Mexican courts, I believe that in a civil code country like Mexico, there is a tendency of the courts to read the laws more rigidly than would be consistent with a flexible "rule of reason." However, I understand that Mr. Castañeda would interpret the Mexican statute flexibly. For example, Article 10 of the Mexican Economic Competition Law on relative monopolistic practices, seems to cover all conduct other than cartel practices. It seems to me that there is a reading of that relative monopolistic section which would find these practices illegal if the challenged firm has substantial market power. Is there a possibility that when these cases are litigated, the Mexican federal courts are going to find the relative restrictive practices to be illegal only if the imposing party has substantial market power?

Castañeda: Article 10 sets out some examples of exclusionary practices, like vertical price fixing, exclusive distribution contracts, tying, boycotts, but it also has a great catch-all, section 7¹⁴, which incorporates all other practices that could unduly restrain competition. The first part of the article also says quite clearly that those practices will be deemed illegal if it is proven that there is: 1) a clear relevant market; 2) substantial market power by the accused party; 3) an assessment of market entry

13. In Mexico, the legal concept of *amparo* involves legal protection of rights specified in the Law of Amparo by procedural remedies. It has been described as having "five diverse functions: (1) protection of individual guarantees; (2) testing allegedly unconstitutional laws; (3) contesting judicial decisions; (4) petitioning against official administrative acts and resolutions; and (5) protection of farmers subject to the agrarian reform laws." H. Fix Zamudio, "A Brief Introduction to the Mexican Writ of Amparo," 9 *Calif. W.Int'l L.J.* 306, 316 (1979).

14. *Ley Federal de Competencia Económica* (Federal Economic Competition Law), ch. II, art. 10 VII, *DIARIO OFICIAL DE LA FEDERACIÓN* (Daily Gazette of the Federation) (Dec. 24, 1992) (En general, todo acto que indebidamente dana o impida el proceso de competencia y libre concurrencia en la producción, procesamiento, distribución y comercialización de bienes o servicios.) (Any act in general, that unduly impairs or impedes the process of competition and free participation in the production, processing, distribution and marketing of goods or services.).

for alternative products or services in the specific market, and 4) (most importantly) standing before the Commission by an injured party. If there's not an injured party, i.e., someone who's been thrown out of the market, or someone who cannot come into the market, there is no way the Commission would deem that there has been an illegal practice. It is arguable that consumers would have standing before the Commission. However, the original idea was not to bring the consumers in. I'm not very familiar with the international practice about consumers, but in Mexico consumers are now well organized. We have thought about requiring that there be substantial groups of consumers, a sort of class action, in order to have standing to complain to the Competition Commission. Mexican law was carefully drafted to avoid inefficient suits; Mexico not being the litigious society that the United States is.

Gordon: Let's move on to the question of remedies. You do provide for injunctive relief. However, Mexico doesn't have treble damages, although there is a provision that seems to provide for double damages for habitual offenders. Could you comment on that?

Castañeda: We have injunctive relief to suspend the practice itself, and then a single damage provision. You don't get that directly from the Commission, which is an administrative entity, but rather from a judge. So you need a decision saying the Commission is satisfied with the plaintiff's assessment of the practice itself, and with the plaintiff's claim to damages. If you get that decision, you go to a federal judge and get an actual judicial decision to obtain damages.

Applebaum: After the Commission has made the assessment and the injured party is entitled to go to the Court, does the Commission play any role in the judicial proceedings? Is it a party, does it have any status, does it intervene?

Castañeda: According to the Mexican Code of Federal Procedure, the Commission can be called by the judge to make comments or give opinions after the administrative decision, but the Commission is not a party. The Commission's job ends when the Commission renders its decision.

Gordon: Would the commission be involved in recommending a certain level of damages?

Castañeda: The way it works is that the Commission will not offer any sort of damage calculation or assessment. It will react to the damages claim brought by the plaintiff. The law is very clear. You have to prove the amount of damages, and the assessment of damages, before the Commission. The Commission may say we think you are right, there has been a breach or violation of the competition law, but we think your assessment of damages is not right.

Gordon: Aren't these damages for violation of the Economic Competition Law quite high compared to other Mexican laws?

Castañeda: The parties do not pay much attention to the assessments of damages in Mexico. There has not yet been one case under the competition law where the amount of damages has been brought before the courts in Mexico. Even in the United States, few cases end in an actual decision. There are out-of-court settlements. In Mexico, that happens very often.

