PREDATORY PRICING IN THE LIGHT OF COLOMBIAN ANTITRUST LAW

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CPI ANTITRUST CHRONICLE
JANUARY 2022

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Predatory pricing has been established as an abuse of dominance forms of conductin Colombia. The law describes two different conducts dealing with the same kind of practice: predatory pricing, and regional predatory pricing. This conduct will take place when a dominant company lowers prices below its cost level, aimed at maintaining or increasing its dominance and/or market share, which may result in the exclusion of one or more of its competitors, may prevent the expansion of existing competitors, and/or prevent new competitors from entering the market. The SIC has considered average costs (not variable costs) to determine the occurrence of these forms of conduct.

I. INTRODUCTION

In order for the market economy to function efficiently, it is necessary for the State to guarantee, within reasonable limits, certain fundamental economic rights, such as private property (Art. 58 P.C.), freedom of enterprise and private initiative (Art. 333 P.C.), freedom to choose a profession or occupation (Art. 26 P.C.), freedom of association (Art. 38 P.C.) and, most importantly, free economic competition (Art. 333 P.C.).

Free economic competition is understood as the effective possibility for market players to compete in a market in order to offer and sell goods or services to consumers, and to build, maintain and/or strengthen a clientele.

As is well known, free competition may be legitimately restricted, eliminated or altered by: (i) the establishment of legal monopolies (in the manner provided by Article 336 of the P.C), (ii) the recognition of trademarks, patents and other industrial property rights, (iii) price regulation in the pharmaceutical sector, among others established by Colombian law. The foregoing, given that they embody principles and protect legal values such as the State's profitable monopoly or the protection of industrial property rights, which within the scale of values of our legal system are preferred in certain instances to the right to free economic competition.

On the contrary, free competition will be illegally affected by restrictive practices, which include the following: (i) in general, any kind of practice, procedure or system tending to limit free competition and to maintain or determine unfair prices,[2] (ii) agreements between two or more companies that prevent, restrict, or distort competition,[3] (iii) unilateral acts performed by companies,[4] (iv) abuses behavior of a dominant position,[5] or (v) engaging in acts of unfair national or international competition (e.g. dumping).[6] These behaviors constitute "pathological behaviors," which arise spontaneously without the natural laws of the market being able to correct or suppress them, and which, on the contrary, introduce important elements of distortion and imbalance.

The behaviors that we have referred to as pathological must be repressed by the State, in order to guarantee freedom of competition and the very subsistence of the market economy. To this end, our legal system, based on the principles of the former Article 32 of the 1886 Political Constitution and Article 333 of the 1991 Political Constitution, which is currently in force, contemplates rules such as the following: (i) rules on prohibition of anti-competitive practices and abuse of dominant market position,[7] (ii) rules on consumer protection,[8] (iii) antidumping and countervailing duty rules [9] and (iv) Rules on the prohibition of unfair competitive conduct.[10]

Now, having exposed a map of competition law in Colombia, it is worth mentioning that the purpose of this paper is to analyze the conduct of predatory pricing under the current legal system that prohibits it when it occurs in the context of an abuse of dominant position.

II. PREDATORY PRICING

In Colombia, predatory pricing is considered an abuse of a dominant position. In this regard, Article 50 of Decree 2153 of 1992, makes a non-exhaustive list of the forms of conduct that are considered abusive, when committed by a company with a dominant position in the market. The complete text of article 50 of Decree 2153 of 1992 is as follows:

> "**ARTICLE 50. ABUSE OF DOMINANT POSITION**. In order to comply with the functions referred to in Article 44 of this Decree, it shall be taken into account that, when there is a dominant position, the following conducts constitute abuse of such position:

2 Article 1 of the Law 155 of 1959.

3 Article 47 of Decree 2153 of 1992.

4 Article 48 del Decree 2153 of 1992.

5 Article 50 del Decree 2153 of 1992.

6 Law 256 of 1996.

7 Contained mainly in the Law 155 of 1959, the Decree 2153 of 1992 and the Law 1340 of 2009.

8 Contained mainly in the Law 1480 of 2011.

9 Contained mainly in the Decree 299 of 1995.

10 *Supra* note 6.

1. The lowering of prices below costs when their purpose is to eliminate one or more competitors or to prevent the entry or expansion of these competitors.

2. The application of discriminatory conditions for equivalent operations, which places a consumer or supplier in a disadvantageous situation compared to another consumer or supplier with analogous conditions.

3. Those whose purpose or effect is to subordinate the supply of a product to the acceptance of additional obligations, which by their nature did not constitute the object of the business, without prejudice to the provisions of other provisions.

4. Selling to a buyer on terms different from those offered to another buyer when it is with the intention of diminishing or eliminating competition in the market.

5. Selling or rendering services in any part of the Colombian territory at a price different from that offered in another part of the Colombian territory, when the intention or effect of the practice is to diminish or eliminate competition in that part of the country and the price does not correspond to the cost structure of the transaction.

6. Obstructing or preventing third parties from accessing markets or commercialization channels." (Emphasis added and Author's free translation).

Of the six forms of conduct listed in the provision, the one referred to as *"predatory pricing"* corresponds to the abuse of a dominant position by *"lowering prices below costs when the purpose is to eliminate one or more competitors or to prevent the entry or expansion of competitors."*

As stated above, and following the interpretation previously made by the Superintendence of Industry and Commerce ("SIC"),[11] in order to establish whether a company is involved in this conduct of abuse of a dominant position, it must be proven: (i) that the company under analysis has a dominant position in the relevant market, and (ii) that this same company abuses its capacity to determine market conditions by *"subordinating the supply of a product to the acceptance of additional obligations" or "obstructing or preventing third parties from accessing the markets."*

A. Concept of Abuse of Dominance

In Colombia, the concept of market dominance is defined in article 45 of Decree 2153 of 1992, which states as follows:

> **ARTICLE 45. DEFINITIONS**. For the performance of the functions referred to in the preceding article, the following definitions shall be observed:
>
> (…)
>
> 5. Dominant Position: the possibility of determining, directly or indirectly, the conditions of a market.
>
> (…)" (Author's free translation)

Now, in order to determine whether an economic agent has a dominant position in a market, the SIC, like other competition authorities worldwide, must carry out an analysis of the market and the position of the economic agent in it. This analysis typically involves one of the most complex tasks within the free competition regime, which is to understand the true dynamics of each market. Thus, the relevant market is defined through three (3) elements which are:

- Product Market: this refers to the products/services that compete directly with the product/service offered by the economic agent under analysis. Within the product market, three (3) factors are taken into account, which are: (i) characteristics, (ii) end uses and (iii) price.

- Geographic Market: refers to the geographic location of the consumers' options to purchase a given service or product.

11 Administrative Act No. 33361 of 2011, issued by the Superintendence of Industry and Commerce on June 26, 2011.

- Temporal Analysis: since markets are dynamic, it is important to mention that the position of an economic agent in the market varies depending on the time period being measured.

Secondly, in order to affirm that there is an abuse of the dominant position of an economic agent in the market, it is necessary to make a normative interpretation of what is legally understood as an abuse of such position. Regarding the latter, it is worth noting that the mere fact of having a dominant position does not mean that a company is infringing the free competition regime, much less that having a dominant position cannot be a legitimate objective of the economic agents. Due to the foregoing, what is prohibited by the Colombian free competition regime corresponds to the abuse of this position, in such a way that it distorts the market and generates barriers that prevent free competition.

B. Concept of Predatory Pricing in Colombia

As mentioned above, the conduct known as predatory pricing is defined in paragraph 1 of Article 50 of Decree 2153 of 1992, according to which *"[t]he reduction of prices below costs when the purpose is to eliminate one or several competitors or to prevent the entry or expansion of these … constitutes abuse of a dominant position."* (Author's free translation)

While discriminatory conduct and tied sales, defined in paragraphs 2 and 3 of the same Article 50, may be committed either in a concerted manner through anticompetitive agreements prohibited by Article 1 of Law 155 of 1959 and Article 47 of Decree 2153 of 1992, or unilaterally through acts or abuse of dominant position, predatory pricing conduct, can only be committed by a competitor with a dominant position in the market, since by its nature no other market player could do this in regular market conditions.

Thus, predatory pricing conduct will take place when the dominant company lowers prices, for a limited period of time, below its cost level, in order to maintain or increase its dominance and/or market share, which may result in the exclusion of one or more of its competitors, may prevent the expansion of existing competitors, and/or prevent new competitors from entering the market.

Moreover, paragraph 1 of Article 50 of Decree 2153 of 1992 does not establish which cost should be used to identify a predatory price: the average cost, the average variable cost or the marginal cost. Said norm is limited to consider abusive *"prices below costs."* For this reason, different theories have emerged that describe the cost parameter that identifies a predatory price. The following paragraphs will provide a brief theoretical framework explaining the theories, and the following section will briefly discuss their applications.

According to classical economic theory, a company makes a profit when it sells above marginal cost. Hence, predatory pricing should be determined considering marginal cost. However, since it is very difficult to determine the marginal cost in real cases, the competition authorities and the doctrine have considered that the cost that most closely resembles the marginal cost is the average variable cost, which corresponds to the variable cost of production, divided by the number of units produced.

Thus, if prices do not cover the company's average variable costs, there is no rational economic justification for it to continue producing, since it is not even covering the variable costs of production. Therefore, if the company holds a dominant position in the market and sells at prices below its average variable costs, this theory states that abuse of its dominant position through predatory pricing should be presumed, unless the company proves that it is minimizing losses.

On the other hand, another theory states that any price that covers average costs (total cost divided by the number of units produced or marketed) should be considered legal, even if it implies the expulsion of one or more competitors from the market, since this price is generating profits and production efficiency should not be punished.

Although the SIC has accepted that the cost to be taken into account for the purpose of determining whether or not predatory pricing exists is the average variable cost, when trying to apply this parameter it has encountered industries that have the same production line for different references, which is why it has used the average cost as a reference.

Likewise, by means of the Resolution 36191 issued on November 15, 2002, the SIC, in order to establish the existence of predatory pricing, continued with the analysis of average cost using the following terms:

> *Thus, in the case under study, it was established that the net price at which Clarks chewing gum was sold was below its average full cost during the period of investigation from August 2002 to December 2003. (Author's free translation)*

Now, once the existence of (i) a dominant position and (ii) pricing below the average cost to produce a certain product or provide a service has been verified, the company's intention must be reviewed. In order to be punishable, the purpose of the conduct must be to eliminate competitors or prevent their entry or expansion in the relevant market.

According to the SIC doctrine, the conduct of selling at a price below costs must have a rational economic justification in order not to be illegal, such as for example the sale of perishable products, in order to avoid the loss of the merchandise; when the products are out of fashion or surpassed by a later, more technologically advanced generation.

> *In fact, there is no different economic condition that justifies having a product at a loss for more than 12 months in the market, because with it, Adams Company was not only failing to recover the total costs allocated to this line of business, but this predatory situation also generated a cost of opportunity, by not allocating those resources to another line of business that would be profitable. In addition, it is necessary to look at the parallel actions carried out by Adams to accompany Clarks' predatory strategy, such as offering the same presentation, the same flavor and coverage of Tumix's zones of influence.* (Resolution No. 36191 issued by the SIC on November 15, 2002) (Author's free translation).

As can be seen, in order to establish the subjective element of the conduct, the SIC relies on evidence to establish that the conduct had no economic justification, such as, for example, the prolongation of the sale below cost.

Regarding the period in which the Company sells below cost, the SIC, in Resolution No. 30835 of 2004 states: "*[t]he rules of experience indicate that whoever wishes to eliminate its competitors by means of price, apart from making a nominal decrease in the price of its product, requires more than one month to weaken and eventually bankrupt its rivals."*

By definition, promotions are temporary in nature. Therefore, it is possible to have promotional campaigns that imply having a price below the average variable costs. But as indicated by the SIC in the aforementioned Resolution, what cannot occur is that a company is below costs for long periods, since this is indicative of a strategy aimed at eliminating competitors or preventing their entry or expansion.

Although consumers are favored by the initial price drop, their interests will be violated when the dominant firm manages to acquire the power or market share it was hoping for. Once competition is destroyed or diminished, it is able to raise prices above the level they would have under competitive conditions, in order to obtain so-called monopolistic profits, which will allow it not only to make up for the losses it incurred during the period of the price drop, but will also bring it extraordinary profits over time.

C. Concept of Regional Predatory Pricing

This conduct is typified in numeral 5 of Article 50 of Decree 2153 of 1992, according to which it constitutes abuse of dominant position *"[t]o sell or provide services in any part of the Colombian territory at a price different from that offered in another part of the Colombian territory, when the intention or effect of the practice is to diminish or eliminate competition in that part of the country and the price does not correspond to the cost structure of the transaction."* (Author's free translation).

The conduct of regional predatory pricing, very similar to "dumping," has the same connotations as the general practice. However, in this case the dominant company leverages or finances the predatory price in the region where it intends to produce the anticompetitive price, with the monopolistic profits it obtains in the rest of the country

The explicit treatment of regional predatory pricing in Decree 2153 of 1992 is probably due to the difficulty of communication between the regions of our country, which could facilitate or encourage the application of this type of anti-competitive practice.

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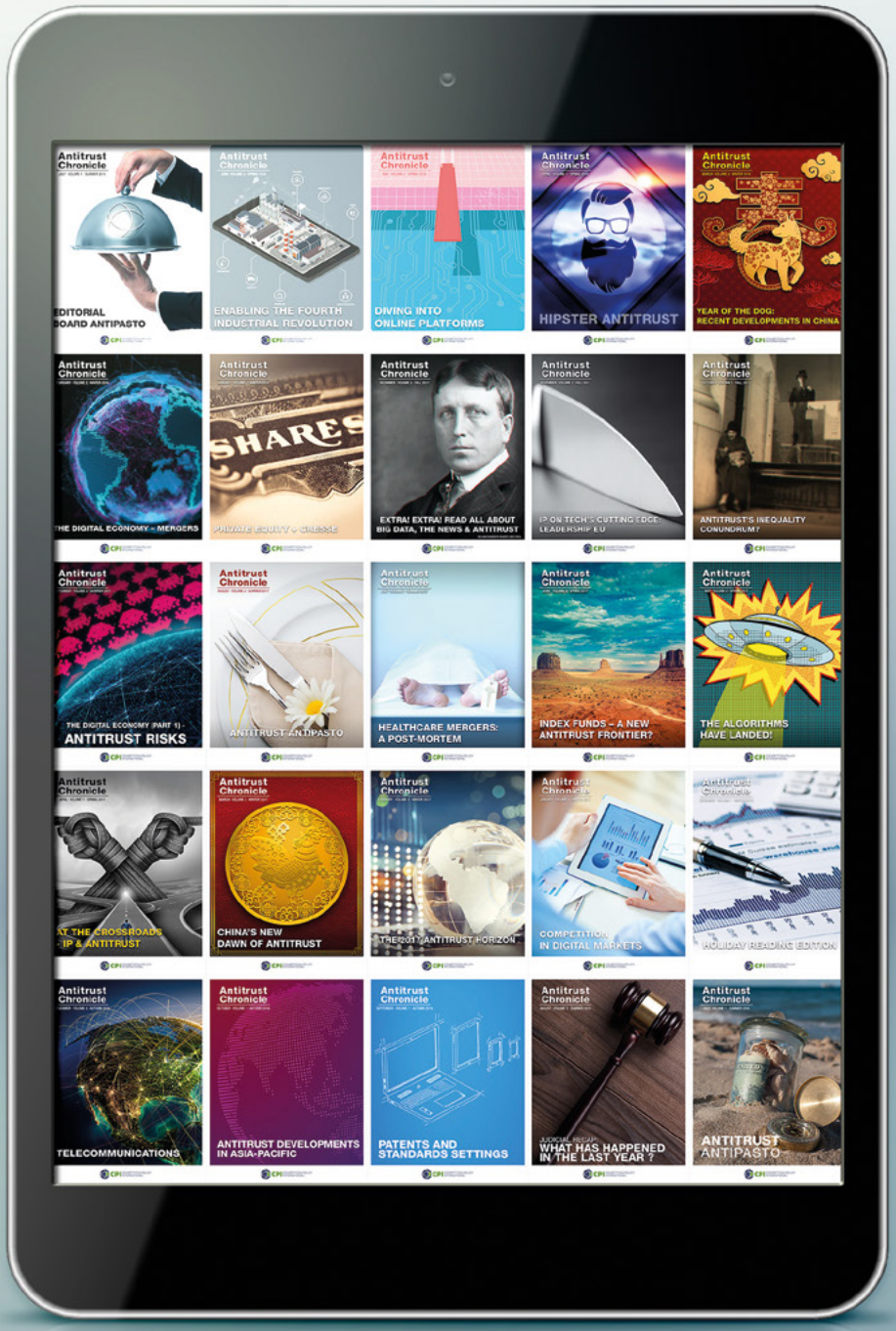


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