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Eleanor M. Fox
Gabriel Castaneda Gallardo
Harvey M. Applebaum

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PART THREE: HORIZONTAL RESTRAINTS OF TRADE BETWEEN COMPETITORS IN MEXICO AND THE UNITED STATES

MODERATOR: MICHAEL W. GORDON*
PANEL MEMBERS:
ELEANOR M. FOX,**
GABRIEL CASTAÑEDA***
HARVEY APPLEBAUM****

THE PROBLEM

The initial marketing of Sollate™ in Mexico by AGRICOLAS was in the area of Mexico City. It concentrated its efforts on building a strong base in the Mexico City area. Meanwhile, GROWFAST, Inc., began to market Sollate™ and other fungicide and pesticide products in northern Mexico, including the Monterrey area. AGRICOLAS has begun to sell a product which competes with Sollate™ and is also marketing some newly developed fungicides and pesticides. GROWFAST is concerned with the rapid growth of AGRICOLAS and especially with its marketing a product similar to Sollate™. It believes the most appropriate solution would be to modify its agreement with AGRICOLAS. AGRICOLAS agrees that some settlement of these concerns is necessary. They mutually agree to the following:

1. AGRICOLAS will discontinue its modest sales of Sollate™ in northern Mexico and Veracruz;
2. Both companies will compete in Guadalajara and the strip along the western coast of Mexico;
3. GROWFAST will not attempt to sell Sollate™ in Mexico City or any of the remainder of Mexico;
4. AGRICOLAS will discontinue selling a new fungicide produced by Insecticidas de Jalisco, S.A. de C.V., and all other competing products except for competing products developed by and owned by AGRICOLAS;
5. AGRICOLAS will grant GROWFAST the exclusive right to U.S. sales of any new pesticide or fungicide products developed by AGRICOLAS;
6. AGRICOLAS will adhere to prices recommended by GROWFAST for the sale of any GROWFAST products in Mexico; and,
7. GROWFAST will adhere to prices recommended by AGRICOLAS for the sale of any AGRICOLAS products in the United States.

* Chesterfield Smith Professor of Law, University of Florida College of Law.
** Walter Derenberg Professor of Trade Regulation, New York University School of Law.
*** Partner, Castañeda y Asociados, México, D.F.
**** Partner, Covington & Burling, Washington, D.C.
THE DISCUSSION

Michael W. Gordon: Now the parties have been functioning for a while, they have been encroaching on each other's turf to certain degrees and they have decided to sit down and carve up the territory. How do we look at the horizontal restraints in contrast to the vertical restraints, from the perspective of Mexico and the U.S. competition laws?

Gabriel Castañeda: On the merits of the case as it is here, it looks like these are not violations of Article 9 of the Mexican competition law.1 This case, at first, seems to involve a horizontal practice among competitors doing several things: market allocation, price fixing, and several others that might come into the same category. But on a second, more profound look, there are some facts we have to take into consideration.

The first question to be asked in regard to Mexican jurisdiction is are these two really competitors or not? Article 9 of the Mexican law is not specific about it, so we have to try to prove whether they are not competitors. This is very important. Has AGRICOLAS the possibility of competing with the U.S. company or not? On first review the answer will be no. This is just a distribution arrangement and the U.S. company is not interested in doing business directly with a special corporation in Mexico. The U.S. company simply enters into a contract with AGRICOLAS to sell the product exclusively. There would be a problem proving those two companies are competitors. However, there may be a potential competitor issue.

Eleanor M. Fox: From the United States point of view we have exactly the same questions. We want to know if and when AGRICOLAS becomes a competitor. As long as AGRICOLAS is simply a distributor for GROWFAST, this presents only a vertical problem. GROWFAST may have set up AGRICOLAS as its prime or exclusive distributor in Mexico; it may have decided that it wants to also offer the same product in the same territories as its distributor in Mexico; or it may decide that it wants to reserve some Mexican territories for itself and give AGRICOLAS other territories. That is not considered a horizontal restraint; it is considered a vertical restraint. It reflects the producer's decision of how it wants to distribute its product. At first, AGRICOLAS, which distributes Sollate$^\text{TM}$, is only handling the distribution of another firm's product. Later, AGRICOLAS develops its own product. So let us take the first stage. AGRICOLAS is distributing the product of two producers. Is the second product really competitive with Sollate$^\text{TM}$, so that there is a new competitor on the market competing with GROWFAST's Sollate$^\text{TM}$? AGRICOLAS is distributing the product of a competitor to Sollate$^\text{TM}$ and GROWFAST says, "Oh, I don't want you to do that, get rid of my competitor's product." Under U.S. law, this is not a problem as long as the competitor of GROWFAST, which has a product competitive with Sollate$^\text{TM}$, has

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other ways of distributing its product. Since the competitor seems to be a Mexican producer, it could probably get its own Mexican distribution. As long as the exclusivity imposed by GROWFAST isn't depriving the competitor of an outlet in the market, there is no problem under U.S competition law.

The only way I see a problem arising in this situation is if AGRICOLAS develops its product competitive with Sollate™ so that GROWFAST and AGRICOLAS are real competitors. GROWFAST says, "OK, you distribute these two products in Mexico, do not come into the United States. I will distribute the two products in the United States and I will not go into Mexico." There you have a cartel. That is a real market division, it eliminates the only competition on the market.

If both the United States and Mexico considered the provision to be unlawful, which in my example it is, is there any method for deciding which nation ought to pursue the matter? In this hypothetical, the consumers in both countries are equally hurt and it is perfectly OK for them both to pursue the suit. Ordinarily we might expect collaboration between the law enforcement authorities, subject to confidentiality requirements. This is a division of markets and is no different from saying I will take east of the Mississippi and you take west of the Mississippi. It would be efficient to have a common agency handling this one case. The counter argument is that there are difficulties of getting a new supra-national enforcement system into place.

Are there any problems with extraterritorial application? In this case, no, because it is one ball of wax that has significant effects in both territories. What if the United States brought an action against both companies for dividing territories in both the United States and Mexico, and Mexico brought the same action? The answer is it would be fine.

Harvey Applebaum: The first issue is whether the companies are competitors. Until AGRICOLAS developed its own competing product they were not competitors. Once they became competitors, with one of them being a U.S. company, and they agreed not to compete in the United States, there is a criminal offense subject to imprisonment and fines as well as a civil violation. It is clearly a horizontal agreement to divide territories, and therefore it is horizontal restraint which has been per se illegal and criminal in the United States for a very long time.

Under these facts no one, even in Mexico, can realistically claim that the United States has exercised undue jurisdiction. The agreement by AGRICOLAS not to sell to the United States is clearly an agreement not to do business in the United States. One of the clearest areas of U.S. jurisdiction is imports to the United States. If AGRICOLAS and another Mexican company were to fix their prices on their sales into the

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4. Id.
United States, that would clearly be illegal under U.S. law. Assuming the companies are actual competitors or clearly potential competitors, an agreement to allocate markets would violate both the U.S. and Mexican antitrust laws. If that is so should there not be some kind of NAFTA application?

The long-term issue of whether there ought to be a common NAFTA antitrust law and therefore a common enforcement agency are dealt with in the American Bar Association Antitrust Section Task Force report on the competition dimension of NAFTA.9

Gordon: Assuming these two companies have become competitors why not simply restructure, form a 50-50 joint venture in Mexico, and let that company handle all the problems?

Fox: If the facts are; there was a market in this one orchid-enhancing fertilizer; there were only two competitors in the market; and the two competitors merged. This is clearly illegal. Therefore a joint venture would also be illegal.

Gordon: The formation of a joint venture in Mexico would be illegal under U.S. law. What about under Mexican law?

Castañeda: Assuming both corporations are now competitors in Mexico, I think it would be illegal. If the transaction exceeds the threshold established by the Mexican Competition law,10 they would have to go to the Federal Competition Commission for clearance.11 If not, I think this would be clearly just a vehicle to cover some sort of illegal intent to monopolize or exclude other competitors from the market.

Gordon: If they did get clearance from the Commission in Mexico to do this, would the United States then possibly pursue it as an illegal activity?

Fox: First of all, to make it interesting, you might say there is a really serious market definition problem. Mexicans might say that Sollate™ and its competitor are wonderful orchid-enhancing fungicide, but there are a lot of other fungicides that do basically the same thing, even orchid enhancement. And the United States might look at it and say, "No, we think nothing else will do for orchids, there is no close substitute that is going to put a good price constraint on GROWFAST and AGRICOLAS." That is where you are going to have your interesting questions.

You do have questions like that all the time. We had one in the Consolidated Gold Fields case12 where there was a question whether the

5. Id.
6. Id.
7. Mexican Competition Law, supra note 1.
11. Article 23 of the Mexican Competition Law creates the Comisión Federal de Competencia (Federal Competition Commission) [hereinafter Commission] as an independent agency of the Secretaría de Comercio y Fomento Industrial (Mexican Department of Commerce) [hereinafter SECOFI].
Oppenheim interests in South Africa were monopolizing world gold production. On the other side of the ocean, the European Community thought the market was really broad and included gold futures. A U.S. Federal District Court in New York City said that mined gold was the market, making the merger illegal. The federal court actually stopped the whole merger, though it had been approved by the European Community and the United Kingdom. So it is possible that Mexico could say the market is much broader and, in fact, the joint venture is productive and going to do good things for orchids. On the other hand, the United States could say, "That is not the way we look at it, there is monopolization here and it's illegal and we want to stop it." Suppose the United States sues and it orders its own company not to join this joint venture. A U.S. court could actually restrain AGRICOLAS if it has personal jurisdiction over AGRICOLAS. Then there would be a direct conflict. How is that possibly to be resolved? In the ABA NAFTA Report we suggested there ought to be dispute resolution for such problems. There ought to be recourse to a higher level disinterested panel that will look at the problem with a view from the top, the business efficiency and consumer interests of North America, and make a decision one way or the other.

**Applebaum:** If the joint venture is simply a disguise for an allocation and division of the market by competitors, then there is no need to do a relevant market review under U.S. law. For example, if there is an agreement not to compete between the two competitors, that is illegal under the U.S. law regardless of whether there are others in the market and regardless of whether there are other pesticides that would do a good job with orchids. So the relevant market issue is considered in joint venture and merger analysis but it is irrelevant in a straight price fixing arrangement between competitors.

If we forget the joint venture for a moment and return to where we started: there are two competitors and they are clearly allocating and dividing markets and/or fixing prices within Mexico. Is there any need to look at the relevant market under Mexican Competition Law?

**Castañeda:** It would not be a defense in Mexico either. However, I want to make two comments. First, I think the probability of the United States being interested in the case because of the fact that there are no U.S. consumers affected by this is very slim because of the fact that there is no U.S. consumers affected by this. Why would the United States be interested in this unless someone in the United States trying to export the product and is being excluded from the Mexican market?

Second, I would be worried about the *per se* classification of these practices. There are many U.S. companies that are in fact looking for more efficient ways to market their products in Mexico. Government regulators should offer a practical solution.

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13. *Id.*
At what point does the U.S. company become a competitor of AGRICOLAS? What is a *per se* price fixing or market allocation violation? The regulators should look at the facts and perhaps into the actual relevant market and the efficiencies of it. I think this is going to be a problem when the case comes to Mexico, not because the Mexican law allows for some sort of defense in horizontal price fixing case, but rather because of the competitive issue.

*Applebaum:* I agree with you that none of these facts are likely to raise U.S. antitrust issues, until you reach a point where AGRICOLAS is truly able to compete with Sollate™ and is negotiating with a U.S. company to export its product into the United States and GROWFAST seeks to block the exports pursuant to its agreement with AGRICOLAS. I think, practically, that would be the first time that the U.S. government enforcement agencies would be interested, when the prospect of competition in the United States with Sollate™ has been foreclosed by a market allocation agreement.

*Fox:* I want to be clear that I was talking about the hypothetical in which the two companies were actual competitors, made their own products that were actually competitive and they were potentially each selling both in the United States and Mexico but they had agreed to stay out of the territory of one another. There was a real competitor market division.

**QUESTIONS AND ANSWERS**

*Allan Van Fleet:* I would like the panel to address the vertical situation. Assume AGRICOLAS has distributorships all over the place, Reynosa, Ciudad Juarez, Nuevo Laredo, and so on. We are strictly in the vertical phase here. What about the agreement of AGRICOLAS that it will not resell Sollate™ into Laredo or McAllen or El Paso. AGRICOLAS agrees to stick to distribution in Mexico. How is that analyzed under U.S. law? What if the United States orchid growers complain to the Antitrust Division?

*Fox:* I think that is a better case for no violation than there is for violation. The reason is this. It is a vertical restraint by a monopolist under a U.S. patent. It is not possible to use this vertical restraint to cartelize because there are no competitors of GROWFAST. In the United States when you start analyzing whether a non-price vertical restraint is illegal, the main thing you look at is whether that non-price vertical restraint can be used to cartelize with competitors at the producer level by shutting out competition and preserving the oligopoly in the territory. Here there is not a potential for facilitating a cartel. It is a monopolist, single firm restriction. The monopolist will be selling to its distributor at a price that is satisfactory to it, meaning that it is going to get that monopoly profit up front, and now the distributor is going to sell at a price satisfactory to it. The high price has already been charged up front and there is probably no harm to consumers.

*Van Fleet:* Suppose AGRICOLAS is a tough bargainer and GROWFAST agrees to permit sales by AGRICOLAS in Texas and California
but AGRICOLAS must sell at the same $20 per pound that U.S. distributors generally charge.

*Applebaum:* After the Sylvania case\(^{14}\), non-price vertical restraints are decided under the rule of reason and are quite defensible. But my view would be that if GROWFAST says you can resell in California and Texas, only at a fixed price, that is illegal vertical price fixing. U.S. law clearly applies because it is an importation. Vertical price fixing remains, *per se*, unlawful. It is a good demonstration of how you can move quickly from a very defensible rule of reason situation and distribution arrangement into a very vulnerable *per se* arrangement.

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