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PRELIMINARY ANALYSIS & COMMENTS

Brief Comments on the new Law on Advertising Contracts

On June 3, 2021, the Federal Executive branch published in the Federal Official Gazette the *DECREE enacting the Law for the Transparency, Prevention and Combat of Improper Practices in Advertising Contracts* (the "***Law***"), which introduces relevant changes that impact the advertising industry in Mexico. The Law becomes effective on September 3, 2021, and is applicable to all acts, contracts, agreements, or procedures entered into between two or more of the economic agents referred to in the Law (media agencies, advertisers, and media), if an advertiser is resident in Mexico and the advertisement is disseminated in Mexico.

According to the explanatory memorandum of the new Law, its issuance responds to the need to avoid "improper practices" present in the advertising industry, such as: ***(i)*** double-dipping by media agencies, since they receive compensation both from the advertisers they represent and from the media where the advertising is executed; ***(ii)*** conflicts of interest present where a media agency represents an advertiser and, in turn, has business relations with the media where such advertiser's content is displayed; ***(iii)*** the purchase of advertising spaces by media agencies for subsequent resale at a markup to advertisers; and ***(iv)*** the execution of simulated contracts or contracts at above-market prices between the media and media agencies.

Thus, the Law aims, in general terms, to: ***(a)*** *promote transparency in the advertising market,* specifically, in the processes of contracting advertising spaces; and ***(b)*** *prevent and combat commercial practices that constitute an undue advantage* to the detriment of advertisers and, ultimately, consumers, mainly through avoiding conflicts of interest on the part of media agencies, since one of their main roles is to act as intermediary between advertisers and the media. Additionally, although the Law does not expressly state so, it seems that it intends to establish mechanisms to *avoid anti-competitive practices in the advertising market* by such intermediaries, whose lack of supervision would have led them, in the legislator's opinion, to inflate the prices of their services or obtain "undue profits" by reselling advertising spaces purchased from the media on a massive scale.

The new Law incorporates certain significant restrictions and obligations for Agencies and the Media, in favor of Advertisers who enter into Advertising Contracts (as such terms are defined in the Law itself). Namely, it prohibits Agencies from: ***(i)*** purchasing advertising spaces on their own behalf for subsequent resale to an Advertiser, since they may only acquire such space on behalf of an Advertiser and "within the framework of an agency agreement"; ***(ii)*** providing services simultaneously to Advertisers and Media; y ***(iii)*** receiving consideration, commissions, or benefits in kind from a Media counterpart over and above the consideration received by the Advertiser.

With respect to new obligations, the Law incorporates a series of responsibilities and processes that, in most non-regulated industries, would be subject to the will of the contracting parties. For example: ***(i)*** the agency agreement entered into between any given Agency and Advertiser must include terms governing consideration and such Agency may only receive, as consideration for the services rendered to the Advertiser, the consideration established in such agreement; ***(ii)*** Agencies must transfer any discounts granted thereto by the Media to Advertisers, in full (a scheme known as pass-through); and ***(iii)*** Agencies must provide periodic information to Advertisers regarding the results of the services rendered, under the terms of the agreed indicators and criteria (e.g., impressions, reach, interactions, clicks and engagement, audience segmentation, optimization methods, technological tools used for rendering the services, among others). In addition, the Law imposes certain obligations on the Media with respect to Advertisers, mainly related to invoicing and delivery of information related to the broadcasting of advertisements in the Advertising Spaces.

As is clearly shown, the new Law intends to achieve its objectives by incorporating certain complementary provisions in the areas of commercial contracting into the Mexican legal system (specifically with respect to advertising contracts), transparency, consumer protection and economic competition. In a certain way, the Law thereby converts the Mexican advertising industry and the contracting of advertising services, into a regulated market and activity.

Based on a preliminary analysis of the provisions of the new Law, we have the following comments:

a) Some of the information disclosure obligations *will help increase transparency* by Agencies in favor of Advertisers, reducing the transaction costs incurred by both parties when negotiating advertising contracts. It is reasonable to anticipate that this measure will benefit smaller Advertisers or Advertisers with smaller advertising budgets to a greater extent, as they are usually in a weaker position to negotiate the terms and conditions of advertising contracts with Agencies.

b) Certain restrictions imposed on Agencies *could contribute to the prevention of conflicts of interest*, which may result in a more adequate and effective representation of Advertisers' interests. If applicable, such measures could have an impact on the reduction of the cost of Advertising Spaces to the benefit of Advertisers.

c) On the other hand, the *measures devised to prevent concentration* in the purchase and sale of advertising spaces (by limiting Agencies to purchase advertising spaces solely on behalf of Advertisers, in their capacity as principals), seem inadequate and could have harmful effects on the advertising market and related markets. In certain cases, the purchase of Advertising Spaces by Agencies allows Advertisers to access prices and terms which would otherwise (i.e., acting individually), not be available. Thus, by prohibiting this type of intermediation, smaller advertisers or those with smaller advertising budgets are prevented from accessing, at least partially, the volume discounts obtained by Agencies that negotiate

"wholesale" advertising space prices. In other words, this restriction may result in the elimination of some efficiencies (via cost reduction) for certain type of Advertisers.

d) Likewise, *it is not clear that restricting the purchase of Advertising Spaces by the Agencies* "for their own account for subsequent resale to an Advertiser", is in accordance with the freedom of trade when it is a lawful intermediation service and involves a certain degree of market speculation. Therefore, it is reasonable to anticipate that this measure, together with other provisions of this new Law, will be challenged before the competent courts by the economic agents who consider themselves affected.

(e) In addition, the explanatory memorandum of the Law states that practices similar to those allegedly identified in the Mexican advertising industry at present have also been identified and investigated in several other countries (France, United Kingdom, United States), namely: a lack of transparency, double-dipping practices and breaches of fiduciary duty to Advertisers by Agencies. Likewise, the bill indicates that "such practices were not typified (sic) as violating competition laws, but as a matter of criminal complaints for fraud and blackmail". Therefore, *it is questionable that the Law empowers the Federal Antitrust Commission to hear and substantiate the complaints* derived from the provisions of the Law, "in accordance with the procedures provided by the Federal Antitrust Law", especially when it comes to the conducts described in this paragraph.

(f) On the other hand, i*f practices in the Mexican advertising industry allegedly violate free market competition*, it is important to take into account that our legal system already has substantive rules, procedures, and competent authorities to hear such complaints, namely: the Federal Economic Competition Law and the Federal Economic Competition Commission (the "**COFECE**").

In this regard, the Law is not clear and fails to clarify: ***(i)*** which parties will have standing to file a related complaint; ***(ii)*** the requirements that such complaint must contain and, more importantly, how such issues or practices are related to antitrust matters, and ***(iii)*** which of the procedures established in the Federal Antitrust Law shall be followed by the COFECE to determine whether or not to impose sanctions.

It is unlikely that COFECE would use its existing investigation procedure regarding monopolistic practices to address complaints associated with the Law, since the mere fact of not complying with the precepts established in the Law does not imply the existence of a practice identified as unlawful in Federal Antitrust Law. In any case, some of the potential violations provided by the Law are perhaps related to tax or administrative obligations of a formal nature, which could hardly be sanctioned by COFECE in an administrative proceeding followed in the form of a trial.

In view of the foregoing, we believe it is important for economic agents participating in the Mexican advertising industry to evaluate: ***(i)*** the measures they can or should take to comply with the provisions introduced by the new Law, in order to avoid or mitigate negative impacts on their current operation and/or business models, as well as ***(ii)*** the alternatives and opportunities to challenge those provisions of the Law

which they consider to be in violation of their rights. We offer you the expertise and experience of our team to advise you in such analysis and, if necessary, in the implementation of the corresponding corporate and contractual measures, as well as in the preparation and filing of the relevant legal remedies.

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