THE OECD'S PROPOSAL TO CARTELIZE MEXICAN TELECOMMUNICATIONS

J. Gregory Sidak[*]

The OECD's proposed regime of asymmetric ex ante *regulation for Mexico's telecommunications marketplace would reduce competition, contrary to the OECD's aims. The OECD's proposals would harm Mexican consumers and force an increase in prices paid for telecommunications services. They would create a government-sanctioned price cartel among the telecommunications providers. They would reward inefficient competitors and penalize efficient carriers, all to the detriment of the consumers. Instead of relying on new layers of counterproductive or ineffective regulations, the Mexican government should remove regulatory entry barriers between video and telephone, thereby creating enduring, facilities-based competition.*

* Chairman, Criterion Economics, L.L.C., Washington, D.C.; Ronald Coase Professor of Law and Economics, Tilburg Law and Economics Center (TILEC), Tilburg University, The Netherlands. Email: jgsidak@criterioneconomics.com. This report was commissioned by América Móvil. However, the views expressed are solely my own.

INTRODUCTION

The Comisión Federal de Telecomunicaciones (Cofetel) hired the Organization for Economic Cooperation and Development (OECD) to produce a report on telecommunications regulations in Mexico.[1] In the report, released in January 2012, the OECD asserts that there is a lack of competition in Mexican telecommunications markets, resulting in harm to Mexican consumers.[2] Based on that finding, the OECD concludes that those consumers would benefit from heavier regulation of Mexico's telecommunications sector.[3]

The OECD thus proposes new kinds of regulatory powers that would dismantle Mexico's existing legal and regulatory institutions. The proposed regulations would significantly harm consumers, turn competitive markets into government sanctioned cartels, and redirect efficiencies away from consumers and into the bank accounts of less efficient competitors. Far from improving the state of Mexico's telecommunications sector, the OECD's policy prescriptions would reduce competition, retard innovation, and harm consumers.

The OECD's harsh criticisms of Mexico's government and legal system are equally baseless and demonstrate a clear bias for regulation over competition. The OECD criticizes Mexico's *amparo* process and the filing of such appeals by Telmex and Telcel with regard to various Cofetel rulings, despite that fact that, as the OECD report itself admits, the courts more often than not found that Telmex and Telcel were correct and that Cofetel had in fact acted unlawfully. Despite this fact, the OECD urges that Cofetel, the organization that requested the OECD report, be given absolute and unquestionable authority over the telecommunications sectors, subrogating the role of the SCT, Cofeco, and the Mexican courts.

In Part I of this paper, I analyze the OECD's specific policy and regulatory recommendations. I demonstrate why, even if one assumes (contrary to the facts[4]) that a market failure exists in Mexico's telecommunications market, the OECD's proposals would not improve matters. The proposals are warmed-over policies that have failed to achieve competitive outcomes in other countries; the result would be no different in Mexico. The proposals would harm Mexican consumers and force an increase in prices paid for telecommunications services.

In Part II, I explain how the OECD's solution of dismantling Mexico's legal and regulatory systems would be grossly overbroad. The OECD's denunciation of *amparos* lacks any rigorous legal or economic foundation. Moreover, there is no credible reason why requiring courts, the Secretaría de Comunicaciones y Transportes (SCT), and the Comisión Federal de Competencia (Cofeco) to defer to Cofetel would solve the purported problems in Mexico's telecommunications sector.

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1. ORGANIZATION FOR ECONOMIC COOPERATION & DEVELOPMENT, OECD REVIEW OF TELECOMMUNICATIONS POLICY AND REGULATION IN MEXICO (Jan. 2012) [hereinafter OECD REPORT]. The OECD states that the report was undertaken "at the behest of the Comisión Federal de Telecomunicaciones." *Id.* Foreword at 3.
2. *Id.* at 9.
3. *Id.* at 114-15.
4. Jerry Hausman and Agustin Ros empirically find that, if sound econometric methods are employed, data indicate that there is *not* a market failure in Mexico. Rather prices are substantially *lower* in Mexico than one would expect based on rates in comparable countries. Jerry A. Hausman & Agustin Ros, *Correcting the OECD'S Erroneous Assessment of Telecommunications Competition in Mexico* (Working Paper, 2012).

I. THE OECD'S RECOMMENDATIONS FOR ASYMMETRIC *EX ANTE* REGULATION WOULD HARM CONSUMERS

The OECD report runs through a wish list of the worst ideas ever conceived by regulators in the Euro-tilted OECD countries. The OECD seems to suspend all disbelief and presume that all of those many regulations have benefitted consumers and have achieved the purpose that regulators intended—without causing adverse unintended consequences. Wishing does not make it so. The OECD's recurring theme is the need for *ex ante* regulation—training wheels for the market—and asymmetric regulation of dominant firms. The particular prescriptions that the OECD dispenses for Mexico would not increase competition or investment; instead, they would harm consumers and efficient competitors that have broken no law.

A. The OECD Does Not Understand Competition and Market Power

The OECD prescribes policies for Mexico on the basis of an incorrect understanding of competition. It appears to measure competition by the number of competitors in a market or the nearness to an equality of market shares among competitors. Furthermore, it advances the significant market power (SMP) framework as the tool to measure market power, which is biased toward finding dominance—even where it does not actually exist—and perpetuating the apparent need for regulation. If the SCT and Cofetel were to adopt the OECD's understanding of competition, they would subordinate the welfare of consumers to that of competitors.

1. Does the OECD Seek to Foster Competition or Prop up Competitors?

The OECD repeatedly espouses as the regulator's objective the advancement of competition in Mexico's telecommunications sector; yet, it provides no clear definition of competition. Does the OECD define competition as ensuring a certain number of competitors in the market or ensuring a minimum market share per competitor? If so, then it follows that the policies that the OECD advocates would not aim to advance consumer welfare. Instead, they would seek only to reduce Telmex's and Telcel's market shares and benefit their competitors, irrespective of the effect on consumers.

It appears that the OECD believes that one properly measures competition by counting the number of firms in the market or by measuring the degree of departure from a stylized equality in the distribution of market shares. For example, the OECD conflates a "lack of effective competition" and a "high level of market concentration."[5] The OECD complains that Mexico's competition policy does not pursue enough goals: "There is no provision for fair competition under this law; neither does it talk about protecting the interests of small enterprises and restricting business concentration."[6] The OECD repeatedly implies that regulators can make a market more competitive by forcing a successful firm to share the use of its assets with the rivals at regulated prices.[7]

These ruminations by the OECD on the nature of competition are ignorant and wrong. Competition does not increase indefinitely with the number of competitors in a market. The building of telecommunications networks requires large sunk and fixed investments; naturally, the number of firms that generate an effectively competitive

5. OECD REPORT, *supra* note 1, at 17.
6. *Id.* at 80.
7. *Id.* at 12, 25, 114.

telecommunications market will be smaller than in industries that do not require similarly large sunk and fixed investments. Robust competition in any industry entails the exit of less efficient producers from the market. It should not be the case that telecommunications firms are subject to greater antitrust scrutiny simply because there are fewer firms participating in the rivalrous process that characterizes effective competition.

Moreover, it is not the welfare of competitors but the competitive process itself that enhances consumer welfare. Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit, one of the world's most respected authorities on competition law and regulation, has explained:

> [T]hough there is a sense in which the exclusion of any competitor reduces competition, it is not [that] sense of competition that is relevant to antitrust law. The policy of competition is designed for the ultimate benefit of consumers rather than of individual competitors, and a consumer has no interest in the preservation of a fixed number of competitors greater than the number required to assure his being able to buy at the competitive price.[8]

Consumer welfare is not generated by there being a certain number of firms in a given market, but rather by robust investment, innovation, and price competition among the firms that exist in that market. Therefore, whether a regulator considers a firm's actions to be "anticompetitive" should not depend on the whether those actions harm other competitors alone. Competition by definition harms competitors, but benefits consumers.

Put simply, the nature of an act that is anticompetitive in the economic sense of the term is not that it harms any one particular competitor in the market or even that it reduces the number of competitors in a market. Rather, to be anticompetitive, an act must harm the competitive process—which is the process by which consumers benefit from greater investment, innovation, and price competition.

2. The Significant Market Power Framework Is Biased Toward Perpetuating Regulation

The significant market power (SMP) framework is a common practice, as the OECD asserts,[9] but it is not a "best practice" as a matter of sound economic analysis. The SMP framework is implemented by defining relevant markets, analyzing the defined markets, and then identifying firms with significant market power.[10] The European Commission typically considers a market share greater than 50 percent to indicate a dominant position,[11] which then justifies imposing asymmetric *ex ante* regulation on the firm that has been declared dominant. Applying the SMP framework would perpetuate regulation where it is not needed.

First, the SMP approach to defining relevant markets is flawed. The Commission's guidelines on SMP conclude, without any analysis, that "mobile telephony services and

8. Marrese v. Am. Academy of Orthopedic Surgeons, 706 F.2d 1488, 1497 (7th Cir. 1983) (citing University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 853 (7th Cir. 1983) (Posner, J.)).

9. *See, e.g.*, OECD REPORT, *supra* note 1, at 62.

10. According to the European Commission, the SMP framework is designed to "designate, following market analysis, undertakings with SMP in the relevant market and to impose proportionate *ex-ante* measures[.]" COMMISSION REGULATION, GUIDELINES ON MARKET ANALYSIS AND THE ASSESSMENT OF SIGNIFICANT MARKET POWER, 2002 O.J. (C 165) 6, 7 ¶ 9 [hereinafter EC GUIDELINES ON SMP].

11. *Id.* at 15 ¶ 75.

fixed telephony services *constitute separate markets*."[12] The Commission assumes away the key feature that any correct market analysis would address at the start: the existence of consumer substitution for the service in question. If Cofeco were to assess Telmex's market power without considering consumers who may switch from fixed to mobile telephony, then it would almost certainly identify Telmex as possessing significant market power. By thus incorrectly defining overly narrow markets, the SMP framework would rig the determination of whether regulation is necessary.

Second, even assuming that the regulator correctly defines the relevant market, the SMP framework implicitly assumes, without any factual evidence, that any firm with a market share above 50 percent can exploit its so-called dominant position to raise prices profitably or otherwise behave anticompetitively. The SMP method and the OECD fail to recognize that high levels of concentration do not ensure supracompetitive prices. Indeed, Jerry Hausman and Gregory Sidak have found no link between market concentration and prices in European mobile markets.[13]

Third, the OECD decries the "near ubiquity" of América Móvil's fixed and mobile networks because it supposedly causes "dependency" on the part of competitors.[14] The OECD's perverse implication is that building out an expansive network somehow causes market failure and the need for regulatory intervention.

By thus advocating the SMP framework, the OECD recommends that Mexico use a market assessment tool that would ensure a finding that the regulator must intervene. This result is not surprising, because regulators need something to do. Consequently, they find SMP everywhere and seek to impose asymmetric regulation so that they may perpetuate the need of the largest firms to seek permission for all of their strategic decisions.

B. The OECD's Criticism of Voluntary Negotiations Is Baseless

Currently, mobile and fixed-line carriers in Mexico negotiate the rates for access services in the first instance.[15] If the parties cannot reach an agreement, Cofetel decides the rate. Either party can appeal Cofetel's decision.[16] In the OECD report, a recurring justification offered for *ex ante* access regulation is that bilateral negotiations are inefficient.[17] For example, the OECD supports asymmetric regulation of Telcel's mobile termination rates as a policy that would "*withdraw[] from operators the right and obligation to negotiate rates bilaterally*."[18] The OECD promotes mandatory unbundling based on the rationale that it "avoids the need for bilateral negotiations between the incumbent and operators."[19] So what? The same could be said of *any* market transaction. If regulators dictated the prices, terms, and conditions of all transactions, buyers and sellers could dispense with bilateral negotiations. Why, though, does this make regulation preferable over bilateral negotiations?

The OECD fails to answer this question. It provides no empirical evidence of market failure resulting from bilateral negotiations. Instead, to support its conjecture that

12. *Id.* at 14 ¶ 66 (emphasis added).
13. Jerry A. Hausman & J. Gregory Sidak, *Evaluating Market Power Using Competitive Benchmark Prices Instead of the Herfindahl-Hirschman Index*, 74 ANTITRUST L.J. 387, 402-03 (2007).
14. OECD REPORT, *supra* note 1, at 71.
15. *Id.* at 64 tbl.2.3 (listing common access regulations in OECD countries that are absent in Mexico).
16. *Id.* at 66-67.
17. *Id.* at 75 ("The historical preference . . . for bilateral negotiations between parties is not constructive . . . . It has also proven to be very inefficient in terms of economic performance.").
18. *Id*. (emphasis added).
19. *Id.* at 63.

bilateral negotiations lead to higher rates, the OECD merely cites two theoretical works (by Jean-Jacques Laffont and Jean Tirole[20] and Joan Calzada and Tommaso Valetti[21]) and one irrelevant empirical article (by Christos Genakos and Valetti[22]).[23] Theoretical arguments alone, however, cannot prove the conjecture. Obviously, Laffont and Tirole, writing in 2000, had no way of knowing conditions in 2012. Although Genakos's and Valetti's article is empirical, it measures the so-called "waterbed effect"—how regulating mobile termination rates increases retail prices—not whether bilateral negotiations result in higher rates.[24] Contrary to the OECD's conjecture, first principles of economics create a strong presumption that voluntary exchange in fact leads to efficient outcomes.[25] Any inefficiency in Mexico's current system of interconnection regulation is less likely due to use of bilateral negotiation and more likely due to reliance on Cofetel to resolve disputes over rates.

The OECD argues that "[t]he current system of intervening on a case-by-case basis is burdensome and provides little regulatory certainty."[26] The "regulatory certainty" that the OECD envisions needs to be properly understood: it is certainty that regulation will manipulate the outcomes of strategic rivalry and interaction in the market. More importantly, the regulatory certainty that the OECD envisions is certainty that regulation will threaten to confiscate a firm's returns to its lawful sunk investment (quasi-rents). If a new price cap set by Cofetel reduces carriers' legitimate returns to investment *ex post*, then the carriers' original investments would not have positive expected values *ex ante*. This form of regulatory certainty—that success may be penalized—would create an added risk factor, which would truncate the expected value of investments, thereby reducing carriers' investment incentives.[27] Even if the regulator does not intend to confiscate quasi-rents, it may do so in attempting to eliminate a firm's monopoly rents by lowering the firm's prices, because it can be difficult for regulators to distinguish between quasi-rent and economic-rent. Permitting voluntary, bilateral negotiations between carriers eliminates this uncertainty, because negotiating parties can accurately distinguish their own quasi-rents from their economic rents and ask for prices that will allow them to recoup their sunk costs. This form of regulatory certainty promotes investment by incumbents and entrants alike. The OECD is wrong to presume that regulators are better at setting prices that achieve those goals than market participants.

20. JEAN-JACQUES LAFFONT & JEAN TIROLE, COMPETITION IN TELECOMMUNICATIONS (MIT Press 2000).

21. Joan Calzada & Tommaso M. Valetti, *Network Competition and Entry Deterrence*, 118 ECON. J. 1223 (2008).

22. Christos Genakos & Tommaso Valletti, *Testing the "Waterbed" Effect in Mobile Telephony* (CEP Discussion Paper No. 827, Oct. 2007).

23. OECD REPORT, *supra* note 1, at 75.

24. Genakos & Valletti, *supra* note 22. The only mention of bilateral negotiations and access charges is: "A large *theoretical* literature has demonstrated that independently of the intensity of competition for mobile customers, mobile operators have an incentive to set charges that will extract the largest possible surplus from fixed users." *Id.* at 25 (emphasis added).

25. *See, e.g.*, ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 584 (6th ed., Pearson Education, Inc. 2005).

26. OECD REPORT, *supra* note 1, at 75.

27. *See, e.g.*, JEAN-JACQUES LAFFONT & JEAN TIROLE, A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION 54 (MIT Press 1993) ("In the absence of a long-term contract, the regulated firm may refrain from investing in the fear that once the investment is in place, the regulator would pay only for variable cost and would not allow the firm to recoup its sunk cost.").

By way of real-world example, the solution urged by the OECD mirrors the costly and ultimately ineffective regime under the U.S. Telecommunications Act of 1996.[28] Entrants would negotiate with incumbents over interconnection rates and bring disputes before state public utility commissions (PUCs) if they failed to agree upon rates. The FCC's and the PUCs' total long-run incremental cost (TELRIC) formula for interconnection rates destroyed any prospect of meaningful price negotiations. Hundreds of arbitration proceedings began in the fall of 1996. Many state PUCs did not await the failure of negotiations, but instead immediately commenced proceedings to determine TELRIC rates. The state PUCs, comprised of political appointees who were more interested in short-term price cuts that would please political constituencies than funding the deployment of new network facilities (whose benefits might not achieve popular recognition until years in the future), almost without exception adopted the cost model inputs that the entrant proposed and rejected the cost models and inputs that the incumbent developed. The results were artificially low rates that reduced the incentives for competitors and incumbents alike to invest in building their own networks and facilities.

C. Asymmetric *Ex Ante* Regulation Would Promote Government Cartelization of Workably Competitive Oligopolies

In the telecommunications sectors, asymmetric regulation generally involves regulation of dominant carriers' interconnection rates and retail prices according to hypothetical cost models. Asymmetric regulation thus effectively subsidizes competitors, at the expense of the firm that has been declared dominant. For example, asymmetric regulation of Telcel's mobile termination rates would subsidize competing mobile carriers every time a Telcel subscriber would call a competing network. The subsidy would arise because the competing carrier could charge Telcel a higher mobile termination charge than Telcel can charge the competing carrier. The OECD strongly supports asymmetric regulation of Telmex and Telcel in its report, recommending that

> Cofetel should be empowered to undertake market reviews, declare that a player or players have significant market power, and put forward appropriate remedies including asymmetric regulation.[29]

The OECD does not, however, explain how asymmetric *ex ante* regulation would promote competition and benefit consumers. It is more likely that the OECD's propensity to recommend asymmetric *ex ante* regulation would lead to government cartelization of telecommunications markets in Mexico, which would reduce competition and harm consumers.

Asymmetric regulation of interconnection rates artificially raises the costs of the dominant carrier, which forces the dominant carrier to charge its subscribers higher retail prices. Thus, asymmetric regulation creates a price umbrella that eases the pressure on competing carriers to reduce their own subscription prices (or to compete on quality terms). The rationale for asymmetric *ex ante* regulation unrealistically assumes that competing carriers would change their competitive strategies after dominant carriers have been subjected to such regulation and the competing carriers have received the benefits. But why would the competing carriers do so? Asymmetric regulation of interconnection

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28. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).
29. OECD REPORT, *supra* note 1, at 127.

rates does not give them the incentive to be aggressive competitors, but rather the incentive to price just below the retail price umbrella created by Cofetel's imposition of higher interconnection costs on Telmex or Telcel. That is because, if the other carriers *did* become more aggressive competitors in response to asymmetric regulation of the dominant carriers, they would drive down Telmex's and Telcel's market shares and eventually cause them no longer to be the "dominant" firms upon which Cofetel could rationalize its imposition of asymmetric regulation. In short, by becoming aggressive competitors they would lose their subsidy. That result would be contrary to the economic interests of the competing, non-dominant carriers. Hence, competitors surely would ask themselves whether having a smaller share of a higher-priced market cartelized by government regulation is preferable to having a larger share of a market where price and quality competition has driven their abnormal profits to zero.

The OECD does not seem to understand that competitors adopt strategies that maximize *profit*, not market share. Sir John Hicks, recipient of the Nobel Prize in economics, famously wrote: "The best of all monopoly profits is a quiet life."[30] The same could be said—but with greater force—of the profits that competing carriers could complacently reap as participants in the government-mandated cartel that would flow from the OECD's policy recommendations.

It bears emphasis that asymmetric regulation typically does not create any legal obligation on the part of competitors to pass any portion of their windfall to consumers. In other words, competitors could (and quite likely would) choose *not* to compete against Telmex and Telcel on price, maintain their current business strategies, and instead pass these Cofetel-provided incremental profits to their shareholders as dividends. Similarly, competing carriers could freely choose *not* to invest their incremental profits in expanding their networks or making them more efficient. In other words, while there is every reason to believe that asymmetric termination rates would harm Telmex and Telcel and their current customers—and benefit competing carriers—there is no reason to assume that Mexican consumers would benefit.

Telefónica is the principal rival of América Móvil in Mexico. Clearly, Telefónica does not need to receive a subsidy from América Móvil's shareholders to become a more potent competitor in Mexico. Telefónica has all the same advantages of scale economies in procurement of equipment, spectrum, base stations, advertising, and customer acquisition that América Móvil does. And even if the OECD sincerely believed that it would benefit Mexican consumers for Telefónica and other competitors to receive subsidies, why does it logically follow that the source of the funding for the subsidy should be the shareholders of América Móvil? Typically, the funding of a public good comes from the public treasury, not from the confiscation of private property. And of course, Article 27 of the Mexican Constitution provides that expropriation of private property must be compensated.[31] After Telcel has successfully competed on price and quality to achieve its current position, it would be absurd for the Mexican government to ask the company to subsidize its competitors in the belief that doing so will make the market "more competitive." And in the case of Telmex, any benefits of incumbency would have been reflected in the price that the Mexican government received from investors when it privatized the company.

The fixed-line and cellular markets in Mexico are each an oligopoly. Those oligopolies have been workably competitive for the past decade. Telcel has been the

30. John R. Hicks, *Annual Survey of Economic Theory: The Theory of Monopoly*, 3 ECONOMETRICA 1, 8 (1935).

31. POLITICAL CONST. OF THE MEXICAN UNITED STATES art. 27 [hereinafter MEXICO CONST.].

leader in lowering price and raising quality in the form of wider coverage. By design or happenstance, competing carriers have charged higher prices and declined to invest in larger networks. The great danger posed by the OECD's proposal for asymmetric regulation of termination rates is that the Mexican government itself would constrain Telcel's ability to reduce price. That regulatory constraint would convert a workably competitive oligopoly into a state-mandated cartel. Telecommunications regulators and competition authorities around the world would justifiably ask, "Why would Cofetel possibly want to achieve this result?"

D. The OECD Recommends Specific Regulations That Have Been Shown to Harm Consumers and Waste Resources

I critique several specific reforms that the OECD advocates in its report. Asymmetric *ex ante* access regulation includes forcing Telmex to unbundle its network elements and to provide wholesale broadband access, as well as capping Telcel's mobile termination rates. The other regulatory proposals similarly target Telmex and Telcel: imposing asymmetric spectrum caps on Telcel, conditioning Telmex's entry into pay-TV on its (and Telcel's) compliance with other asymmetric regulations, and giving Cofetel the authority to impose larger fines and mandate functional and structural separation of Telmex and Telcel. These proposed reforms are unnecessary to achieve competition in Mexico, and implementing them only would impede competition and harm consumers.

1. Mandatory Unbundling of Essential Facilities at Regulated Prices

The OECD considers Cofetel's current case-by-case intervention in access negotiations between carriers to be inefficient. It attributes the purported lack of competition in the fixed-line market to the absence of *ex ante* interconnection regulation.[32] The OECD evidently prefers regulation that would have greater elements of central planning. The OECD recommends that Cofetel have the authority to "declare bottlenecks and essential facilities" and "establish non-discriminatory conditions for access to these facilities."[33] Specifically, "[a]ccess to essential facilities should include local loop unbundling of the incumbent's local loops, including collocation at cost-based pricing."[34] The OECD recommends that Cofetel set interconnection rates *ex ante* using a cost-based model, such as a long-run incremental cost (LRIC) model.[35] To help implement this policy, Cofetel should, according to the OECD, require Telmex to publish its interconnection terms and conditions—just as several EU regulators require dominant carriers to publish reference interconnection offers (RIOs).[36] By regulating interconnection terms and conditions *ex ante*, Cofetel could supposedly "ensure[] that non-discriminatory interconnection charges are applied[.]"[37] The OECD thus proposes that the Mexican government adopt a regime of mandatory unbundling of network elements at regulated rates. There is no evidence, however, that this policy would benefit Mexican consumers—and nothing in the OECD

32. OECD REPORT, *supra* note 1, at 66-67.
33. *Id.* at 127.
34. *Id*.
35. *Id.* at 67. The OECD's formal recommendation is: "Cofetel should be authorised to regulate interconnection tariffs ex-ante to foster competition among operators and facilitate sector development and growth." *Id.* at 126.
36. *Id.* at 63.
37. *Id*.

report conditions this regulatory intervention on a showing by the regulator that forced access would increase consumer surplus.[38]

Regardless of the experience of mandatory unbundling elsewhere, forced sharing is unnecessary for areas of "greenfield" deployment of networks. Telefónica is as capable as Telmex of building infrastructure in new neighborhoods. These geographic areas are genuinely contestable. In older neighborhoods, wireless may be more cost effective for any competitor to enter.

Furthermore, respected jurists and scholars have examined the actual effect of forced sharing on both incumbents' and entrants' investment.[39] In his separate opinion in *AT&T Corporation v. Iowa Utilities Board*, Justice Stephen Breyer explained the importance of incentives to invest on innovation: "Nor can one guarantee that firms will undertake the investment necessary to produce complex technological innovations knowing that any competitive advantage deriving from those innovations will be dissipated by the sharing requirement."[40] It is not logical for an incumbent to invest more if entrants may purchase use of the incumbent's network at wholesale rates (less avoided costs) lower than retail rates, as is the case under mandatory unbundling.[41] In fact, Thomas Hazlett observed that capital expenditures in U.S. local exchange facilities by the (incumbent) regional Bell operating companies (RBOCs) increased from approximately $22 billion in 1996 to $38 billion in 2000, when capital expenditure programs that had begun *before* the passage of the 1996 Telecommunications Act had been completed, but then decreased to $17 billion in 2003.[42] Michal Grajek and Lars-Hendrik found results in EU states consistent with the U.S. experience. They found that the introduction of access regulation from 1997 to 2002 in the European Union reduced incumbents' infrastructure investment by approximately €1.1 billion from 1997 to 2006.[43] It is therefore not the least bit surprising that "when Cofetel published new interconnection regulations requiring all operators to provide third-party access, Telmex responded by cutting planned investments in 2009 by a third."[44] Telmex's reduced investment is a rational response to protect its shareholders—a response entirely consistent with the regulatory experience in the United States.

According to the OECD, mandatory unbundling would promote entry into and investment in the fixed-line market: "non-facilities-based entry may be a legitimate entry strategy for new players. In addition, facilitating resale may enhance the value and therefore incentives to invest in new infrastructure."[45] The OECD does not provide

38. The proposal that mandatory unbundling be conditioned upon evidence that consumer surplus would increase under such regulation originated in Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to Mandatory Unbundling of Telecommunications Networks*, 109 YALE L.J. 417 (1999). *See also* Dennis L. Weisman, *A "Principled" Approach to the Design of Telecommunications Policy*, 6 J. COMPETITION L. & ECON. 927 (2010).

39. *See, e.g.*, Jerry A. Hausman & J. Gregory Sidak, *Did Mandatory Unbundling Achieve Its Purpose? Empirical Evidence from Five Countries,* 1 J. COMPETITION L. & ECON. 173 (2005); Marc Bourreau, Pinar Doan & Matthieu Manant, *A Critical Review of the "Ladder Investment" Approach*, 34 TELECOMM. POL'Y 683 (2010); Rainer Nitsche & Lars Wiethaus, *Access Regulation and Investment in Next Generation Networks—A Ranking of Regulatory Regimes*, 29 INT'L J. INDUS. ORG 263 (2011).

40. 525 U.S. 366, 429 (1999) (Breyer, J., concurring in part and dissenting in part).

41. ROBERT W. CRANDALL, COMPETITION AND CHAOS: U.S. TELECOMMUNICATIONS SINCE THE 1996 TELECOM ACT 69-70 (Brookings Institution Press 2004).

42. Thomas W. Hazlett, *Rivalrous Telecommunications Networks With and Without Mandatory Sharing*, 58 FED. COMMC'N L.J. 477, 492-93 (2006).

43. Michal Grajek & Lars-Hendrik Röller, *Regulation and Investment in Network Industries: Evidence from European Telecoms* 16 (Eur. Sch. of Mgmt. & Tech., Working Paper, 2009).

44. OECD REPORT, *supra* note 1, at 81.

45. *Id.* at 121.

theoretical or empirical evidence supporting this conjecture. Empirical evidence indicates that entrants have *reduced* investment in new networks once regulators offered them cheap access to incumbent facilities. Jerry Hausman and Gregory Sidak evaluated the effects of forced sharing in the United States, the United Kingdom, Canada, and Germany.[46] Their analysis found that U.S. entrants increasingly relied on leasing access to incumbents' unbundled network elements (UNEs) as their preferred mode of entry in the early 2000s.[47] From December 1999 to December 2002, the percentage of entrants' UNE lines out of total entrant lines increased from 23.9 percent to 70.5 percent.[48] In another analysis of U.S. data, Hazlett also concluded that the pattern of UNE entry in the United States suggested that competition achieved through forced sharing and wholesale price controls did not lead to facilities-based entry; instead, rapid growth in the use of unbundled network elements quickly became the dominant form of entry.[49] These results show that mandatory unbundling fails at achieving facilities-based competition, thereby delaying innovation that stems from facilities-based competition. More recent research confirms this investment effect. Hans Friederiszick, Grajek, and Röller found that the introduction of access regulation in Europe corresponds to reduced investment by entrants over five years equal to approximately 112 percent of the entrants' infrastructure stock.[50] That is, entrants would "more than double their infrastructure over 5 years if they did not have regulated access to the incumbent's local loops."[51]

Hazlett also found that capital expenditures in wireline telecommunications networks declined dramatically for both incumbents and entrants. He estimated that the simple correlation between UNE lines and non-cable facilities-based lines was roughly –1.[52] That negative correlation indicates that, as the use of unbundled network elements increased, construction of facilities-based competitive lines decreased. The number of non-cable facilities-based lines decreased from 4.1 million at the end of 2000 to 3.2 million by mid-2003 in the United States.[53] Grajek and Röller similarly found empirical support for a tradeoff between infrastructure investment by both incumbents and entrants and access regulation.[54] They estimated that the introduction of typical access regulation in the European Union from 1997 to 2002 resulted in €16.4 billion in lost infrastructure investment from 1997 to 2006.[55] Hazlett explained that competitive networks most likely develop not from regulation that compels the opening of existing delivery platforms to multiple operators, but from policies nurturing the development of rival infrastructure in adjacent markets or from the adoption of alternative technologies, like broadband and wireless communications networks.[56]

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46. Hausman & Sidak, *Did Mandatory Unbundling Achieve Its Purpose?*, *supra* note 39, at 195.
47. *Id*. at 200-04.
48. *Id*. at 200.
49. Hazlett, *Rivalrous Telecommunications Networks*, *supra* note 42, at 488.
50. Hans Friederiszick, Michal Grajek & Lars-Hendrik Röller, *Analyzing the Relationship Between Regulation and Investment in the Telecom Sector* 32-33 (ESMT, White Paper No. WP-108-01, 2008). *See also* Bourreau, Doan & Manant, *supra* note 39.
51. Friederiszick, Grajek & Röller, *supra* note 50, at 33.
52. Hazlett, *Rivalrous Telecommunications Networks*, *supra* note 42, at 488.
53. *Id*.
54. Grajek & Röller, *supra* note 43 (concluding that access regulation decreases incumbent investment and increases entrants' total investment but decreases each *individual* entrant's investment, which indicates that access regulation induces entrants to engage in service-based competition rather than facilities-based competition).
55. *Id.* at 16.
56. Hazlett, *Rivalrous Telecommunications Networks*, *supra* note 42, at 490-91.

From the perspective of benefitting consumers, the absence of unbundling and *ex ante* interconnection regulation in Mexico should be viewed as an asset—not a liability—of Mexico's telecommunications sector. The asymmetric unbundling policies in the United States and elsewhere were a policy failure that consumed billions of dollars in implementation and administration costs, that discouraged investment in facilities by the incumbents and entrants alike, and that created virtually no meaningful or enduring local competition.[57] The Mexican government has the opportunity to skip the same regulatory misadventure. Because local telephone competition from wireless and cable telephony and next-generation broadband already exist, mandatory unbundling is irrelevant.

2. Mandatory Wholesale Broadband Access at Regulated Prices

Without any explanation, the OECD claims that Telmex's and Telcel's alleged market power in the fixed and mobile markets is "*likely* to restrict fixed/mobile broadband competition significantly."[58] The OECD therefore recommends mandating the unbundling of local loops to promote competitive supply of broadband. It would "require[e] Telmex to offer wholesale broadband access and/or unbundled loops."[59] Additionally, the OECD believes that "[m]andating wholesale broadband access can also apply to the dominant mobile company by requiring the provision of access to MVNOs [mobile virtual network operators]."[60] These recommendations are misguided. Forced sharing for broadband is surely not what stands in the way of higher broadband penetration in Mexico.

The seemingly low penetration rate appears to be primarily a demand-side issue. As of 2010, approximately 25 percent of households in Mexico reportedly had a computer.[61] In contrast, as of 2009, approximately 81 percent of U.K. households had a computer.[62] Because computers are a necessary input in using broadband service, access to computers is critical to increase broadband penetration. Another potential impediment to broadband penetration is the lack of compelling Spanish-language applications or content for Mexican residential customers. Mandatory unbundling does not increase access to computers, nor does it make broadband content more compelling.

Empirical research demonstrates that open-access policies, after properly controlling for other factors that influence broadband penetration, do not positively contribute to broadband penetration in a significant and lasting way.[63] Using a linear regression model

57. *See* J. Gregory Sidak, *The Failure of Good Intentions: The WorldCom Fraud and the Collapse of American Telecommunications After Deregulation*, 20 YALE J. ON REG. 207 (2003).

58. OECD REPORT, *supra* note 1, at 74 (emphasis added).

59. *Id*.

60. *Id*.

61. Boletín Informativo, S.A.B. DE C.V., Teléfonos de México [Newsletter, S.A.B. de C.V., Telephones in Mexico] (Apr. 28, 2010), *available at* http://www.telmex.com/mx/corporativo/salaPrensa_ComPrensa2010_280410.236.html. *See also* OECD FACTBOOK 2011-2012, Mexico, Computer and Internet Access by Households, *available at* http://stats.oecd.org/BrandedView.aspx?oecd_bv_id=factbook-data-en&doi=data-00589-en (last visited Mar. 21, 2012) (reporting that, as of 2009, 26.8 percent of households in Mexico had a home computer).

62. OECD FACTBOOK 2011-2012, *supra* note 61. The percentage of households with a computer in the United States and Canada were not available for 2009. As of 2008, 79.4 percent of households in Canada had a computer. *Id.*

63. *See, e.g.*, George S. Ford, Thomas M. Koutsky & Lawrence W. Spiwak, *The Frontier of Broadband Adoption Across the OECD: A Comparison of Performance*, 25 INT'L ECON. J. 111 (2011); Harold Ware & Christian M. Dippon, *Wholesale Unbundling and Intermodal Competition*, 34 TELECOMM. POL'Y 54 (2010); Jan Bouckaert, Theon van Dijk & Frank Verboven, *Access Regulation, Competition, and*

of panel data on twenty OECD countries from 2003 to 2008, Jan Bouckaert, Theon van Dijk, and Frank Verboven found a significant and positive relationship between broadband penetration and demand-based factors, including GDP-per capita and the percentage of households with personal computers.[64] In contrast, Bouckaert, van Dijk, and Verboven found that facilities-based intra-platform competition (through wholesale unbundling) does not significantly affect broadband penetration, and service-based intra-platform competition (through retail bitstream access) significantly decreases broadband penetration.[65] In an econometric study of sixteen OECD countries, Harold Ware and Christian Dippon found a significant, positive relationship between broadband penetration and the percentage of households with a computer and population density.[66] They found no significant relationship between unbundling and broadband penetration.[67] George Ford, Thomas Koutsky, and Lawrence Spiwak found that non-policy factors (such as age, income inequality, and the number of wireline telephones per capita) explain virtually all the variation in broadband subscriptions across thirty OECD countries studied.[68]

Why can these and numerous other studies not find any evidence of a statistically significant contribution that mandatory unbundling makes to broadband penetration? One possibility is that entrants using incumbent facilities are unable or unwilling to make the necessary investment in brand name recognition to attract subscribers. Another possibility is that mandatory unbundling has, in fact, decreased broadband prices, but not so much as to induce a significant number of marginal customers to overcome demand-side factors of broadband adoption and subscribe. It is doubtful that mandatory unbundling and wholesale broadband access would have any significant effect on broadband penetration in Mexico.

3. *Asymmetric* Ex Ante *Regulation in the Mobile Market*

The OECD strongly recommends that Mexico impose both access and price regulation in the mobile market. It advocates that

Broadband Penetration: An International Study, 34 TELECOMM. POL'Y 661 (2010); Scott Wallsten & Stephanie Hausladen, *Net Neutrality, Unbundling, and Their Effects on International Investment in Next-Generation Networks*, 8 REV. NETWORK ECON. 90, 102-07 (2009); Scott Wallsten, *Broadband and Unbundling Regulations in OECD Countries* 1, tbls.1, 2 (Joint Center AEI-Brookings Joint Center for Regulatory Studies, Working Paper 06-16, June 2006); Mario Denni & Harold Gruber, *The Diffusion of Broadband Telecommunications: The Role of Competition* (Working Paper, 2005); Kenneth Flamm, *The Role of Economics, Demographics, and State Policy in Broadband Availability* (LBJ School of Public Affairs, Working Paper, 2005); Debra J. Aron & David E. Burnstein, *Broadband Adoption in the United States: An Empirical Analysis* 7, 22 (Working Paper, Mar. 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=386100; Johannes M. Bauer, Jung Hyun Kim & Steven S. Wildman, *Broadband Uptake in OECD Countries: Policy Lessons from Comparative Statistical Analysis*, Prepared for presentation at the 31st Research Conference on Communication, Information and Internet Policy (2003).

64. Bouckaert, van Dijk & Verboven, *supra* note 63, at 668.

65. *Id*. at 663, 667-69. Bouckaert, van Dijk, and Verboven also found that intermodal competition between platforms significantly increases broadband penetration. *Id.* at 668-69.

66. Ware & Dippon, *supra* note 63, at 60-62.

67. *Id.* at 61.

68. Ford, Koutsky & Spiwak, *supra* note 63, at 118-120.

> Cofetel should be authorised to regulate interconnection tariffs *ex-ante* to foster competition among operators as well as facilitate sector development and growth, providing regulatory certainty and a level playing field in the mobile market.[69]

Key questions arise from the OECD's recommendations regarding the mobile market. First, what is the objective of *ex ante* regulation of mobile termination rates? It cannot be to prevent the elimination of a competitor, because exclusion is impossible. Spectrum is a perfectly durable asset, and towers and base stations are relatively long-lived assets. Consequently, a new competitor would enter as soon as an old competitor exited. Furthermore, the government itself ultimately controls entry by virtue of its spectrum allocation decisions.

Second, how does the OECD define "a level playing field"? This cliché in antitrust and telecommunications has become notorious for its overuse and vacuity.[70] Does a level playing field connote equality of opportunity or equality of outcomes?[71] Currently, Mexico has four mobile providers: Telcel (with a 70-percent share of the mobile market), Movistar (owned by Telefónica Mexico) (with a 22-percent share), Iusacell (with a 4-percent share), and Nextel (with a 4-percent share).[72] Mobile termination rates have fallen over the past decade,[73] yet the OECD characterizes the mobile market as suffering from a lack of competition. A level playing field defined by equality of outcomes suggests that the OECD believes that the competitive process would produce equal market shares among the mobile providers. To achieve this outcome, the OECD recommends (1) asymmetric regulation of Telcel's mobile termination rates and (2) the elimination of on-net and off-net price discrimination.[74] These policies, however, would harm consumers.

a. Asymmetric Ex Ante *Regulation of Telcel's Mobile Termination Rates*

The OECD argues that "bilaterally negotiated termination rates are likely to be set at a level that is significantly higher than cost, which in turn puts a floor under retail pricing."[75] According to the OECD, asymmetric regulation of Telcel's mobile termination rates is needed because "the detrimental consequences of high rates for competitors to the largest firm are very acute when that firm has 78% of subscribers, as in Mexico."[76] The OECD would thus "apply cost-based termination rates and asymmetric

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69. OECD REPORT, *supra* note 1, at 10.

70. The OECD's "level playing field" is the fifth most common cliché in the English language, according to the Oxford University Press, which has "ranked [clichés] in order of their frequency in the Oxford English Corpus, a database consisting of hundreds of millions of words of contemporary written English." Oxford University Press, Compact Oxford Thesaurus for Students, Avoiding Clichés, http://www.oup.com/uk/booksites/content/0199216290/streamline/clichebuster/ (last visited Sept. 9, 2011). The Oxford University Press advises: "Try to avoid using clichés . . . . They tend to annoy people and may create an impression of laziness or a lack of careful thought." *Id.*

71. The OECD evidently favors "fair" competition. But markets are distinctive for their efficiency properties, rather than the equity of their outcomes. *See* J. Gregory Sidak & Daniel F. Spulber, *Deregulation and Managed Competition in Network Industries*, 15 YALE J. ON REG. 117 (1998).

72. OECD REPORT, *supra* note 1, at 96 tbl.2.7.

73. *Id.* at 68-69. In 1999, fixed-to-mobile and mobile-to-mobile termination rates were $0.19 (USD). In 2007, Telcel's termination rate was $0.13. In 2008, the interconnection rate between Axtel and Telcel and between Telefónica and Iusacell was $0.05. In March 2011, Cofetel lowered the termination rate between Telcel and Alestra to $0.03. Current termination rates set by Cofetel's cost model are $0.03. (I converted the rates from MXN to USD.)

74 OECD REPORT, *supra* note 1, at 69.

75. *Id.* at 75.

76. *Id.* at 68-69.

remedies, enabled by Cofeco's market power designations[.]"[77] The OECD suggests that "[o]ne way of doing this is by setting caps on termination rates, leaving operators the freedom to negotiate rates below these caps."[78] According to the OECD's logic, price caps would lead to lower retail prices.

The creation of asymmetric termination rates would in effect force Telcel to subsidize a competitor every time a Telcel subscriber calls someone on the competing network. The subsidy would arise because competitors would be able to charge Telcel a higher termination charge than Cofetel would permit Telcel to charge competitors to terminate calls on Telcel's network. This asymmetry in termination rates would artificially raise costs for Telcel, which would force Telcel to charge its own subscribers higher prices than it otherwise would. Thus, the proposed regulation would create a price umbrella that would ease the pressure on competitors to reduce their own prices to subscribers (or to compete on quality terms).

Clearly, this regulation would cause an immediate loss of consumer surplus. Assuming that the OECD believes that Cofetel's mandate is to increase consumer surplus, how could it possibly justify its proposal to impose asymmetric termination rates? Presumably, the OECD envisions a two-period model of regulation. In the first period, it is willing to weaken Telcel as a competitor and sacrifice consumer surplus in the belief that such intervention is an "investment" in transforming the market structure for cellular telecommunications in Mexico. Under that scenario, Telcel's competitors would supposedly use the cash flow from their termination-rate windfalls to make themselves more potent competitors—for example, by investing more in their networks. Then, in the second period of the regulatory model, Cofetel would expect the newly invigorated competitors to unleash lower prices and quality improvements that would capture market share from Telcel and benefit consumers.

For three reasons, this rationale for asymmetric termination rates is implausible. First, if greater investment in competitors' networks could genuinely be expected to generate positive incremental profits for the carriers, inclusive of a competitive return on capital, then the capital markets would supply the necessary funds. It would be unnecessary for the industry's regulator to create a subsidy and play the role of investment banker.

Second, the discounted present value of future gains in consumer surplus must be large enough to recoup the immediate sacrifice in consumer surplus that would result from weakening Telcel as a competitor. Only then could Cofetel's "investment" begin to earn a positive return. However, even then it would still be necessary to compare the return on Cofetel's "investment" to the proper counterfactual—namely, the level of consumer surplus that would exist in the second period of the model if Telcel were *not* burdened by the regulatory obligation to subsidize its competitors through asymmetric termination rates. Simply as a matter of arithmetic, the discounted cash flow calculations are not likely, under any plausible parameter values, to yield a positive payoff in terms of consumer surplus. In other words, the short-term harm to consumers would not be offset by some longer-term benefit.

Third, as I explained above in Part I.C with respect to asymmetric regulation in general, capping Telcel's mobile termination rates would provide no guarantee that competing mobile carriers would compete more vigorously on price or quality terms. The regulation would result in a government-supported cartel, in which Mexican consumers lose the benefits of lower price and higher quality that result from competition.

77. *Id.* at 75.
78. *Id.*

b. Banning Price Differentials for On-Net and Off-Net Calls

The OECD supports the elimination of differential pricing between on-net and off-net mobile rates (although it is unclear from the OECD report whether the OECD recommends that Cofetel enforce an explicit ban on price differentials for on-net and off-net calls. Movistar recently reduced its retail price from MXN 3.65 per minute to 1.98 per minute, "irrespective of whether the call is on-net or off-net, local or long distance."[79] The OECD remarks, "[a]lthough the final overall per minute rate may have not decreased to that extent, *it is important that the on-net/off-net price gap disappears*."[80] The OECD's rationale behind the stance is that differential on-net and off-net pricing "puts the larger operators in a position where they can gain a competitive advantage and large profits."[81] The OECD attributes this advantage to "club effects" (or so-called "tariff-mediated network externalities").[82] For example, the OECD asserts that Telcel's practice of "provid[ing] a certain number of uncharged on-net calls . . . creates difficulties for other market entrants to gain market share."[83]

Contrary to what the OECD appears to believe, club effects are not market failures. They are market *attributes*. Many markets exhibit such demand complementarities. Two-sided markets, for example, do not "fail" because of their two-sidedness. A closed user group is a group of subscribers in which an individual cares not only about his own cost of making a mobile call, but also the price others members must pay to call him. When the OECD speaks of a "club effect," I understand it to mean the economic effects that arise from a closed user group. For example, a closed user group could consist of a group of friends and family, who have an interest in keeping call costs among themselves down in general. In the business context, a closed user group could consist of employees and would reflect the business subscriber's desire to minimize the cost of mobile communications among those employees. The consequence of a closed user group is that a mobile subscriber will pay attention to the prices paid by others who call her, which places competitive pressure on mobile carriers to keep their prices low.

If the OECD believes that Telcel customers are unlikely to switch to competing mobile carriers, how can the OECD be sure that the reason is not a failure of those other carriers to compete vigorously on price and quality? The OECD ignores the possibility that Telcel gained its market share through a superior business strategy. Iusacell was the incumbent in Mexico's wireless market, not Telcel.[84] The OECD asserts that "telecommunications markets must be 'contestable,' that is, that potential competitors find barriers to entry and exit low[.]"[85] But Telcel already proved the contestability of the mobile market by surpassing Iusacell. It would be an inexcusable act of regulatory malpractice for the OECD to claim to have found a market failure if the real reason that consumers are reluctant to switch to other carriers is that their prices and quality are inferior to Telcel's.

Furthermore, price discrimination is ubiquitous in competitive markets. William Baumol and Daniel Swanson argue that "it is competition, rather than its absence, that in

79. *Id.* at 69.
80. *Id*. (emphasis added).
81. *Id*. at 68.
82. *Id*.
83. *Id*. at 29.
84. *Id.* at 101 ("Iusacell entered the mobile market in the late 1980s, prior to Telcel.").
85. *Id.* at 120.

many cases serves to impose discriminatory pricing."[86] The OECD must supply a very compelling argument (which it does not and cannot) for why Telcel's use of such pricing should justify Cofetel's preemptive regulation of retail prices for cellular service, something that virtually all other countries have either abandoned or declined to impose. By adopting this retail price regulation for cellular service, Cofetel would have Mexico follow the example of Paraguay and Kenya—not the OECD countries.

If the OECD's argument is that differential pricing becomes competitively threatening when a firm's market share reaches a certain size, then the OECD is really denouncing scale. The OECD's argument would seem to be, "once it reaches a certain size, Telcel is too attractive for customers to leave." It is difficult to see why customer loyalty is evidence of market failure. Furthermore, Nobel laureate George Stigler observed decades ago that different productive tasks within a firm will manifest economies of scale at different levels of output.[87] What kind of market structure emerges depends on which economies of scale dominate as an empirical matter. The OECD makes an unstated assumption that its club-effect conjecture is more empirically significant in terms of influencing market structure than the other economies of scale in the production of cellular service. I see no reason why that assumption should be true.

The OECD's solution to its hypothesized problem of the club effect is to deny Telcel the right to exploit economies of scale that it lawfully acquired through competitive behavior that built its customer base. The OECD would reduce the access charge that Telcel may charge its competitors. Telcel's regulated rates would be based on cost. This regulation would be aimed at unabashedly diminishing Telcel's cost advantage over its competitors. In other words, Cofetel would compel Telcel to lower its termination rate so competing carriers could offer their own subscribers lower prices to call persons on Telcel's network, thus reducing the advantage of being a Telcel subscriber rather than a subscriber to a different network. However, there is another way to view Cofetel's denial of Telcel's right to exploit its efficiencies: Cofetel would be destroying economic value. Cofetel would reduce economic efficiency in the name of benefiting non-dominant carriers. Most importantly, there is no assurance that customers of those carriers will ever derive any benefit, as these carriers need not use the reduction in Telcel's termination charges to lower their own retail prices or improve their service.

4. *Allocating Spectrum to Achieve "More Balanced" Competition*

The OECD would use spectrum allocation as a tool of competition policy. According to the OECD, "[t]he principal challenges for spectrum policy are thus to provide the capacity to achieve the country's broadband objectives, and *to achieve a more balanced competitive structure* in the mobile communications sector."[88] Thus, the OECD advocates "impos[ing] strict spectrum caps on Telcel" to "limit its ability to extend its dominance from mobile voice to mobile data services."[89] The OECD's objectives and recommendations are problematic on multiple grounds.

The OECD's two stated objectives of meeting demand for mobile broadband data service and achieving "more balanced" competition are at odds with each other. Using

86. William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70 ANTITRUST L.J. 661, 662 (2003).
87. George J. Stigler, *The Division of Labor Is Limited by the Extent of the Market,* 59 J. POL. ECON. 185 (1951).
88. OECD REPORT, *supra* note 1, at 94 (emphasis added).
89. *Id.* at 75.

spectrum policy as a competition tool squanders spectrum. It keeps parties from putting spectrum to its highest valued use. It is *efficient* allocation of spectrum that will best achieve the goal of meeting demand for mobile broadband. In contrast, there is no reason why *equal* allocation of spectrum across mobile providers would accelerate the deployment of mobile broadband data services.

Not surprisingly, the key "problem" that the OECD identifies is Telcel's 70-percent share of mobile subscribers. It appears that the OECD would constrain Telcel's network capacity using spectrum auction design, so that network congestion would limit Telcel's number of subscribers.[90] By allocating spectrum this way, Cofetel would limit or reduce Telcel's market share. But how would doing so benefit consumers?

Indeed, Telcel's market share is not, on its face, evidence of market failure that would justify the OECD's recommendation to rig the design of spectrum auctions. The OECD never considers the possibility that Telcel's 70-percent market share is a result of its and other mobile operators' differing business strategies. Nextel has 4 percent of Mexico's mobile subscribers, but it targets "high ARPU clientele, principally the business community[.]"[91] It is therefore not surprising that Nextel's 4-percent share of subscribers yields a 13-percent share of mobile *revenues*. Firms aim to maximize *profits*, not subscribers. Nextel would prefer not to increase its market share if doing so would require lowering its prices and lowering its profits. The two spectrum auctions in 2010, Tender 20 and Tender 21, "were designed to promote competition."[92] For that reason, Iusacell, Telcel, and Telefónica were subject to spectrum caps,[93] whereas Nextel increased its spectrum holdings from 22 MHz to 53 MHz.[94] But, if Nextel is satisfied with having 4 percent of mobile subscribers, will Nextel even use all of its newly acquired spectrum?

During the 2010 tenders, Cofetel also "made explicit attempts to encourage a new international entrant to enter the market. These efforts were unsuccessful[.]"[95] This *regulatory failure* speaks volumes about the absence of market failure in Mexico's mobile broadband sector. Cofetel's failure to attract entrants indicates that it is not attractive for an investor to enter Mexico's mobile market and under-price the dominant firm. Perhaps, then, the dominant firm's prices are not so high. The OECD says that "[o]ne powerful deterrent to entry is likely to have been Telcel's dominance and the perception that the regulatory regime had failed to constrain anti-competitive behaviour."[96] The OECD's reasoning is wrong. Its causation is backwards. If Telcel were exploiting market power, then its prices would be high. Those high prices would attract outside investors. The absence of entry indicates that there is a lack of rents to gain by entering.[97] Thus, the difference in market shares among the existing mobile providers is likely to be a result of different, *competing* business strategies.

No principle in economics and no empirical evidence support the OECD's premise that governments are better at determining optimal competitive structures than markets.

90. *Id.* at 129.
91. *Id.* at 98.
92. *Id.* at 96.
93. *Id*.
94. *Id.* at 96 tbl.2.7. Before the auctions, after Tender 20, and after Tender 21, Telcel's holdings were 54 MHz, 54 MHz, and 77 MHz; Telefónica's were 39 MHz, 55 MHz, and 61 MHz; Iusacell's were 44 MHz, 54 MHz, and 53 MHz. *Id.*
95. *Id.* at 96.
96. *Id.* at 99.
97. *See, e.g.*, DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 61-62 (4th ed., Addison-Wesley 2005).

Yet, the OECD would deviate from market mechanisms, advancing novel approaches such as a spectrum floor, which Ofcom recently introduced in the United Kingdom.[98] The OECD provides no evidence that Ofcom's new approach has increased consumer welfare. The OECD appears to support a spectrum floor because it "gives a preference for a lower bid from an entrant over a higher one from an incumbent" by offering a "specified amount of spectrum to at least one newcomer."[99] Although this approach would succeed in securing a given number of competitors in the mobile broadband market, would it achieve effective competition? Certainly not if the market is already a rivalrous oligopoly.

When the OECD—and ultimately Cofetel—speak of "more balanced" competition in mobile broadband, do they envision equal market shares for each mobile provider? This goal may be the case, as the OECD proposes that the government "allocat[e] a significant part of 700 MHz spectrum to an operator that, instead of being vertically integrated into the downstream retail market, will act as a platform for competing MVNOs[.]"[100] The OECD wants forced sharing; MVNOs amount to spectrum unbundling. However, MVNOs can be commercially negotiated. Again, why is the government better at stimulating efficient MVNO entry than are market mechanisms? The OECD's approach to the design of spectrum auctions favors competitors to the detriment of consumers. The regulatory objective should be to allocate spectrum to firms that can put it to its highest-valued use. In contrast to the OECD's vision of "more balanced" competition, that objective rooted in economic efficiency would benefit consumers.

5. *Increasing Fines to Deter Anticompetitive Conduct*

The OECD recommends expanding Cofetel's powers to impose fines:

> The regulatory authority should be empowered to impose meaningful fines that are sufficiently high (much higher than at present) to act as a deterrent and ensure that regulations are adhered to and regulatory objectives met.[101]

This proposal is problematic for two major reasons. First, Cofetel is not a court, yet the OECD would empower it to impose fines without the usual protections of due process. There can be little doubt that the OECD envisions fines that would run into the hundreds of millions, if not billions, of U.S. dollars, seeing as the OECD praised the $1 billion (USD) fine that Cofeco imposed on Telcel for alleged margin squeeze.[102] When coupled with the OECD's proposal that regulatory actions cannot be stayed pending appeal, Cofetel would have the ability to extract vast sums of money from a firm until it could prove that it was entitled to have its money returned because the regulatory decision was invalid for some reason. The OECD plainly envisions giving Cofetel powers that are both punitive and confiscatory.

Second, the OECD ignores the lessons learned from the economic research on optimal fines, which would constrain the regulator's power to impose unreasonably large fines. The general economic theory of optimal fines was developed beginning in the late 1960s by economists and legal academics; it crystallizes important intuitions about the

98. OECD REPORT, *supra* note 1, at 100.
99. *Id*.
100. *Id.* at 99.
101. *Id*. at 10.
102. *Id.* at 115.

effects of monetary sanctions on behavior.[103] According to this theory, the benchmark for the optimal fine is the harm caused by an offender. In a world of perfect enforcement, a fine equal to the harm would successfully deter wrongful conduct: a firm contemplating such conduct would find that its benefit would be offset by the fine. At the same time, a firm that is planning to engage in legitimate activity would not fear fines because, in a world of perfect enforcement, fines would never be imposed on it. Assuming that the cost of imposing the fine is zero, the optimal fine should equal the harm divided by the probability of detection.[104] If the cost of imposing the fine is non-trivial, then the cost of enforcement will be added to the optimal fine.[105]

Realistically, however, two important types of errors may occur and affect the optimal fine.[106] The first is a *false negative*, meaning that a firm that truly caused harm is not held accountable for it, either because the firm's offense is not detected or because the firm is not found liable after its offense has been detected. This possibility weakens deterrence. The importance of this type of error depends on the magnitude of the harm resulting from the wrongful act (the greater the harm, the more troubling is a false negative).

The second type of error is a *false positive*, meaning that a firm that did not cause harm is nonetheless found liable. The possibility and social costs of false positives are well recognized in antitrust law.[107] This outcome can chill a firm's engagement in a beneficial activity that might (falsely) give rise to liability. The significance of the chilling effect depends on the magnitude of the societal benefits that are lost as a result of deterring such a firm.

The optimal fine will reflect the two errors just described. To the extent that false negatives are a problem, the fine should be raised to offset the dilution of deterrence. If this were the only type of error, the fine should exceed the harm. For instance, if the chance of escaping liability is one-half, the fine would need to be twice the harm to create proper deterrence. However, to the extent that the risk of false positives applies, the fine should be lower to reduce the chilling effect on socially desirable conduct. If a false positive were the only type of error, the optimal fine would be less than the harm.

While advocating that "[f]ines should be raised to the level where they would act as a deterrent even for large companies,"[108] the OECD does not specify how Cofetel would achieve those levels. Defining principles for determining the magnitude of fines is difficult. The optimal level of a fine will depend on the facts of the given case. The OECD's simplistic conclusion that all fines need to be higher to deter anticompetitive behavior is arbitrary and assumes away the difficulty of the task.[109]

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103. Gary Becker won the Nobel Prize in economics in significant part for his contribution to the economic analysis of sanctions. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 75 J. POL. ECON. 169 (1968). The subsequent literature on optimal sanctions is surveyed in A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. ECON. LIT. 45 (2000).

104. Polinsky & Shavell, *supra* note 103, at 58.

105. *Id.*

106. *See, e.g.*, I. P. L. Png, *Optimal Damages and Subsidies in the Presence of Judicial Error*, 6 INT'L REV. L. & ECON. 101 (1986); A. Mitchell Polinsky & Steven Shavell, *Legal Error, Litigation, and the Incentive to Obey the Law*, 5 J. L., ECON. & ORG. 99 (1989); Louis Kaplow, *Optimal Proof Burdens, Deterrence, and the Chilling of Desirable Behavior*, 101 AM. ECON. REV. PAPERS & PROC. 277 (2011).

107. *See, e.g.*, Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414-15 (2004); Pacific Bell Tel. v. linkLine Commc'ns, 129 S. Ct. 1109, 1120 (2009).

108. OECD REPORT, *supra* note 1, at 125.

109. The OECD also fails to clarify how Cofetel would impose the larger fines. If Cofetel's decisions are no longer suspended until after judicial review, would Cofetel ask the firm to pay the fine first and then refund the firm if the court overturns the decision?

6. *Conditioning Telmex's Entry into Television Upon Its Submission to Asymmetric Regulation*

Cofetel has taken the position that Telmex currently cannot provide pay-TV services or use its telephone or broadband network to provide free television services. Consequently, Telmex cannot offer triple-play packages.[110] The OECD recognizes that "convergence is an increasingly important technological trend."[111] However, the OECD argues, "the Mexican market has certain characteristics, which should compel the authorities to consider very carefully whether Telmex should be entitled to provide pay-TV services."[112] The OECD believes that "Telmex is in a position to leverage its market power in broadband and telephony to the pay-TV market, taking advantage of service bundling."[113] Moreover, the OECD observes, "Telmex has been highly successful in challenging asymmetric regulation in courts[.]"[114] Therefore, the OECD argues, Telmex should be allowed to provide pay-TV services *only if*

> Telmex and Telcel accept asymmetric regulation and, in particular, provide a reference interconnection offer based on the Cofetel interconnection model, providing a service level agreement with quality of service conditions (including access to passive infrastructure such as ducts, poles, towers and buildings for collocation), accepting full local loop unbundling, and accepting the elimination of the non-competitive zones by providing local interconnection.[115]

According to the OECD, the condition that Telmex and Telcel accept asymmetric regulations would be "a means of finally circumventing Telmex's delaying tactics" in courts.[116]

Although perhaps better characterized (based on OECD's own admissions of Telmex's success in its appeals) as circumventing Telmex's constitutional rights, this proposal also would harm consumer welfare. The experience in the United States with similar line-of-business regulatory quarantines is that they sacrificed gains in consumer surplus in the market-to-be-entered in return for conjectural or nonexistent gains to be had in the regulated firm's current market.[117]

a. *The U.S. Experience with Line-of-Business Restrictions*

Before 1984, most consumers and businesses in the United States received their wireline telephone service from AT&T and its subsidiaries, collectively known as the "Bell System." The Bell System's customers used its network to place and receive "long-distance" as well as "local" calls. The modern era in U.S. telecommunications policy

110. *Id.* at 86.
111. *Id.* at 87.
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.* Elsewhere in its report, the OECD generally recommends: "Telmex should be authorised to provide television services only when it is subject to adequate asymmetric regulations and there is evidence that it is complying with them and not resorting to judicial challenges to delay or suspend their fulfillment." *Id.* at 10, 128.
116. *Id.*
117. *See, e.g.*, Jerry A. Hausman, Gregory K. Leonard & J. Gregory Sidak, *Does Bell Company Entry Into Long-Distance Telecommunications Benefit Consumers?*, 70 ANTITRUST L.J. 463 (2002); Robert W. Crandall & Charles L. Jackson, *Antitrust in High-Tech Industries*, 38 REV. INDUS. ORG. 319 (2011).

began in 1984, when the U.S. Department of Justice (DOJ) broke up AT&T pursuant to the settlement of an antitrust suit that the DOJ had filed a decade earlier. The terms of the settlement were reflected in a court order entitled the "Modification of Final Judgment" (MFJ). The MFJ required AT&T to divest its subsidiaries, the Bell Operating Companies (BOCs), which provided local exchange service, and it forbade the BOCs from, among other things, providing long-distance service.

Like the OECD's justification for conditioning Telmex's entry into pay-TV on its and Telcel's compliance with asymmetric regulation, the rationale for the MFJ was the "quarantine theory."[118] Before divestiture, the local companies were thought to have market power due to a natural monopoly, despite the fact that they were regulated at both the state and federal level to limit the exercise of any such market power. The quarantine theory suggested that, in the absence of the entry restriction, the BOCs would cross-subsidize competitive long-distance services with revenues from their local services and, further, would discriminate against competing long-distance companies when providing the connection to the local network.

The MFJ contained a waiver procedure by which the BOCs would request relief from the MFJ for specific services so long as "there [was] no substantial possibility that the [petitioning BOC] could use its monopoly power to impede competition in the market it seeks to enter."[119] However, the MFJ's waiver process became mired in delay, impeding the evolution of efficient new technologies.[120] The parties had agreed to a triennial review of the MFJ, and the first such review began in 1987. This review led to the removal of the MFJ's prohibition on the provision of information services by the BOCs. However, the first triennial review was not completed by either 1990 or 1993, when the *second* and *third* reviews were scheduled to take place. A second triennial review *never* took place.

The MFJ significantly harmed consumers. Empirical research has found that the line-of-business restrictions in the MFJ caused consumers to forgo billions of dollars of consumer surplus annually because of the delay in introducing new telecommunications services.[121] For example, AT&T initially proposed to offer voice-messaging services in the late 1970s, before the breakup of the Bell System. The FCC first refused to allow the BOCs to offer voice-messaging services on an integrated basis with the rest of their telecommunications services. The MFJ's subsequent line-of-business restrictions forbade the BOCs to offer (among other services) voice-messaging services.

It was not until 1988 that the MFJ court vacated the line-of-business restriction on information services (which included voice-messaging services). The BOCs began to offer the services in 1989, more than *ten* years after AT&T first proposed to offer them. The services have been widely available since 1990, and about 16 million consumers bought them in 1996. If, as Jerry Hausman has estimated, the consumer surplus from

118. *See* MICHAEL K. KELLOGG, JOHN THORNE & PETER W. HUBER, FEDERAL TELECOMMUNICATIONS LAW 199-248, 401-28 (1992); J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES 55-99 (Cambridge Univ. Press 1999); WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY 130 (MIT Press 1994).

119. Modification of Final Judgment, § VIII.C., 552 F. Supp. at 231.

120. In 1993, the average waiver request had been pending for 36 months, despite the fact that the DOJ had opposed relief in only 6 of the 266 waiver requests filed by the RBOCs. *See* Paul H. Rubin & Hashem Dezhbakhsh, *Costs of Delay and Rent-Seeking Under the Modification of Final Judgment*, 16 MANAGERIAL & DECISION ECON. 385, 385-87 (1995). By the end of 1993, the average age of pending waiver motions before the district court had grown to 54.7 months, despite the fact that the decree court had fully approved 96 percent of all waiver requests filed. *See id.* at 389, 392.

121. *See* Jerry A. Hausman, *Valuing the Effect of Regulation on New Services in Telecommunications*, 1997 BROOKINGS PAPERS ON ECON, ACTIVITY: MICROECONOMICS 1, 13-24 (1997).

these services was $1.27 billion in 1994 alone,[122] then the decade of regulatory delay cost consumers many billions of dollars. Relative to the consumer-surplus losses from the delay in the introduction of voice messaging, one would expect similarly large losses in consumer surplus in Mexico if the OECD's proposed line-of-business restrictions on Telmex were to delay the introduction of new or improved technologies, products, and services in Mexico's free-TV and pay-TV markets.

Furthermore, BOC entry into long distance did not result in higher prices. The U.S. Telecommunications Act of 1996 retained the MFJ's ban on BOC entry into long distance.[123] However, section 271 of the act provided a process by which BOCs could gain regulatory approval from state PUCs, the FCC, and the DOJ to enter the long-distance market in their local exchange regions.[124] Contrary to the predictions of the quarantine theory, long-distance prices fell; BOC entry did not impede competition in the long-distance market. States where BOCs entered the long-distance market experienced average consumer savings of 8 to 11 percent on monthly long-distance bills compared with consumer bills in states without BOC entry into long distance.[125] Furthermore, the average local bill (excluding long-distance and local toll services) did not experience any significant change in states where BOC entry occurred.[126]

b. Telmex's Entry into Television Would Benefit Consumers

The lessons from the U.S. experience in line-of-business restrictions highlight the risks of the OECD's proposal to restrict Telmex's entry into pay-TV. While emphasizing the potential increase in Telmex's market power, the OECD ignores the consumer-welfare gains that would result from Telmex's entry. In one of the strangest passages in the OECD report, the OECD laments that

> Telmex's nationwide network and financial power makes it capable of deploying pay-TV services extensively within a very short timeframe. In addition, Telmex is very active in the Spanish content market in Latin America, so it has the capacity to enter rapidly the television market in Mexico.[127]

Why are these conditions a threat to the pay-TV market? The fact that Telmex has the resources to deploy pay-TV services quickly and widely means that it would be an efficient competitor in the pay-TV market. It could offer lower-priced services to a greater number of consumers, and it could offer lower-priced, higher-quality triple-play packages. This passage indicates how far the OECD's vision of competition is removed from the interests of consumers.

Consider, for example, Dish's 2008 partnership with Telmex to provide direct-to-home pay-TV services, using Telmex's billing services and retail space to sell subscriptions. With this partnership, Telmex began to offer a low-priced bundle of

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122. *Id.* at 2. *See also* Jerry A. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition*, *in* THE ECONOMICS OF NEW GOODS 209 (Timothy F. Bresnahan & Robert J. Gordon eds., Univ. of Chicago Press 1997); Jerry A. Hausman, *Mobile Telephone*, *in* HANDBOOK OF TELECOMMUNICATIONS ECONOMICS 585 (Martin E. Cave, Ingo Vogelsang & Sumit K. Majumdar eds., North Holland 2002); Jerry A. Hausman, *Sources of Bias and Solutions to Bias in the CPI*, 17 J. ECON. PERSP. 23 (2003).

123. Pub. L. No. 104-104, 110 Stat. 56.

124. 47 U.S.C. § 271.

125. Hausman, Leonard & Sidak, *supra* note 117, at 464, 477-78.

126. *Id.* at 464, 480.

127. OECD REPORT, *supra* note 1, at 87.

landline and pay-TV (which is provided by Dish but billed by Telmex). The OECD emphasizes competitors' complaints that Telmex has been engaging in discriminatory practices and that the Telmex-Dish bundle is predatory; specifically, competitors have alleged that "the bundled price is well below the sum of the standalone prices of each of the individual services provided."[128] This argument is laughable, because, if taken seriously, it would outlaw economies of scope. By definition, economies of scope exist if a firm can produce a bundle of products at a price less than the sum of the stand-alone costs of producing those products separately.[129] The ability to exploit economies of scope and provide a menu of services is not anticompetitive on its face nor does it say anything about market power. If anything, the presence of product differentiation and heterogeneity in a market should be treated as an attribute of an effectively competitive market.[130] Consumers should not be denied the benefit of lower retail prices resulting from economies of scope so that a competitor, which offers a narrower range of services that do not achieve economies of scope, can be assured of achieving profitability.

Economies of scope benefit consumers. Through its partnership with Telmex, Dish "targeted the lowest price-segment of the pay-TV market with a drastic price cut, offering a lower number of channels."[131] Consequently, Dish "gained 2 million subscribers in two years, while reducing the price of [direct-to-home] subscription by 70%."[132] Those results constitute substantial benefits to consumers. The OECD does not consider the possibility that, by offering a package with fewer channels at a lower price, Dish fulfilled the demand of consumers who were previously priced out of the market. The Dish-Telmex partnership is a dramatic example of the gains to consumers from product differentiation and differential pricing. Similar gains in consumer welfare could result from Telmex's ability to enter the pay-TV market.

c. Is Restricting Telmex's Entry into Television Constitutional?

Finally, the OECD's proposal is an affront to due process because it would require Telmex to forgo its right to challenge or appeal other regulations that it believed were unlawful in exchange for being granted entry into television. Article 8 of the Mexican Constitution grants the right of petition to all citizens: "Civil servants and public employees shall enforce the right of petition granted by this Constitution to individuals as long as the respective petition is a written request made in a peaceful and respectful way."[133] It is an "unconstitutional condition" to require someone to forfeit a constitutionally protected right in return for the receipt of a benefit from the government.

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128. *Id.* at 85.

129. *See, e.g.*, CARLTON & PERLOFF, *supra* note 97, at 52. *See also* David E.M. Sappington & J. Gregory Sidak, *Competition Law for State-Owned Enterprise*, 71 ANTITRUST L.J. 479, 510 (2003) (explaining that economies of scope in the provision of product *A* and *B* cause the firm's "marginal cost producing *B* to decline as the [firm's] supply of product *A* increases"); SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 118, at 22 (A firm "exhibit[s] economies of scope when it is less costly for one firm to produce a set of goods jointly than for distinct firms to produce individual goods or subsets of goods separately.").

130. SIDAK & SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT, *supra* note 118, at 22 ("although natural monopoly implies economies of scope, the converse is not the case. Most multiproduct firms derive economies of scope from joint production").

131. OECD REPORT, *supra* note 1, at 85.

132. *Id*.

133. MEXICAN CONST. art. 8 ("Los funcionarios y empleados públicos respetarán el ejercicio del derecho de petición, siempre que ésta se formule por escrito, de manera pacífica y respetuosa; pero en materia política sólo podrán hacer uso de ese derecho los ciudadanos de la República.").

The Mexican Constitution further explains that "[n]o one shall be deprived of her . . . rights but by a judicial ruling issued by a court which is pre-existent to the respective trial and in which due process of law has been enforced."[134] Read in conjunction, these two provisions indicate that depriving someone of the constitutional right of petition (or appeal) is only permissible through due process of law—which necessarily includes a trial that enforces due process. Depriving an entity of its right to petition without such a trial—including deprivation of the right to petition merely in exchange for a benefit—does not comport with the language of the Mexican Constitution.

This argument is all the more powerful if Mexican constitutional law recognizes that the OECD's proposal effectively would force Telmex to exchange one constitutionally protected right, due process, to receive another already-guaranteed constitutional right, freedom of expression. In its 2010 report on freedom of expression in Mexico, the Inter-American Commission on Human Rights emphasized that "the allocation of radio and television licenses has a definitive impact on the right to freedom of expression in its two dimensions: the right to freely express oneself and society's right to receive diverse ideas and opinions."[135] Moreover, in *Chesapeake & Potomac Telephone Co. v. United States*,[136] a U.S. federal district court held that a ban on the provision of cable television service by telephone companies was a "facially unconstitutional as a violation of [the telephone companies'] First Amendment right to free expression."[137] The court explained that the ban was not narrowly tailored to serve the government's interests in "promoting competition in the video programming market and preserving diversity in the ownership of communications media."[138] Rather, the ban restricted more speech than was necessary to advance those goals. (Indeed, one could ask how such a ban could advance competition and diversity *at all*.) Given the pervasive migration of speech from printed to electronic form, one would expect that, under the Mexican Constitution, entry into television similarly falls under the category of protected expression.[139] If entry into television does indeed constitute protected expression, then the OECD's proposal would force Telmex to pick which constitutional right to forgo—freedom of expression or due process.

E. The OECD Fails to Recognize That the Availability of Transmission Capacity on the CFE's Network Obviates Asymmetric Regulation

An important and recurring problem in telecommunications policy is whether a company will invest billions of dollars to build a state-of-the-art network linking businesses and homes with optical fiber if it is likely that this new network will promptly be subjected to retail price regulation, mandatory access to competitors at regulated wholesale prices, and other costly asymmetric regulatory obligations. Policy makers worldwide have used the "enduring bottleneck" justification to perpetuate such regulation, often to disastrous results.

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134. *Id.* art. 14 ("Nadie podrá ser privado de la libertad o de sus propiedades, posesiones o derechos, sino mediante juicio seguido ante los tribunales previamente establecidos, en el que se cumplan las formalidades esenciales del procedimiento y conforme a las Leyes expedidas con anterioridad al hecho.").

135. INTER-AMERICAN COMMISSION ON HUMAN RIGHTS, 2010 SPECIAL REPORT ON FREEDOM OR EXPRESSION IN MEXICO 70 (2010).

136. 830 F. Supp. 909 (E.D. Va. 1993).

137. *Id*. at 932.

138. *Id*. at 927, 931-32.

139. *Id*. at 931-32.

The enduring local bottleneck rationale for continuing regulation of fiber networks reduces to a breathtakingly prosaic proposition: It is expensive to dig holes and move dirt so as to lay fiber-optic cable. This problem is not unique to telecommunications or network externalities or "convergence." It is fundamentally the same "enduring bottleneck" argument that could have been lodged against the Roman builders of the Appian Way. This argument, which permeates the OECD report, has led telecommunications policy astray for several decades. It should not be permitted to distract the next generation of telecommunications policy in Mexico.

The OECD correctly observes that the Comisión Federal de Electricidad (CFE), a state-owned enterprise, operates a nationwide fiber optic network with "substantial excess capacity."[140] In 2010, the CFE auctioned a share of its network to a consortium consisting of Televisa, Telefónica, and Megacable (the sole bidder). The consortium, Grupo de Telecomunicaciones de Alta Capacidad (GTAC),[141] may sell capacity to other network operators but not to end users.[142] The OECD recognizes that this network "reduces the dependence of the three firms on Telmex . . . as a supplier of transmission services, and gives other operators a major additional option."[143] Yet, with respect to providing access to the CFE's network, the OECD asserts, "[t]he tariffs should be based upon a long-run incremental cost methodology."[144] This conclusion shows that the OECD misses the point. The excess capacity in the CFE's network should *obviate* access price regulation, not perpetuate it.

Laying excess fiber capacity is cheap and enables future entry, particularly in a consortium setting. One could say that the trench is the essential facility; if the government funds the digging of trenches and allows third-party network operators to drop their fiber into those trenches, then the government would have effectively ensured competitive outcomes enforced by the credible threat of immediate entry. The OECD acknowledges that "[t]he availability of dark fibre represents a significant increase in the supply of a key interconnection product."[145] Specifically, "the continued overhang of spare capacity in the [CFE's] network means that further competition can in principle be developed via an appropriately designed subsequent auction."[146] Consequently, the CFE's fiber optic network capacity "provides a significant potential to increase competition in the backbone and backhaul market."[147]

Instead of regulating access to the CFE's network, the Mexican government could permit the CFE to auction periodically the right to use this dark fiber, thereby generating a market-determined price of the then-current fair value of broadband capacity. In contrast, in the United States the attempt to value access to the existing narrowband copper network consumed ten years of litigation in the U.S. Supreme Court and U.S. Court of Appeals for the D.C. Circuit following the enactment of the Telecommunications Act of 1996 because the FCC tried to replicate the price information that actual market transactions would have generated. Moreover, this exercise proved not

140. OECD REPORT, *supra* note 1, at 71.
141. *Id.* at 60.
142. *Id.* at 71.
143. *Id*.
144. *Id*. at 117.
145. *Id.* at 71.
146. *Id.* at 72.
147. *Id.* at 92.

to be robust when commodity prices rose and caused the forward-looking cost of an unbundled copper loop to exceed its historic cost.[148]

Price regulation of the next-generation network would be completely unnecessary by auctioning off excess capacity. In lieu of price regulation, the regulator would simply opine that the time had come to auction a further increment of fiber-optic capacity. The CFE and the consortium owning (part of) its network, in essence, would credibly commit themselves to a kind of "limit pricing" model of entry through the form of additional increments of dark fiber being auctioned and lit. The irrelevant discussion of the prohibitive cost of digging holes in the ground (or stringing aerial cabling) would no longer cloud the debate.

II. THE OECD'S RECOMMENDATIONS TO EXPAND COFETEL'S POWERS ARE MISGUIDED

The OECD proposes that Cofetel usurp the powers of the courts, the SCT, and Cofeco. But, Cofetel has no expertise or comparative advantage in interpreting the law, making political decisions, or assessing competition.

A. The OECD's Denunciation of the *Amparo* Is Wrong on Both Economic and Legal Grounds

A party may appeal one of Cofetel's regulatory decisions on constitutional grounds by filing a motion for an *amparo*. The OECD attributes the asserted problems in Mexico's telecommunications sector to the use of *amparos* by regulated carriers to challenge Cofetel decisions. The OECD argues:

> This abuse of *amparos* has frustrated and delayed regulation designed to promote competition . . . . The problem with the *amparo* process is not so much that decisions can be reviewed . . . . The problem lies in the fact that appeals lead to a suspension of the regulatory action. Appeals that freeze, or delay, regulatory decisions undermine the timeliness and legal certainty that is vitally important in a regulated market.[149]

The OECD thus advocates that a regulation be enforced—instead of suspended—while the courts review the *amparo*. The OECD's criticisms of the *amparo* system are misplaced and, to the contrary, regulatory decisions should be suspended while courts decide whether to overturn or affirm those decisions.

The filing of an *amparo* cannot in itself be abusive, even if the court affirms the challenged regulation after having suspended it. A standard constitutional limitation on the scope of competition law (known as the *Noerr-Pennington* doctrine in the United States) is that competition laws cannot be used to bar parties from invoking their constitutional right to petition the government.[150] Like the United States, Mexico

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148. Jerry A. Hausman, J. Gregory Sidak & Timothy J. Tardiff, *Are Regulators Forward-Looking? The Market Price of Copper versus the Regulated Price of Mandatory Access to Unbundled Local Loops in Telecommunications Networks*, 61 FED. COMM. L.J. 199 (2008).

149. OECD REPORT, *supra* note 1, at 122.

150. *See, e.g.*, AM. BAR ASS'N SECTION OF ANTITRUST LAW, MONOGRAPH 25, THE *NOERR-PENNINGTON* DOCTRINE (2009). The U.S. Supreme Court's decisions in Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961), and United Mine Workers of Am. v. Pennington, 381 U.S. 657 (1965), established the doctrine that a firm cannot be held liable for competitive injuries resulting from petitioning conduct that is "reasonably calculated or genuinely intended to petition government decision-makers for

explicitly guarantees the right to petition government in its Constitution.[151] Assuming that the OECD is not advocating that parties be prohibited from engaging in legitimate efforts to protect their constitutional rights, the problem that the OECD alleges must be that regulated carriers are engaging in what is sometimes referred to as sham litigation, whereby the initiating party seeks to use the judicial process itself, as opposed to the outcome of that process, to harm competitors or competition. To qualify as a sham, litigation must be "objectively baseless," meaning that "no reasonable litigant could realistically expect success on the merits."[152] Are Telmex's and Telcel's *amparo* petitions objectively baseless?

No *amparo* claim that results in the suspension of a regulation can be objectively baseless. It is my understanding that the *amparo* process in Mexico consists of two key stages. First, the court decides whether an *amparo* claim is frivolous and denies the claim if it is deemed frivolous. If the court does not deny the claim as frivolous, *then* the challenged regulation is suspended until the court decides whether to affirm or overturn the regulatory decision.[153] The OECD omits any discussion of the first stage of the review process, but that stage is crucial in assessing whether the *amparo* system is an anticompetitive abuse of process. Importantly, a challenged regulatory decision is not suspended until *after* the court decides that the *amparo* claim is not frivolous. A frivolous claim is virtually the same as an objectively baseless claim. The mechanism for denying frivolous *amparo* claims before regulations are suspended serves as a safeguard against wrongly suspending regulatory decisions. If an *amparo* claim has been deemed frivolous and thrown out, there was no delay of the challenged regulatory decision, so the existence of the *amparo* process will have done no harm. If, on the other hand, an *amparo* is granted in the first stage, it must have some chance of succeeding on the merits. Thus, no *amparo* petition that results in suspension of a regulation can be a sham petition.

More importantly, successful litigation can *never* be a sham. The OECD states that "Mexico has a surprisingly high number of court appeals that result not only in suspension, but also in the overturning of application of a regulatory decision."[154] This admission is breathtaking because it *refutes* the OECD's claim that *amparos* have caused the purported problems in Mexico's telecommunications sector. If Telmex's and Telcel's *amparo* petitions have been granted, one cannot credibly argue—as the OECD does—that the companies are abusing the *amparo* system to achieve anticompetitive results.

The high rate of instances in which the court overturned a Cofetel decision has two important implications. First, it shows that the first stage of the *amparo* process is successfully eliminating frivolous (or objectively baseless) claims and thereby minimizing harm from erroneously suspending regulations. Second, because it is more

redress." THE *NOERR-PENNINGTON* DOCTRINE, *supra* note 150, at 1-2. Similarly, the Court of the First Instance in the European Union held that the criteria for establishing sham (or "vexatious") litigation "must be interpreted and applied restrictively in a manner which does not frustrate the general rule of access to the courts[,]" for the "ability to assert one's rights through courts . . . underlies the constitutional traditions common to the Member States[.] Case T-111/96, ITT Promedia NV. v. Comm'n of the Eur. Communities, 1998 E.C.R. II-02937, Summary ¶ 1, ¶ 72.

151. MEXICO CONST. art. 8 ("Civil servants and public employees shall enforce the right of petition granted by this Constitution to individuals as long as the respective petition is a written request made in a peaceful and respectful way.") (trans. Carlos Pérez Vázquez) [hereinafter MEXICAN CONST.] (The original Spanish text reads: "Los funcionarios y empleados públicos respetarán el ejercicio del derecho de petición, siempre que ésta se formule por escrito, de manera pacífica y respetuosa; pero en materia política sólo podrán hacer uso de ese derecho los ciudadanos de la República.").

152. Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 60 (1993).

153. *See, e.g.*, Bruce Zagaris, *The Amparo Process in Mexico*, 6 U.S. MEX. L.J. 61, 62 (1998).

154. OECD REPORT, *supra* note 1, at 122.

likely that an *amparo* that survives to the second stage of review will be granted, the suspension of all challenged regulatory decisions pending judicial review in the second stage is justified. That is, a high rate of reversal of Cofetel's suspended decisions vindicates the automatic suspension of Cofetel decisions during judicial review.

By nonetheless asserting that "[t]he underlying and critical problem is that anti-trust regulation is repeatedly overturned or suspended in Mexico's courts,"[155] the OECD is implying that Mexican courts are wrong when they suspend and overturn Cofetel decisions. On what basis is the OECD making that claim? Is it not more likely that Cofetel's regulatory decisions are overturned because they are flawed applications of the law? The OECD ignores the possibility that the regulator might (1) make errors of factual or substantive analysis or (2) have an agenda that strays from the regulatory agency's mandated purpose. The OECD succumbs to the "nirvana fallacy" of decrying "imperfect markets" and then assuming perfect regulation.[156] Contrary to the OECD's assumption that regulators are always correct, the U.S. Court of Appeals for the D.C. Circuit has reversed the decisions of the FCC (the most experienced telecommunications regulator in the world) numerous times. In one such case, Judge Robert Bork wrote that the FCC had "rebut[ed] the presumption of its own expertise."[157]

The OECD is similarly naïve to assume that regulators are pure in their intentions. To the contrary, regulators can and have acted opportunistically. Former FCC Chairman Reed Hundt said the following about the FCC's interpretation of the mandatory unbundling provisions of the Telecommunications Act of 1996:

> The . . . compromises had produced a mountain of ambiguity that was generally tilted toward the local phone companies' advantage. But under principles of statutory construction, we [the FCC] had broad . . . discretion in writing the implementing regulations. Indeed, like the modern engineers trying to straighten the Leaning Tower of Pisa, we could aspire to provide the new entrants to the local telephone markets a fairer chance to compete than they might find in any explicit provision of the law.[158]

There is no reason to believe that Cofetel, given nearly unlimited authority as the OECD envisions, would never abuse its discretion to achieve goals that favor individual competitors over the public interest.

B. The OECD's Solution Would Remove Cofetel's Accountability

The OECD would transfer the SCT's authority to make policy decisions to Cofetel.[159] The OECD, however, never provides a factual basis for the implied problem that the SCT has been overturning Cofetel's decisions. Moreover, although the OECD says that the SCT "should be responsible for policy-making"[160] it never clarifies the distinction between policy-making and making policy decisions. It fails to redefine clearly the distinction between the SCT's and Cofetel's roles—and only insists that Cofetel needs

155. OECD REPORT, *supra* note 1, at 82. The OECD asserts that "the fact that the [Mexican] courts do not defer to the regulator or policy-making bodies is also problematic." *Id.* at 122.

156. *See* Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1 (1969).

157. Alltel Corp. v. FCC, 838 F.2d 551, 562 (D.C. Cir. 1988).

158. REED E. HUNDT, YOU SAY YOU WANT A REVOLUTION: A STUDY OF INFORMATION AGE POLITICS 154 (2000).

159. OECD REPORT, *supra* note 1, at 123 ("The SCT . . . should not have the right to . . . overturn Cofetel's decisions. The responsibility for making a decision should belong to Cofetel.").

160. *Id.*

more independence. Similarly, the OECD recommends that Cofeco only assist in Cofetel's "understanding the competitive implications of its regulations," but Cofetel "should have the authority" to declare market power.[161] What authority, then, is actually left for Cofeco and the SCT?

The OECD seems to equate a regulator's "independence" with its ability to rid itself of political or legal accountability. Notions of forbearance, restraint, and—at the other end of the spectrum—*abuse* of discretion, are alien to the OECD's vision of what it would mean for Mexico to follow "OECD best practices."[162] To the OECD, independence consists solely of Cofetel's unreviewable exercise of the power to coerce those subject to its jurisdiction. With respect to the SCT, the OECD decries that the Secretary's powers do not reside instead at a lower level of government, in Cofetel:

> Cofetel's independence is insufficient and does not accord with OECD best practice. This is because Cofetel's role remains largely consultative in many areas, and subordinate to the SCT in matters such as renewal, and modification of the terms and conditions of licenses and permits. Cofetel cannot impose fines on companies, but can recommend such action to the SCT. In fact, Cofetel lacks the power to carry out its mandate effectively to supervise, review and promote competition and efficiency in the development of the telecommunication sector.[163]

Because these activities are so important, the OECD seems to argue, they should be pushed farther down into the bureaucracy.

One interpretation of the OECD's critique is that it does not trust the SCT to act independently. The OECD may be correct that it comports with prevailing practices in OECD nations to devolve from a higher level of government to career bureaucrats the powers to renew telecommunications licenses, to modify their terms and conditions, and to impose fines. However, it does not follow as a matter of logic or common experience that reducing the accountability of telecommunications regulators is any form of "independence" to be envied by anyone other than those who hope to shed such accountability. Again, the OECD defines its vision of "independence" in terms of action and nonchalance, rather than restraint and circumspection:

> [I]t should be acknowledged that [Cofetel] has had a number of opportunities in the past to use its limited powers to take action, but has not done so, pending appeals on Cofeco's decisions. This was the case when Cofeco identified Telmex and Telcel as holding a position of dominance in 2009 but did not take the initiative to subject these operators to asymmetric regulations until the third quarter of 2011, when it issued remedies to dominant operators in the leased lines market (currently the subject of a publc [sic] hearing at Cofemer). Cofetel feared that the courts might stop the process of imposing asymmetric regulation, as happened during a previous attempt that began in 2000.[164]

To the OECD, the regulator's "fear[]" of judicial review is something to eliminate. A "best practices" agency could impose regulation far more expeditiously than Cofetel has done so far if only Mexican judges would stop insisting that the agency's actions conform to the rule of law. The OECD gives no consideration to the possibility that prior judicial appeals of Cofeco's decisions might produce valuable information for Cofetel as to

161. *Id.* at 124.
162. *Id.* at 47.
163. *Id.*
164. *Id.*

whether a possible course of regulatory intervention that it is currently contemplating would be lawful. It is telling that the OECD's recommendation to increase the power of Cofetel to regulate is, concomitantly, a recommendation to reduce the power of Mexican courts to say what the law is. The OECD well understands that for a regulator, no power is so intoxicating as unaccountable power.

III. Conclusion

The sweeping changes that the OECD recommends for Mexico's regulatory and legal institutions would not promote competition. To the contrary, the OECD's proposed asymmetric *ex ante* regulations would harm Mexican consumers by creating a government-sanctioned cartel of telecommunications providers in Mexico. The OECD's recommendations would protect inefficient competitors and reduce the investment incentives of both incumbents and entrants.

The solution to increasing deployment and adoption of next-generation telecommunications technologies lies not in propping up individual competitors, but in removing regulatory barriers to entry into the television and mobile markets. Doing so will promote innovation in differentiated products and bundled service offerings, which will benefit Mexican consumers and facilitate broadband adoption.