

United States - Mexico Law Journal

Volume 9 Presentations at the Ninth Annual
Conference

Article 11

3-1-2001

Comparative Perspectives of the Regulatory Process

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Recommended Citation

Santiago Gonzalez Luna, Leon R. Elizondo Castro, Omar Guerrero Rodriguez, Alfred Mathewson & Rafael Valdes-Abascal, *Comparative Perspectives of the Regulatory Process*, 9 U.S.-Mex. L.J. 105 (2001).
Available at: <https://digitalrepository.unm.edu/usmexlj/vol9/iss1/11>

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COMPARATIVE PERSPECTIVES OF THE REGULATORY PROCESS

LIC. SANTIAGO GONZÁLEZ LUNA, MODERATOR*

Panelists: Lic. León Ricardo Elizondo Castro, Lic. Omar Guerrero Rodríguez
Prof. Alfred Mathewson; Lic. Rafael Valdés Abascal

GONZÁLEZ: Licenciado Guerrero, I would like to ask why you think the Warner resolution is inconsistent with prior resolutions by the court? Why do you think that part of the forum was expecting that the Supreme Court was going to support Warner-Lambert's position instead of the Federal Competition Commission's position?

GUERRERO: First of all, there were two Warner-Lambert cases. In the arguments raised in both cases, I thought at least some of them were sufficiently grounded to obtain the protection of the Supreme Court of Justice. I am going to concentrate on the catch-all provision. Going one step back, the Federal Law of Economic Competition provides in Section 9 of the law a list of activities that can be considered horizontal practices or *per se* violations of the law. Those activities are absolute monopolistic practices. Section 10 provides a list of six activities, including distribution agreements, stipends, boycotts, resale price and maintenance. The list concludes with the catch-all provision which says that any act that unduly drives out competitors from the market can be considered a monopolistic practice. In my conception, that provision is unconstitutional or contrary to the Constitution. Because a person might be deprived of assets or be sanctioned by the Commission with a strong penalty, divestiture of assets, suspension or suppression of acts or, in some very limited cases, to criminal penalties, it is necessary to know exactly what kind of behavior can be punished. Therefore, Warner-Lambert was a predatory pricing case. The question that was raised during the proceedings was what kind of costs should be considered: average variable cost, total cost or any other kind. I know that from the U.S. perspective, you have your standard in the *Broad Group, Ltd.* tobacco case issued in 1993 whereby there is a uniform and appropriate measure of cost and recovery of losses. We do not have that in Mexico. In Mexico, the defendant does not know from the beginning of the proceeding which kind of cost will be considered, whether recovery losses are important, whether the defendant needs to suffer losses too, etc. I think it is going to be difficult for the defendant to set forth sufficient arguments to convince the Commission that it is mistaken. It is also important to take into account that the Commission commences the proceedings, the Commission is going to judge whether or not an unlawful practice has been committed and the Commission is also going to legislate what kind of costs or elements of the infraction will be considered. If I go to definite resolution, the Commission is going to resolve again. Then, I have to escape out from the resolution of the Commission in order to challenge that in *amparo* in order to get the protection of the Supreme Court. In the Warner-Lambert case, this issue was not finally resolved because the Supreme Court of Justice considered a procedural matter at that stage. Since we won the case in the first instance and we were just warned by the Commission, we did not have any harm to put before the

* A summary of the background of each of the participants in this panel follows on the last page of the panel discussion.

Court. Therefore, we just had to wait until we could be condemned. That day arose just some months after the initial decision when we were condemned for predatory pricing behavior. That case is still pending resolution by the Court.

The second remark I would like to make is that I truly believe that the Commission makes "fishing expeditions." Often the Commission starts, as in the case that Lic. Elizondo mentioned, the Mexilub and Pemex Refining case, an investigation in 1997 and the defendant is indicted in 1998 or 1999. I think it is an extremely long period of time for indicting some person. I think the Commission needs to have some kind of limit on the authority it is exercising. The Court has said in prior cases that legal certainty is a value that needs to be protected and I think the Court has superseded those precedents and has supported strongly the law because it has considered the law to be important in a globalized economy.

GONZÁLEZ: Licenciado Valdés, first of all, I would like to give you an opportunity to explain with more detail the tequila case because I think there was a piece missing. It was the shortage in the principle raw material for producing tequila, which is the agave. I would like Lic. Valdés to explain to us a little more about that and about why, with such, from an outsider's perspective, a small market participation of only 38% of both after the concentration of Cuervo and Herradura, it is justified to block such a merger?

VALDÉS: I think that a market share is one of the elements to consider in order to determine if the concentration must be challenged. There are other elements as well, including the levels of concentration, with the calculation of the Herfindahl and the Dominance indices, the barriers to entry and, in this case particularly, the access to exports. Analyzing the first element, the market shares, in itself is very relevant because Cuervo and Herradura together have 38% of the market share, which is bigger than the 50 smaller competitors in the tequila market combined, making it impossible for them to counteract the power of these merged companies. Cuervo and Herradura are twice as large as the competitor that would be in second place after the concentration, Sauza. It would even be difficult for Sauza to counteract an economic agent twice its size in regard to market shares. Furthermore, when applying the Herfindahl and Dominance indices, in all the cases it appears that the concentration will surpass the limits established by the law and the criteria issued by the Commission for considering whether the market operates in competition conditions. As Lic. Elizondo said, the Dominance index permits a limit of 2,500 points and the Herfindahl index permits a limit of 2,000 points; in all cases, this limit was surpassed. Well, when analyzing production, the level was a little bit lower than the limit. However, the tequila that Cuervo acquired from other small producers was not considered along with that which Cuervo sells with its own trademarks; if this production had been included along with the production of Cuervo, obviously the limits would have been exceeded. The other element is the barriers to entry, which I mentioned roughly. But I think the most important element in this case to analyze is the agave market. Agave is the most important input of tequila but has been very scarce for the last five or six years due to a plague that has affected approximately 25% of this plant. The agave demand has grown enormously given the increasing demand for tequila. In the last four years, tequilas such as those produced by Herradura have had an estimated 200% in their sales. This situation has led to a very high price of agave. Tequila Cuervo and Tequila Herradura, both separately and together, now have secure access to the input. They

have long-term contracts with producers and they also have their own production of agave. So Tequila Cuervo and Tequila Herradura are able, with this guaranteed supply of agave, to keep their tequila prices at a reasonable level. Because the other producers depend more on the spot market, they will face very high prices unless they do one of two things. One option is to sell at the same price as Tequila Cuervo and Tequila Herradura; however, that would lead them to financial problems because of the cost of the input. The other is to sell the tequila at the higher price to reflect the cost of agave, effectively forcing them out of the market because nobody will buy their product.

GONZÁLEZ: Lic. Elizondo, how do the different enforcement agencies in Mexico interact? You have natural monopolies regulated by specific agencies. You have the telecommunications agency, the energy agency and the banking agency. But then we see a case like the Telmex case that you presented to us today and it seems like the Federal Competition Commission steps into a territory that belongs to someone else and is willing to impose its criteria without respecting the division of jurisdiction. As I said, this is the perspective of an outsider. I was not in the case so I have no idea if that is what happened but I would like to understand how jurisdictions interact.

ELIZONDO: When the case of Warner-Lambert was tried before the Commission, there was no regulation. Therefore, there were no specific provisions to regulate the proceeding. In 1998, the regulation of the FLEC was passed and so that we have now this proceeding as well as the kind of conduct that will go within the catch-all provision. Right now, Article 27 of the regulation states that the procedure before the Commission has two different stages. One is for the investigation that, according to this article, could last no less than 30 days and no more than 90 days. Because the initiation of the investigation is published in the official gazette of the federation, the "no less than 30 days" provision gives any other person that may have knowledge the opportunity to come forward. Any other person that may have a problem in the same market that is going to be analyzed or investigated by the Commission could get in the boat and contribute information to the Commission. After that, the Commission has already been convinced that presumably liability is in that particular defendant. In other words, that defendant is summoned and given the right and opportunity within 30 days to produce its defense and then to provide all of the evidence and information that they think could be possible in order to challenge the arguments of the Commission. That is the rule right now, though it actually did not exist at the time these proceedings occurred. However, we can discuss a lot about the fact that whatever any firm or company could have knowledge of at that time, even without the existence of the relation, that predatory pricing was illegal. The fact is that Article 10 of the FLEC says that we have to be confronted with an undue displacement from the market. What is "undue" from the legal point of view is what is against any law. A firm or a corporation is created by nature in order to make money. The main reason for having a corporation or for entering into a venture or business is to make money. We may have some additional reasons, to develop human reserves and technology or whatever, but a business is no longer a business when it stops making money. In order to carry out a predatory practice, you necessarily need to subsidize the losses that you have with one product with another. So it is irrational to sell below cost. The difficulty is trying to decide whether we are talking about total costs, variable

costs, marginal costs, etc. Actually, I could agree that it is very difficult to define. But when the Commission made this decision, it put the criteria in Article 7 of the regulation and determined that it will be predatory pricing when the plaintiff or firm systematically sells below variable costs or occasionally sells under total costs. Right now, there is great confusion as it is stated in the regulation. But as a matter of information, the Supreme Court is about to make its final decision on this case and also we expect it will be supported by some foreign criteria and by all the decisions that have been produced in foreign countries.

The interaction that the Commission has had with several authorities at the federal level is found in two provisions of the regulation, Article 50 and Article 51. Article 50 provides that when it is necessary to give the opinion of the Commission in a competition matter, the proceeding followed there has to be observed. And the cases arose when laws were passed in many of these regulated sectors, such as telecommunications or energy. The Commission participated in the elaboration of this loss in order to integrate the provision for those cases where there was an absence or lack of competition or where there was some market power. There is a case, for instance, in Telmex. The telecommunications law says that when the Competition Commission decides that there is a firm with market power, a dominant firm, then the Telecommunications Commission will have to apply the specific isometric regulation for that particular firm. It is isometric because it does not apply to all of the competitors, only to that one especially. The same happens in airports, in ports, in maritime terminals, in some concessions and permissions for distribution and transportation of gas, natural gas and LP gas, etc. The coordination that has been achieved between the Telecommunication Commission and other entities has found its source in the specific laws providing that these regulators are in charge. It has also been found in the sales that their own federal government makes when they are privatizing some companies, as in the case of the privatization of the railroad or the general warehouses. The opinion of the Commission has to be first taken in order to make a clarification of the interest and the parties interested in participating in these public biddings. Otherwise, when the federal government finally awards the winning party because it offered the highest bid, they would still have to go to the Commission in order for the Commission to say, that's perfect, he was the winner and the one who will give you more money than anyone. I have a problem with that. The trouble with that scheme is that all the participants go first to the Commission to obtain this authorization, after which they can go to the party organizing the bidding, which is regularly a federal agency, in order to finalize the sale of these state-controlled assets. Those are the cases in which I think there is a lack of coordination between the Commissions.

GONZÁLEZ: And to Professor Mathewson, I would like to ask about the confidentiality issue. This is a very Mexican question and I am sorry to pose it like that, but I would like to understand how you think, from an American perspective, confidentiality will work. In Mexico, we even have in our regulation a paragraph that says when a "denounce" is presented in a merger case and the notification period has not expired yet and the merging parties notify the merger in time, the notification procedure shall prevail. The "denounce" procedure will be stopped but all the information given by the demanding party or the plaintiff would have to be considered in resolving the notification case. And furthermore, it says that party, the plaintiff, will not have access to the rest of the docket. How can you defend your

rights without having complete access to all information that is on the docket? This is linked to one procedural aspect of Mexican *amparo*. *Amparo* against procedures can only be applicable where one of the parties is considered to have lost a very important element in his defense because of the conduct of the authority. In Article 159 of the *Ley de amparo*, one of these elements is not having complete access and the right to argument of all the evidence in the docket. So in other words, it would seem that under *amparo* law, the kind of procedure that our regulation is establishing to coordinate notifications and denounces is a clear violation of procedural rights under the *Ley de amparo*. So that is what puzzles me. What is the solution you have given in American law, within antitrust or any other area based on your experience? How do you manage confidentiality issues in the United States? Who has access to the docket that contains all the very important information in order for the Federal Trade Commission or the Department of Justice to make a reasoned decision? Who has no access to that and is the business community concerned about confidentiality, other than giving the data to foreign agencies? Or do they also have domestic concerns about confidentiality?

MATHEWSON: From what I have read, I do not see an issue with respect to confidentiality in the United States. And what I understand is that the data and information submitted to the FTC and DOJ is exempt from disclosure, I believe prohibited by the Hart-Scott-Rodino Act itself, from disclosing that information unless you have a subsequent administrative proceeding and the information is relevant. I think that part of the problem has to do with, in terms of confidentiality, there is a difference in the America process in terms of the recourse of non-parties to the merger. Technically, a non-party could still challenge the merger if that person was injured by the merger apart from approval by the administrative agency. So if they filed suit apart from the process, you would get into the discovery process and then you get into a court looking at discovery. In that instance, the party would have to get the information from the merging company, the company that has applied to the DOJ or the FTC. You can not get it from the administrative agencies themselves so you would have to go through discovery. Once you got to court, and I am not sure that you could, there is information the courts may not be willing to give in you in the discovery process. I know there have been some lawsuits where Coca-Cola has been sued occasionally by plaintiffs who have tried to discover the secret formula for Coca-Cola. I don't think they have gotten it but it seems to me the issue gets shifted over to the court. I have not seen confidentiality within the United States as an issue and I think the way that this has come up is that the rules for confidentiality here may not be the same rules that are used in other countries. That has been the concern, which is why they tell us, if you are going to share it, let us know in advance, because once it gets shared and there is a different set of rules, then you have the question.

GONZÁLEZ: Do you think this is the first case of monopsony? The power by the buyers or am I completely wrong?

VALDÉS: I think that the case of Telmex is one of the most important. If I understand your question, it is whether the fact that the persons involved in the transaction also have dominant power in the related market of the inputs and the markets that require such inputs is the rationale for objecting to or challenging the transaction? I think the case of Telmex is maybe more important than Tequila Herradura. The issue in Telmex was not analyzing a concentration per se but

analyzing the dominant power of Telmex. There, you can find that the local telephone company, the basic input of the long distance services, is monopolized by Telmex. So Telmex has all the incentives to block access by competitors in long distance with the local telephone market. That has allowed Telmex to gain more market power in long distance and even in cellular and markets related thereto.

GONZALEZ: Do we have any questions?

KRUMBEIN: Yes, a question and a comment. My name is Richard Krumbein and I am a member of the law firm Darcy & Whitney. First of all, I thank the panel. The only thing I am sorry for is that we didn't have this session four weeks ago. Three weeks ago I found myself in Mexico City in a law firm sitting there with my team preparing the three-inch thick document for notification. I agree with Professor Mathewson that the cost is a concern. However, I think there is an overriding concern which I would call predictability. I am going to direct a question to Lic. Elizondo regarding the issue of predictability. What happened was that while we were working preparing the filings and all of the documents, I received the dreaded question from my client. He called me from the U.S. and said Richard, you are going to file this week, there is 45 day period for the answer, as long as there are no requests for more information, what are the chances that this is not going to be objected to? Well, we had done some research and we did a lot more research with the team of five attorneys in there, and we came up with the answer: we don't have a clue! Because both the law and the regulations are fairly recent, we really couldn't answer the questions, even as far as defining the size of the market, the concentration and so on. So we really could not give any degree of predictability. So Lic. Elizondo, maybe you could shed some light on what we are supposed to do in those cases. Especially in the case where we are going to file notification as required and because whatever the constraints, financial constraints, timing, we need to proceed with a transaction before the expiration of the 45 day period.

ELIZONDO: The FLEC orders that you have to file the pre-notification before you close the transaction. Once pre-notification has been filed, you may close the transaction the very next day. However, you do so at your own risk. The predictability that you may have could be in accordance with the market share that your client has; market share is undoubtedly a very good sign of the probable result of the decision. However, if you are in a hurry for the resolution, you may want to close it even before you go before the Commission. You may stipulate a kind of suspense condition in your contracts that says that this transaction will not have effect in Mexico until the time the decision of the Commission has been issued. You may wonder whether I am just saying that when in reality, it starts having effects immediately and there is no reason for the stipulation. But what is required by the Commission is that you not only state the stipulation in your contracts but that you take necessary measures in order to prevent the transaction from having any effect before the decision of the Commission is in. For example, you may enter into an escrow agreement for the stock shares. You may establish that no registration of the translation of the change of the ownership of those stock shares will be registered in the books of the company. You may not be able to start making decisions about the board of directors, the general directors or any policy affecting the way this company is operating. In other words, aside from the stipulation in the contract, it is desirable that you are able to provide the Commission with enough elements to show that the effects of the transaction within the boundaries of the

jurisdiction of the Commission will not affect the process of the Commission. And coming back with the issue of predictability, the market share could be a good indication of that as well as the barriers for competition, in order to evaluate how much power you are going to have after the transaction is closed. You may have a perfect monopoly within the country, as far as there are no restrictions for the entry of new competitors. In some industries or markets where, as is in the telecommunications industry, nobody is going to start a long distance service from one day to another, there is a very powerful barrier that will concern the Commission. But the situation is different if you are talking about some plastic producer that only requires facilities that cost about one million pesos and that allow you to start producing this kind of product right away. In that case, one million pesos may not be easy to obtain right now or everyday, but some investor would be willing to enter into that business because they are obtaining very good earnings. He will immediately get in because you don't need any concessions or permits in order to participate in that market. You don't have barriers to entry and therefore the Commission will not be concerned about that transaction. Those are the kinds of situations in which one, as a lawyer, has to start thinking as an economist or has to get the advice of an economist in order to have some kind of a certainty about the predictability. And also look into the official gazettes that are published by the Commission. Three years ago, the Commission decided to publish extracts of the resolutions in the gazettes. There, you may find some cases that are related or similar to the one you will post to the Commission for consideration and you will be able to make some kind of evaluation about your case. You may even quote some of those precedents in order to try to keep the same criteria that were taken before. I hope that's cleared up.

RODRIGUEZ: My name is Luis Manuel Rodriguez from Mexico City. First of all, I have to say that I feel very happy with this panel. All the lectures were very interesting, so thank you for that. I have two comments and two questions for the members of the panel. First, I agree with Lic. Guerrero's opinion's about the recent criteria from the Supreme Court in Mexico. We waited almost seven years to have an interpretation from the courts about our law and I think that we had better expectations from the court. I feel very disappointed with most of the resolutions that really don't support a minimal analysis. On the second hand, I think that the Mexican law is a very good effort for a Mexican competition policy and relation. However, after the CFC's seven years of experience, as well as our experience as lawyers, I think that we must ask ourselves if this law needs to be reviewed in order to fill in some of the gaps and in order to review some other provisions that could be, and I agree with Lic. Guerrero's opinions, unconstitutional. The two questions that I have are first of all related this comment. First, can the members of the panel can see in the near future amendments to our law or maybe a new competition law? The second question is for all the members of the panel and specifically to Lic. Elizondo. I don't know if all of you know a couple of precedents from the circuit courts in Mexico City which established that the objection of the CFC for a notified concentration doesn't imply any prohibitions for the parties to close their transaction. It is merely a technical, economic opinion without any further effect, allowing a party to go ahead and close the transaction. Does the CFC think that this could have an effect against the relevant market or does the Commission need to begin an investigation and follow all of the proceedings? Thank you very much.

ELIZONDO: Thank you for your question. As to the possibility of cutting some of the amendments to the FLEC, the Commission has been working since the beginning of this year on a kind of reform in order to make some improvements in the law. We are conscious that many of these problems of unconstitutionality may be resolved if some of the provisions that are currently contained in the regulation are put into the law itself. Right now, many things are clear as to the proceeding and as to the substance of how the conducts in particular are integrated. So if the only thing we need to do is to put it in the law, we avoid that part of the problem of constitutionality. But other things that we think are necessary inside the Commission are some measures that may give it more efficient power in order to control some things and more flexibility in order to close some transactions without having to go with this transactional clause. One of the things that may be very useful as a tool in order to have more effective decisions is, for instance, the ability to issue temporary restraining orders. Many times the claimants go with their order from the Commission and they are not able to stand even eight months more with that pressure of dominant fear obligating them to, for instance in a tie-in agreement, buy some products that they are not even able to displace. In those cases, the Commission has been able to require these potential defendants to stop doing that, at least for a reasonable time, in order for the Commission to see if there is real and actual risk of driving that competitor out of the market unless the Commission issues an immediate order to stop it. Maybe another good element or tool that could be considered in this amendment is to give more flexibility and clarity to the provisions that make exemptions for those transactions that do not have to be pre-notified to the Commission. Right now, for instance, if you make a financial restructuring in the same economic group, you still have to file your pre-notification. That is because Article 20 of FLEC says that even if you have 90% of the stock shares of both subsidiaries, you are making a concentration. Maybe you feel that for that 10%, there is no risk at all. But that is one thing that still has to be decided by the Commission, after the analysis. So I think that one of the good things that may be included in an amendment of the FLEC is to leave all those transactions that actually do not pose any risk out of this obligation. Instead, the Commission should concentrate on those transactions that, due to their complexity, will require a substantial amount of time to make the decision and should spend much more time on the deep economic analysis for making these decisions.

With regard to the second question, this decision was made by a district court. Or at least it corroborated the judgment of the District Court and it was, I think, very important and a little bit complex because of the technical part of the *amparo*. In the *amparo*, the main procedure is that in which the judge has to decide whether or not the act is unconstitutional or if there is some illegality. But there is also an ancillary proceeding, the *Procedimiento Incidenta de Suspensión*, in which the judge, in order to avoid the risk of staying without the substance of the case, orders the authority to stay and not to execute the order that was given. For instance, if termination of the contract has been decreed by the judge and the consequences of that could be worse, the judge could say, "Okay. Stop right there until I find out at the end of the main procedure if this is actually illegal or not." So in that case, the suspension sought by the claimant was premised on the fact that he would like to close its transaction but could not do so because the Commission had already ruled that this is a forbidden concentration, thereby obstructing his right to do his

business. There, the judge said that the decision of the Commission is not a prohibition. It means that, if you finally decided to close the transaction, you would not be challenging or going against the decision of the Commission. You are going against the law. Because the law prohibits you from may closing a transaction when all those circumstances gathered together and give the elements to the Commission to rule that that is a forbidden concentration. That was confirmed by the Circuit Court but I think it's a little tricky the way that the judge made the analysis. I am not going to give you the suspension. I am not going to tell the Commission to let you close the transaction. If you close the transaction, it is on your own and you will be violating the FLEC, not the decision of the Commission. So I think we could find these tricky things in the decision.

DOBROWITZKY: Margaret Dobrowitzky from Delphi Automotive. Many companies in the United States try to leverage technology of their competitors and their suppliers by entering into technology co-development agreements. These are generally viewed as pro-competitive in the U.S. under the guidelines that the DOJ publishes for collaboration among competitors as long as they don't involve things like price fixing or output restrictions, allocations of customers or markets. I am wondering how would such an agreement involving a Mexican company be structured in order to comply with FLEC?

VALDÉS: I think, as you said, agreements can be pro-competitive. Horizontal agreements are prohibited, per se and as you perfectly pointed out, there is a limited and exhausted list of cases whereby agreements among competitors are prohibited for being horizontal agreements. I have actually closed teaming agreements for computer companies in order to try and participate for private and public meetings. What I have done, and I am not saying this is the right way to do it, but it is my suggestion, is to state in the recitals of the agreement the true motive or the true reason why you are entering into those agreements. We do not have in Mexico something like the guidelines issued by the Department of Justice. Therefore, we have to make the interpretation on our own. But I will say in the recitals that the true reason for entering into the agreement is collaboration and not elimination of competition among competitors. I will say that you need to enter into that kind of agreement because you are seeking a higher objective that will improve, at the end of the story, competition. If you try to support that assertion in the recitals of the agreement or in the warranties provisions used in the United States, I think you will be in safe harbor unless you are using that agreement as a vehicle for those practices that you were just talking about.

DOBROWITZKY: Licenciado Elizondo, would you view that as complying with FLEC? Such an agreement as he just described?

ELIZONDO: Yes, as Lic. Guerrero said, Article 9 prohibits agreements between competitors but, for me, it is very clear that those agreements are illegal when the purpose is to fix pricing because fixed pricing and market allocation, output restrictions and regulating are all intended to fix price and to obtain an oppressive rent. So, if you enter into a research and development agreement by a joint venture, I think that the right analysis of this transaction is that it is a concentration in that case because you have to make a definition of a market. You have to override the power of those two economic agents participating in the joint venture and you have to evaluate all the deficiencies that would come from this final transaction. So in those cases that we have had in the Commission like this one, the

analysis led the Commission to determine that it was a concentration or a merger acquisition.

BIOGRAPHICAL SUMMARIES

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