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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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More documentation related to this discussion can be found at: oe.cd/csos.

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Competition Law and State-Owned Enterprises

- Contribution from Korea -

1. A numerous state-owned enterprises participate in the market making transactions or competing with private companies. In sectors where there is a concern for under-supply or reduced quality of service when only left to the market, the government may intervene in the market through state-owned enterprises to provide public goods or services. Thus, state-owned enterprises are different from private companies that only pursue profits in terms of the rationales for establishment and the reason for taking a part in the market. Nevertheless, state-owned enterprises should also comply with the competition law as a market participant. And if state-owned enterprises commit acts that distort competition, same set of rules should apply as to the private companies. However, the public nature of a state-owned enterprise may be taken into account when judging the illegality, although there are not many cases as such. Below are the specific descriptions of competition law enforcement cases by the Korea Fair Trade Commission (hereinafter, “the KFTC”) against state-owned enterprises and enforcement activities.

2. The definition and scope of a state-owned enterprise is prescribed in the *Act on the Management of Public Institutions*. The said Act classifies state-owned enterprises according to whether 1) the government secures de facto control over decision-making on policies by possessing a certain ratio of shares and/or exercising the power to appoint executive officers, 2) self-generating revenue is equal to or greater than 1/2 of the amount of total revenue. In short, the crucial elements of a state-owned enterprise are whether it is controlled by the government to some degree and/or seeks profits.

3. In addition, a state-owned enterprise tends to hold a substantial competitive edge through laws and regulations or government’s financial support. Sometimes a state-owned enterprise is secured with a dominant position in a particular market by laws, or gains competitive advantage over other private companies due to government’s financial support, tax deduction, etc. Therefore, there is some criticism that the fairness in competition suffers just by letting a state-owned enterprise participate in a market. In this respect, some argue that privileges and support that a state-owned enterprise receives from the government should be provided to the minimum extent necessary for achieving the goal, and discriminatory privileges that cause the distortion in the market should be abolished. The argument is based on facts that the discriminatory privileges can cause inefficiency including X-inefficiency or distortion of market competition.

4. It may be possible to sanction the wrongdoing with competition law when a state-owned enterprise committed a conduct that distorted market competition based on its competitive advantage. Nevertheless, it may not be possible to regulate the market participation itself applying competition law. In fact, the competition law applies to rectify the conduct of harming competition ex post, not to prohibit a company from participating in the market. In this regard, some raised issues over Korea National Oil Corporation, a state-owned enterprise founded to manage and monitor the amount of sales and price of oil, when it started ‘Economical gas station’ project a few years back in Korea. The competitors in gas station market argued that it was unfair and in violation of competition law as the Corporation was able to sell gas at lower price using its capital advantage acquired from the government. At that time in Korea, there was no fierce price competition in the gas

station market due to monopolistic and oligopolistic structure and ‘Economical gas station’ project was intended to reinforce the competition pressure. Despite the competitors’ argument, the KFTC decided that market participation of state-owned enterprise itself should not be governed by competition law.

1. Business entity

5. Competition law prohibits the conduct of a market player restricting competition. Thus, business entities are only subject to regulation. The court defines a business entity as “an entity that does economic activities supplying goods or services and also autonomously makes various decisions related to such activities.” Accordingly, conduct that does not receive benefits in return such as donation or charity work is not subject to competition law. More importantly, when we determine whether a specific entity falls into the category of a business entity, profitability is not to be considered. Moreover, whether the obligation of the business entity is stipulated in the law and the intention thereof is public in nature does not really matter. Accordingly, a nation or local government that acts as an agent of business is also subject to competition law. In fact, the Supreme Court has acknowledged that Seoul city, a local government, was a business entity as a party to contracts for producing, supplying and purchasing subway trains. After all, even though state-owned enterprises are established and controlled by a country or local government, they fall within business entities for the purpose of the said Act in so far as they provide public service and receive benefits in return.

2. Lawful conducts pursuant to other laws

6. However, if an act by a state-owned enterprise was conducted with a special intent of pursuing public interest, it can be excluded from being subject to competition law. In that regard, *Monopoly Regulation and Fair Trade Act* has a provision stipulating that “the Act shall not apply to lawful acts of a business entity or a trade association conducted in accordance with other Acts or orders issued under such Acts”. The court ruled on the meaning of “the lawful acts” in the said provision as “the minimum necessary act conducted in accordance with law or the orders thereof that specifically acknowledges the exceptions of free competition in businesses where restricting competition is reasonable due to their specialty or in businesses where a monopolistic position is guaranteed due to the system of permission, authorization, etc. and a high level of public regulation is required for sake of public interest”.

7. A case in point is that in the past in Korea, National Agricultural Cooperative Federation (hereinafter “the Agricultural Cooperative”) signed exclusive transaction contracts with fertilizer manufacturers. At that time, the Agricultural Cooperative insisted that its conduct was a lawful one grounded on the Agricultural Cooperatives Act, etc. and hence, the competition law should not be applied. The Agricultural Cooperative is a special corporation that is engaged in training business, purchasing business, credit business, etc. for its members after having been established in accordance with the Agricultural Cooperatives Act. The court said that “there is no rationale that stipulates the chemical fertilizer purchase as a business reasonable to restrict competition, or secures monopolistic position of the Agricultural Cooperative, or acknowledges the exception of free competition due to the need of a high level of public regulations in any of the provisions the Cooperative presented”, and thus ruled that the competition law applies to the case. In

other words, it is not that a certain conduct of a state-owned enterprise is automatically immunized from competition law just because the conduct has legal grounds. Immunity is granted only when it is based on the law that specifically approves competition restriction to achieve public interest.

8. Anti-competitiveness of state-owned enterprises is especially problematic in abuse of market dominance and unfair trade practices.

3. Abuse of market dominance

9. Since state-owned enterprises have no intention of maximizing profits, they have less incentive to be involved in exploitative abusive behaviours such as excessive pricing or output control. Still, even after measures such as deregulation and privatization were taken, there are incentives for state-owned enterprises to do anticompetitive conducts such as exclusive transactions to hold on to their monopolistic status.

10. A major example is the Agricultural Cooperative's exclusive dealing on fertilizer purchase, which had already been mentioned above. In the past, there was a policy called "*monopoly system*" in Korea, which allowed the Agricultural Cooperative to buy the whole amount of chemical fertilizer in order to balance supply and demand and stabilize price of chemical fertilizer. This policy was abolished in 1987. Since then, chemical fertilizer has been distributed through either the Agricultural Cooperative or general distributors. Nonetheless, the Agricultural Cooperative still enjoyed the monopolistic status having 93.2% of chemical fertilizer supply.

11. The KFTC has detected that the Agricultural Cooperative signed purchasing contracts with the fertilizer manufacturers with conditions as follows; 1) The manufacturers should trade BB fertilizer, a type of chemical fertilizer, exclusively with the Cooperatives. 2) As for the rest of fertilizers, the manufacturers should sell at a price set by the Cooperative, otherwise the Cooperative can adjust the purchasing price without prior consultation. 3) The manufacturers should not sell the equal or similar fertilizers to those traded with the Cooperative to other distributors. Otherwise the Cooperative can terminate the purchase contract on all type of fertilizers.

12. In this regard, the KFTC decided that the conducts done by the Cooperatives is against the competition law for the reasons as follows: The Agricultural Cooperative signed exclusive contracts with fertilizer manufacturers every year by abusing market dominance which caused restriction of the trading partners' freedom to choose clients, and foreclosure of competitors' market entry and expansion of businesses. All the more, monopoly in the purchase and distribution channels led to the undue restriction of free competition among business entities in the fertilizer retail market.

4. Unfair practices

13. Korea's competition law regulates a conduct as 'unfair practices' that may not be anticompetitive but gives undue disadvantages to the trading partners through unfair transaction means or methods. So far, application of competition law against state-owned enterprises focused more on unfair practices than abuse of market dominance. Their unfair practices may have been stemmed from the environment that was cultivated in the process of enjoying existing monopolistic status rather than from the specific intention or purpose

of abusing market power. For your reference, the KFTC has imposed remedies against about 20 state-owned enterprises for unfair practices between 2015 and 2017. The unfair practices conducted by state-owned enterprises can be categorized into two types as below.

- The case where a state-owned enterprise, which is a large-scale ordering body and purchaser, commits unfair practices such as unreasonable reduction of construction price, non-payment of various construction costs, excessive collection of contract deposits, unreasonable reduction of costs in design changing contracts, non-payment of delayed interests for construction, etc.
- The case where a state-owned enterprise supports companies that are in special relations such as affiliates, companies where their retirees are employed, etc. through discriminatory dealings. Signing private contracts with a company established by their retirees and leasing a property at a lower price than other companies can be an example.

14. The KFTC believes that a rigid enforcement of competition law is essential to rectify abuse of market dominance or unfair practices conducted by state-owned enterprises. It is because unfair practices conducted by state-owned enterprises, etc. have substantial adverse effects on market's competition order as the public sector accounts for a considerable ratio of the economy. Also, unfair practices by a state-owned enterprise, which is a large-scale purchaser or supplier, are highly likely to cause a series of disadvantages not only to the trading partners but also to the SMEs which are at the lower-level of transactions.

15. To respond to this, the KFTC is closely monitoring the market whether infringements of competition law by state-owned enterprises do not occur. At the same time, the KFTC continues to provide trainings through competition law seminars, etc. so that state-owned enterprises can voluntarily improve their unreasonable trade practices.