



# Mexico's Telecom Reform

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After months of a loud and often fractious debate, the Mexican Congress passed the implementing legislation for telecom reform nearly a year after the constitutional reform to the sector was approved. Reform of the telecom sector promises to be as transformative as that of the energy sector.

The reform's main objective is to enhance Mexican economic competitiveness by bringing down costs and improving the quality of telecom services. The means by which it seeks to achieve these goals is a revamped regulatory regime built on two pillars: an autonomous and technically capable regulatory agency with real sanctioning power and new operating rules for the sector.

Even before the enabling legislation was passed, the reforms began to demonstrate their power to change expectations and the operational calculus of incumbent firms, especially for cellular and fixed-line telephone services.

This white paper explains and analyzes the most significant changes to Mexico's telecommunications commission, to the operating rules for the sector, and how these changes have played out thus far with particular emphasis on cellular and fixed-line telephone services. The brief will also cover América Móvil's surprising announcement that it will divest some of its assets in a voluntary effort to reduce its market share in direct response to the reform.

## The Federal Telecommunications Institute (IFT or Ifetel)

A well-known fact about Mexico's old telecom regulatory agency (Cofetel) was its limited capacity to do its job. It faced a wide range of constraints, including a lack of autonomy from the executive branch, politically motivated selection of commissioners, a lack of legal authority to regulate the entire sector, weak sanctioning authority, and weak legal implementation of Cofetel rules. The telecom reform seeks to create a far stronger regulatory agency by meaningfully addressing all of these issues.

### Legal and Financial Independence

For the first time, Mexico's telecom regulatory agency will be fully independent. Rather than operating within the Communications and Transportation Ministry and thus subject to political pressure to make rulings favored by the presidential administration, the IFT is now a fully independent agency, both legally (constitutionally) and financially. Its commissioners are selected through a three-step process designed to maximize technical knowledge and abilities. (A technical evaluation committee works with universities to select three to five candidates and sends this list to the president; the president chooses one from the list who is then proposed to the Senate for confirmation.)

### Sole Regulator

The IFT is now the sole regulator for the entire telecom sector, pay and open TV, and radio, Internet, and fixed-line and cellular phone services. The only exception is the power to regulate TV and radio *content* rules, which will

be under the authority of the Interior Ministry (Gobernación).

### Power to Sanction Preponderant Companies

The IFT's sanctioning power is impressive. It has the power to regulate the sector asymmetrically, to penalize monopolistic practices and promote competition, apply steep fines, and even require the sale of assets in extreme cases.

The IFT's authority to regulate the sector asymmetrically, and specifically the power to declare companies "preponderant" in radio/TV and telecom, has undoubtedly received the most news coverage. Any company that controls more than 50 percent of the market for radio/TV or telecom (cellular, fixed-line telephone, Internet, and cable TV) is automatically considered "preponderant" and subject to meaningful asymmetric regulation by the IFT, fines, and divestment – whatever the IFT deems necessary (more on this in the "Divesting América Móvil Assets" section, below). But, in a meaningful development, the IFT can also declare that a firm has "substantial market power" *even if its market share is below 50 percent* and apply asymmetric regulation anyway.

To be sure, such a declaration must be the result of an exhaustive investigation by the IFT to prove that a firm has exploited its market position to generate excess profits or otherwise implement anticompetitive practices.

It is worth noting that the legislation does not clearly define what "substantial market power" means in practice but instead gives the IFT full authority to determine this on a case-by-case basis. As a result, the validity of IFT rulings identifying an actor as possessing such market

power is apt to be challenged in court for the foreseeable future (not unlike the nebulous definition of "essential production inputs" contained in the competition policy reform approved earlier in 2014 and discussed in another [ManattJones Global Strategies white paper](#)).

### Authority Over Dominant Companies

The IFT has a variety of sanctioning tools at its disposal:

- The IFT can fine firms for failing to conform to its rulings but, for the first time, these fines can be very significant. The IFT can fine firms up to 6 percent of their Mexico revenue for a first offense and up to 12 percent for subsequent offenses.
- The IFT can order "preponderant" firms, as well as those with significant market power, to sell assets, although as demonstrated by the IFT's initial rulings that Televisa and América Móvil are preponderant firms in their sectors, the power to *order* divestment is apt to be a last resort of regulators.
- The IFT has the authority to revoke telecom concessions, though only if the licensee fails to carry out the business for which they received the concession or if it fails to comply with the obligations contained in the concession, including adhering to all IFT rulings.

Nor can the IFT's rulings be blocked in court, with the exception of fines and divestment.

Using the *amparo* (judicial injunction) to suspend the old telecom regulator's rulings while they were being appealed was the first line of defense for Mexican telecom firms for nearly two decades. In the future, while they can appeal the IFT's rulings, their implementation cannot be suspended during the appeals process, with the important exception of fines and divestment.

Equally important but often overlooked, the telecom reform creates telecom courts



dedicated to hearing these appeals, as well as challenges to the broader telecom legal framework. In the past, telecom cases were heard by ordinary judges. Given the complexity of telecom issues, and the profound familiarity the firms' lawyers have with the issues at hand and the relative lack of understanding of these issues on the part of the judges hearing the cases, rulings often reflected this imbalance of information rather than the actual facts of the case. In the future, all telecom cases will be heard by judges in courts that specialize in telecom matters.

### **New Operating Rules for Mexico's Telecom Sector**

The new rules regulating the operations of telecom firms fall into two categories – those designed to reduce prices and improve quality directly (benefiting business as well as individual consumers) and those designed to do this indirectly by increasing competition in the sector.

#### **Reducing Prices and Increasing Quality of Services**

The most significant reduction in prices will come on January 1, 2015, when telephone companies must stop charging long-distance rates for all calls within Mexico (all calls within Mexico must now be charged as local calls). In addition, the reform prohibits cellular firms from charging more to connect calls to their customers from outside their network than within it, and forces cell companies to roll over the minutes remaining on prepaid phone cards when these are renewed. With regard to the quality of services, all phone numbers must become portable within 24 hours of contract termination. Furthermore, phones must be unlocked at the end of a contract, contract terms

cannot be modified without prior notification, and consumers must be compensated through refunds or discounted services for failures in telephone services or erroneous charges. None of these changes were accepted practice before the reform.

The reform also requires “net neutrality” and allows the IFT to formally collaborate with the consumer protection agency (Profeco) to ensure compliance with service and fee requirements, and establishes “must carry, must offer” for all cable television providers (e.g., cable companies must include all open television channels in their basic package).

#### **Increasing Competition**

To encourage competition, and as noted above, this is the first time the Mexican telecom regulator has had the power to regulate the sector asymmetrically. It can now declare firms either preponderant in a particular sector or “with substantial market power” in the provision of a particular service and then issue regulations that apply only to those firms.

This authority has two objectives: First, to prevent dominant firms from using their market power to implement anticompetitive policies, such as preventing competitors from entering the market or overcharging consumers (above the price a competitive market would establish) or providing poor customer service. And second, to encourage preponderant firms to divest – to sell enough assets to reduce their market share. In other words, the Mexican government is not going to be a “trust buster” in the telecom sector, but it can and does create a regulatory environment that encourages dominant players to take this action on their own. And as noted below, the core target is América Móvil, which

has responded to IFT's "encouragement," and MUCH more quickly than the government anticipated.

Other measures to increase competition promote investment in the telecom sector. This begins with a change in the nature of telecommunications concessions in Mexico.

Mexico will no longer issue concessions for individual telecom services. Instead, the IFT will issue single concessions that allow operators to provide any and all telecom services and thus compete in every sector of the industry – open TV/radio, pay TV, Internet, and cellular and fixed-line telephone. In addition, the IFT will not grant concessions solely on the basis of price and the applicant's capacity to provide telecom services, but also on the prevention of renewed concentration (another phrase whose precise meaning was not clearly laid out in the legislation).

To further promote investment, the government will auction the spectrum for two additional TV networks, and the rights to construct a new broadband network; the reform also requires Televisa and América Móvil (Telmex and Telcel) to allow all telecom firms operating in Mexico to use their infrastructure (and authorized the IFT to set the price for this access if the two sides cannot agree on price).

Most controversially, the reforms set interconnection rates at zero (the fee telecom operators must pay Telmex and Telcel to connect calls through their network). Rather than allowing the IFT to set these rate as competitive conditions require, free interconnection is now law in Mexico, making it hard to adapt to changing circumstances, which is particularly problematic in the telecom sector, where rapid

and repeated shifts in technology make change the norm.

Finally, to specifically promote foreign investment, for the first time foreign firms will be allowed to own up to 100 percent in fixed telecom firms (telephone and Internet) and up to 49 percent in open TV and radio.

Attracting investment in the telecom sector was thought to rest on government auctions (of television spectrum and rights to construct a broadband network) and reducing interconnection fees and improving network access for new market entrants. However, the process received an unexpected potential boost in early July when América Móvil announced a plan to divest selected assets.

### **The Likely Effectiveness of Telecom Reform**

The likelihood that the reform will successfully reduce costs and increase quality in the telecom sector depends heavily on two things: the effectiveness of the IFT as an autonomous and capable regulator and the amount of new investment in the sector. Initial signs on both fronts are encouraging, especially with regard to telephone services.

After years of unsuccessful attempts to regulate Mexico's highly concentrated telecom sector, the performance of the IFT thus far has been eye-opening. It moved quickly and decisively against both Televisa and América Móvil, declaring them preponderant and announcing painful sanctions against both. This promising start obviously does not ensure long-term regulatory effectiveness, but it does show a greater seriousness and capacity to use regulations to promote market efficiency in the telecom sector than has been seen before in Mexico.

## Targeting América Móvil

In relative terms, the telecom reform has targeted the interests of Carlos Slim much more aggressively than those of Mexican media mogul Emilio Azcárraga (Televisa). The accepted wisdom in Mexico is that this reflects the close political and personal relationship between President Peña Nieto and Azcárraga (and the very favorable coverage Televisa provided candidate Peña Nieto during the 2012 presidential campaign), and the clear distance between President Peña Nieto and Carlos Slim. While this is not insignificant, it is far from the principal reason for this bias in the reform.

Simply put, any reform designed to enhance Mexican economic competitiveness by reducing the costs of telecom services in Mexico would inevitably target cellular and Internet services. While reducing the price of television and radio advertising matters, the impact of advertising costs on national economic competitiveness pales by comparison to the cost of cellular and Internet services.

It is thus unsurprising that the 19-month reform process, including the IFT's declaring América Móvil a preponderant actor last March and imposing costly asymmetric regulations against it, hit the company's stock prices hard. These regulations eliminated several lucrative sources of revenue while preserving the prohibition on América Móvil's providing television services, and thereby created uncertainty about the firm's financial future (the stock price rebounded following the July announcement of Slim's divestment strategy).

Carlos Slim has long wanted to enter the cable television market, seeing it as important for América Móvil's long-term growth potential in Mexico. Cable is the most rapidly expanding

portion of the Mexican telecom market (growing at double-digit annual rates) and Internet TV is not far behind.

In this context, the IFT added a sweetener to its sanctions against Telmex and Telcel as preponderant operators: If América Móvil were to reduce its participation in the telephone market to less than 50 percent, these sanctions would be removed AND the firm could apply for a revision of its concession to include television.

## Divesting América Móvil Assets

This incentive to encourage América Móvil to divest some assets bore fruit much more rapidly than Mexican regulators (and politicians) ever imagined. Before the implementing legislation was published in the federal register (the equivalent of being signed into law), América Móvil announced that it was planning to sell enough assets to fall below the 50 percent threshold that qualifies it as "preponderant" in telephone services. And a few days later Carlos Slim indicated that the firm planned to have completed this divestment within six months.

The assets mentioned by the firm as apt to be sold include Telcel's cellular towers (although it appears that these will be spun off rather than sold) and other infrastructure (which under the sanctions regime Telcel must now pay to maintain while making it available to its competitors free of charge) and Telmex's rural customer base (its least lucrative market segment). América Móvil also announced that it will abandon its option to buy 51 percent of Dish, an acquisition that faced an uphill struggle for IFT approval.

A rapid sell-off of assets equivalent to 20 to 30 percent of América Móvil's Mexican market share, however, is far from a done deal. There

are at least three significant obstacles that could undermine the strategy.

First, the process through which América Móvil can be certified as no longer “preponderant” in telephone services is long and involved.

Analysts estimate that it will take at least 16 months for (1) the IFT to approve a divestment plan, (2) for América Móvil to implement it, and (3) for the IFT to verify that the outcome brings América Móvil below a 50 percent market share. That means any potential buyer or buyers will have to be very patient.

Second, Carlos Slim has stated his preference for selling Telmex and Telcel assets in bulk – Telcel infrastructure to a single buyer and Telmex’s rural network to a single buyer. But it is not unreasonable to imagine the IFT investigating such ownership concentration and potentially concluding that the new owners enjoy “substantial market power” and can thus be regulated asymmetrically (although this is unlikely to prevent the new owners from charging interconnection fees or entering the television market, since these regulations only apply to firms declared preponderant).

Third, there is no legal guarantee that at the end of the process the IFT will expand América Móvil’s concession to include television. The IFT has the legal authority to investigate a firm with less than a 50 percent market share to determine if it has “substantial market power.” It could thus legally conclude that even after divestment, Telcel or Telmex are dominant enough to warrant continued asymmetric regulation, which could include refusing to revise its concession.

This is why Carlos Slim has said that he will not sell any assets until he receives assurances that after the sale América Móvil will be authorized to

provide cable television, something the new IFT might be hesitant to provide in its early stages of operation while trying to build its reputation as a truly autonomous and capable regulator.

Stay tuned...

#### **About ManattJones Global Strategies, LLC**

ManattJones provides strategic business advice and advocacy to companies operating in, investing in, or exporting to Mexico and Latin America. The firm helps clients identify and take advantage of opportunities and address strategic, political, and market access challenges. With years of experience, we offer unmatched market knowledge, extensive regional experience, and a deep network of relationships with senior business, government and civic leaders. The firm has assisted both large and midsized companies to do business in and with Mexico across a wide range of sectors.

ManattJones is a consulting subsidiary of Manatt, Phelps & Phillips, LLP, a leading United States-based law firm, and has offices in Washington, D.C., Los Angeles and Mexico City. For more information, visit [www.manattjones.com](http://www.manattjones.com).

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