

Número 624

**Disruptors and Discontented  
Incumbents: An Antitrust Story Retold**

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NOVIEMBRE 2019

CENTRO DE INVESTIGACIÓN Y DOCENCIA ECONONÓMICAS



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## **Advertencia**

El objetivo de este documento es arrojar luz sobre la política actual de competencia y la discusión reguladora al observar los hechos, la velocidad de intervención y los efectos en la entrada de Roku en el mercado mexicano. Lo hacemos presentando experiencias históricas pasadas y casos anteriores de aplicación de la ley antimonopolio. Concluimos que aunque la interrupción no es un fenómeno nuevo, lo que ha cambiado sustancialmente entre los diferentes casos es la velocidad a la que ocurren estos cambios y la dificultad para identificar innovaciones que pueden cambiar sustancialmente las reglas del juego. Por lo tanto, una visión que los reguladores y las autoridades de competencia podrían querer adoptar es la necesidad de proteger el desarrollo dinámico del mercado. Como resultado, es necesario que adapten las herramientas y procesos de análisis actuales que evitan o detienen mejor a los titulares que ralentizan el desarrollo y la incursión en el mercado de nuevos productos.

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## Abstract

The objective of this document is to shed light on the current competition policy and regulatory discussion by observing the facts, the speed of intervention and the effects on the entry of Roku into the Mexican market. We do this by presenting past historical experiences and previous cases of antitrust law enforcement. We conclude that although the interruption is not a new phenomenon, what has changed substantially between the different cases is the speed at which these changes occur and the difficulty in identifying innovations that can substantially change the rules of the game. Therefore, a vision that regulators and competition authorities might want to adopt is the need to protect the dynamic development of the market. As a result, it is necessary that they adapt the current analysis tools and processes that better avoid or stop holders who slow down the development and incursion into the market of new products.

**Keywords:** Net neutrality, OTTs, Convergence, Telecom, Antitrust, Technical change, Sham litigation, Copyright

## Resumen

El objetivo de este documento es arrojar luz sobre la política actual de competencia y la discusión reguladora al observar los hechos, la velocidad de intervención y los efectos en la entrada de Roku en el mercado mexicano. Lo hacemos presentando experiencias históricas pasadas y casos anteriores de aplicación de la ley antimonopolio. Concluimos que aunque la interrupción no es un fenómeno nuevo, lo que ha cambiado sustancialmente entre los diferentes casos es la velocidad a la que ocurren estos cambios y la dificultad para identificar innovaciones que pueden cambiar sustancialmente las reglas del juego. Por lo tanto, una visión que los reguladores y las autoridades de competencia podrían querer adoptar es la necesidad de proteger el desarrollo dinámico del mercado. Como resultado, es necesario que adapten las herramientas y procesos de análisis actuales que evitan o detienen mejor a los titulares que ralentizan el desarrollo y la incursión en el mercado de nuevos productos.

**Palabras claves:** Neutralidad de red, OTT, Convergencia, Telecomunicaciones, Competencia, Cambio técnico, Litigios simulados, Derechos de autor

## Introduction

**T**he aim of this paper is to shed light on the current competition policy and regulatory discussion by looking at the facts, speed of intervention and effects in Roku's entry into the Mexican market. We do so by presenting past historical experience and previous antitrust enforcement cases.

Disruptors in “new economy”<sup>1</sup> industries, such as computer, internet, telecommunications, and technology-enabled services, typically enter markets that have yet to be delineated. They are usually the undertakings pushing the industry to change services, products, technology, customs and uses in a way that redefines what has been done until then. They are the firms that trigger a novel view of what will need to be done next. This is how the story usually goes, a narrative that reads like the story of Don Quixote, fighting against windmills—real or imagined, depending on which side of the legal aisle one is standing on: plaintiff, defendant, regulator, judge—to push for a new vision that may or may not pan out in the end. Thus, the paper explores historical instances where disruption has pushed the envelope enough to change the industrial landscape and where incumbents have attempted to prevent, adapt and survive this changing landscape, sometimes successfully, sometimes not.

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<sup>1</sup> By “New Economy” industries we are referring to aspects or sectors of an economy that are producing or intensely using innovative or new technologies, for more information see <https://stats.oecd.org/glossary/detail.asp?ID=6267> & <https://marketbusinessnews.com/financial-glossary/new-economy-definition-meaning/>.

Next, our focus is on how we could use and apply some of these lessons to the current wave of entry by OEM's, OTT's, digital platforms and other modern "disruptors"; noting the different reactions that each respective incumbent has had, as well as common features in their actions, conducts, effects (foreclosure), and the types of regulatory reactions that have arisen as a result. We compare these features to Roku's experience in entering into the Mexican market and derive some lessons.

Our conclusion is that, while interruption is not a new phenomenon, what has changed substantially among the different cases is the speed at which these changes occur and the difficulty in identifying innovations that can substantially change the rules of the game. Therefore, a vision that regulators and competition authorities might want to adopt is the need to protect the dynamic development of the market. As a result, so it is necessary that they adapt current analysis tools and processes that better prevent or halt incumbents from slowing down the development and market incursion of new products.

## **DISRUPTION AND COMPETITION FOR THE MARKET**

The development and adoption of new technologies in productive activities and the development of new products are key elements to boost economic growth. In addition, over the last decades, economists have measured how they improve consumer welfare by raising standards of living. For instance, Hausman (1999) showed that the introduction of new cell phone products in the telecommunication market induced a price reduction of 1.8% per year. Meanwhile, Petrin (2002) showed that the introduction of the minivan produced a large gain in consumer welfare, outweighing the cost of development and the profits obtained by the innovator. New products that differentiate themselves from existing products generate substantial gains for consumers and large profits for the innovator.

In the case of information technologies, capturing and sharing information is a practice inherent to humankind since time immemorial; it is how we learn and communicate. However, communication through digital means has sped up these possibilities, sometimes in ways that cannot be fully grasped but that have had an

important impact on individual productivity, marginal productivity of factors of production and measurements of total factor productivity. Cave y Flores-Roux (2017), for example, building on a Koutroumpis and Cave (2016) study, note that the measurable effects of digitization in Mexico could add an additional 4% to GDP growth over the years 2016 and 2021. On the other hand, Cave, Guerrero, and Mariscal (2018) show that recent policies whose effects were aimed at lowering the relative costs of telecommunications services were largely concentrated in the lower income deciles of the population, thus enhancing the positive effects to society at large. Thus, while there is evidence of wealth creation in digitizing an economy (Cave and Flores-Roux, 2017), there is also important income redistribution when implementing policies aimed at lowering the costs of telecommunication services (Cave, Guerrero, and Mariscal 2018).

In addition to the measurable economic effects for firms and consumers, there are important gains to be made for society at large, particularly those relating to democratic institutions. Information technologies have proven to contribute towards inclusion in the democratic development of society by facilitating interactions between different sectors (Government, individuals, firms, NGAs). This situation is also illustrated in the conclusion reached by the Hargreaves Report (Hargreaves 2011): *“Today’s advanced economies live or die by their ability to get smarter”* after analyzing the British Intellectual Property framework and its relationship with economic growth. The report states that growth does not come from competition to lower labor costs, raw materials or access to capital, but from the capacity to innovate, especially when it comes to knowledge intensive businesses.

It should therefore come as no surprise that encouraging innovation and ensuring that there are conditions in place for inventors and innovators to develop products and services that fully take advantage of the fruits of their investments and ingenuity should be among the goals of regulatory agencies, including competition agencies—more so when it comes to technological change in information-heavy industries. The removal of barriers in both an *ex post* but also a preemptive way is one vital step, but also the timely intervention when incumbent conduct is causing anticompetitive harm. So is the importance of allowing competition to take place, not inferring anticompetitive intent from incumbent behavior to start with. In fact, most of

the behaviors in innovative markets are part of a vigorous and sometimes aggressive competition process.

Competition agencies, as almost all of them note, protect the process of competition and not competitors, but in markets where innovation and rapid change takes place to the benefit of consumers, they should remain vigilant to potential short and long terms harm. In this, we are simply echoing the concerns voiced by many economists and attorneys today. In the last report of CMA (Furman et al. 2019) for digital markets, a panel of experts called for an update of policy competition to protect and expand competition for the sake of consumers and dynamic economics. One of its recommendations, noted that the CMA should simplify and facilitate its processes for greater and faster use of provisional measures to protect rivals against significant damage.

### **On the nature of innovation and its effects**

It is worthwhile making a distinction about two different types of innovation identified in the literature. Bower and Christensen (1995) identify two different types of technological innovation. One that simply improves the efficiency of current technology while continuing to meet the prevailing needs of users. This type of innovation is limited to offering only those characteristics that consumers value on the products or services already consumed. They label this as "*incremental innovation*".

The other type of innovation, when is introduced to the market, offers new features not valued by consumers of current technology, while also offering elements that consumers of the previous technology value and that can be modified at accelerated rates. After some time, consumers may come to value these new features and decide to move or switch to the new technology. These are innovations that "*introduce a very different package of attributes from the one mainstream customers historically value, and they often perform far worse along one or two dimensions that are particularly important to those customers*". They label this as "*disruptive innovation*".

Another, similar definition of disruptive innovation comes from Alexandre de Streel and Pierre Laruche (2015) who considers disruption to be a form of innovation that is created outside the value network, as opposed to sustained innovations created

within the value network. In his conception, this type of innovation takes place in two phases. In the first phase, a new market is created through a product or service which performs worse and targets low-end consumers. During the second phase, the innovation progresses very quickly and reaches mainstream consumers.

Disruptive innovation not only offers new features, but often also introduces a different business model, not compatible with that of established companies. Disruptive innovations begin by focusing on niche markets that value these new features while offering some characteristics valued by mainstream users and which, although present, may exhibit failures or poor performance (OECD, 2015). Overtime, as these technologies show incremental improvements and match the valuations of a greater number of mainstream users, they are gradually taken up by a greater number of consumers. In this way, disruptive innovation has the potential of delineating new markets and making obsolete the goods or services provided by incumbent agents.

In terms of competition policy, distinguishing between incremental and disruptive innovation is important because, although both types of innovation create benefits for society, incremental innovations are more likely to serve as a means for retaining and entrenching incumbent market power. Incremental innovations usually build upon past investments/inventions or are anchored on sunk investments and assets, including patents or copyrights, and very often rest on production, distribution or marketing improvements that these agents have made.

In contrast, disruptive innovation has the capacity to delineate new markets and strengthen competitive restrictions that established economic agents face, particularly when the agents of change are new to the market or participate in its fringes. It is no surprise then that these types of innovations are subject to strong and aggressive reactions by incumbent agents—in most cases, as part of a normal competition process but in some cases, these include potentially anticompetitive actions, some of them aimed at delaying the emergence or massification of new technology. It is here that antitrust enforcement should remain vigilant and competition law should be adapted in a way that allows to authorities act sooner to prevent this scenario.

In general terms, disruptive innovation not only involves new products or manufacturing processes—examples of these are the internal combustion engine,

digital photography— but also the emergence of new business models. In any case, the main characteristic is that it drastically alters markets as opposed to incremental technological development. It involves radical changes, unforeseen by the market and can dramatically alter the market shares of incumbent firms or create new ones (OECD 2015).

### *Reacting to innovation*

Incumbents can react to disruptive change through different means, among them taking actions that seek to delay services that these new entrants may require. Examples of these types of dilatory actions are denials to grant enough information, licenses or permits to access established networks, or other actions that bar or delay the use of a good or service; they also include superfluous or abusive litigation strategies brought before different authorities, as a means of delaying decisions that can correct or limit foreclosure. Mergers are a recent form of dilatory actions—sometimes indefinite delays—that can bar entry or slow down disruption. The acquisition of a maverick with the potential to generate disruption, by embracing new technologies or new business models, can be a strategy to maintain substantial market power in a ‘threatened’ market. With the current regulation, disruptors have little space to avoid actions that prevent their entry into the market. Although it is possible for a disruptive agent to lodge a complaint with the regulator, the speed at which the market evolves relative to the pace of regulatory action and processes can lead to irreversible damage to disruptors and therefore the market and consumers.

The increased Internet penetration allowed the emergence of new business models that pose a threat to firms that had traditionally dominated the sectors for many years. The movement towards digitization is having a disruptive effect on traditional industry dynamics and business models and is no longer constrained simply to the OTT-Telco dynamic. Different companies have dealt with this in different ways –an example from the retail sector is Amazon purchase of Whole Foods, or more recent examples of retailers purchasing online platforms like Walmart seeking to expand and improve its

online retail presence by purchasing Jet.com, Flipkart, and Cornershop.<sup>2</sup> In these cases, size seems both to matter and not. The target companies can be large, as in the case of Whole Foods, or relatively small, like as in Jet.com in the US, FlipKart in India, or Cornershop in Chile, but with a perceived large upside which makes them valuable for the larger players.

Disruption into the brick and mortar business has gone as far as pushing for newly revamped regulations into markets that were traditionally considered to be already regulated. Some of the entrants using digital apps, have upped the competitive pressure on traditional businesses that were once considered to be completely off limits to these types of disruptions. Take the case of platforms that manage unused capacity, be they transportation (Uber), housing (Airbnb), event tickets (StubHub) or restaurant seats (OpenTable), where platform companies that have designed their business model to match supply and demand have encountered various regulatory problems with traditional companies. In the case of Uber, for example, and the numerous cities and countries that have sought to protect their taxi businesses from a new type of entrant<sup>3</sup> whose business involves the transportation of people, goods or services but serves various demands and does not own assets (cars, for example), does not have employees, but offers similar services. Then the case of Airbnb, who “competes” with hotels, using assets from a different type of user seeking to make better use of a durable asset it is not using all the time but that upsets local regulations that treat hotels and houses or apartments in a different manner.

Since the entry of these services, we have witnessed different reactions by incumbents to prevent the growth of new economic agents.

In the case of the telecom and broadcasting sectors, the emergence of new business models has posed a threat to firms that had traditionally dominated the

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<sup>2</sup> See (Bloomberg.Com 2017) <https://www.bloomberg.com/news/articles/2017-06-16/amazon-to-acquire-whole-foods-in-13-7-billion-bet-on-groceries> and <https://www.bloomberg.com/news/articles/2016-08-08/wal-mart-agrees-to-buy-jet-com-for-3-billion-to-fight-amazon>, <https://www.bloombergquint.com/technology/walmart-to-take-control-of-flipkart#gs.MeuaC45S>, <https://news.walmart.com/2018/09/13/walmart-to-acquire-cornershop-in-mexico-and-chile-further-investing-in-last-mile-delivery-and-strengthening-omnichannel-strategy>.

<sup>3</sup> For example: <https://www.telegraph.co.uk/technology/picture-galleries/11902080/Anti-Uber-protests-around-the-world-in-pictures.html?frame=3458648>.

sectors for many years. In many cases, these incumbent firms were legacy public utilities, many of them recently privatized but still very much entrenched and protected in a way by the government, either because they were part of it or because they were seen as still undergoing changes and making investment to modernize. Instead, the entrants tended to veer towards over-the-top (OTT) services. For those that entered OTT services relating to the transmission of video on demand, the incumbents are traditional cable systems companies accustomed to competing amid a vertically integrated business model, with large sunk costs and large investments in spectrum and permits to broadcast, so it is possible that traditional cable operators have incentives to prevent entry to OTT video streaming providers or to other agents that could facilitate the growth of OTT services.

But this story, of innovators seriously disrupting a market and challenging incumbents that seek all means to protect and maintain their position in the market, is not new. In its seminal work on copyright and free culture, Lessig (2005) talked about two burdens that halted innovation:

- i) uncertainty of the law, and
- ii) the effort by many in the content industry to use the law to directly regulate the technology of the Internet so that it could better protect their content.

We next look at some historical examples, not only to understand the mechanics of disruption and protection against disruption, but to better build tools that can identify instances of pro- and anti-competitive behavior, and propose ways in which these may be addressed promptly and preemptively or in an *ex post* fashion but one that reduces potential damages to other competitors, consumers and society in general.

### *Historical examples of incumbents reacting against disruptors*

Among the oldest historical examples that illustrate resistance to innovation through the entry of disrupting agents is Ancient Rome, when emperor Augustus ordered the execution of the flexible glass inventor as a response to the threat that these new products posed to his wealth. This resistance to innovation, led to a 2,000-year

postponement of the use of flexible glass —with a consequent loss in consumer welfare. Another example is the printing press, invented in the 15<sup>th</sup> century and quickly disseminated throughout Europe.

The printing press allowed information to travel more rapidly and significantly reduced information transmission costs, forever changing the information landscape. However, when the printing press arrived in the Ottoman Empire, the Sultan banned the printing of Arabic characters. Coşgel, Miceli, y Rubin (2012) argue that although the printing press would have allowed the Sultan to raise his rents through economic growth —namely, dynamic efficiencies— his decision to ban was calculated based on a short-term concern that the press would undermine his legitimacy. The religious elite was central to his decision-making process as printed books endangered the elite's role and, they argued, reduced the Sultan's legitimacy, ultimately reducing his capacity to extract rents. As a consequence, the Muslim community in the ottoman empire continued to rely primarily in oral communication for knowledge transmission for the next 300 years.

A more recent example is the invention of the FM (Frequency Modulated) radio receiver. Edwin Armstrong invented the FM device after ignoring the widespread conclusion at the time that FM would offer no advantage over AM (Amplitude Modulation). As we know, radio communications carried over AM have interference resulting in poor fidelity. Armstrong's invention succeeded in carrying voice over FM with much better fidelity than AM, but established firms were not enthusiastic about his plans.

Although he filed patents and began a quest to persuade people that FM radio was superior to AM and convinced the Federal Communications Commission (FCC) to award him a portion of spectrum to be used with FM, incumbent firms with an interest in conserving the *status quo*, including AM broadcast stations as well as TV networks who were new at the time, lobbied the FCC to change the FM frequency band. This change rendered Armstrong's FM radio receivers obsolete. In addition, a long legal fight ensued between Armstrong and RCA, over Armstrong's alleged used of technologies without paying royalties. These legal battles drained his resources and may have

contributed towards his eventual suicide. FM radio eventually overtook AM radio, of course.

The development of VCR is another example of delaying tactics when facing disruptive entry. This technology allowed users to record content in cassettes, eventually paved the way for the development of the Replay TV market, where a digital video recorder (DVR) allowed users to store television programs on a hard drive for later viewing. These cases involved lengthy legal processes which highlight incumbents' litigious responses when faced with the threat of entry of a new product or process. For example, in the case of Universal City Studios and Walt Disney Productions, producers of motion pictures and other audiovisual works for television broadcasting, alleged that the new technology violated copyrights because the product allowed to distribute content without the owner's authorization.

Universal and Disney started a legal process against Sony (Sony Corporation and Sony Corp. of America) in 1976, claiming that VCR consumers had been recording some of the copyrighted works of the plaintiffs, and this was content that they had been exhibited on commercially sponsored television. The analysis of the case consisted in evaluating whether unauthorized home videotaping of television broadcasts for noncommercial "time shifting" purposes was fair use<sup>4</sup>. The Court ruled that the use was fair. During the case, the following was stated: "*If a device is sold for a legitimate purpose and has a substantial non-infringing use, its manufacturer will not be liable under copyright law for potential infringement by its users*",<sup>5</sup> i.e., producers are not *per se* responsible for the use that consumers can give to their products.

In a similar case, copyrights owners (producers and broadcast companies) complained about the launch of DVRs equipment that allowed not only the recording of TV programs but also skipped advertising and shared this recording over Internet among the users of the equipment. Similar to the case against VCR producers, the complaints alleged that the development and use of DVRs supposedly infringed

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<sup>4</sup> In Copyright law, fair use is an exception that reduces the scope of exclusive rights granted to copyright owners by allowing the public to make limited uses of protected works, particularly if the uses have social benefits. Crews D, Kenneth. "Copyright, Fair Use, and the Challenge for Universities". University of Chicago Press, p.22.

<sup>5</sup> «Sony Corp. v. Universal City Studios, 464 U.S. 417 (1984)» s.f.

copyrights provisions. The VCRs and DVRs cases are examples of how traditional providers can use legal procedures to impede the entry of new firms which threaten their market power.

At first sight, the last case we present relating to ReplayTV would appear to be mild. However, when Replay TV announced that its new products would have the ability to detect and omit commercial ads, the entertainment industry responded by alleging copyright infringement. Led by Paramount,<sup>6</sup> they accused SONICblue and its subsidiary Replay TV of undermining the “vitality of the industry”, based on the development and sale of a DVR. After these accusations SONICblue was unable to subsist and filed for bankruptcy. In 2003, with the approval of the Bankruptcy Court, SONICblue sold its Replay TV assets to Digital Networks North America. A new Replay TV was later launched, eliminating in this new model the characteristics that gave rise to the initial complaint, that is, the possibility of omitting commercial adds and transmission of copies between owners via broadcasting.<sup>7</sup>

Although it is not surprising that incumbents try to hinder entrance or limit the growth of their competitors if they remain in the market, the previous cases highlight the difficulties faced by disruptive companies in entering the market. These examples also show that consumers may be the most affected parties, to the extent that actions carried out by incumbents bar the launch of new products or, delay this launch indefinitely.

### **How has competition unraveled in markets with disruption?**

The historical examples presented above reflect two important issues regarding the presence of disruptive agents and the dynamics of competition they may face in the markets. First, it is common for established companies to seek to delay the entrance of the new product into the market in response to the negative impact that it may have on their dominant position. We label this *'anticompetitive behavior'*. An example of how

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<sup>6</sup> In total there were 25 plaintiffs all of them film and television companies.

<sup>7</sup> Case No. CV01-9358FMC.

this situation could arise is through excessive litigation against the disruptor, which can cause both economic and reputational losses.<sup>8</sup>

Second, it is possible that existing regulation in a particular market (e.g., passenger transport) may not be "ready" for the entry of new products/services that break with the standards already established in the sector. In this scenario, there is a risk that the incumbents may demand a "proper" enforcement of existing regulation—including antitrust regulation based on traditional tools of more static and mature markets—to block innovation in an attempt to protect existing products and business models. This second type of situation, which we label '*use of regulation to foreclose*' becomes more prevalent where business models that rely on information technologies are very dynamic, as there is a greater risk that new regulation will become obsolete once it comes into force. Here, regulators must be vigilant and sensitive about the suitability of overregulating new services with old tools and, where appropriate, consider the possibility of changing these rules for disruptors.

In general terms, we've identified four different responses to entry by a disruptor, each with differing effects on welfare (de Stree and Larouche 2015):

- (i) *No response*: the disruptor, typically a small firm, may be able to carry out the innovation and grow on its own;
- (ii) *Acquisition to grow*: the large firm may acquire the disruptor and use its financial means to speed up the innovation deployment;
- (iii) *Foreclosure*: the mainstream firm may engage in anti-competitive conduct to block the innovation (e.g., foreclosing the access to the low-end customer or by limiting the interface between the old value network and the new value network); and
- (iv) *Acquisition to forestall*: the mainstream firm may acquire the disruptor to eliminate the innovation.

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<sup>8</sup> See the case of SONICblue who after the legal proceedings declared bankruptcy.

The first two behaviors increase consumer welfare by allowing the emergence of a new product; additionally, for the first case, it is possible to observe an increase in competitive pressure towards established economic agents, which may reduce prices. Regarding behavior (iii) and (iv), it is clear that they have the effect of reducing welfare since they impede the development of innovation.

In terms of competition policy, behaviors (ii) and (iv) must be reviewed in the context of merger analysis, since both have the potential to maintain the dominance of the incumbent even when one of these appears to be enhancing the ability to bring the product or service to a wider audience or set of consumers. In the context of disruptive innovation, the analysis of the effects of a merger on the market becomes more complex and may depend on the life cycle of the innovation, its pace, adoption and the expected uses and outcomes of the new technology as it is implemented in practice.

A priori, it is difficult for competition authorities to identify if the acquired company has the potential to become a disruptor, especially if it is a newly created company, where its market still does not reach mainstream users. Under this scenario, and using traditional tools of competition policy, it is likely that an operation aiming to eliminate innovation could be authorized, thus affecting welfare. But the story may be different, in fact, especially where mergers involve multisided platforms where take-up by multiple users of the platform becomes crucial to its survival and so, many factors need to be accounted for and the response to the answer on whether a merger should be approved, conditioned or barred is the never popular “it depends”.

Consequently, the authority needs to determine the probability that the acquisition of said agent is strategic to maintain dominance in a relevant market. Competition authorities must make it their business to have an in-depth understanding of the economic reasons behind the merger and the development plans for the innovation projects previously carried out by the acquired company. For example, in a merger of two medical device manufacturers (Medtronic/Covidien), the European Commission imposed structural remedies to prevent the loss of products in the pipeline that were in the last stage of development by Covidien, which could compete directly with those that Medtronic commercialized. Through this measure, the European

Commission forced Medtronic/Covidien to sell that business division in order to authorize the operation.<sup>9</sup>

An additional problem is the one pointed out by de Stree and Larouche (2015), namely that if the reporting thresholds are related to sales revenue, it is likely that many mergers involving disruptors will not be reviewed by competition authorities, as the transactions will be below thresholds. In many instances small companies have little time in the market and may not meet the threshold criteria and there are no alternative filters by which authorities can check these mergers except for the one-year stay notice that requires an investigation or complaint to be opened. It may be necessary therefore to modify the threshold criteria, particularly for at risk sectors, in order to determine if a merger should be notified or not.

Finally, regarding behavior (iii), companies could undertake actions that prevent the growth of disruptive agents, which should be analyzed as an abuse of dominance conduct or as a potentially anticompetitive vertical restraint. As with the case of the analysis of mergers, the analysis of abuse of dominance becomes more complex in disruptive markets, making it necessary to modify the theories of harm used especially when there are likely dynamic efficiencies present in the markets analyzed. Let us elaborate. By definition, disruptive innovation creates new markets so that any damage identified may not occur in the market where the incumbent has dominance. This requires the authority to have greater knowledge of where the technology is heading in a way that stops the incumbent from foreclosing the entrant.

Given that conditions under which firms compete in disruptive markets are in constant change, competition has to be seen as a process where all players need to adjust: incumbent firms, entrants, competition and regulatory authorities, the courts, as well as the various customer groups that are served. It has been challenging to determine how to proceed in this environment and it is clear that there is a gap between the speed at which entrants arise and the speed with which merger reviews or investigations are undertaken, the speed at which regulatory guidelines are updated or, failing that, are re-evaluated. Perhaps merger injunctions are the only effective means

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<sup>9</sup> Case No COMP/M.7326, Medtronic/ Covidien.

to solve this problem in the mergers and acquisitions context, but this needs to be carefully investigated in the future.

In addition, there is the problem that the effects of the strategies adopted by the incumbents do not necessarily fall within common antitrust violations, so there is no "base model" by which they can be evaluated. Although the tools to analyze them do not differ from the traditional analysis, the analysis must be different and should focus on adjacent markets, as well as seek to achieve dynamic efficiencies.

### **The Difference between competition ‘in’ and ‘for’ the market**

In competition policy, it is possible to distinguish between two types of competition: competition in the market and competition for the market. The former reflects the common approach used in competition policy about the actions of incumbents and imitative entrants in well-established markets. That is, it considers the type of battle entered into between incumbents and entrants in an attempt to position themselves in the best way possible in a mature market.

A different form of competition is underway when markets are not delineated. In these cases, there is a struggle to create a new market or a new standard that may modify or lead to a different product or service, a different market even, through innovation. Here innovation brings new displacing technologies to an evolving market (P. Geroski 2003), with new available resources—technologies or improved human capital. However, the fact that the process can be seen as an evolutionary process, and not the displacement of one player for another, does not mean that the actions and processes conducive to such a change cannot fall within the purview of antitrust analysis. Another way of seeing this process is by considering that competition for the market is actually creating a new market, not to be confused with “the evolution of the market”, which would entail *incremental innovation* or sustaining innovation that tends to maintain a rate of improvement, giving customers “something more or better in the attributes they already value” (OECD 2015).

In order to better understand why both types of competition should be evaluated with different approaches, we’d like to clarify the characteristics and differing natures of the changes that each type of competition involves. Competition in

the market implies imitative entry and is therefore like-for-like competition: firms compete by “dividing the pie” away, they try to win market share by charging lower prices, providing price discipline on firms already in the market as well as potential entrants into this market. By contrast, competition for the market, involving innovative entry, tries to encourage consumers and complementary producers to do something different. To invest in a new pattern of consumption or production behavior that could take place, for example by investing in a new product, service or brand, and thus it is “changing the pie”.

Consequently, *competition for* and *in* the market: (i) impose different types of discipline on incumbents, and therefore elicit different reactions from incumbents, and (ii) may involve a different business design altogether and not simply a technical adjustment or rapid response. As a result, each type of competition is likely to have different effects on the performance of the market. Once the main differences between both types of competition have been identified, it is easy to see that both of them, for the purposes of our analysis, require a different approach and involve tracking different groups: imitative and innovative entrants (OECD 2015). This aspect we will consider in more detail later in the paper.

### **OTTs and Telco’s: Convergence and competition for the market**

As digitalization propagates, technology giants and other entrants into these markets have caused a stir in the telecommunications industry, in part because of the threat that new products, services and/or business models represent for traditional businesses. Combined with this, it is becoming relatively easier for agents who are clients of traditional service companies to bet on the construction of their own infrastructures and thus sever the historical relationships they had with other players.

Recent purchases of content providers by the large telecommunications companies, can be viewed as efforts to sever vertical ties between the infrastructure providers with traditional content producers with an indirect effect of increasing barriers to entry, for example. Another instance where relationships between agents in this sector have changed are the acquisitions or investments in network deployment firms by companies like Google or Facebook, who were traditionally simply apps that were built

on top of the pre-existing infrastructure. Now these “apps” have become large enough to require expansion of this network. Thus, who is “big” and who is “small”, who has the cash to invest and who is the consequence of the restrictions imposed by the sunk costs of these investments no longer follows a preconceived narrative.

In the telecommunications and broadcasting sectors, change has been particularly fast and sharp with the advent of digitization. Here technological change has not only blurred the boundaries among mostly infrastructure providers and content developers, but services have tended to converge much faster than the regulation. Utility regulation for mostly telecommunication companies is being rethought as these offer bundled services that include infrastructure access but also content provision—some of which is self-produced, the other sold through its physical network. In addition, the rapid technological change that is taking place in these industries is not confined to them: traditional telecommunication services now have important linkages to other sectors and industries, thus any technological changes occurring within telecom have important spillover effects in other sectors of the economy.<sup>10</sup>

For example, the ‘intrusion’ of infrastructure providers into services that were not necessarily theirs, but which are now being developed, purchased or acquired by them—ATT/Time Warner in the US or, in a different direction, Televisa/IZZI in Mexico—has led to a change in incentives for the incumbents’ offering of services to the smaller entrants, namely content providers. Those who were previously considered entrants have now become their competitors, not their clients on one side of the multisided platform services that incumbents offered. Particularly exposed to these changing incentives are over-the-top services or OTTs: video, audio, voice or data services that are transmitted over fixed or mobile internet platforms and that compete with services now provided by traditional telecommunications operators.

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<sup>10</sup> This discussion can be traced to Albert O. Hirschman’s, 1958, *The Strategy of Economic Development*. For a short summary, see *Reviewed Works: The Design of Development* by Jan Tinbergen; and *The Strategy of Economic Development* by Albert O. Hirschman, Review by Hollis B. Chenery *The American Economic Review*, Vol. 49, No. 5 (Dec, 1959), pp. 1063-1065.

OTT's come in all shapes and sizes, with the spreading of firms characterized by rapid innovation, who enter and leave the market constantly unless ignition has finally occurred. This is particularly true of OTT businesses that are multi-sided in nature, which means that once a certain threshold of customers can be secured—a critical mass—firms secure ignition (Evans 2009). Some OTT's are in a position to counteract behaviors aimed at foreclosing, forestalling or disadvantaging—such as YouTube (distribution of audio and associated video), Skype and Facetime (audiovisual content on demand), Netflix and Claro TV (video), WhatsApp and Line (messaging services), Facebook, Twitter and LinkedIn (communication through social networks), etc.—while others may not have the scale or scope to do so. And even for these 'larger' OTT's, the 'fight' is not always easy—see for example the Comcast/TimeWarner Cable merger which positioned Netflix as a direct challenger of the transaction.<sup>11</sup>

Among the innovations that characterize OTT service platforms is that their use requires only a device with internet access, and do not depend on the place or time in which a user may access the service or content. This markedly differs from the provision of content in traditional networks (e.g., open and restricted television), which are subject to time schedules, geographical broadcasting areas and access through a single device (single-homing). This scenario suggests potential areas of conflict between an incumbent and disruptor as traditional telecommunications providers have a well-defined market and are subject to specific regulation about the time certain content can be broadcast, for example, while OTT services can challenge these existing business models and effectively attract audiences and content producers, in some cases, more effectively.

The entry of disruptors, who often participate in markets with important direct and indirect network externalities and thus have to overcome them in order to effectively compete with the incumbent while at the same time create a new market with similar or different consumers—for example, Roku and traditional cable providers—while allowing for greater competition, also means that asymmetry in

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<sup>11</sup> See Netflix petition to deny Comcast and Time Warner Cable's application to merge <https://ecfsapi.fcc.gov/file/7521819696.pdf>.

regulatory standards and the possibility to arbitrage among them, becomes an important tool in competing with them.

In this context, incumbents have tended to either resist innovation, through anticompetitive means and sooner or later adjusting to the "conditions" of the new market; or accepting the challenge these entrants propose and initiate change, not always in a frictionless and compliant way. The introduction of change by an entrant, however, does not guarantee success, or even a similar marketplace and product where new and traditional players participate—hence the notion of competition for the market becomes relevant here. The fact is, every company accepting the challenge of competition into these evolving markets must face the uncertainty resulting from innovation.<sup>12</sup>

## **THEORIES OF HARM**

To understand whether a particular conduct or a set of behaviors can potentially prevent, restrict or distort competition is to identify what would have happened absent the behavior or conduct. This narrative or story is what we refer to as a theory of harm (ToH). A theory of harm, however, needs to fulfill certain minimum characteristics in order to be valid and useful (Zenger y Walker 2012).

- Articulate the mechanism through which harm arises relative to a credible and well-defined counterfactual.
- Internally and logically consistent.
- Articulate all the incentives of the parties involved in a consistent manner.
- Consistent with available empirical evidence.

A coherent theory of harm has to explain how competition takes place, as well as the mechanisms through which a particular conduct or set of conducts can negatively affect consumers. It needs to analyze the counterfactual to ensure that the theory of harm is coherent, and it should be able to withstand an empirical check with reality.

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<sup>12</sup> Network industries: effects and externalities of re. Bauer\_TELECOMS REGULATION (2008).

To establish that the practice or conduct would result in damage to the competition, the theory of harm must consider the role of competing agents. In particular, it must establish that competitors in the market are not able to replicate or to respond the actions of companies under scrutiny.

In the case of potential harm caused by incumbents seeking to block or foreclose disruptors in the new emerging markets, building this coherent theory of harm and measuring it up to a credible counterfactual as well as empirical evidence is vital in order to avoid “protecting competitors vs. protecting the competition process”, that is a type I error: over-regulation.

### **How to analyze anticompetitive behavior**

So far, we have seen that a theory of harm is a methodology that allows us to propose a hypothesis to collect evidence that identifies when a behavior could harm competition and not just competitors. However, it is necessary to establish how the economic analysis should be carried out to determine that indeed an action, and the evidence related to it, could generate an anticompetitive effect.

The Economic Advisory Group on Competition Policy (Gual *et al.* 2005) proposes that the analysis of conducts related to abuse of dominance should be done using an effects-based approach without consider the particular form of the conduct (e.g. exclusivity agreements, tied sales, etc.). Thus, this approaching would focus on the presence of anti-competitive effects on consumers, although taking into account the particulars of each case.

The economic approach seeks two objectives that turn out to be complementary:

- Ensure that anticompetitive behavior does not outwit legal provisions by making it difficult for companies to circumvent competition policy constraints through the use of different business practices. Moreover, the new approach means that practices that lead to the same result are subject to comparable treatment.

- Ensure that legal provisions do not unduly hamper procompetitive strategies by taking into account that many business practices may have contrary effects under different circumstances.

In this context, it is necessary to demonstrate that the behavior of an incumbent generates some effect on the market that prevents its competitive development. Thus, it is necessary to assess whether such behavior generates any competitive advantage for the party that is doing the conduct.

Subsequently, it should be assessed whether the competitive advantage granted by the conduct prevents the permanence or entry into the market of other economic agents. It is important to note that this analysis is carried out under the assumption that the affected party is at least as efficient as the company under scrutiny, therefore the way in which the competitive dynamics of the market is affected should be established.

At first glance, it seems that the construction and validation of a theory of harm can be restricted to situations related to commercial practices directly related to the production of goods or services (e.g. predation, granting discounts, margin squeeze, etc.) however, it is also useful in situations where the action does not affect prices or profit margins.

The literature refers to such practices as "non-price predation", "raising rivals' cost strategies" and "cheap exclusion" (O'Donoghue and Padilla 2013). Some examples of behaviors that could fall into this classification are the cases of Vexatious Litigation and the use and abuse of Regulatory or Government Procedures.

Behaviors aimed at foreclosing the entrance of disruptor cannot easily be classified or set in stone, especially in dynamic, changing markets. Many of these conducts fall under the "raising rivals' costs" classification which encompass any behavior by a dominant agent aimed at reducing demand, increasing costs or otherwise disadvantaging another firm. The harm can be even greater when it not only involves excessive litigation but somehow includes the explicit or tacit participation of government or regulatory agencies.

It is important to note that the competition analysis related to Vexatious Litigation does not contradict the right of companies to litigate issues that they may consider affect their business interests, this is a general rule accepted in most countries in the world and has been established by the General Court in its resolution of the *ITT Promedia NV v Commission* case:<sup>13</sup>

access to the Court is a fundamental right and a general principle ensuring the rule of law, it is only in wholly exceptional circumstances that the fact that legal proceedings are brought is capable of constituting an abuse of a dominant position within the meaning of Article 86 of the Treaty.

In that case, the General Court established conditions under which legal procedures can be considered as an abuse of dominance (O'Donoghue and Padilla 2013). Under this criterion, the action:

1. Cannot reasonably be considered as an attempt to establish the rights of the undertaking concerned and can therefore only serve to harass the opposite party (i.e. the action is manifestly unfunded); and
2. Is conceived in the framework of a plan whose goal is to eliminate competition.

Regarding the use and abuse of Regulatory or Government Procedures, these are behaviors by which the incumbent seeks, through the abuse of regulatory requirements, to delay or prevent the entry of new participants. This has been observed mainly in products that require approval before entry into the market.

This type of behavior includes abuse in the registration of trademarks, where incumbent could complain and try to prevent an entrant from registering its trademark, under groundless arguments that there could be confusion among consumers,<sup>14</sup> or other abuses including IP.

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<sup>13</sup> Case T-111/96.

<sup>14</sup> See case Osram/Airam in the Eleventh Report on Competition Policy (1981).

Anticompetitive harm does not end with behaviors undertaken by a dominant economic agent; mergers can also become a form of “silencing” a disruptive competitor. We discuss this further next.

### *Mergers*

Anticompetitive mergers can lead to loss in consumer surplus when these facilitate coordination among market players (coordinated effects) and/or enhance market power of an already dominant player (unilateral effects). In markets where economic agents have tended to compete quietly, the entrance of a disruptor can lead to adjustment to new competition conditions that not all firms are easily equipped to handle. If, in addition to this, we consider that financial markets do not always work well and reputable incumbents can more easily and cheaply obtain funds, then it is not surprising that they can access their deep pockets in order to acquire a troublesome disruptor or maverick.

A competition agency should not limit its analysis in this case to simply reviewing concentration ratios and industry structure, but should try and look beyond and understand the nature of competition to construct and revise a solid and congruent ToH that can credibly build a narrative of the future, that allows it to determine whether leaving this disruptor outside of the control of incumbent does more benefit to consumers, innovation and society as a whole, or not.

One of the ‘novel’ observations that have come about in rapidly changing markets is that these types of transactions have involved players in vertically or otherwise related markets. Traditionally vertical mergers were viewed as less worrisome than horizontal ones. Nevertheless, recent mergers are slowly changing this perception. For example, it has been widely discussed that mergers involving OTTs like Facebook and WhatsApp, or Google and Waze, may not have been desirable from a dynamic viewpoint, even if at the time these did not appear to pose a competition problem. Even recent vertical mergers between telcos and content providers, which may not have raised antitrust concerns before, have been met with outright prohibition

(Comcast/TWC) or skepticism and litigation (AT&T/TW and more recently T-Mobile/Sprint).

*The counterfactual: Is total welfare enhanced?*

The entrance of innovators in the markets of digital platforms of multiple sides (for example, Roku), is characterized by the existence of indirect network externalities. That is, the greater the number of content generators, the greater the audience of consumers interested in consuming the generated content. Vice versa, the greater the number of consumers interested in acquiring or buying audiovisual content, the greater the number of possible content generators interested in its production.

Therefore, the analysis of welfare in these markets –and the damages due to the absence of effective competition conditions—must be carried out not only on the side of the platforms that compete for the advertisers, but also on the two sides that inhabit these markets: content generators on one side and content consumers, or audience, on the other side (Tatos 2018).<sup>15</sup> To reach a point of ignition, a digital platform requires a critical mass of customers and content generators on both sides of the markets, which allows the platform to exploit the network externalities that are derived.

Competition between different platforms (digital and non-digital) also involves costs of change for adopters. Therefore, in the presence of an incumbent with market power in a market platform, the entry of a new competitor is usually limited by the switching costs that audiences and audiovisual content generators must assume.

Finally, the entry of new innovative companies also reveals a dynamic aspect of expanding the size of the set of products available to consumers when firms pursue competition for the market. It is through the creation of a wide variety of better products derived from innovation that new markets are created, satisfying new needs of consumers. This is the way in which dynamic competition translates into competition ‘for’ the market. This is why barriers to entry for this type of innovation not only stop

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<sup>15</sup> The Supreme Court declared in the case of *United States v. Am. Express*, 10-CV-4496 (E.D.N.Y. February 19, 2015) that: “*In this case, both sides of the two-sided credit-card market—cardholders and merchants—must be considered... credit-card networks are best understood as supplying only one product—the transaction—that is jointly consumed by a cardholder and a merchant. Accordingly, the two-sided market for credit-card transactions should be analyzed as a whole.*”

society from reaching the production possibility frontier—the curve that shows the maximum possible output combinations of two goods or services an economy can achieve when all resources are fully and efficiently employed—but also its potential expansion (Motta 2004).

### **Resolving an Identification Problem: Competition on the merits**

In Competition Policy, “Competition on the Merits” usually refers to the idea that it is possible for a dominant firm to lawfully engage in conduct that can be merit-based, that is the result of legitimate efforts to compete aggressively but within the law, even if the consequence of this behavior is that rivals are forced to leave the market or their entry is discouraged. In this case, merits can outweigh possible anticompetitive effects in the competition process.

Under this premise, the competition authorities have defined a series of tests to determine whether a conduct has anticompetitive effects. These tests, based on a traditional analysis of competition, are used to determine whether it is possible to exclude a disruptive agent but can still be inconclusive. Some authors have pointed to a need for designing tests to determine whether damage to disruptive innovation exists as opposed to damage to competition itself.

We describe next the commonly used tests as well as the need to have a new framework to analyze the damage to disruptors. These are based on a number of tests whose aim is to determine whether a dominant firm’s conduct should be considered competition on its merits or not. It is important to keep in mind that all the test have certain strengths and weaknesses and that there is no specific test recommended for a type of anticompetitive conduct (OECD 2006).

#### *The profit sacrifice test*<sup>16</sup>

The profit sacrifice test states that conduct should be considered unlawful when it involves a profit sacrifice that would be irrational if the conduct did not have a tendency to eliminate or reduce competition. More specifically, the test holds that when a

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<sup>16</sup> It was originally proposed by industrial economists in the early 1980s.

dominant firm engages in conduct requiring it to forego short run profit, the conduct should be deemed unlawful if it would be irrational absent its tendency to eliminate or reduce competition in the longer run. (OECD 2005).

#### *The no economic sense test*

The no economic sense test avoids under-inclusiveness because it does not require profit sacrifice. Its fundamental idea is that a conduct should be unlawful if it would make no economic sense without a tendency to eliminate or lessen competition, i.e., to be exclusionary under this test, it is enough that the conduct confers an economic benefit only if it eliminates competition. Another feature is that it can be used offensively (to argue that conduct was exclusionary because it made no economic sense) and defensively (to demonstrate that conduct should not be condemned because it did make economic sense), but on the other hand, it seems to have difficulty with some conducts that has mixed effects (OECD 2005)

#### *As efficient competitor test*

The as efficient competitor test, or equally efficient competitor test, states that all conduct that is likely to exclude rivals at least as efficient as the company under analysis from the market should be consider illegal, since consumers are best served by more efficient firms, and so, less efficient firms (those that exhibit lower costs) should not receive any protection from aggressive competition. However, the fact than an equally efficient firm might be able to enter in the market and survive does not necessarily imply that competition can be preserved (O'Donoghue and Padilla 2013).

#### *Consumer welfare balancing test*

The consumer welfare test in its most general forms holds that a conduct will not be illegal unless there is a tendency to reduce consumer welfare (e.g. raising prices, decreasing production). However, it is common practice that a conduct leads to both positive and negative effects. When this is the case, the test gives to decision-makers the difficult task of making a balance between these two effects and in this sense it is particularly difficult to have a test that can be applied accurately, objectively, and consistently (OECD 2005).

## **THE NEED FOR COUNTERFACTUAL TESTING TO EVALUATE HARM**

The above tests have helped to determine the possibility that a particular behavior will damage the competition process, however, there is a risk that they will not be conclusive if applied to a behavior that has the purpose of damaging the disruptive innovation. *A priori* there is the difficulty of detecting if an innovation is disruptive or not, or if an economic agent has potential for disruption. This is because in its first phase, disruptive innovation usually has poor performance and focuses on meeting the needs of niche markets, and features in its offering is usually poor not valued highly when taking into account mainstream users.

In this context, the results of the tests described before can lead to the erroneous conclusion that the disruptive agent left the market because it was not efficient, instead of considering that exit from the market may have been part of an incumbent's strategy to eliminate the disruption. In an extreme case, the "As Efficient Competitor Test" will never allow us to determine the existence of an anti-competitive conduct against a disruptive agent, largely because, by definition, the disruptor is less efficient than incumbent.

Also, once efficient innovation is accepted by mainstream users, there is little that established agents can do to stop the growth of the disruptor. Hence the importance of competition authorities having the ability to timely detect any behaviors that try to stop disruptive innovation.

The test carried out by a competition authority must be able to identify those strategies that have the capacity to generate exclusion, strategies that may not necessarily be reflected in an increase in benefits by the incumbent, since they do not seek to preserve market power and may even occur in a competitive market. Instead these strategies may seek to prevent the disruptor from beginning to provide services to main users, the central concern of the incumbent and its objective to halt growth by any means, including what could look like a pro-competitive acquisition. As a consequence, greater care must be taken in those strategies that imply the refusal to provide an asset (such as licenses or patents).

## HARM TO COMPETITION: THE CASE OF ROKU IN MEXICO

### Background

Roku was spun out of Netflix in 2008 as a standalone company, to become a streaming platform that could connect “the entire TV ecosystem”. Among the innovations it introduced were: the first app store for TV; the first universal search for streaming TV, allowing users to search for content across multiple apps and find the best price based on subscriptions and other options; the first streaming stick, a device not bigger than a thumb drive, that plugged directly into a TV port and allowed streaming of television shows, movies, music, games and other content from the Internet, in some cases without extra cables or remote controls; the first (and only) dedicated TV streaming operating system; the lowest cost streaming player.<sup>17</sup>

But one of the key elements of disruption brought about by Roku was to include the platform business into its business model. The income from its platform business consists of revenue sharing schemes between itself and legitimate content services, as well as income from advertising. In fact, there is a growing consensus that *“the streaming device market is not winner-take-all, but the company with the highest installed base [that] will benefit from attracting more content apps, which will in turn attract more users. [Thus,] Roku has been able to stay relevant over the years by shifting its business model, first to a product platform and second to a software platform. And it still has room to grow as smart TV penetration continues to expand.”*<sup>18</sup>

Roku’s size as measured by number of active accounts—those that stream content on Roku in the past 30 days—is equivalent to the size of the third largest US pay TV company (over 30 million “households”, comparable to Pay TV). This is obviously a serious competition challenge for existing pay TV companies. Roku has licensed its operating system, software, hardware and platform, to operators as a means of retaining and expanding pay TV customer base, a strategy that has been successful in appeasing incumbents in the UK, Germany, Italy, the Philippines and Australia. However, for Mexico the story has been different.

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<sup>17</sup> Roku Class A Common Stock. <https://ir.roku.com/node/6671/html>.

<sup>18</sup> [Roku: From Product, to Product Platform, to Software Platform, Digital Innovation and Transformation, February 26, 2017, Natalie.](#)

Roku launched its business in Mexico in 2015, and experienced rapid market adoption. Roku secured rights to over 4,000 content channel offerings and shelf space in every major retailer in Mexico for sale of its hardware. In 2017, however, its hardware sales were blocked by a court order arising from a complaint from the incumbent pay TV provider in the country which asserted allegations of copyright infringement, claiming that Roku was responsible for the actions of third parties that utilized its platform to engage in video piracy. It took 16 months for Roku to obtain a Federal appellate court order to lift the City court injunction which prohibited the sale of its hardware by the major retail stores and on-line platforms that were offering it in Mexico. Hence, Mexico became the exception among the 23 countries in which Roku then operated where a court blocked the sale of its hardware products for more than a year.<sup>19</sup>

Who was this pay TV provider? Cablevision or Izzi, as it is branded today, is a subsidiary of Grupo Televisa. It is a telecommunications company operated by Empresas Cablevision, S.A.B. de C.V. and is listed in the Mexican Stock Exchange under the code CABLE. Izzi provides telephone, Internet, and cable TV services to individuals and companies; its service offering covers more than 60 cities in 29 states of Mexico, with a network that covers over 30,000 kilometers (19,000 mi) of optic fiber and 77,000 km (48,000 mi) of coaxial cable. It broadcasts 20,000-titles of on-demand television content which is available in some areas, and on mobile devices using the izzi go app.<sup>20</sup> The Roku case began with a complaint by Cablevision lodged in a Mexico City court in June 2017.

### *A chronology of the case facts*

On June 5, 2017 Roku, through its distributors, was informed of the beginning of a civil proceeding by Cablevision before the 38<sup>th</sup> Court in Civil Matters in Mexico City. Cablevision's main argument in filing this lawsuit was that Roku was infringing copyright and violating antipiracy laws, which barred it from transmitting content that

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<sup>19</sup> [Director of Roku tells us how and why they returned to Mexico, Unocero, October 17, 2018, Erick Tapia.](#)

<sup>20</sup> [Izzi Telecom, Wikipedia.](#)

other broadcasters had to pay for. In a way, it was alleging that Roku was bypassing regulation that other non-digital businesses, such as Cablevision, were subject to.

As a result of this lawsuit, Cablevision was granted a broad injunction that barred Roku from selling and importing its products to Mexico. For its enforcement, this order was noticed to Mexico's Ministry of Finance, its Internal Revenue Service, and the General Customs Administration. On the private side, notices were sent to the key distribution outlets and stores selling Roku products (*e.g.*, Sears, Walmart, Amazon, Best Buy, Radio Shack, Office Depot, etc.)—these distributors also challenged through separate proceedings the court order, each of which were deferred at various times and were appealed by Cablevision whenever they were successful, as was the case of Walmart, for example. The litigation that ensued followed a labyrinth path, packed with delays, frivolous petitions from Cablevision, and all sorts of legal maneuvers to keep the process going and far from reaching the legal analysis of the injunction, let alone the underlying copyright claims. In sum, the circumstances under which the injunction was granted and the particularly slow unfolding of the procedure, were notoriously dilatory.

On June 19, 2017, Roku filed an amparo lawsuit to challenge said injunction, requesting a stay to cease temporarily its effects. On June 22, 2017, a District judge granted a provisional stay against the effects of the injunction, but on June 28, 2017 Cablevision filed an appeal before a Circuit Tribunal and requested that the Supreme Court of Justice attract the case.

The Supreme Court denied Cablevision's request and sent the case back to the Eleventh Tribunal for Civil Matters in the First Circuit for resolution in October 2017. This Circuit Tribunal denied the stay while continuing to study the merits of the case.

It was not until October 16<sup>th</sup>, 2018, that the Eleventh Tribunal for Civil Matters in the First Circuit quashed the ban on sales for Roku's devices. The tribunal considered that the nature of the requested type of injunction was preemptive, in order to keep the *status quo* of a situation until the final decision is issued. However, the Tribunal ruled that, by banning the import and distribution of Roku's devices, the local court had modified the original situation and had created a new state of affairs that unjustifiably prejudiced Roku. This amounted to 16 months without sales in a fast growing and new

market, a situation that had to have an impact not just on Roku's bottom line, but on consumer welfare and the possibility of introducing new technology in a market.<sup>21</sup>

The overall background and circumstances of this case did not pass unnoticed for the press and the public opinion. A number of experts, journalists and technology bloggers reported and followed this case. Clara Luz Álvarez, a prominent voice in telecommunications and researcher at Universidad Panamericana, affirmed that the injunction requested by Cablevision to stop selling Roku's devices in Mexico was rather a part of strategy to block competition, than to combat piracy, since Roku is a platform that competes in content distribution and advertising; therefore, pay TV companies see it as a competition.<sup>22</sup> *"It is evident that in Mexico, by judicial means, Roku is being blocked from accessing the market under the pretext of piracy"*, she asserted.<sup>23</sup>

One of the leading and most prestigious Mexican newspapers for economy, finance and politics, 'El Economista', published an article in which directly stated that judges in Roku's trial were biased and issued abusive decisions.<sup>24</sup> José Soto Galindo, the author of the publication, also pointed out the lack of legal basis for ordering the ban of distribution of Roku's devices or its period of validity, and even the court's jurisdiction.

Soto further criticized the decision of the Second District Court of the Auxiliary Center of the Eleventh Region in Coatzacoalcos, Veracruz, which refused to grant protection to Roku against the injunction, even though there was no evidence of the violation of an intellectual property rights wielded by Cablevision. He concluded: *"Roku cannot be credited for being responsible for transmissions that infringe copyright, as a car that is used to run over a crowd on public roads or the carbonated soft drink used to torture cannot be held responsible to someone. Illicit acts are the responsibility of the people who execute them and not of the devices or things with which they are performed."*<sup>25</sup>

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<sup>21</sup> Techbit, El Universal, October 17, 2018, Juan Carlos Peña.

<sup>22</sup> [They accuse interest in Roku's blockade, Reforma, July 11, 2018, Alejandro Gonzalez](#); [Mexico: there would be interests of private companies in the blockade of Roku. FayerWayver, July 11, 2018, York Perry.](#)

<sup>23</sup> [They accuse interest in Roku's blockade, Reforma, July 11, 2018, Alejandro Gonzalez](#)

<sup>24</sup> [The only pirate in the Roku case are the rulings against it, El Economista, July 8 2018, José Soto Galindo](#)[José Soto Galindo](#)

<sup>25</sup> [The only pirate in the Roku case are the rulings against it, El Economista, July 8 2018, José Soto Galindo](#)[José Soto Galindo](#)

The author also stated that the decision of the Eleventh Circuit Tribunal for Civil Matters in Mexico City which lifted the ban of distribution of Roku's devices "*solely confirmed that the only illegal thing in the Roku case were the rulings against it, requested by Cablevision.*"<sup>26</sup>

This highly contrasts with Roku's efforts on the matter. Even the National Chamber of the Film Industry ('CANACINE') publicly supported Roku, stating that the company performs critical actions to detect, combat and stop piracy, and said "*we believe that Roku is an important player in the industry, which is committed with the legal distribution of content and is a relevant platform for Mexican content producers and generators to take their productions to different audiences.*"<sup>27</sup>

In the Spring of 2018, Roku published a press release<sup>28</sup> about the success of its antipiracy program which resulted in removal of substantial piracy content from its platform around the world, including in Mexico. According to this press release, over the past years, Roku has implemented solid measures to fight piracy on its platform, including advanced software and tools to detect, deter and take down streaming channels that violate its anti-piracy policies, as well as enforcement measures against pirates who attempt to disguise themselves as legitimate streaming channel developers.

Furthermore, Roku had tracked more than 400 pirate organizations and has removed their associated channels from its platform and secured the removal of thousands of Facebook and other social media pages that misappropriate its trademark rights to promote channels that provide access to infringing content.

A popular technology blogger, 'LuisGyG', posted abundantly about Roku's struggle over the pendency of the injunction and criticized the conduct of Cablevision.<sup>29</sup> He also pointed out the lack of expertise among the national judges which should be guided by advisors that would allow them to see cases like Roku's with a better

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<sup>26</sup> [The only pirate in the Roku case are the rulings against it, El Economista, July 8 2018, José Soto Galindo](#)  
[José Soto Galindo](#)

<sup>27</sup> [Combat of piracy and use of streaming, Mundo Ejecutivo, June 13, 2018.](#)

<sup>28</sup> [Roku Streaming Data Reveals Effectiveness of Anti-Piracy Measures, June 26, 2018.](#)

<sup>29</sup> [Who benefits from not selling Roku in Mexico?, LuisGyG, May 24, 2018.](#)

perspective.<sup>30</sup> LuisGyG was also questioning throughout the case Cablevision's real motives for requesting an injunction banning Roku's devices: "*Will Cablevision now seek to ban the sale of Android devices? We are talking about 70% of the mobile phones in the market. [...] will they extend the ban to Amazon and Sony?*"<sup>31</sup>

Piracy is an industry-wide problem in Mexico and is not specific to one company or platform. Roku, as a part of its comprehensive approach, has discussed its anti-piracy efforts with Mexican government bodies and trade organizations, including CANACINE, IFT, MPA and others. All these anti-piracy efforts have driven pirate organizations off the Roku platform.

### *On the merits of the case*

A core argument in Cablevision's complaint was the allegation that Roku was enabling piracy. This in spite of the fact that Roku showed its use of anti-piracy tools was reducing the potential violation of copyrighted content; the growth of legitimate streaming in its channels. A fact that supports arguments not just that these policies were being put in place as a way of complying with regulation but as a way of improving business.

This was not the first time that Grupo Televisa had tried to prevent the entry of a disruptor that threatened its position in the pay TV market. In the file E-IFT/UC/DGIPM/PMR/0005/2013,<sup>32</sup> the Federal Telecommunications Institute (IFT) investigated the refusal of Grupo Televisa to grant license of its air tv channels to an online video on-demand provider under the grounds that it was not forced to license its channels to companies that did not have a concession to provide Pay TV services, for example.<sup>33</sup>

In the case of Roku, Grupo Televisa also tried to prevent the growth and development of a company with the potential to reduce Cablevision's position in the

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<sup>30</sup> [Who benefits from not selling Roku in Mexico?, LuisGyG, May 24, 2018.](#)

<sup>31</sup> [Who benefits from not selling Roku in Mexico?, LuisGyG, May 24, 2018.](#)

<sup>32</sup> <http://www.ift.org.mx/sites/default/files/conocenos/pleno/sesiones/acuerdoliga/versionpublicapif%230915417.pdf>.

<sup>33</sup> The IFT decided to close the investigation in the grounds that the refusal of licensing did not prevent Yuzu to enter to the market. A few weeks after the investigation was closed, the video on demand service went out of the market.

market. The increase in the penetration of broadband services in Mexico and the emergence of a variety of online content providers generated a change in consumer preferences. In this context, Roku allows the agglomeration of online content providers, which means that for a part of consumers the traditional pay-TV service is expendable. Unlike the previous case, Grupo Televisa was not in a position to deny access to an input to enter the market (i.e. the licensing of channels), so it sought to prevent the growth of Roku through other means.

Although the right of Grupo Televisa to protect the copyright of its channels is legitimate, in the particular case it is not clear that this right could be violated by Roku because in theory the licensing of channels must specify the means through which the channels can be transmitted. Additionally, Roku's anti-piracy platform policies and tools were designed to prevent unauthorized people from uploading the channels and transmitting them through Roku's device. Thus, it is plausible to consider that the legal processes brought by Grupo Televisa to protect its copyrights were part of a strategy to prevent the entry and growth of Roku.

### **Anticompetitive behavior and the opportunistic use of the legal process**

The antitrust community worldwide has turned its attention increasingly to potential antitrust problems arising in the digital economy. While most of the focus relates to large players foreclosing entry to new, competing and smaller firms, by acquiring them or discriminating against them relative to their own businesses in various ways—self-referencing their own services, using data they've gathered from competitors or from users in a way that is advantageous to them, etc.—the specific case of Roku in Mexico relates to foreclosure undertaken by a company initially not part of the digital economy but to the telecommunications industry. In this case foreclosure was aimed at ceasing participation of an entrant who had introduced a disruptive innovation through its digital platform business, regulated and operating under different regulatory standards.

Despite the fact that this case may bring to mind the net neutrality discussion of an entrant that favors its own content in its physical network over the content of another firm, in reality the main issue here was the use and abuse of IP regulation and

the legal system to bar a competitor from introducing a new product, a product where the wired ISP edge provider (Cablevision) did in fact compete, as it was vertically integrated into the production and distribution of content and was developing its own digital business to stream this content. Although some common elements are present, this is, however, different from net neutrality which relates to network management and traffic and was the subject of much debate as the US's Federal Communications Commission (FCC) issued first one order preventing blocking, throttling (degradation) or otherwise prioritizing through payment internet traffic (see FCC, 2015) and later changes to the order in 2017.<sup>34</sup>

The fact was that Cablevision used its dominant position in the restricted pay TV and local cable businesses to pursue sham litigation to halt the growth of a new disruptive player in a market it was just beginning to be understood. Its arguments, very much rooted in piracy and copyright regulation, look very similar to the historical cases we've described before. Its actions were particularly harmful given that the cost of entry into these markets tend to be low for traditional firms, such as Cablevision, and one of the key elements of success for new entrants is securing critical mass, that is, persuading enough users on various sides of its platform to join—something that Roku was well on its way to establishing—and delaying or destroying the work to securing this critical mass sets back the buildup to the business by more than the time already invested, as there is now catchup to play.

Why did no one sound the alarm? One of the key problems was the lack of preparedness of the Mexican legal system to detect and halt this type of foreclosure and to label it as a competition matter—a means by which rivals use the legal process of unduly foreclosing markets for other competing firms and harming consumers and society during this process. If undertaken in a nascent industry prone to fast change and innovation, this conduct would need to be addressed more quickly than what would be expected, as three recent reports on digital markets emphasize.<sup>35</sup> Instead, it was allowed to linger for 16 months.

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<sup>34</sup> Reference: [https://transition.fcc.gov/Daily\\_Releases/Daily\\_Business/2015/db0312/FCC-15-24A1.pdf](https://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0312/FCC-15-24A1.pdf) followed by <https://www.fcc.gov/document/fcc-releases-restoring-internet-freedom-order>.

<sup>35</sup> Quote from Furman, European Union, ACCC.

The other problem is the unwillingness of the antitrust authorities to address these types of cases which lie at the crossroads of antitrust, sham litigation, and opportunistic use of regulation. How to build tests that can easily identify whether an agency faces an antitrust problem or not is usually difficult, but here the problem is greater, and it is compounded by the fact that after 2014 there are 2 regulators who, depending on the substance of the case, may claim to be competent to investigate a case: the Federal Economic Competition Commission (COFECE) or the IFT.

The next section looks at the ways in which different jurisdictions have addressed vexatious litigation and compares it to Mexico's experience in dealing with these types of conducts in the past.

### **The legal record: International Experience**

In this contentious context of incumbents seeking to maintain their *status quo*, a peculiar phenomenon has arisen on the legal side: The use –and abuse– of rights, both substantive and procedural, to hold back disruptors with onerous, litigious strategies whose main purpose is the legal attack itself, regardless of its merits.

These anticompetitive practices are defined as “sham litigation” in the United States and referred to as “vexatious litigation” in Europe, where they have been conceptualized as “*predatory or fraudulent litigation with anticompetitive effect... the improper use of the courts and other government adjudicative process against rivals to achieve anticompetitive ends*”.<sup>36</sup>

However, asserting that a claim or that opening an administrative procedure necessarily constitutes sham litigation poses the question to courts of what should be the standard to establish that this is indeed taking place, what can qualify as sham litigation, and how to distinguish it from a legitimate use of the legal system. This challenge is compounded if one takes into consideration that courts are obliged to give answer to any petition that a citizen files before them, pursuant to fundamental rights,

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<sup>36</sup> Klein, C., “*The Economics of Sham Litigation: Theory, Cases, and Policy*”, Bureau of Economics Staff Report to the Federal Trade Commission, 1989.

such as the right of access to government that derives from the First Amendment in the US, or access to justice, as set forth under Article 17 of the Mexican Constitution.

The complexity of this problem increases if we add to the equation that not only baseless claims can produce sham litigation, but also claims which, at first glance, might appear to have some legitimacy but end up being part of a strategy to hamper the competition process:

Both legitimate and strategic attempts to use the regulatory/litigation process may impose costs on competitors, these being costs incurred in order to ensure the defence of their interests in the regulatory/litigation process.<sup>37</sup>

This is something that also caught the attention of renowned judge and scholar Richard Posner, who affirmed that even claims that have a legal basis could constitute sham litigation.<sup>38</sup> But on the other side, the unintended “chilling effect” on the use of legal proceedings in legitimate causes is also a focus of concern when examining sham litigation.

Given that judicial processes can be initiated regardless of the risk that the real intention of the claiming party is to affect its competitors, companies can use it as a cheaper way to unfairly improve their position in the market without undertaking any illegal practice. More so in a dynamic and fast changing market, especially where the costs generated to the respondent party are not related to its production or sales (non-price predation).

Considering that it is impossible to discern if in each case the regulatory/litigation processes have been used as a dishonest strategy to displace a competitor from the market, it is unclear whether it is within the scope of competition law or not. In the US and in the European doctrine it is still imprecise whether the

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<sup>37</sup> Lianos, I. “Vexatious”/“Sham” Litigation in EU and US Antitrust Law: A Mechanism Design Approach”, UCL Centre for Law, Economics and Society, Research Paper Series: 1/2017.

<sup>38</sup> “But we are not prepared to rule that the difficulty of distinguishing lawful from unlawful purpose in litigation between competitors is so acute that such litigation can never be considered an actionable restraint of trade, provided it has some, though perhaps only threadbare, basis in law. Many claims not wholly groundless would never be sued on for their own sake; the stakes, discounted by the probability of winning, would be too low to repay the investment in litigation.” Posner’s opinion in *Grio-Pak* (1982) case.

conduct and its effect lend the competitors that are already in the market, a certain type of antitrust immunity where a party can constantly exercise its right of access to courts to affect a competitor through baseless reclamations. Nevertheless, such apparent immunity should not shelter the abuser of judicial processes from the violation of the rights used for purposes other than those originally intended.

In examining the existence of sham litigation, the courts have used a narrow and a broad approach. The first focuses on the motive of the claim and its connection to merits, while the other takes under consideration the real motive of the party based on the economic factors in perusing the claim. This method may include lawsuits where, even if the probable cause is established, the expected outcome of the proceeding, reduced by the probability of winning, might not be sufficient to reimburse the costs.

Since the main feature of sham litigation is the lack of a real interest in obtaining a judicial relief and the use of the proceeding in order to achieve monopolistic rents, European and American courts' main objective has been to discern the real motive of the accused party. However, in doing so, the authorities must exercise caution not to infringe the fundamental rights such as access to justice, due process, and right of petition.

## *USA*

In the US, the main concern regarding sham litigation, in accordance with the Supreme Court's ruling in *City of Columbia v Omni Outdoor Advertising*, is the abuse of the process as an anti-competitive weapon where the private party can injure competition despite the Antitrust authority's power.

Under the US common-law, the developed case law of sham litigation serves as an exception to the well-established Noerr-Pennington<sup>39</sup> doctrine which protects the values not related to competition from violation of antitrust law and grants immunity from competition law liability, unless the purpose of the litigation aims to abuse the process. In accordance with said doctrine, as well as with the case law pertaining to the

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<sup>39</sup> The name of the doctrine comes from these cases: *E. R.R. Presidents' Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965).

First Amendment, rent seeking activities are excluded from competition law liability due to the need for preventing Congress from shortening people's right to request harm compensation from the government.

Nevertheless, the history of the US Supreme Court ruling shows the development of the recognition of sham litigation, from establishing that a single lawsuit can constitute an antitrust violation, to prescribing that such litigation requires bringing the claim without grounds in order to harm the competition.

Moreover, since in US the litigation may be challenged only if the proceeding is tangibly unjustified, the US Supreme Court developed in *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.* ("PREI"), a test to recognize such litigation by examining (i) the objective merits of the lawsuit in connection to the realistic expectation of its success with (ii) the suspected attempt to harm competition. This scrutiny is understood by the Eight Circuit as a further exception to the Noerr-Pennington doctrine, however "*only where a defendant's resort to the courts is accompanied or characterized by illegal and reprehensible practices such as perjury, fraud, conspiracy with or bribery of government decision makers, or misrepresentation, or is so clearly baseless as to amount to an abuse of process, that the Noerr-Pennington cloak of immunity provides no protection*".<sup>40</sup>

### *European Union*

In a similar way as the Noerr-Pennington doctrine, the European Union also provides instruments to protect the citizens' right to participate in the political process.<sup>41</sup> Under EU law, any natural or legal person with the residency status or registered office in any of the Member States, is entitled to file a petition with the European Parliament, concerning any of the EU's scopes of activities, including matters that affect the citizens directly. Although those regulations are rather limited compared to the scope of the First Amendment of the US Constitution, they may be also applicable to anticompetitive activities listed in the European Parliament legislation.

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<sup>40</sup> *Razorback Ready Mix Concrete Co., Inc. v. Weaver*, 761 F.2d 484, 487 (8th Cir. 1985).

<sup>41</sup> Articles 20 and 227 TFEU, as well as Article 44 of the Charter of Fundamental Rights of the EU.

Compared to the US, EU competition law offers more mechanisms to investigate vexatious litigation by the public authority and provides a broad case law. For example, in *Industrie des Poudres Sphériques v Commission*, the General Court considered that the participation of a company in an investigation carried out by EU institutions in anti-dumping proceedings cannot be in itself contrary to Article 102 TFEU,<sup>42</sup> as “to assert that mere recourse to such a procedure is, of itself, contrary to Article [102 TFEU] amounts to denying undertakings the right to avail themselves of legal instruments established in the interest of the EU”.<sup>43</sup>

Further, in *Boosey & Hawkes* case, due to the Commission’s suspicion of the vexatious litigation in terms of anticompetitive practices conducted by a party—ceasing to supply—the Commission adopted a decision under which Article 102 is currently imposing provisional measures that require supply delivery.

Lastly, in *ITT Promedia v. Commission* and confirmed in *Protégé International Ltd v Commission* the General Court established that, under particular conditions, vexatious litigation constitutes an abuse of a dominant position contrary to Article 102 TFEU.

### **The legal record: Mexico**

In comparison to the European and US legal systems, Mexico does not have a sham/vexatious litigation doctrine contained in the law, nor developed by the antitrust agencies or the courts. There is no concept or legal figure in Mexico related to both the abuse of administrative and judicial processes, and competition law. The only rules that might resemble the principles of the sham or vexatious litigation doctrines that can be found in the Mexican legal system are civil procedural rules that forbid the submission of notoriously meritless or groundless actions, or the generic civil rules that establish the obligation to indemnify a person whenever that person suffers a damage due to the abuse of a right. These rules, along with the general prohibition set forth under Article 56-XI of the Federal Economic Competition Law (LFCE), which forbids increasing the costs or altering the production process or reducing the demand of an economic agent,

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<sup>42</sup> Art. 102 of TFEU states: “Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. [...]”

<sup>43</sup> Case T-5/97, *Industrie des Poudres Sphériques v. Commission* [2000] ECR II-3755.

can allow Mexican authorities to determine the existence of and punish sham/vexatious litigation conducts.

Another example can be found under Article 7Bis of the Federal Law on Administrative Contentious Procedure, which grants the judges the powers to set fines on those parties who file actions, recourses, or any other kind of petitions that are evidently frivolous.

Also, Article 57 of the Federal Code for Civil Proceedings forces judges to reject hearing cases where there is an evidently malicious or groundless claim. In a similar manner, Article 140-V of the Code for Civil Proceedings of Mexico City establishes that procedural expenses will be charged to those who start legal actions that are baseless and do not comply with the legal requirements. Article 1084-V of the Federal Commercial Code contains the same rule.

When examining any legal issue in Mexico, in addition to the legal system set forth by the laws issued by the legislature and their corresponding regulations set out by the Executive branch, the “*jurisprudence*” established by the Federal Judiciary must be always consulted to have a clearer idea of the prevailing law and its interpretation by courts and authorities.

All the courts and jurisdictional entities<sup>44</sup> are required to apply interpretative criteria called “*jurisprudence*”. This obligation is established in the Mexican Constitution and is stipulated in the Amparo Law. Jurisprudence consists of criteria that are construed by judicial precedents of the Supreme Court or Circuit Courts and is only binding within the courts that comprise the Judicial Branch, in a descendent order of the hierarchical structure.<sup>45</sup>

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<sup>44</sup> Such as the Federal Institute for Telecommunications, the Federal Competition Commission, the Mexican Institute for Industrial Property, when they carry out jurisdictional functions in contentious proceedings.

<sup>45</sup> Jurisprudence formed by the plenary of the Supreme Court of Justice will be binding to its chambers, to Circuit Courts, to District Courts, to the local judicial and military courts, and to the administrative courts, be it local or federal. Likewise, jurisprudence established by Circuit Courts is only binding to District Courts, to the local judicial and military courts, and to the administrative courts, be it local or federal.

In this field, the jurisprudence developed by the Mexican federal courts has been developing to preempt and fine frivolous or abusive litigation, as can be seen from these examples:

- **Temerity and Bad Faith Litigation as Concepts Needed in Order to Allocate Legal Costs<sup>46</sup>**

Temerity, also known as bad faith litigation, can encompass diverse acts and omissions from one of the parties, given that its configuration is not limited to the lack of evidence, but also implies the following: exercise of an action knowing its improper character, opposing to an action without a reasonable cause, as well as filing an improper and frivolous procedure in order to hinder the court's ruling.

- **Procedural loyalty. Its comprising elements<sup>47</sup>**

Within the good faith litigation, we can find specific conducts such as a exposing the facts truthfully, avoiding the offering of any unnecessary evidence and staying clear of any act that could hamper the normal unfolding of a procedure. Furthermore, procedural loyalty imposes a group of ethical conduct rules to all the parties (e.g. disputants, lawyers, attorneys, etc.) in order to dodge any judicial cheating, crooked legal recourses, or useless evidence.

- **Notoriously malicious and improper submissions and recourses. Its connotation<sup>48</sup>**

Malicious promotions are identified with one of the disputant's bad faith litigation when, for example, his actions are meant to delay the execution of a judicial resolution or its proper materialization. Therefore, legislation aims to avoid petitions that turn to be idle or inconsequential, whether because they

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<sup>46</sup> Thesis ID number 240981. <http://sjf.scjn.gob.mx/sjfsist/Documentos/Tesis/240/240981.pdf>.

<sup>47</sup> Thesis ID number 2018319. <https://sjf.scjn.gob.mx/SJFSem/Paginas/Reportes/ReporteDE.aspx?idius=2018319&Tipo=1>.

<sup>48</sup> Thesis ID number 188538. <http://sjf.scjn.gob.mx/SJFSist/Documentos/Tesis/188/188538.pdf>.

have an obvious delaying purpose, or because their requests are clearly unfounded.

Notwithstanding that there are no rules that explicitly restrain and punish sham litigation, we can derive from the above exposed legal rules and jurisprudence that Mexican judges have inferred from the legal system some inherent principles that must apply in every proceeding, such as good faith in every petition before an administrative authority or court.

Additionally, as stated before, the punished monopolistic practice of increasing the costs or altering the production process or reducing the demand (Art. 56-XI FECL) can be denounced or investigated by the authorities to determine whether infringement occurred and punishment is due for vexatious/sham litigation conducts. In fact, there have been few precedents in which the analyzed conducts could have been deemed as sham or vexatious litigation, had the corresponding authorities applied a wider criterion with the elements of this doctrine, and carried out a comprehensive, systematic interpretation of the Mexican legal framework. Some of these cases are briefly analyzed next.

### *IP rights abuse*

Concerning the aggressive use Intellectual Property rights, there is a precedent from the 4<sup>th</sup> Circuit Court on Administrative Matters of the 1<sup>st</sup> Circuit, that states that no person may claim an IP right to maintain unlawful competition conditions.<sup>49</sup>

### *Public Tender 21*

The “Public Tender 21” was launched by the Federal Telecommunications Commission (COFETEL) for private companies to bid for the management and exploitation of the frequencies 20 and 21 of the radio spectrum. The peculiar thing of this case was, first,

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<sup>49</sup> Thesis ID number 911994. <http://sjf.scjn.gob.mx/SJFSist/Documentos/Tesis/911/911994.pdf>

that the parties that did not win the tender, and even third parties that did not participate in it, systematically started Amparo proceedings in order to challenge the decision and to suspend the effects of the tender. Secondly, that most of the parties that filed the Amparo suits were subsidiaries of the same company, which evinced the aim to only delay the proceeding through different agents.

In reality, the decision of the Federal Telecommunications Commission did not affect the complainants, nor were there any substantive rights being violated, but all the judicial proceedings and the stays granted within them abusively served to delay, through different subsidiaries of a single company, the result and effects of Public Tender 21 for many years.

### *Combugas v. Integradora*

Another relevant case on abuse of proceedings and raising rivals' costs is the case DE-019-2010 Gas LP<sup>50</sup>, in which "*Integradora*", a company dedicated to the breeding, selling, and distribution of chickens, as well as the self-supply of liquified petroleum Gas (LP Gas).

*Integradora* decided to build an LP Gas Plant and to this end, faced several obstacles. First, during its construction, a civil case was filed by a third company "*AFS*", who asked for an injunction of "dangerous construction" and delayed several times the development of the trial by opposing four times the elected judge. *AFS* also filed several requests for inspections and produced fake documents ordering the cancelation of the construction by the Energy Authority. Nevertheless, said case was dismissed due to the absence of a fair cause.

Moreover, *AFS* initiated two administrative procedures challenging the environmental permissions granted by the energy and environmental authorities, which delayed again the operation of the plant. These actions were accompanied by several offers to buy the plant and threats to stop its construction.

*Integradora* argued that the actions undertaken by *AFS* were made on behalf of one of its competitors in the LP Gas market, *Combugas*. However, COFECE determined

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<sup>50</sup> Docket No. De-019-2010. Federal Competition Commission. 2013.

that a relation between AFS and Combugas could not be proved and, thus, there were no elements to find monopolistic practices.

### *Cement boycott*

CEMEX is the biggest cement producer in Mexico. In 2016, CEMEX' competitors CDM and MCC decided to import a load of 26 million tons of cement to Mexico through the ship "Mary Nour". CEMEX began several actions and legal processes to stop such imports.

On 2006, CDM and MCC filed a complaint against CEMEX before the COFECE for the commission of monopolistic practices. COFECE opened an investigation that ended in 2008 with the following findings:

- CEMEX forced the National Chamber of Cement (in which it has majority of votes) to deny the affiliation to the importing company as member of the cement importers list.
- It pressured the cement producers in Indonesia and Taiwan to stop providing cement to the importing company.
- It stopped, through legal recourses, the docking of the ship Mary Nour at Tampico.
- It stopped the entrance of the imported cement through the port of Altamira through legal proceedings filed by the National Chamber of Cement against the port.

On 2012, the COFECE punished CEMEX with various punitive measures (DE-017-2006): CEMEX was forced to stop the blocking actions; to adopt a code of conduct in accordance with the Competition Law and to distribute it among its employees; and fined CEMEX \$10,179,000.00 MXN, which, at the time, constituted the maximum fine for a monopolistic practice according to the Law.

However, this decision did not rely on the sham litigation accusations, but on the boycott performed by CEMEX, such as the pressure on its partners in Taiwan and Indonesia not to sell cement to its competitors. In this sense, the legal actions filed in

order to stop the entrance of the ship to Mexican ports were considered part of a series of actions that, as a group, demonstrated the intentions of CEMEX of inviting different agents to hinder the marketing of its competitors' products.

The referred cases are the most emblematic examples of raising rivals' cost through the use and abuse of substantive rights and legal proceedings known by the Mexican authorities, even though they were not framed under the sham litigation doctrine.

### **Can we apply competition law to Roku's case?**

As can be seen from these cases, the abusive use of administrative and judicial proceedings is not strange to the Mexican legal practice and, even with a lack of sham litigation doctrine, there are some rules, principles and case law that aims to prevent or restrain the use of the Government for illegitimate purposes, such as delaying the resolution of a proceeding, or causing damages or inconveniences to counterparties.

This has a high cost for society in general, which goes beyond the direct damage to the parties involved. The central premise of regulation and competition laws is to improve the welfare of consumers. In traditional competition analysis, the objective of competition policy is to protect the competition process and not competitors. In the presence of disruptive agents, the analysis takes a focus on the rescue of dynamic efficiency (Schumpeterian), in which competition acts as a selection mechanism or process, by which the most efficient companies replace the least efficient ones. This process is referred to as creative destruction. Its true value comes not in reducing prices, but in encouraging innovation and promoting technological change.

In this context, it seems that Mexican agencies and courts have not seized the opportunity to resort to the anticompetitive conduct consisting of hindering the competition process, established under Article 56-XI of the Federal Competition Law, to find the existence of conduct comprising sham litigation where disruptors are involved. To do so, it would be necessary to move away from the traditional competition analysis based on forms (form-based) of behavior and introduce another more modern based on the analysis based on the effects (effect-based) of the behavior. The analysis

of effects focuses on the damage to consumers that can cause the behavior of economic agents. In particular, it is emphasized that the investigations of the behavior of economic agents are carried out, case by case, based on conjectures derived from the economic analysis, that are reasonable and consistent, and supported by incentives, solid data and relevant evidence that consider the dynamics of the market.

The above suggest that a systematic, comprehensive interpretation of the Mexican legal system, along with a solid, theoretical backbone, and good will of the authorities, could introduce this legal concept in Mexico.

## Conclusions and recommendations

Among our conclusions is that while disruption is not new, and competition in the market and for the market has occurred over time as well as foreclosing of these disruptors by different incumbents, what has changed substantially is the speed at which these changes occur. Network effects make barring and entering a more immediate and permanent threat. Immediate, in the sense that because entrants can very quickly spread and “ignite” a platform business, incumbents have an even greater incentive to move quickly to foreclose and thus bar truly “innovative” or “disruptive” vs. merely “incremental” or “imitative” innovation. The larger the market share of these incumbents, the greater the money at stake and the incentives to foreclose.

Because competition for the market involves incipient or not yet fully formed markets, the analysis requires to take the long view. A long-term perspective not just in the possible effects that conduct may have, but to consider dynamic efficiencies, long run costs and benefits, long-term consumer welfare considering not just immediate price decreases and benefits to consumers but the long-term consequences of not having an innovative or disruptive product or service at an earlier time—or alternatively, of hindering the growth of an efficient and dynamic competitor by overprotecting competitors—that is, foregone consumer surplus.

Given that it is difficult to identify whether an innovation is disruptive or not, competition agencies should carefully assess those operations and/or behaviors that relate to companies that provide innovative services with a different business model than those observed in similar products. This does not imply the use of new analysis tools but rather a different use of them that allows to protect the development of new markets.

In general, for competition policy, but most importantly in the case of dynamic and innovative markets, the essential role of competition policy, to police market in such a way that dynamic efficiencies and economic growth can be realized with a long term view, should be the objective—front and center—when deciding to intervene or

not to intervene in ways that allow players to participate under equal conditions in actual or potential markets.

In the context of the antitrust analysis, legitimate and strategic litigations have been used in litigation proceedings before the judiciary or in the use of administrative remedies before the regulatory authority. International and national evidence has shown that the use of strategic litigation by incumbents, without clear reasoning about the harm that may be caused by a new technology developed by an incoming operator, may end up damaging the competition process, in particular by increasing the costs of the new competitors, avoiding the production process and innovation. or reduce the demand for incoming agents in the markets (see Section XI of the Mexican Competition Law).

The competition authorities of the United States and Europe, as well as their courts, have been able to develop and incorporate new standards of analysis supported by a theory of harm based on the effects and provide the empirical elements needed to support to the truth of the complaint. Otherwise, we would be subject to a recurring events of sham litigations.

As we have indicated previously, the anti-competitive behaviors of historical operators in highly innovation sectors (such as telecommunications and broadcasting) focus on the early acquisition of new incoming distributors or the establishment of barriers that raise their operating costs, rather than strategies of predatory pricing. Similar behaviors of sham litigation are recurrent in this type of situation. That is reason why in the sectors where we can expect rapid developments of new technologies associated with dynamic efficiencies and the abrupt adoption of new standards, with strong displacement effects of established operators, a permanent monitoring and a prompt intervention of the agencies is required.

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Art. 8 of the Universal Declaration of Human Rights; Art 6 and 13 of the European Convention of Human Rights; Art. 47 of the EU Charter of Fundamental Rights; and Art. 67(4) of the EU Treaties.

Doctrine's name comes from the following cases: E. R.R. Presidents' Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers of America v. Pennington, 381 U.S. 657 (1965).

Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.

Octane Fitness, LLC v. ICON Health

Razorback Ready Mix Concrete Co., Inc. v. Weaver, 761 F.2d 484, 487 (8th Cir. 1985).  
Articles 20 and 227 of the TFEU, as well as Article 44 of the Charter of Fundamental Rights of the EU.

Art. 102 of TFEU states: “Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. [...]”

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