

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Global Forum on Competition

**COMPETITION LAW AND STATE-OWNED ENTERPRISES – Contribution
from Latvia**

- Session V -

30 November 2018

This contribution is submitted by Latvia under Session V of the Global Forum on Competition to be held on 29-30 November 2018.

More documentation related to this discussion can be found at: oe.cd/csoes.

Please contact Ms. Lynn Robertson [E-mail: Lynn.Robertson@oecd.org], if you have any questions regarding this document.

JT03440237

Competition Law and State-Owned Enterprises

- Contribution from Latvia -

1. Situation in Latvia with state-owned enterprises (SOE)

1. In Latvia there is a large scale of companies which are state or municipally owned. Some of the SOE do maintain dominant position in the markets even after they have been liberalised. In addition, municipalities in Latvia are very eager to establish their own companies instead of creating an investment promoting environment. However, in Latvia, both state and municipal enterprises are treated just as any other market players and they are subject to the Competition Law.
2. By now, the Latvian Competition Council (the CC) has addressed to nearly all largest SOE – either through enforcement, sector inquiries or through competition advocacy. There have been cases on Latvian Railway, Freeport of Riga Authority, International Airport “Riga”, Lattelecom, the only Latvian natural gas supplier Latvijas Gāze, the largest electricity supplier Latvenergo, the largest postal services provider Latvijas Pasts, etc.
3. This time we would like to bring to your attention two cases against SOE. One is about prohibited actions in Riga passenger transport services market between municipal company and private passenger service provider. The other one covers several repeated cases against the Freeport of Riga Authority for restricting competition in tugboat services market.

2. Competition restrictions in tugboat services in Freeport of Riga

2.1. About the case

4. Freeport of Riga Authority (FRA) is public administrative body that performs both public administrative functions (supervises navigation security, firefighting and pollution prevention, rescue, issues licenses for companies to operate in freeport zone, etc.) and commercial activity in Freeport of Riga. It has distorted competition for more than seven years. The FRA used its market power and also administrative resources in order to ensure competitive advantages to its daughter company’s Rīgas brīvostas flote Ltd. tugboats, at the same time discriminating and creating barriers for private tugboat service provider – PKL flote Ltd. (PKL) – already operating in the Freeport of Riga.

5. The CC investigated and closed three cases against the FRA with infringement, fines and remedies in 2009¹, again in 2011² and in 2015³.

6. The CC found that the FRA after purchasing its own tugboats and starting its commercial activity in the market of tugboat services restricted PKL to provide services to its actual customers, instead forced to choose FRA tugboats, delayed or even refused to sign agreement with PKL without an objective justification, set unreasonable higher requirements for licensing of PKL tugboats, restricted cooperation with certain ship agents and terminals granting part of the customers to the FRA tugboats, as well as applied other discriminatory requirements to prevent private tugboat companies from operating in the port.

2.2. Main challenges and lessons learned

7. One of the challenges was to decide how to reach deterrence in enforcement and stop infringements repeated by SOE. It should be admitted that political influence over SOE and administrative power granted to SOE may negatively affect deterrence and competition authority should take this factor into account.

8. The other issue that concerned the CC was calculation of correct turnover from economic activity conducted by the FRA. To reach deterrence it is also important to take into account realistic turnover. On year 2009 for abuse of dominant position the CC imposed a fine on the FRA in the amount of EUR 64 029 and legal obligations to immediately allow PKL to commence supplying tugboat services in port of Riga. In this case the CC took into account turnover which included income from evident commercial activity. The CC excluded port fees considering *prima facie* these as the income from public activity.

9. On year 2011 the CC imposed a fine in the amount of EUR 149 402 that became almost three times more than previous time. This time the CC took into account net turnover of the FRA including port fees due to its commercial nature separated it from taxes and government (and municipal) fees established by legislative acts. Port fees is also important element of price competition between different neighbouring ports. Although calculated fine was 1% of turnover – almost EUR 450 000 – the CC decreased the fines to amount of EUR 149 402 because the CC considered that tugboat services made less than 10% from whole turnover of the FRA.

10. Even though both decisions were upheld by the Supreme Court, distortion of the competition continued, and the FRA refused to observe obligation imposed by the CC to ensure equal conditions in the port of Riga for private tugboat operator and the FRA tugboats.

¹ <https://www.kp.gov.lv/posts/fines-and-legal-obligations-imposed-on-freeport-of-riga-for-abuse-of-dominant-position-31>

² <https://www.kp.gov.lv/posts/the-cc-repeatedly-fines-riga-freeport-authority-for-abuse-of-dominant-position-52>

³ <https://www.kp.gov.lv/posts/the-competition-council-agrees-to-conclude-an-administrative-contract-with-the-freeport-of-riga-authority-to-immediately-eliminate-distortion-of-the-competition-in-the-rigas-port-423>

11. In the third case in 2015 the FRA committed to cease the infringement voluntarily and the CC decided to sign an administrative contract with it. To deter the FRA from future infringements the CC made some precondition for signing administrative contract:

- Structural remedies anticipated that the FRA ceases to provide commercial services of tugboats and transfers assets to an independent undertaking, thus, terminating discrimination of private tugboat service operators.
- The FRA pays the fine in the amount of EUR 622 363. And it was released from higher fines due to voluntary commitment to comply with serious remedies, also not to initiate court proceedings and to pay the fines.

12. Since 2016 the FRA is restricted to engage in commercial activities that can be fully ensured by the private sector. As before, for the FRA it is not prohibited to fulfil its public functions using its tugboats, e.g. winter navigation, rescue, firefighting and pollution prevention.

13. This shows that in cases against SOE enforcement should try to challenge and prevent conflict of interest if it arises from performance of public functions from one side and commercial activity from another side. It could be reached not only with deterrent fines but also effective remedies.

14. These enforcement cases against the FRA show that to reach deterrence it is important to take into account realistic turnover acquired by SOE economic activities. Conservative approach may lead to under-enforcement and repeated infringement. Remedy will be effective tool to deter from future infringement in case of repeated infringements. If commercial activity of SOE is closely related to performance of its public functions and it creates an inevitable interest to act discriminatory way against other private competitors, effective remedies should be more important to cease conflict of interests and eliminate discrimination implemented by SOE.

3. Restrictions in city passenger transport services in Riga

3.1. About the case

15. On February year 2017, the CC adopted decision⁴ against two passenger transport service providers in Riga municipality – one solely owned by municipality, other – private company (operating approx. on 20% of the routes in the city).

16. In 2013, the municipal company SIA Rigas Satiksme (RS) which provides transportation by bus, trolleybus and tram organized a public tender for provision of special kind (higher standard) of transport services (by minibuses). The winner was private company PS Rīgas mikroautobusu satiksme (RMS) that submitted the lowest price offer and thus gained rights for the next five years to provide minibus services in Riga city in parallel routes with the municipal company.

17. Analysing the harm to competition the CC took into account two facts. Firstly, while concluding the contract, the private carrier was obliged with additional clause to adjust to the price changes of the municipal company. Thus, after gradual price increase

⁴ <https://www.kp.gov.lv/posts/the-cc-imposes-a-fine-on-two-public-transportation-service-providers-for-coordination-of-fares-694>

already two years later the prices (tariffs) of both carriers were on the same level and the agreement price rise was dramatic – about two times.

18. Secondly, if the change of tender conditions would be known during the tender, it might have brought different competitive results.

19. The CC took into account the scope and economic nature of rights transferred to private company RMS through the tender and concluded that it did not act as an agent of municipal company but as an independent operator. The CC came to this conclusion because RMS was entitled to receive payments from passengers directly, etc. It has to be added that the municipal company to a large extent is subsidized by municipality, but the private minibuses service provider is not. Due to this price restrictions were unnecessary.

20. Based on these facts the CC considered agreement between RS and RMS as a forbidden vertical agreement with a horizontal effect. The CC concluded that the price agreement between both companies constituted price restrictions (resale price maintenance). The CC imposed fines on both service providers in amount of 2,16 million EUR. and the CC also requested both undertakings to cease the behavior described in the decision by changing restrictive conditions in the agreement and by setting the new tariff for RMS based on costs.

3.2. Main issues in this case applying Competition Law on SOE

21. This case brings three issues addressing enforcement of Competition Law on SOE's. First, enforcement of Competition Law on agreements concluded through public tender procedure. SOE are usually subject to public procurement procedures and performing this way it's their public functions although concluded agreements after are solely private by nature. The second, is concerning binding obligations that are applied to SOE. Are there remedies in competition authority's disposal if the public administrative body (municipality) issue legislative act to legalize the actions acknowledged by the CC as unlawful and to neutralize effective enforcement of the CC decision? The third issue is concerning the fines applied to SOE. In this case level of fines applied to SOE for setting unreasonable price restriction was essential (1,4% from aggregate turnover of RS). Question might arise about criteria how to evaluate applicability of fine at all in such kind of cases or to determine deterrent amount of the fine for SOE.

3.2.1. Challenges that arise from separation of public functions and commercial activity of SOE

22. First, having regard to the fact that the SOE often combines two functions (public and private) there comes issue where performance of public functions ends, and Competition Law may be enforced. This apply also to public tender procedures that without doubts are performance of public function but the result of this procedure – concluded service, supply or other agreement is private by its legal nature. Such agreements may also contain conditions that restrict competition and should be examined by competition authorities.

23. As it was described, municipal company RS organized a public tender for provision of special kind of transport services (by minibuses) and agreement latter evaluated by the CC was the part of tender documents. The parties defended the argument that conditions applied at the public tender cannot be evaluated through the Competition Law norms as they were evaluated by public procurement legislation and were not addressed as illegal.

24. The CC came to conclusion that such agreement may (also in restrictive way) affect the competition conditions in market. Evaluation through the Competition Law cannot restrict but only strengthen the organization of fair, competitive and transparent procurement procedure according to procurement regulation. The CC in its decision indicated that it is legally to assess the civil agreement and conditions included in the agreement after public tender. That means this does not restrict performance of public functions and effective organization of public procurement.

3.2.2. Challenges that arise from public authority's interventions during enforcement of the CC infringement decision

25. The imposition of a legal obligation is aimed to prevent negative effect of the infringement and to cease the infringement, including the prevention of a further repetitive infringement. Both companies were given 3-month period to change restrictive conditions in the agreement. RMS was obliged to independently calculate and introduce the new tariff based on objective and reasonable (that means cost based) principles in 6 months period.

26. SOE (also municipality owned enterprises) are subject to supervision of public authorities at the same level as private undertaking. It creates a challenge that public administrative body as owner of SOE unduly interfere in SOE commercial activities and may use a public power to grant privileges to SOE's vs. others in relevant market.

27. Although there is infringement decision taken in competition case with remedies there could be a situation that obligation to SOE to enforce decision may be backed by public authority using public powers and making Competition Law enforcement ineffective. And in this case Riga municipality used its legislative power to prevent enforcement of the CC decision. Riga municipality obliged both companies to apply identical tariffs in Riga city.

28. Enforcement of decision is crucial for the individual and general prevention of infringements, equal application of competition rules to SOE and other private companies and overall effectiveness of competition rules to create level playing field. It is shown that application of competition rules with classical competences may lack essentially crucial powers to enforce decisions against public administrative bodies. Competition authorities who lack the powers to act against decisions of public authorities will not have enough powers to challenge such public acts.

3.2.3. Issues and challenges applying sanctions and setting the level of fines.

29. In this case fines set to municipal company RMS for including unreasonable price restriction in the agreement was essential – 2,16 million euros (1,4% of aggregate turnover). Fines were applied for the vertical price restriction. Due to overlapping of routes between both companies, CC concluded that there is also horizontal effect. The CC considered that municipal company RS is initiator of such price restrictions, but RMS passively adapted to the conditions set by the RS.

30. The one of the argument that were brought during investigation was related to risks of passing on the fines to consumers through higher tariffs or municipal budget will suffer due necessity to increase subsidies for RS. It is not the first time when the CC hears such arguments. Similar scenarios appear also in other dominance cases against private companies. In such cases, there is always a risk that fines could be passed to the clients, consumers of dominant company. Equally the CC does not consider such an argument while enforcing Competition Law in this case and setting the fines to municipal company RS.

31. Another party argument was about the RS inability to set the price independently from municipality and obligations to apply such restrictions to RMS. Price of RMS was regulated by municipality setting the price cap, but the losses of RS was compensated from budget. From RS point of view according to public transport regulations and legislative acts, RS was not able to act independently from regulations already in force.

4. Conclusions

32. Overall analyzing the CC cases against SOE it should be remained that such cases in some sense will be more complicated due to different reasons – mixed public and commercial activities that create conflict of interest, advantages and restrictive regulations arising from legislative acts, justification for calculating the correct turnover that include economic activities, how to reach effective deterrence in case of SOE with the fines and remedies.