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ROUNDTABLE ON COMPETITIVE NEUTRALITY IN COMPETITION ENFORCEMENT

-- Note by Costa Rica --

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This document reproduces a written contribution from Costa Rica submitted for Item 9 of the 123rd meeting of the OECD Competition Committee on 16-18 June 2015.

More documents related to this discussion can be found at www.oecd.org/daf/competition/competitive-neutrality-in-competition-enforcement.htm.

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COSTA RICA

1. The principle of Competitive Neutrality as such has not been developed in Costa Rican Law. That principle requires that the Government's commercial activities do not enjoy of competitive advantages over their private sector counterparts.

2. One of the objectives of Act for the Promotion of Competition and Effective Consumer Protection, Law 7472, is the wardship and promotion of the competition process and free concurrence, by preventing, prohibition of monopolies, monopolistic practices and other restrictions on the efficient functioning of markets (Article 1 of Law 7472). On their part, the Commission to Promote Competition (COPROCOM) has the obligation to know, ex officio or by complaint, all practices which constitute impediments or difficulties on free competition. (Article 21, Law 7472.)

3. Given the distortions that may arise in the market if a public company holds advantages over their private sector competitors, the Commission to Promote Competition considers that competitive neutrality is necessary in order to have effective competition in the markets and, to prevent those distortions by affecting its efficiency and the consumers or users. In this manner, the legal and regulatory framework for those businesses owned by the State should ensure equal conditions in markets where state and private sector companies compete in order to avoid distortions. Even if does not correspond to an objective embodied in the regulations, this body has understood from the beginning that it is a basic principle to have more efficient markets and has shown in their opinions regarding the recent opening of the telecommunications markets and insurance.

4. Governments grant to the companies they owned or other public entities, certain advantages for its commercial operation. These conditions can give rise to unequal conditions for the private counterpart, since governments have the responsibility to ensure that the companies they own be successful, obeying to public policy objectives.

5. However some government business enterprises have also disadvantages that prevent them from competing in the same way as the private companies do, to mention some is the inflexibility in hiring and firing human resources, as well as legislation for procurement of goods and services which may limit response times to markets changes in relation to the way a private company would do it.

1. On state trading enterprises

6. In accordance with the definition of the Organization for Cooperation and Economic Development (OECD) of the Commercial State Companies, there are 39 companies identified that participate in the market by buying or selling goods or services[1]. (Annex 1). Most of these companies are concentrated in the financial sector (24), nonetheless, they relate mainly to companies in the financial group of the four public banks[2]. The 24 State financial companies are distributed as follows: 6 in banking, 5 in the marketing of insurances (3 of them as subsidiaries of the same number of state banks engaged in insurance brokerage), 5 as pension operators (3 of which they are subsidiaries of the

[1] Information furnished by the Ministry of Foreign Trade in relation to the work of other work groups of OCDE.

[2] Banco Popular y de Desarrollo Comunal is included, founded by Act N°4351, as No-State public commercial bank.

same number of public banks), 4 investment funds management companies, all of them subsidiaries of public companies and 4 Stockbrokers in circumstances similar to the previous case.

7. In the public services the State has 9 companies that provide postal services, electricity, water, telecommunications, hydrocarbons and railroad transport. In addition, 4 other companies offer other goods and services, such as distillation and marketing of alcohol, lottery, book publishing and open services of radio and television. Finally, two companies are engaged in the Administration of Ports.

8. This type of companies often are in public services such as energy, transport and telecommunications, whose public service is of great importance to large segments of the population and other parts of the business sector. Currently, several State commercial enterprises still maintain monopolies among them we have electricity transmission and the purchase of electricity from private generators, distillation and alcohol marketing, distribution of hydrocarbons and work injury insurance and of vehicles which is mandatory. In all other public sectors, public corporations compete with private companies.

9. With respect to State commercial banks, the decree of nationalization of banks issued in 1948 created a legal monopoly in the market for public deposits. This represented a restriction of access to these deposits, which coupled with the ability to access Central Bank of Costa Rica rediscount (BCCR) from state banks and the explicit guarantee on the return of deposits by the State[3]1, represented a limitation on competitive neutrality in the financial system.

10. Notwithstanding the nationalization of banks only established the public monopoly on deposits and on savings, which opened the possibility for financial intermediaries could mobilize resources through term securities. The role of private banks increased considerably during the eighties, by a reform to the law of the Central Bank of Costa Rica in 1984, which authorized the access of private banks to the rediscount. Then, in November 1995, again the Law of the BCCR was amended allowing breaking the monopoly of the deposits in current accounts existing so far existed in favor of State banks.

2. About Competitive Neutrality of State commercial entities in some sectors.

11. The State guarantee on customer deposits in state banks can be in conflict with the principle of competitive neutrality, because this condition is a disadvantage in raising funds from the public of private banks. The above, on the understanding that the State guarantee can generate a preference among depositors towards public banks, by providing the security for the repayment of the amounts placed in these institutions.

12. It should be noted that the Attorney General's Office has ruled on the coverage of the state guarantee of deposits of other companies within the same financial group of State banks created to provide various services in stock exchange, insurance brokerage and others. In such a manner that the principle of competitive neutrality would be fulfilled in these other services offered by the State bank. On this respect the Attorney General's Office stated: *"1. The brokerage houses of State banks and the INS authorized by Article 55 of the Securities Market Act, N. 7732 of December 17, 1997 are public companies. While these companies are owned by banks and the INS, are separate legal entities, are holders of their own assets. 2. The rule of law determines that the State is the guarantor of another entity while there is a legal rule that so provides. 3. The guarantee that the State has given to state banks and the INS is related to monopolistic activity that in due course were entrusted and, therefore, referred to the sphere of activity that the law on which it is granted regulates and protects. 4. In the absence of a legal rule that expressly granted in favor of its operations the State guarantee, this is not*

[3] As established in article 4 of the Organic Law of the National Banking System, N°1644.

entitled to secure and account for the operations of the brokerage houses created by the State banks and the National Insurance Institute.'"[4]

13. It is worth to mention that there are several Projects of Law that have been submitted to the Legislative Assembly, as the project of law No. 17660 on the System of Insurance, Deposits and Banking Resolution, in order to improve the competitive neutrality of the financial system as regards, inter alia, the state guarantee on deposits in state banks. These projects seek to replace the State guarantee for a system for bank deposit insurance, which is paid by all commercial banks.

14. Additionally, an example of the principle of competitive neutrality, even if it has not been established by any standard, it has been considered in the development and opening of new markets in the financial sector in recent years, indicated in Article 41 of the Law of Workers Protection No. 7983. This law creates a mandatory supplementary pension scheme, which is set out by the above mentioned Article a State guarantee on the contributions of workers, regardless of whether it is public or private entities.

15. Regarding the insurance market, with the Law of General Insurance of 2008, the opening of a market was given in which the National Insurance Institute (INS) was a monopoly since its creation in 1924. This institution holds a monopoly on Labor Risks Insurance and the mandatory auto insurance. Additionally, the INS kept the Costa Rican State guarantee on the insurance operations of the entity.

16. Another advantage that the legislation gives to the INS over its competitors, it is stipulated in Article 7 of the General Insurance Law No. 8653 which states: *"Under the principle of unity of the State, both the Central Government and other institutions of the public sector recognize the INS as the only insurance company in the State. The State contracted directly with the INS all necessary insurance to satisfy their needs, provided that the INS offers more favorable conditions considering premium deductible, coverage and exclusions, as well as the quality of financial support and reinsurance support.* "However, there is evidence that some public institutions buy insurance with other insurers, in view of best offered conditions.

17. Also in 2008, the General Telecommunications Law No. 8642 was enacted, which completed the opening of the telecommunications sector to the competition, this sector was a monopoly of State-owned Costa Rican Electricity Institute (ICE).

18. Since its origin was intended that the opening in this sector would give competitive neutrality. Thus, the Free Trade Agreement between Central America, the United States and the Dominican Republic approved by Law No. 8622 of November 21, 2007 that introduced the process of opening of telecommunications in Costa Rica, contained in Chapter 13, several provisions concerning that the country will supply telecommunications services on terms and conditions no less favorable than those established or granted by current legislation. Specifically in reference to the mentioned chapter which contains -in point 13.7.3- the commitment that neither party to the Treaty grants "*to any supplier of public telecommunications services or to a supplier of information services, a more favorable treatment than that accorded to a like suppliers of the other Party on the ground that the supplier receiving more favorable treatment is owned, total or partially, by the national government of the Party ".*

19. Similarly, the General Telecommunications Law No. 8642 has among the ruling principles, Article 3, the following:

> *"f) <u>Effective competition:</u> establishing appropriate mechanisms to ensure that all market operators and providers compete on equal terms in order to ensure the greatest benefit of the inhabitants and the free exercise of constitutional law and freedom of choice. g) <u>Non-</u>*

[4] See document C-212-2000 dated September 5 2000 from the General Attorney's Office of the Republic

discrimination: treatment no less favorable than that accorded to any other operator, supplier or user, public or private, a service similar or equal telecommunications.

20. On the other side the Law for the Strengthening and Modernization of Public Entities of the Telecommunications Sector, No. 8660 was issued, with which a number of restrictions were removed in relation to hiring and procurement of goods and services and the like, as public companies had and which put them at a disadvantage against private companies. This law incorporates, in its Article 18 a provision which established that when the ICE and its companies act as operators or providers, in national competitive markets of telecommunications services and electricity, these will be subject to the payment of income and sales taxes. In other cases, the exemptions granted under Decree Law No. 449 of April 8, 1949, as well as any other which gives them their order will remain in effect.

21. Notwithstanding the foregoing, during the following years of the opening and with the startup of new companies a number of facts presented at the local government level that prevented or delayed the installation of telecommunications networks especially from the incoming companies. Situation that contrasted with the local operator that had an standard that allowed it to exercise its right to use squares, streets and other public places, to establish and take advantage of the necessary network for the telecommunications services.[5]

22. The courts of the country finally came to solve the problems encountered, ruling that since the opening of the telecommunications market, the ICE stops operating as a public company with monopoly powers but to do it in terms of private law and competition, indicating:

> *"The previous legal framework, in the opinion of this Court, necessarily lead to the conclusion that, in the context of an open telecommunications market and competitive as it exists today, ICE can no longer be perceived as a gifted operator of privileges or exorbitant powers of public law, but it becomes as other commercial player, that is involved in this activity invested with the ability to private law that recognize ordinal 1 and 3.2 of the General Law of Public Administration (LGAP) and subject to regulatory telecommunications law as any other operator or provider. This, as far as concerns under examination leads inevitably to the conclusion that the ICE is not excused to fulfill as are not other operators and suppliers- with all regulations pertaining to urban planning, the time to deploy your telecommunications network and the entire infrastructure required for this, including the need to request and obtain the corresponding municipal building permits required. Understanding this otherwise imply that institution recognize more favorable treatment than that granted to other operators and suppliers, in open contradiction to the principles of openness and competitiveness clearly enshrined in the legal system of the subject and which We have mentioned previously. Indeed, the various exclusive and excluding powers previously exercised by the Institute only made sense for the purpose of carrying out full control hitherto exercised by the State in the field of telecommunications; today, its continuation would only distort space to non-discriminatory competition embodied in the relevant legislation and put our country in terms of breach of international commitments previously mentioned ... "*[6]

23. The Constitutional Court also ruled in relation to the obstacles imposed by local governments for the development of networks, especially new incoming companies, stating:

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5 Law that regulates rates and conditions of Telecommunications Services of ICE, No. 3226, October 28, 1963.

6 Statement of the Sixth Section of the Contentious Administrative Court and Civil Finance Court in judgment number 86-2012-VI at sixteen hours of May twenty first two thousand twelve, resumed in the judgment 00056-2014-III, of February 12th, 2014 by the Administrative Court, Section III.

> *"One consequence of this is that the interests of any decentralized Costa Rican public entity, as might be the municipalities can not take precedence over the clear public interest in telecommunications infrastructure thereby declared, expressly, by the national legislature through a law that expresses the general will (Articles 105 and 121, paragraph 1, of the Constitution), which must prevail over the interests of local, given that municipal autonomy does not allow municipalities to escape what has been declared interest of national character, otherwise territorial autonomy is perverted transforming municipalities in micro states, abstracted from the inter-subjective direction or guardianship may exercise the State, through the constitutional bodies, by issuing laws valid and effective conclusion of international agreements and treaties by the executive and approved by the Legislative Assembly (Articles 7, 121, subparagraph 4°, and 140, subparagraph 10° , of the Political Constitution ". "Under this intelligence municipalities must provide certificates of land use for the construction and installation of telecommunications infrastructure in any zoning area of the canton, so there is no requirement that the Regulatory Plan or Zoning Regulations preexisting -in case these exist-be amended, modified or added to regulate a specific area to locate the telecommunications infrastructure. For the location of the infrastructure sufficient to meet the technical requirements and location set by national legislation and regulations of the Executive Power or specific municipalities".*[7]

3. Alcohol distillation and Marketing

24. In relation to the market of alcoholic beverages, the National Liquor Factory (FANAL) holds a monopoly in the production, processing and marketing of ethyl alcohol for liquor production purposes as required by Article 443 of the Tax Code of 1850, as stated:

> *"Article 443- Are stagnant items, spirits, alcohol and all alcoholic drinks made in the country, whatever the process used to be obtained and the name by which it is designated. From the above the exceptions are beer, wines produced with natural fermentation of fruits which alcohol content does not exceed twelve percent (12%), and alcoholic preparations mixed with foodstuffs such as eggs, milk, sugar and cornstarch, provided that these products are subject to special regulations. The Ministry of Economy, Industry and Commerce shall be the entity responsible of regulating the production of alcohol and will be the body responsible for issuing the policies of this activity, in accordance with the following sector scheme: a) The production and use of ethyl alcohol for liquor production and industrial purposes and the preparation of raw rums for national consumption and for exports, shall lie on the National Liquor Factory, who will regulate the activity according to the current legislation."*

25. The rulings C-397-84 of December 19, 1984, C-076-96 of May 15, 1996 and C030-1999 of February 2, 1999 and OJ -005 to 2000 of January 21, 2000, all from the Attorney General's Office, they have come to clarify the scope of that monopoly. In such pronouncements it states that it is clear that the alcoholic drink produced in the country, either by individuals or by the factory itself, is subject to the condition rather stagnant, meaning it, according to the Dictionary of the Royal Spanish Academy, a well the free course is prohibited, "granting its sale to individuals or entities", in this case, the National Liquor Factory.

26. It is through a reform of the tax code that allowed the factory to "lease" the activity of liqueurs, to those to whom it gives them a concession. So that there are entry barriers to manufacture or produce distilled spirits in the country. On the one hand because the "manufacturing" is a FANAL monopoly and on the other side because to "prepare" these drinks it is required, first the lease or concession from the State enterprise, and then of the ethyl alcohols that can only be acquired from it, which ultimately results its competitor in the sale of spirits, rums and other distilled beverages.

[7] Res. Nº 015763-2011, Constitutional Court of the Supreme Court of Justice. San José, at nine hours forty six minutes of November sixteen two thousand eleven.

4. Tools of the Commission to Promote Competition

27. The competition law included a number of exceptions designed to protect State monopolies and concessionaires of public services, a concept that included some State commercial entities. The interpretation rendered by COPROCOM about that rule was always at its most narrow sense, meaning, considering that they were exempt from the rules of unique competence and exclusively in relation to the public service they provided and/or the monopoly good or service. In such a manner that the Commission to Promote Competition has investigated several State companies[8] for alleged anti-competitive practices and to date has sanctioned the following:

- Five pension operators of public character by a collusive agreement (in convergence with two private operators who were also penalized)
- A company providing electricity service in a given geographical area, limiting access to an essential facility necessary for the provision of telecommunications services.
- The State Insurance Company for introducing deliberate barriers to exclude competition.

28. Two State Banks have also been fined for refusing to provide information in a proceeding in which they were investigated, arguing that the request was "banking secrecy". Although they went to the courts, the sentences of both cases were issued in favor of the Commission to Promote Competition, through which they were compelled to furnish the requested information and pay the fine imposed.

29. On the other hand, it is important to add that the weakness of Law N°7472 on the number of sectors exempted from the competition rules could be overcome with the Law on Ratification of the Association Agreement between Central America and the European Union, Law N° 9154, effective from July 2013, which includes provisions that would expand the scope of the competition law by providing in Article 280 referred the "Public Enterprises and Enterprises entrusted with special or exclusive rights, including designated monopolies" the following:

> *"1. Nothing in this Title prevents a Republic of the Central America Party or a Member State of the European Union to designate or maintain public companies, enterprises entrusted with special or exclusive rights or monopolies according to their national law. 2. "The entities referred to in paragraph 1 shall be subject to the laws of competition insofar as the application of such laws do not obstruct the performance, in law or in fact, of the particular tasks assigned to them by a Republic of the Central America Party or by a member of the European Union. "*

30. This would mean that the Commission to Promote Competition could investigate and punish, as the case may be, any conduct performed by the monopolies or State enterprises that affect competition and that are typified by the regulations. However, if the behavior that affects competition is one that is allowed for that company under a special law, such a rule would be above the Law N° 7472 and would not be possible for the Commission to Promote Competition to sanction through its own powers. It is noted that this body has no powers other than those granted by law.

31. The Commission to Promote Competition may issue an opinion pointing out the distortions found in the market and its effects to promote reforms. One mechanism that has been used in a preventive way is to render an opinion in relation to the projects of law that may reduce the competitive neutrality in the market. The most recent cases are related to the opening of the telecommunications market and insurances, in which the competitive neutrality was advocated, as well as eliminating barriers to State-owned enterprises in the areas of recruitment.

[8] The National Liquor Factory (FANAL) has been subject to several investigations for alleged anti-competitive practices, which were not finally proven so cases have been filed. Also investigated were two state banks for alleged tied sales, which ultimately were not sanctioned by unverifiable behavior.

6. Application of the Law on Competition to State and public enterprises.

32. It should be noted that the Commission has found no difference in the enforcement of competition between State commercial companies and private companies, beyond the exceptions that the legislation contemplated in the past, and to date has not experienced pressures to file any research involving government property.

33. Likewise major differences in behavior could not been found that both types of companies may make. The preceding despite the recent opening in the insurance and telecommunications markets caused that State Commercial Companies formerly occupied dominant positions in the market which led to be investigated and, even have been at some time, already sanctioned for relative monopolistic practices.

34. Moreover, the legislation does not give the State Commercial companies any advantage in reference to the defense for anti-competitive conducts, the standard and the burden of proof apply equally to public and private sectors. Similarly, on the issue of sanctions the same variables that are considered for the private sector are analyzed. An example is the fine imposed on pension operators by agreement on the fees charged, the highest fines were applied to two State companies, because of their increased market participation, which implied a greater benefit from the anti-competitive agreement.

35. Due to the fact that State trading enterprises generally enjoy autonomy in their actions, this at Constitutional level, they are not subject to directives from the Executive Power, that has allowed them to be seen as independent companies and competitors among themselves, both in the analysis of cartels and merger control.

36. The deterrent nature of the fines imposed on State enterprises does not vary from that applied to private entities. The independence of those companies from the Executive Power, both in their actions as in relation to the development and management of its budget, leads to sanctions once deposited, these can not be claimed or reimbursed through other means.

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ANNEX 1: PUBLIC ENTITIES BY SECTORS

1. Financial Sector

1.1 Banking

Banco Crédito Agrícola de Cartago (BCAC)

Banco de Costa Rica (BCR)

Banco Nacional de Costa Rica (BNCR)

Banco Internacional de Costa Rica S.A. (BICSA)

Banco Hipotecario de la Vivienda (BANHVI)

Banco Popular y de Desarrollo Comunal (BPDC)

1.2 Insurance

Instituto Nacional de Seguros (INS)

Banco de Costa Rica. Corredora de Seguros S.A

Banco Nacional Corredora de Seguros S.A

Bancrédito Sociedad Agencia de Seguros S.A

INSurance Servicios S.A

1.3 Pension operators

BN Vital Operadora de Pensiones Complementarias S.A.

Banco de Costa Rica. Planes de Pensión S.A.

INS Operadora de Pensiones Complementarias S. A.

Operadora de Pensiones Complementaria y de Capitalización Laboral de la CCSS, S.A

Banco Popular Operadora de Pensiones Complementarias S.A.

Vida Plena Operadora de Pensiones Complementarias S.A.

1.4 Administrative corporations of investment funds

BCR. Sociedad Administradora de Fondos de Inversión S.A.

Banco Nacional Sociedad Administradora de Fondos de Inversión S.A.

INS Sociedad Administradora de Fondos de Inversión S.A.

Sociedad Administradora de Fondos de Inversión del BPDC S.A

1.5 Stock brokerage stores

BCR Valores Puesto de Bolsa S.A.

Banco Nacional Valores S.A.

INS Valores S.A.

Popular Valores, Puesto de Bolsa S. A.

2. Public Services

Correos de Costa Rica S.A.

Instituto Costarricense de Electricidad (ICE)

Instituto Nacional de Acueductos y Alcantarillado (AYA)

Compañía Nacional de Fuerza y Luz

Empresa de Servicios Públicos de Heredia (ESPH)

Junta Administrativa de Servicios Eléctricos de Cartago (JASEC)

Radiográfica Costarricense S.A. (RACSA)

Refinería Costarricense de Petróleo (RECOPE)

Instituto Costarricense de Ferrocarriles (INCOFER)

3. Other goods and services

Fábrica Nacional de Licores (FANAL)

Junta de Protección Social

Editorial Costa Rica

Sistema Nacional de Radio y Televisión S.A.

4. Management of ports

Instituto Costarricense de Puertos del Pacífico (INCOP)

Junta de Administración Portuaria y de Desarrollo de la Vertiente Atlántica (JAPDEVA)