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Competition for-the-market

Competition for the market: the case of “Puerto Nuevo”

- Contribution from Colombia* -

1. This contribution intends to study some key issues regarding the concept of “Competition for -the-market” in the context of antitrust enforcement. Competition and regulatory notions are integrated into the analysis, as well as a relevant case for example. The case “Puerto Nuevo”, to which we refer all through the document, appears pertinent to the subject matter because it highlights several considerations regarding the evolution of market dynamics over time. “Puerto Nuevo” raised both theoretical and practical enforcement challenges related to the structure of the market; first, with the interactions among firms competing for the market, and later on, with the competition in the market that was constituted with a concession. Issues regarding merger review in the context of a concession, vertical and horizontal integrations, the debate between natural monopoly vs. dominance of the firm that was granted the concession and the following exclusionary behaviors against market agents are all at the heart of this case.

2. This contribution is organized as follows. First, we will present some background words on the facts of the case. After that, we highlight the enforcement challenges (questions and problems) raised by the case throughout the stages of the administrative antitrust procedure. The three-enforcement challenge that we are going to present are, first, the analysis of the Antitrust Division related to the dynamic market; second, the analysis of the Competition Authority in merger case vs. an antitrust enforcement; third, the risks that can be prevented by the Competition Authority in a merger process which involves participants from different links in a value chain. Finally, we present our analysis and conclusions.

1. The case

3. The Antitrust Division initiated an investigation to determine if PNSA, as concessionaire of a public port, had abused of its dominance by denying the access to the public port to multiple users. In addition, the Antitrust Division started an investigation against PRODECO, a company that is shareholder from PNSA and is dedicated to the coal exportation. The investigated conduct by the competition authority is related to determinate if PRODECO adopted a system aimed at competition restriction through its influence on PNSA to prevent that coal export competitors could access to the port. Additionally, Antitrust Division began an investigation against the natural people who participated in the conducts.

4. To comprehend this case, it is necessary to consider three elements:

* This contribution was prepared by the Superintendence of Industry and Commerce.

- Competition for the market in a public concession process. The Colombian Government carried out a concession process, looking for an agent that was able to fulfill the design, construction, operation and administration of the port. The societies that could participate in this process should be coal producers.
- The merger process. Once the concession process started, the coal exporting companies that wanted to be concessionaries, presented an integration request to the Competition Authority. At that time, the Authority analyzed the viability of the merger between exporting companies, with the purpose of design, build, operate and administrate the port. The conditions market analyzed by the Superintendence, at the moment of the merger request, changed with the passage of time, which caused that the market conditions were not the same when the port began its operation.
- Competition in the market - The operation of the port. Once the port started its operation, PNSA was made up of companies from the same corporate group, which motivated that these companies denied the access of coal exporting competitors.

2. Background of the case

5. We decided to present this specific case for its circumstances which made it particularly complex. It works as an input to illustrate the importance of time and the consequent dynamism that transforms a market and therefore the Competition authority's work. **PUERTO NUEVO** shows how the assessment of market conditions by the competition authority varied and became more complex depending on the stage of the concession: at the beginning of the concession the Superintendence had to review a merger operation and later on, during the operation, it conducted an investigation in order to determine whether the market agents had infringed any competition law.

6. This section of the paper presents both facts regarding the initial planning of the concession and the public tendering process and then those related to the operation of the port. All of which are crucial to a complete understanding of the enforcement challenges faced by the authority.

2.1. Initial planning and tendering process

7. In 2007 the Government carried out a public tender to award a concession for the design, construction, operation and management of a public port called "Puerto Nuevo". The main purpose of this project was to consolidate in a unique public port for Colombian coal exportation. This port would have direct-loading facilities and exclusive railway access. Thirteen coal exporters expressed an interest in participating. The Government and the thirteen coal exporters decided to sign a memorandum of understanding to join forces with the objective to consolidate in a unique public port for Colombian coal exportation. To that effect, they committed to constitute a new company integrated by all thirteen coal exporters that were interested and to which the concession would be later on awarded.

8. It is important to note, as to the memorandum of understanding, that the signing parties were competitors in the coal exportation activity. For that reason, they asked the Competition Authority (Superintendence of Industry and Commerce) for the competitive assessment of the merger operation. For they would no longer be competing for the market (the concession). The three principal conditions that were put under consideration of the

Competition Authority were (i) the characteristic of public service port, (ii) the general rules regarding access to the port for third parties who were also coal exporters and (iii) the port capacity. During the merger review, five of the companies announced their intention to withdraw from the initial agreement. Under those circumstances the Competition Authority approved the merger of eight out of the thirteen of the initial companies that were interested in the project.

9. Following the merger approval some more companies decided to withdraw from the project as well. By December 2009, only four companies integrated the concessionaire company: PRODECO, CARBONES DE LA JAGUA, CARBONES EL TREORO and CONSORCIO MINERO UNIDO. All of which belonged to the same business group called GLENCORE PLC (or PRODECO GROUP for the purpose of this contribution). This circumstance changed the initial market conditions taking in consideration by the competition authority in the merger evaluation.

10. It is also relevant to acknowledge the fact that the Government included as a term of the concession that the port capacity would be determined by the amount of coal to be exported by the companies which expressed interest. The result of capacity analysis based on thirteen coal exporters that expressed an interest in the concession summed up to 60 million tons per year (Mt/y) for the final phase of the concession (30 years). To build a port with that capacity the Government established an initial investment structured by Take or Pay agreement (ToP) signed by the Interested Parties and the concessionaire.

11. In 2010, Government granted the concession to PNSA (vehicle company in charge to design, build, operate and administrate PUERTO NUEVO). This company was constituted by the four remaining coal exporters (PRODECO GROUP). In 2011, the concession contract was signed. According to the agreement the port would start operation with an initial load volume of 21.4 Mt/y, corresponding to the ToP contract subscribed between PRODECO, its affiliates companies (coal exporters) and PNSA (concessionaire). Additionally, the concession conditions established that port capacity would be up to 32 Mt/y in the initial phase which would allow third-party coal exporters access and it would be a public service port. Finally, in the last phase of the project the port would have a capacity of 60 Mt/y. This last capacity includes the exportations necessity of all the coal Colombian exporters which express interest in export coal by a public port.

12. To recapitulate consider the following about PUERTO NUEVO characteristics:

- Public service port. This element demands from the concessionaire to provide a public service to coal exporters who were willing to pay rates and to accept operation conditions.
- Port capacity. PUERTO NUEVO would have a capacity of 32 Mt/y in the initial phase and a capacity of up to 60 million tons per year (Mt/y) for the final phase of the concession. The port would start operations with an initial load volume of 21.4 Mt/y. Since the initial phase capacity conditions sought to guarantee the exportation from PRODECO and multiple users.
- This port would have direct-loading facilities with conveyor belts. This condition responded to the environmental Government demands.
- Transport from coal mine to the port would be made by train (domestic transportation). Thus, the only access to the port would be by railroad track.

2.2. Port operation and management

13. The principal characteristics of a port in Colombia are delimited by the nature of the service –public or private–, the domestic transport to access to the port –land, waterway or railroad– and the type of the port –multi-purpose or specialized port–. According to the combination of those characteristics each port participates in the market in different circumstances. In the case of PUERTO NUEVO, the Antitrust Division found that this port has special characteristics which made it unique in the mineral coal export transport market because it became an efficient logistics cluster compared to other port services. PUERTO NUEVO, was the only one being public, specialized, with access by railroad and direct-loading facilities in a specific region in Colombia, the region of Ciénaga, Magdalena.

14. There were also conditions that made this port a “node” in an entire integrated coal transport chain. The PRODECO GROUP –shareholder of PNSA– has mineral rights over “LA JAGUA” and “CALENTURITAS” mines. The coal extracted from these mines is transported in its entirety by the railroad administered by “FERROCARRILES DEL NORTE DE COLOMBIA S.A.” (FENOCO). This railway is interconnected with PUERTO NUEVO and is the only way to access this port. Additionally, PRODECO GROUP is one of the main shareholders of FENOCO.

15. As evidenced, PRODECO GROUP’s companies, through their participation as a shareholder of FENOCO and PNSA, integrate the entire coal transport chain from the mine to the export location. Furthermore, PRODECO benefits as a user of the railroad and the port, which made PRODECO an efficient coal exporter for having control of the infrastructure for the coal transport. The theory demonstrate that chains of the different transport nodes generated economies of scales (Jara-Díaz, 2007).

3. Enforcement challenges

16. This apart studies circumstances which represented challenges for the Antitrust Division related to market conditions. The principal challenges that the Superintendencia had to face in the analysis of the case were three. First, the dynamism of the market that produced changes of the agent position (PNSA) during a period of time (2008 – 2017) in the relevant market. Second, the analysis of antitrust conducts in a market that were analyzed before by the Competition Authority in a pre-evaluation merger. Finally, the risk occasioned by the conflict of interest of agents that participates in different links in the value chain of coal exportation.

17. *First situation.* The Authority identified that the conditions of the market varied substantially at the different stages of the concession.

18. *First enforcement challenge.* In order to establish the position of an agent in a relevant market, the Antitrust Division had to perform a dynamic economic analysis that involved a temporary assessment of market definition and the behavior of agents.

19. *Analysis.* The broadness of the object of the concession (design, construction, operation and management of the port) contributed to the definition of the market structure and its conditions. Depending on the stage of the concession PNSA was a participant in a selection process in the first stage, a natural monopolist in the second stage and an agent with dominant position in the third stage.

20. In the initial stage the Government call for the participation of different coal exportation companies with the objective to constitute a concessionaire company to design, build, operate and manage a public port (PUERTO NUEVO). In this stage agents competed for the concession (competition for market), however, all the coal exporters that manifested interest in design, build, operate and administrate a public port decided to join forces with the objective of constitute one company which will be the unique concessionaire. The Competition Authority approved the merger of eight companies that were interested in the project. This situation had as a result that agents interested in the project did not compete for the market but they pursued the constitution of one agent that represented their interests. However, at the moment the concession was granted the concessionaire company only have as shareholders the companies of PRODECO GROUP.

21. In the second stage, PNSA was considered as a natural monopolist because was the only concessionaire that has the obligation of design and build the project PUERTO NUEVO. In this second stage, PNSA designed and built a port according to the exclusive necessities of exportation of PRODECO GROUP, without any consideration of the necessities of any other participant in coal exportation market. This conduct had an important consequence in the market because it occasioned that third party coal exporters would not be able to access to the port. This situation provokes that PUERTO NUEVO did not accomplish the condition to be a public port –access to multiple users–.

22. During the third stage PNSA had a dominant position. When PUERTO NUEVO had entered into operation the Antitrust Division realized that market conditions changed. As a provider of coal export port service, PUERTO NUEVO might face competitive constraints from other ports which had some common conditions. However, the Antitrust Division recognized that PUERTO NUEVO had dominant position in coal export transportation service market in Ciénaga, Magdalena. The dominant position was deducted from PUERTO NUEVO because was the only public port¹ with access by railroad², specialized and direct-loading facilities³ in Ciénaga, Magdalena. These characteristics made PUERTO NUEVO unique in mineral coal export transport market because it became an efficient logistics cluster compared to other port services in the area⁴ which in turn granted PNSA market dominance.

¹ Private ports can only meet the needs of coal exporters to which they are linked.

² Despite potential substitutes in the provision of port services, connection port with domestic transport shows how this category separates the market in which PUERTO NUEVO participates. The environment in which economic agents compete is composed of integrated rail transport logistics and public port node in the geographical area of Ciénaga, Magdalena. If a mineral coal producer has vertically integrated facilities, the price to be paid for transport would be the most efficient. However, many of the possible third-coal exporters did not have access to a railroad. Therefore, transport modalities such as road transport did not constitute an effective source of immediate competition for rail transport modalities. This means that PUERTO NUEVO did not have real competitive pressures that limit the possible restrictive behavior of competition by PNSA. Additionally, interconnection absence with the railroad node limited other public ports capacity to constitute effective substitutes for a PNSA consumer.

³ Ports that even when they are public, they are not specialized in coal exportation at high speeds and have not direct-loading facilities which made these ports less efficient.

⁴ Low elasticity of supply in the downstream market (coal exportation) produces that efficiency for a coal exporter have to derive from cost savings by economies of scale and vertical integration in related markets.

23. *Conclusion of the first challenge.* According to the previous case analysis, the relevant market definition changed over the time. First, the relevant market was delimited to the competition for the market in the concession process. Second, the relevant market definition was limited to the port design and construction by one concessionaire company (existence of a natural monopoly). Finally, when the port went into operation the Antitrust Division analyzed the competition in the market, in this sense the authority took in consideration all the agents that participates in mineral coal's export transportation service market which includes transportation from a mine to a port in a territorial market (Ciénaga, Magdalena).

24. *Second situation.* The circumstances analyzed by the Superintendence at the time of approval of the merger operation changed over time. The Antitrust Division identified that merger analysis made by the Competition Authority was based on an integration by multiple coal exporters before the concession was granted. At time of merger approval, they were eight Interested Parties from different economic interest businesses. At the time of the concession was granted, the merger which had been approved was made up only of companies belonging to the same business group (PRODECO GROUP).

25. This led to the fact that at the time of concession was granted the circumstances were different from those previously analyzed in the merger.

26. *Second enforcement challenge.* Competition authorities might deal with restrictive behaviors in a concession which had been evaluated in a previous merger process. In regarding these cases, the competition authority must analyze whether factual circumstances in a merger process coincide with those in the concession process and a competition restriction scenario. Furthermore, the fact that merger was known does not exclude the possibility that occurs anticompetitive conducts in the future.

27. *Analysis.* Antitrust Division found that these circumstances (participation from a business group) led to PNSA not having incentives to protect multiple competing agents' interests (public nature of service port was a main characteristic of the concession).

28. The fact that a single coal export agent would be in charge of port's designing and building produces negative incentives. The coal exporter in charge for the port's construction had no real incentives to build and operate a public service port bigger than its export capacity, because this would close doors to its competitors to carry out coal exportation.

29. Within the investigation framework carried out by the Antitrust Division, it was intended to determine whether PRODECO and PNSA had incurred in restrictive competition behaviors. In relation to PRODECO, the Antitrust Division sought to determine whether this company would have implemented a system aimed at competition restriction through its influence on PNSA. This influence would have directed to PNSA to prevent coal export competitors from accessing PUERTO NUEVO. For its part, PNSA would have abused its position as a concessionaire of PUERTO NUEVO by having prevented access by third-party coal exporters.

30. The restriction would have developed through three behaviors. First, the limitation of the port's export capacity to the needs of PRODECO GROUP. Second, the design and setting of access conditions which prevented and discouraged third-party coal exporters' entry. Finally, the obstructive behavior through which unfairly denied access requests to the port submitted by third-party coal exporters. All these behaviors have been endorsed and promoted by PRODECO –as a shareholder of PNSA– in order to favor their particular interests as a coal exporter.

31. Export capacity limitations to PRODECO needs is evidenced by the construction of a port which presented limitations for multiple users' access. Port designs exclusively focused on PRODECO's export operation. Therefore, the port could not be granted access to other users as its capacity was full. This led to the port becoming a PRODECO GROUP's privately operated infrastructure, distorting the public nature of the port⁵.

32. Access policies set by PNSA included restrictive clauses which prevented and discouraged third-party coal exporters. This led third-party coal exporters to not meeting the high standards set in the policies or avoid showing up due to port access disincentives. These access policies were not evaluated by the Competition Authority in the merger process.

33. Finally, PNSA influenced by PRODECO would have adopted an obstructive behavior through responses to requests which were submitted by third-party coal exporters. PNSA denied the requests through unjustified responses or with invalid arguments based on the obstructive policies previously adopted.

34. *Conclusion of the second challenge.* We evidence that even the fact that a Competition Authority is involved in a merger process this circumstance does not exclude the possibility that the same authority can investigate a restrictive behavior. The Antitrust Division concludes that factual circumstances analyzed in the merger process does not coincide with those in the concession process and the competition restriction scenario. In fact, merger evaluation involved companies from different multiple business group which could have mitigated the risks. The concession was granted to PRODECO GROUP which had no incentives to protect multiple competing agents' interests. It justified Antitrust Division investigation.

35. *Third situation.* Once the operation port started, the coal exporter (PRODECO) shareholder of the port concessionaire (PNSA) might incur a conflict of interests. It could be more favorable for their private interests to favor their own exportation in contravention of the interests of other exporters. This conflict could even lead to obstruct third-party exporters' entry through denial of access or imposition of disadvantageous access conditions. The conduct would lead to the denaturation of public port service for which it was granted, because it would be based on the private operation of a single agent (PRODECO GROUP).

36. *Third enforcement challenge.* Antitrust Division identified a specific risk which can be prevented in a merger process which involves participants from a different value chain. This relates to joint administration.

37. *Analysis.* The Antitrust Division identified restrictive behaviors were directed through a PRODECO GROUP guideline to favor its particular interests. The conduct was viable due to PRODECO and PNSA joint administration (shared legal representatives and members of the board of directors). Additionally, PRODECO and PNSA signed a back-office contract through which it was possible to directly influence management decisions.

38. In a recent merger which involved a creation of a public port, the Superintendence imposed a conditioning for merger approval (Resolution N. 44482 of 2019). The Superintendence established that the interested parties must guarantee autonomy and independence in Port administration from its shareholders. It is a clear example of structural separation requirement to the assessment that prevents the operator from distorting

⁵ Port activity is one of the nodes within logistic coal export chains. Therefore, the ability to compete in the downstream market (coal exportation) is derived from competitive conditions in the upstream markets (coal exportation transport service).

downstream firms. Those conditions for merger approval were the result of the previous study case like PUERTO NUEVO investigation.

39. *Conclusion of the third challenge.* The results of restrictive conducts analysis cases by the Antitrust Division evidence the risks which could be mitigate by structural requirements imposed in a merger evaluation. More specific, in cases of competition for the market that involves public concessions it is necessary to evaluate the possible impact not only in the concession process but the impact in the competition in the market, where the concessionaire company could distort horizontal and vertical competition. For that reason, it is necessary to implement cooperation between Merger Division and Antitrust Division to analyze case by case the possible antitrust effects when the competitors in a concession process (competition for the market) are integrated in one agent and the impact of that situation in a future competition in the market.

4. Conclusion

40. As of the date of submission of this contribution, there is still no decision from the Superintendent of Industry and Commerce. The procedure advanced by the Antitrust Division has focused on determining whether PRODECO would have implemented a system aimed at competition restriction through its influence on PNSA. This influence would have directed to PNSA to prevent coal export competitors from accessing PUERTO NUEVO. For its part, PNSA would have abused its position as a concessionaire of PUERTO NUEVO by having obstructed third-party coal exporter's access. Additionally, natural people participation who would have executed, facilitated, authorized or tolerated the investigated behaviors is investigated.

41. PUERTO NUEVO case has a particular characteristic. This case shows that markets are dynamic. According to the dynamic aspect in the market analysis, the Antitrust Division identified three essential changes in the market structure in this specific case. In an initial scenario relates to a competition for the market where agents competed for the concession. Once the concession was granted, the concessionaire acts as natural monopoly in the phase of the port design and construction. Finally, when the port started operation, the concessionaire participates in the market as competitor with some specific characteristics that give it a dominance position.

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