

# STATE-OWNED ENTERPRISES AND COMPETITION: EXCEPTION TO THE RULE?

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## **Abstract:**

The regulation of state-owned enterprises (“SOEs”) presents both traditional and unique challenges from a competition perspective. SOEs seldom seek to solely maximise profit and are often instructed to pursue public interest goals which can be contrary to profit maximisation. The combination of profit and non-profit objectives as well as other aspects can increase the incentives and ability of SOEs to act anti-competitively. However, certain international jurisdictions make specific provisions under which anti-competitive behaviour by SOEs can be justified and exempted from competition laws, or prevented altogether.

The purpose of the paper is to examine the appropriate framework for assessing competition involving SOEs. This includes an evaluation of the ‘competitive neutrality’ framework adopted in most developed countries. A closer examination of the EU and US competitive neutrality frameworks is also undertaken with the view of determining the provisions under which anti-competitive behaviour can be exempted from competition policy. The final area of focus is an assessment of South African approach including key case, and the identification of key policy questions for South Africa.

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## I INTRODUCTION

Antitrust law was originally developed in the United States in an attempt to reduce the ability of aggressive private firms acting anti-competitively against smaller firms.<sup>2</sup> US antitrust law originally did not cover state-owned entities (“SOEs”) as it had limited state ownership.<sup>3</sup> However as antitrust principles were adopted by more statist countries the approach to SOEs evolved. For instance, prior to signing the Treaty of Rome, a number of EU businesses in important sectors were state owned and received preferential treatment during public procurement processes.<sup>4</sup> Countries started to recognise that anti-competitive acts by SOEs are as harmful to competition as those acts performed by private firms. The signing of the Treaty recognised the need to remove potential anti-competitive conduct caused by the preferential treatment given to SOEs and level the playing field between them and private firms. There has been a growing recognition that SOEs, just as private firms, can behave anti-competitively. Thus SOEs are subject to competition law and policy in the majority of countries with minor exceptions.<sup>5</sup> Some of the key international abuse of dominance cases have involved SOEs or semi-state owned enterprises (such as Deutsche Post and US Postal Services). This is also true for South Africa where key abuse of dominance cases have involved SOEs such as Telkom and South African Airways.

This paper deals with the question of how competition law and policy should treat SOEs relative to other (private) firms. For instance, should SOEs be treated less harshly by competition authorities because of the public interest mandates imposed upon them and not being fully profit maximising? Or should SOEs perhaps be held to higher standards because they are responsible for the provision of services that are deemed to be of national interest?

The paper is structured as follows. Section 2 will discuss the reasons why SOEs may have a greater incentive and ability to act anti-competitively relative to private firms. Section 3 evaluates the international approach to SOEs and competition law and policy, including the concept of competitive neutrality. Section 4 investigates the South African experience and competition policy approach to SOEs. Section 5 concludes and provides a high-level assessment of the South African approach and specific policy questions raised by international experience.

## II STATE-OWNED ENTITIES: ABILITY AND INCENTIVES FOR ANTI-COMPETITIVE BEHAVIOUR

Economic theory usually assumes firms operating in a competitive market are profit-maximisers. It is held that most private firms operating in highly competitive markets generally act in accordance to profit maximisation theory. However, state-owned entities (SOEs) do not always conform to the same principles.

SOEs seldom seek to solely maximise profit and are instructed to pursue goals which can be contrary to profit maximisation. Such goals might include universal service obligations whereby a particular service must be provided to all individuals irrespective of whether it is profitable, or profit maximising, to do so. Unlike private firms whose sole interest is to attain

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<sup>2</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 3.

<sup>3</sup> *Ibid.*

<sup>4</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 5.

<sup>5</sup> SOEs are specifically exempted from competition law and policy in the United Arab Emirates. See E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 11.

maximum profit, SOEs may find some value in increasing revenue even if costs increase such that there is no, or even a negative, effect on profits. Even though SOEs will place some value on the profit generated from anti-competitive behaviour, it might find it optimal to engage in anti-competitive behaviour to increase its revenue or volume. Profit and non-profit maximisation incentives as well as state support results in five reasons why SOEs might act more anti-competitively relative to private firms. These are explored below.

First, SOEs may be created under a legal framework which imposes certain public service obligations on it such as maintaining services in rural areas or providing essential utilities at affordable rates.<sup>6</sup> As a result, the SOE is likely to place less emphasis on profit maximisation relative to private firms and greater value on meeting its obligations. As the obligations are state imposed, capital investment and operating costs would in certain instances be funded from the fiscus.<sup>7</sup> These obligations in conjunction with state support may provide the SOE with a greater incentive and ability to maintain prices below costs over a longer period of time relative to a private firm and consequently exclude them from the market.

Second, certain countries have efficient public procurement rules to encourage a competitive bidding process. Nevertheless, SOEs often continue to receive preferential treatment from governments as a natural consequence of the interrelationship. In addition, SOEs benefit from the information asymmetries associated with public procurement processes by having access to information or data that is not available to the private sector. The SOEs can exploit these asymmetries by tailoring their offerings to meet government's requirements more closely and so have a greater ability to foreclose private firms from the market.<sup>8</sup>

Third, SOEs which value both profit and revenue may have a greater incentive to predatory price relative to private firms.<sup>9</sup> The public service obligations imposed on SOEs will incentivise it to overinvest in capital to ensure these obligations are met. Overinvestment in capital is likely to reduce marginal costs below the level it would have been if investments were performed efficiently.<sup>10</sup> Overinvestment and the associated lower marginal costs will increase the likelihood that the SOE would price below what the "competitive" level, or even costs, would otherwise have been. Furthermore unlike private firms, SOEs may have the ability to carry losses over a longer time period because they can either (i) recoup losses in adjacent markets where they have a statutory monopoly or (ii) never recoup the losses.<sup>11</sup> Consequently, efficient private firms may be excluded from the market (or from entering the market) or at a minimum have a relatively lower market share than if prices were at the competitive level.

Fourth, SOEs may contravene competition law as a result of state measures. Particularly, once the state has conferred exclusive rights upon an SOE to operate as a monopoly in a market, the SOE may extend this monopoly to ancillary activities in adjacent markets.<sup>12</sup> For example, a SOE given a monopoly position in the provision of a telecommunications network may also be tasked with setting standards for devices that may be connected to the

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<sup>6</sup> A. Capobianco and H. Christiansen, (2001). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 8.

<sup>7</sup> OECD, (1999). Promoting Competition in Postal Services, *Best Practice Roundtables on Competition Policy No. 24*, at p. 55.

<sup>8</sup> Capobianco and Christiansen (2011) Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 6.

<sup>9</sup> A successful predation case relies on (i) whether a company lowers price below costs with the aim to exclude its rivals and (ii) has a realistic chance of recouping the sacrificed profits.

<sup>10</sup> G. K. Leonard, (2011). State-Owned Enterprises: Incentives, Efficiency and Antitrust. *NERA Economic Consulting*, p. 2.

<sup>11</sup> SOEs have lower incentives than private firms to recoup losses through price increases because they can fund the losses through direct fiscal support.

<sup>12</sup> OECD, (2009). Roundtable in the application of antitrust law to state-owned enterprises – European Commission. *Working Party No. 3 of the Competition Committee*, p. 8.

network.<sup>13</sup> Should this monopoly start competing with suppliers of these devices in the downstream market, it often has the incentive and ability to deem its devices suitable for connection, while concluding that none of its competitors' devices meet the requirements. Thus the SOE is able to arbitrarily determine who is able to compete in the market for supplying these devices.<sup>14</sup> The extension of its monopoly position into contestable markets not only raises barriers to entry, preventing entry efficient firms from entering a market, it also leads to the exclusion of efficient firms from said market.

Fifth, an SOE might enjoy certain privileges and immunities that increase its incentives to engage in anti-competitive practices. These may include locked-in equity<sup>15</sup>, specific tax exemptions and special/exclusive rights. Locked-in equity reduces the ability to transfer control/ownership of SOEs and in some instances exempts the company from paying any dividends to its shareholders. The absence of this obligation reduces its incentives to earn a reasonable return and results in the SOE's management having less incentive to operate the business efficiently.<sup>16</sup> Specific tax exemptions may reduce an SOE's operating costs below that of a private firm allowing it to set prices below that of an equally efficient competitor and exclude them from the market. Special/exclusive rights assigned to an SOE can therefore exclude other competitors from the market and create an environment conducive to anti-competitive behaviour. These privileges and immunities, individually and collectively, provide an SOE with the ability to act anti-competitively and exclude its competitors from the market.

These are five prominent reasons why SOEs might have a greater ability and/or incentive to act anti-competitively relative to their private competitors. The recognition of this has prompted greater scrutiny of SOEs by competition authorities.

### III INTERNATIONAL APPROACH TO SOES AND COMPETITION

Historically, SOEs were in some instances exempt from competition law as their behaviour was not considered to form part of the "market economy".<sup>17</sup> For example, the US Postal service enjoyed antitrust immunity until the *Flamingo Industries* case in 2002.<sup>18</sup> More countries started to recognise that SOEs have greater incentives and abilities to act anti-competitively and have moved to either privatise or introduce competition into these markets. Many SOEs are still active participants in a number of industries and often have to compete with private firms. However, some of these SOEs are still subjected to the public interest mandates entrusted to them prior to corporatisation and as such continue to pursue both profit and non-profit objectives.<sup>19</sup> The question then arises to what extent competition law should apply to SOEs as well as whether certain actions should be exempt from competition litigation? We provide an overview of approaches to SOEs and competition internationally as well as specific country examples of approaches adopted by different countries in their

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<sup>13</sup> Case C-18/88 RTT v. GB\_Inno-BM [1991] ECR I-5941.

<sup>14</sup> Case C-18/88 RTT v. GB\_Inno-BM [1991] ECR I-5941.

<sup>15</sup> Locked-in equity refers to the nature of SOE ownership. Control of an SOE cannot be transferred as easily as in privately-owned firms and there ownership/equity is locked into the company. See Capobianco and Christiansen, (2011). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 6.

<sup>16</sup> Capobianco and Christiansen, (2011). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 6-7.

<sup>17</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 7.

<sup>18</sup> The US Court of Appeals held that the US Postal service is subject to antitrust law because "Congress has withdrawn the cloak of sovereign immunity from the Postal Service and given it the status of a private corporation" See: *United States Postal Service v. Flamingo Industries (USA) LTD.* (02-1290), at para. 2.

<sup>19</sup> D.E.M Sappington and J.G. Sidak, (2003). COMPETITION LAW FOR STATE-OWNED ENTERPRISES. *Antitrust Law Journal*, vol. 71, p. 479.

application of competition law to SOEs and under what circumstances they are protected from competition law.

## Competitive neutrality and competition

As countries started to recognise the greater incentive and ability of SOEs to act anti-competitively they have moved to level the playing field between SOEs and private firms in an attempt to neutralise any benefits or effects attributable to state ownership. This is known as “competitive neutrality”. According to the OECD<sup>20</sup>:

*“Competitive neutrality [is a] regulatory framework (i) within which public and private enterprises face the same set of rules and (ii) where no contact with the state brings competitive advantage to any market participant.”*

As previously discussed, SOEs may set prices below the competitive level as a result of government mandates and financial support. However, competitive neutrality is aimed at removing any competitive advantages enjoyed by SOEs purely based on their public sector ownership.<sup>21</sup> The implementation of a competitive neutrality framework generally requires an in-depth overhaul of the legislative and administrative environment within which SOEs operate to create a market environment that closely resembles that faced by private competitors.<sup>22</sup> Competitive neutrality approaches can address concerns through the implementation of either *ex ante* or *ex post* competitive neutrality frameworks. *Ex ante* neutrality frameworks deal with neutrality issues through regulations aimed at reducing the ability of SOEs to act anti-competitively. For instance, Australia adopted an *ex ante* neutrality framework whereby any market distortions that arise from a company being publically owned are removed.<sup>23</sup> Australia adopted key competitive neutrality principles in areas such as taxation, debt and regulatory neutrality to remove any net benefits for SOEs.<sup>24</sup> These principles also applied to all levels of government in order to ensure policy coherency at national and state level. The merger control function of competition authorities could also represent an *ex ante* approach that embodies competitive neutrality. *Ex post* competitive neutrality frameworks generally employ competition law as a tool for addressing neutrality issues. While competitive neutrality can therefore be approached in a number of ways, this paper will focus more squarely on competition law and the role of competition authorities where they are provided with a greater or expanded role.

The EU *ex post* neutrality framework is recognised as a good model for other countries aiming to instil competitive neutrality particularly through the use of competition law. EU Member States are subject to the provisions contained within the Treaty on the Functioning of the European Union (“the EC Treaty”). Article 106 of the EC Treaty, formerly Article 86, provides that EU competition law applies to SOEs, including companies given special or exclusive rights, in the same manner as it would apply to private firms. More specifically Article 106(2) states:

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<sup>20</sup> United Nations Conference on Trade and Development. Competitive Neutrality. Available online: <http://unctad.org/en/Pages/DITC/CompetitionLaw/ResearchPartnership/Competitive-Neutrality.aspx> [Last accessed: 14 August 2014]

<sup>21</sup> Australian Productivity Commission. About competitive neutrality. Available online: <http://www.pc.gov.au/agcnco/competitive-neutrality> [Last accessed: 16 August 2014]

<sup>22</sup> Capobianco and Christiansen, (2011). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 5.

<sup>23</sup> Australian Productivity Commission. About competitive neutrality. Available online: <http://www.pc.gov.au/agcnco/competitive-neutrality> [Last accessed: 16 August 2014]

<sup>24</sup> The tax, debt and regulation neutrality principles aim to ensure a level playing field by removing any tax exemptions, borrowing costs advantages or differences in regulatory environments that SOEs might enjoy over private firms. See Capobianco and Christiansen, (2011). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 16.

*“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition...”*<sup>25</sup>

Article 106(2) does not make explicit reference to SOEs yet these entities are still covered by competition rules. For a firm to be subject to competition rules, it must qualify as an “*undertaking entrusted with the operation of services of general economic interest.*” This implies that an entity, irrespective of whether it is a public or private company, can be subjected to competition policy as long as it engages in an economic activity. In the *Commission v. Italy*, the European Court of Justice (“the ECJ”) had to determine whether the Amministrazione Autonoma dei Monopoli di Stato (a state owned tobacco company that did not have a separate legal personality from the state) should be characterised as a “public authority” or a “public undertaking”.<sup>26</sup> The ECJ held that the legal form chosen by a firm (e.g. a separate legal entity from the state) is irrelevant to deciding whether it may be regarded as a public undertaking; thus ensuring all state owned entities could be characterised as undertakings and thus be subjected to competition law.<sup>27</sup> The judgement thereby ensured a competitive neutrality framework for the assessment of anti-competitive behaviour in the EU.

### **Justifications for anti-competitive behaviour by SOEs**

The adoption of competitive neutrality frameworks and particularly *ex post* competition policy frameworks whereby SOEs are subjected to the enforcement of competition law has been recognised to increase competition in previously monopolised markets.<sup>28</sup> Yet certain traditional reasons for differential treatment of SOEs remain valid. SOEs by nature are often compelled to act in accordance with public interest mandates imposed upon them and at a minimum to be accountable to the people of that country. This suggests that there may be some instances where anti-competitive behaviour might be justified. Two primary *ex post* justifications under which anti-competitive behaviour by SOEs can be exempted from competition law have been raised: a public interest mandate and the state action defence. We explore these two justifications in more detail.

SOEs are often not strictly profit maximising firms as a result of public interest obligations entrusted to them. Some of these SOEs have been granted exemption from competition policies in instances where their anti-competitive behaviour can be justified by these public interest obligations imposed upon them by the state. Under certain public interest mandates, strictly enforced by government, the SOE will have no other choice but to act anti-competitively in order to comply with its state mandate. Under these conditions, the undertaking no longer acts autonomously and if its actions are deemed to have contravened competition policy it may invoke the public interest defence in an attempt to immunise itself from competition litigation. The public interest defence allows SOEs to provide services for the overall well-being of the population even if it may be contrary to competition law.<sup>29</sup> Alleged anti-competitive behaviour in postal services is often defended under the public interest mandate defence as postal operators often have strict public mandates imposed.<sup>30</sup> Countries would normally require the state-owned postal operator to offer a minimum postal

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<sup>25</sup> Article 106 (2) of the EC Treaty.

<sup>26</sup> Public authorities are defined as “*the State and or regional authorities*” whereas a public undertaking is defined as “*any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it*” See case C-118/85 *Commission v. Italy* [1987] ECR 2599, para 5.

<sup>27</sup> Case C-118/85 *Commission v. Italy* [1987] ECR 2599, para 11.

<sup>28</sup> OECD, (2009). Policy Roundtables: State Owned Enterprises and the Principle of Competitive Neutrality. DAF/COMP(2009)37, p. 11.

<sup>29</sup> OECD, (2011). Regulated Conduct Defence. *Policy Roundtables*, p. 21.

<sup>30</sup> Capobianco and Christiansen, (2011). Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options, *OECD Corporate Governance Working Papers No. 1*, OECD Publishing, p. 8.

delivery service across the country at a uniform price. Under uniform national pricing, an operator would have to subsidise the costs of servicing rural areas from the services offered to more densely populated metropolitan areas. Under normal competition policy, this type of behaviour could potentially be considered anti-competitive if performed by a dominant undertaking. However, it could also potentially be seen as a necessary and proportionate act to meet the public interest obligations entrusted upon the SOE.

In the EU, Article 106(2) of the EC Treaty provides a framework within which this behaviour can be characterised and potentially exempted. The scope for exemption under Article 106 is however very narrow and can only be applied if three cumulative conditions are satisfied.

1. The SOE must be mandated with the “*operation of a service of general economic interest*”;
2. The application of competition policy by the EC would “*obstruct the performance, in law or in fact, of the particular tasks assigned to them*”; and
3. The exemption cannot be applied if the activity undermines the development of trade contrary to the interest of the EU as a whole.

The first condition requires that the SOE be mandated to perform a service of general economic interest. The term “service of general economic interest” is not defined in the EC Treaty and raises questions on what type of activity should be included. No predefined framework is provided to assist in characterising the type of services that would be classified as serving the general economic interest, but rather each Member state has been given the discretion to decide what would constitute a service of general economic interest.<sup>31</sup> In *Federation Française des Sociétés d'Assurances (FFSA) and others v. Commission*, the Court of First Instance held that the EC should exercise a degree of discretion when determining whether Member States and public undertakings are complying with competition policy.<sup>32</sup> The EC would have to consider the inherent demands imposed on the undertaking as well the important role of Member States to regulate certain sectors which are required to meet public interest.

The second condition requires the SOE to provide sufficient evidence that the anti-competitive conduct is necessary to provide the service of general economic interest.<sup>33</sup> Here, the SOE would have to prove that its anti-competitive actions are a necessary consequence in order to provide its mandated service. In *British Telecommunications*, the incumbent telecommunications operator refused private message-forwarding agencies access to its network.<sup>34</sup> It argued that if it was to grant third party access to its network that it would endanger the performance of its tasks. The ECJ held that British Telecom did not provide sufficient evidence to prove third party access would impede its ability to deliver its state mandated service and rejected its public mandate defence.<sup>35</sup>

The final condition required for exemption is that the conduct may not undermine the development of trade contrary to the interest of the EU. The primary reason for the creation of the EU was to enhance trade between Member States and this condition ensures that anti-competitive conduct does not undermine this. If a public company can provide sufficient

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<sup>31</sup> OECD, (2009). Roundtable on the application of antitrust law to state owned enterprises – European Commission. *Working Party No. 3 of the Competition Committee*, p. 10.

<sup>32</sup> *Federation Française des Sociétés d'Assurances (FFSA) and others v. the Commission*, Case T-106/95, pars. 98-99.

<sup>33</sup> In certain instances one would have to determine whether the anti-competitive conduct is proportionate for the delivery of the service. The conduct can be considered proportionate if it is the minimum restriction required to provide the service

<sup>34</sup> *British Telecommunications v. Commission*, OJ [1982] L 360/36, [1983] 1 CMLR 457 and case 41/83 Italy v Commission [1985] ECR 873, [1985]2 CMLR 368.

<sup>35</sup> OECD, (2009). Roundtable on the application of antitrust law to state owned enterprises – European Commission. *Working Party No. 3 of the Competition Committee*, p. 10.

evidence that it meets the three criteria set out in Article 106, its conduct will be exempted from any competition litigation based on public interest grounds.

The state action defence is the second primary justification raised by SOEs when they have been found in contravention of competition rules. Under the state action defence, a SOE might argue that it engaged in anti-competitive conduct as a result of direct and unavoidable government legislation. A state action defence requires the SOE to provide sufficient evidence to prove its anti-competitive behaviour was state imposed either by legislation or other types of binding state measures instead of an autonomous decision. If the state action defence is upheld, the SOE's actions will be exempt from liability under competition law. However, the continuation of anti-competitive behaviour by SOEs will often have substantial economic costs associated with the conduct. The question then becomes who is responsible for the violations of competition law and the associated economic costs? Countries have generally held that if anti-competitive behaviour can be justified by the state action defence, the state should be held responsible and should either remove or modify the legislation and/or measures imposed on SOEs causing the anti-competitive behaviour. Yet not all competition authorities have the necessary power to issue legally binding decisions to compel the government to remove or alter the anti-competitive legislation and measures. We examine the EU and US approach to the state action defence and discuss the difference between the conditions which have to be met for the state action defence to be upheld.

In the EU, if a SOE is found to have infringed either Article 101 or 102 of the EC Treaty as a result of government legislation, it can raise a state action defence under Article 106 of the EC Treaty. Article 106(1) of the EC Treaty states<sup>36</sup>:

*"In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties"*

Under this provision, if an SOE is found to have contravened competition rules and raises the state action defence, the EC must determine whether the SOE acted anti-competitively because of state-imposed legislation. An important element of the state action defence is that the SOE would have to prove the legislation restricted all aspects of competition.<sup>37</sup> If the conduct is found to be state-imposed, the SOE would not be held in contravention of competition rules however the state would then be held liable for the imposition of anti-competitive behaviour. The EC can then issue a directive ordering the state to remove the regulation/legislation causing the anti-competitive behaviour. In *Greece v. Commission*<sup>38</sup>, the Commission held Greece contravened section 106 of the EC Treaty by granting the Public Power Company (PPC) exclusive rights over the majority of exploitable lignite deposits.<sup>39</sup> PPC's exclusive rights enabled it to maintain its dominant position in the wholesale electricity generation market through the cost advantages arising from using lignite as the fuel source. PPC's conduct excluded other competitors from entering the market and prohibited them from competing effectively with PPC in the Greek electricity market. The Commission held that Greece reinforced PPC's monopoly position through the adoption and enforcement of the exclusive rights and contravened Article 106(2) and 82 (now 102) of the EC treaty. The

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<sup>36</sup> EC Treaty, Article 106(1).

<sup>37</sup> In *Commission v. Ladbroke*, the EU Court of Justice held that "if anti-competitive conduct is required of undertakings by national legislation or if the latter creates a legal framework which itself eliminates any possibility of competitive activity on their part, Articles [81 and 82] do not apply." Joined Cases C-359/95P and C-379/95P, *Commission v. Ladbroke*, [1997] ECR I-6265.

<sup>38</sup> *Greece v. Commission*, (2008). Case IP/08/36.

<sup>39</sup> Lignite is a solid fuel mostly used for electricity generation. Greece is the second largest EU producer of lignite after Germany and all lignite produced in Greece is used for electricity generation. See Commission Decision, (2008). "Granting or maintaining in force by the Hellenic Republic of rights in favour of Public Power Corporation S.A. for extraction of lignite", p. 7.

Commission's findings led to Greece committing to grant lignite exploitation rights to four lignite deposits by means of public tender, excluding PPC, to ensure equal access and the enhance competition in the Greek electricity generation market.<sup>40</sup> The ultimate decision did not find against PPC specifically as it was held that its acceptance of the exclusive rights did not constitute an abuse.<sup>41</sup> Therefore under EU legislation, anti-competitive behaviour by SOEs can be exempted from competition law if they can prove that their behaviour is state-imposed. The EC then has the legislative mandate to publish directives ordering the contravening Member State to remove or alter the respective legislation or state-imposed measure.

The state action defence under US law has a broader application than the EU framework. In *Parker v. Brown*, the US Supreme Court held that antitrust law was initially not intended "to restrain state action or official action directed by the state" but that anti-competitive behaviour can be exempted from antitrust law if the behaviour is imposed through state regulation and legislation.<sup>42</sup> In subsequent judgements, the Supreme Court developed a two-part test to determine whether anti-competitive behaviour can be justified under the state action defence. More specifically exemption will be granted if the following two conditions are met<sup>43</sup>:

1. "The challenged restraint must be one clearly articulated and affirmatively expressed as state policy" and
2. "The policy must be actively supervised by the State"

The first condition requires that the anti-competitive behaviour must be authorised and clearly articulated by means of state policy. This would require the state to have consciously assessed the policy as well as its potential anti-competitive effects and decide to implement policy through using its statutory powers. The authorisation has to come from either the executive, legislative or judicial branches of the state as restrictions imposed by state subdivisions such as municipalities are not exempted from antitrust enforcement.<sup>44</sup> In *Southern Motor Carriers Rate Conference v. United States*<sup>45</sup>, a group of motor carriers operating in the North Carolina, Georgia, Tennessee, and Mississippi undertook a collective ratemaking system that was deemed in contravention of antitrust laws. The parties argued that their collective ratemaking was authorised by their respective states and should thus not be subject to antitrust laws. The Supreme Court held that the collective ratemaking was immune from antitrust law as the behaviour, even though not compelled, was induced by state policy.<sup>46</sup>

The second condition requires that the anti-competitive behaviour be actively supervised by the state to ensure the firms are acting within the boundaries of the statute and not committing additional anti-competitive acts not covered by the statute. The mere potential to supervise is therefore not sufficient under this condition rather active supervision is demanded. In *California Retail Liquor Dealers Association v. Midcal Aluminum Inc*<sup>47</sup>, all Californian wine producers and wholesalers had to file price schedules with the state under a Californian statute. Wine wholesalers that sold wine below the established price faced fines or license suspensions. A wholesaler requested an injunction against the pricing scheme as

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<sup>40</sup> See IP/09/1226. Available online: [http://europa.eu/rapid/press-release\\_IP-09-1226\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-09-1226_en.htm?locale=en) [Last accessed: 21 August 2014]

<sup>41</sup> OECD, (2009). Roundtable on the application of antitrust law to state owned enterprises – European Commission. *Working Party No. 3 of the Competition Committee*, p. 11.

<sup>42</sup> See *Parker v. Brown*, 317 US. 341, 351 (1943).

<sup>43</sup> *California Retail Liquor Dealers Association v. Midcal Aluminum Inc.*, 445 U.S. 97 (1980).

<sup>44</sup> OECD, (2011). Regulated Conduct Defence. *Policy Roundtables*, p. 32.

<sup>45</sup> *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985).

<sup>46</sup> *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985).

<sup>47</sup> *California Retail Liquor Dealers Association v. Midcal Aluminum Inc.*, 445 U.S. 97 (1980)

it was contrary to the Sherman Act. The association argued that the established price came about under a state statute and should therefore be exempted from antitrust laws. The California Court of Appeal held that even though the established price scheme resulted from a clearly articulated state policy, it did not meet the second condition and can therefore not be exempted from antitrust law.<sup>48</sup>

Therefore, in the US, SOEs and private companies can raise the state action defence and be exempted from antitrust law if the Supreme Court's two conditions are met. Nonetheless the US framework does not provide for the US competition authorities to provide consent orders compelling states to remove or alter the anti-competitive inducing statute. Rather they would consult with the relevant departments and attempt to convince them of the anti-competitive nature of the statute. The relevant state department can then autonomously decide whether to keep, remove or alter the statute under investigation.<sup>49</sup>

The public interest and state action defences have been raised as a justification of anti-competitive behaviour by SOEs in the past. However SOEs are still encouraged to comply with competition policy when possible. In the EU, if the conduct is found to be state-induced rather than state-imposed, both the SOE and the state will be held liable for the contravention. Article 106 in conjunction with Articles 101 and 102 therefore do not only prohibit Member States from compelling SOEs to act anti-competitively but also prohibit them from inducing SOEs to act anti-competitively.<sup>50</sup> The SOE is however still held accountable for its anti-competitive actions if it had sufficient autonomy not to act anti-competitively within the state induced legislation.<sup>51</sup> The economic benefits accrued from not exempting anti-competitive behaviour by SOEs would likely be substantial, but with limited associated costs.<sup>52</sup> SOEs acting within the borders of competition policy are likely to result in more competitive markets and benefits to consumers. In addition, the prohibition of anti-competitive behaviour by SOEs is likely to reduce the economic costs associated with this type of behaviour resulting in a net benefit for the economy as a whole. Therefore, the onus of responsibility to act in accordance with a country's competition policy should likely remain with the SOEs.

Other countries have opted not to rely on such frameworks for assessing anti-competitive conduct by SOEs and instead entrusted regulatory-type powers to their competition authorities. For example, in Mexico, the competition authorities have sufficient power to challenge anti-competitive measures imposed at the federal, state and municipal level. The Mexican Competition Authority can issue binding and non-binding legal opinions at the federal level however may only submit non-binding opinions at the state and municipal levels.<sup>53</sup> Whereas in Italy the Italian Competition authority has the necessary power to take judicial action against any government regulations or measures that contravene competition policy. The authority must submit an opinion detailing the alleged contraventions, if the

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<sup>48</sup> The California Court of Appeal found that the state only approved the prices without investigating the reasonableness of the prices schedules. See *California Retail Liquor Dealers Association v. Midcal Aluminum Inc.* 445 U.S. 97 (1980).

<sup>49</sup> OECD, (2011). Regulated Conduct Defence. *Policy Roundtables*, p. 189-190.

<sup>50</sup> OECD, (2009). Roundtable on the application of antitrust law to state owned enterprises – European Commission. *Working Party No. 3 of the Competition Committee*, p. 4.

<sup>51</sup> *Commission v. Ladbroke* Joined Cases C-359/95P and C-379/95P, *Commission v. Ladbroke*, [1997] ECR I-6265.

<sup>52</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 43.

<sup>53</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 33.

government decides not to act on the submitted opinion the competition authorities can appeal through the State Attorney.<sup>54</sup>

Countries have adopted different competition neutrality frameworks and entrusted their competition authorities with varying degrees of enforcement power. The non-uniformity in competitive neutrality frameworks recognises that competitive neutrality may also be attainable through a policy framework that is broader than a standard competition law treatment.

#### IV SOES AND SOUTH AFRICAN COMPETITION LAW

In the early 1990s, the South African economy was characterised by highly concentrated markets dominated in many instances by SOEs. The primary objective of the South African Competition Act<sup>55</sup> (“the Act”) was to promote competition in order to underpin economic efficiency as well as adaptability, international competitiveness, market access and employment creation.<sup>56</sup> As part of its objective, the Act specifically recognises the historic role of the State in the creation of monopolies in certain markets and as a result implicitly acknowledges the potential liability of SOEs under the Act and thus appears to adopt a competitive neutrality framework.<sup>57</sup> The Act provides for the treatment of competition infringements by SOEs, under section 3 and 81 jointly. Section 3(1) states “*this Act applies to all economic activity within, or having an effect within the Republic...*” and Section 81 reads “*this Act binds the State.*” Section 3 ensures that all activities performed within the boundaries of the country as well as any acts having an effect in South Africa will be covered irrespective of ownership structure. The joint interpretation of the two provisions appears to ensure that SOEs may not argue that their actions are exempt from competition enforcement solely because of their ownership status. The two provisions strengthen the ability of the South African competition authorities to address anti-competitive conduct by the State and ensure non-preferential treatment between public and private firms.<sup>58</sup>

The record of enforcement of the Competition Commission (“the Commission”) and Competition Tribunal (“the Tribunal”) would also suggest that a competitive neutrality framework has been adopted in South Africa. These authorities have shown a willingness to investigate and act against South African SOEs found in contravention of the Act.<sup>59</sup> For instance, in the South African Airways cases<sup>60</sup>, it was found that South African Airways had abused its dominance through travel agent incentive schemes that has the effect of excluding its competitor (Nationwide) from the market. The Competition Tribunal has also found against Telkom.<sup>61</sup> The Competition Tribunal first found against Telkom in 2012. It found that Telkom contravened sections 8(b) and 8(d)(i) of the Act by not supplying access to an essential facility to Value Added Network Service Providers and inducing customers not to deal with Telkom’s competitors. The Tribunal imposed an administrative penalty on Telkom of R449 million for the contraventions. In the second case involving allegations of excessive pricing and margin squeeze by internet service providers, the Commission found

<sup>54</sup> E. M. Fox and D. Healy, (2013). When the State harms competition – The role for competition law. *New York University Law and Economics Working Papers*, paper 336 at p. 34.

<sup>55</sup> The Competition Act No. 89 of 1998 as amended.

<sup>56</sup> Sutherland, P. and Kemp, K. (2013). *Competition Law of South Africa*, 3-43.

<sup>57</sup> Sutherland, P. and Kemp, K. (2013). *Competition Law of South Africa*, 4-32.

<sup>58</sup> Sutherland, P. and Kemp, K. (2013). *Competition Law of South Africa*, 4-32.

<sup>59</sup> The Tribunal has heard a number of cases involving SOEs and found them to have been in contravention of the Act. See *Competition Commission v. Telkom*, Case 11/CR/Feb04 (SAVA Complaint) and (016865) [2013] ZACT 62 (the 2009 complaint) as well as *Competition Commission v. South African Airways*, Case 18/CR/Mar01.

<sup>60</sup> *The Competition Commission v. South African Airways*, Case no. 18/CR/Mar01 and *Nationwide Airlines and others v. South African Airways*, Case 80/CR/Sept06.

<sup>61</sup> *Competition Commission v. Telkom SA Ltd*, Case No. Case 11/CR/Feb04 and *Competition Commission v Telkom SA SOC Ltd (016865) [2013] ZACT 62 (18 July 2013)*

Telkom to be in contravention of sections 8(c) and 8(d)(iii) of the Act. The Commission and Telkom reached a settlement agreement whereby Telkom undertook to implement transparent transfer pricing essentially creating wholesale and retail separation of the incumbent, non-discriminatory pricing as well setting prices of certain products to cover the associated costs in order to not engage in a margin squeeze.<sup>62</sup>

Unlike the international approaches covered above, South Africa's Competition Act does not appear to include explicit provisions under which SOEs can raise similar public interest mandate<sup>63</sup> and state action defences. In terms of public interest, there are a number of areas where firms may be granted exemption from the Act or parts thereof, but it is not clear that these are comparable to the public interest mandate defence available in terms of the EU. For instance, public interest aspects may be considered by the authorities as part of *ex ante* merger control as well as in the context of an application for an exemption from the prohibited practices provisions of the Act in terms of Section 10. Yet it is not clear that the specific public interest provisions contained within the Act would apply directly to the type of public interest mandates imposed upon SOEs (e.g. equal access and uniform pricing). Professional rules may also be exempted from the application of Sections 4 and 5 of the Act under certain conditions although this would likely not be relevant to the typical SOE or the typical abuse behaviour of SOEs that one would be concerned with. It is not clear whether a public interest mandate defence would be available for an SOE in South Africa.<sup>64</sup>

In terms of a state action defence, there may be room for such a defence in South Africa where anti-competitive conduct is specifically required by legislation. This is because the scope for remedial action by the Tribunal is unclear. The Tribunal would not appear to have the power to impose a remedy against anti-competitive behaviour that is specifically called for by legislation. Such a remedy would result in a hard conflict with the legislation causing the anti-competitive behaviour. In *Venter*, the Tribunal appeared to recognise the possibility of such a conflict when it stated that "*the only way remaining to support an argument that section 4(1) does not apply, is to contend that the [Competition] Act is ousted in this respect as a matter of statutory interpretation to avoid a conflict of law.*"<sup>65</sup> Therefore an SOE could potentially be able to raise a type of state action defence if it can prove that state legislation removed all possibility for an SOE to act autonomously. Nevertheless it is not clear how the Tribunal would approach such a defence and whether an SOE would subsequently be exempted from the Act. Although Telkom appeared to raise a type of state action defence whereby it argued that its conduct was necessary due to universal service obligations, ultimately the Tribunal did not need to rule on it.<sup>66</sup>

## V CONCLUSION

The regulation of SOEs presents unique challenges from a competition perspective. SOEs seldom seek to only maximise profit and are often instructed to pursue public interest goals

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<sup>62</sup> *Ibid*, para. 4.2 and all subparagraphs

<sup>63</sup> The terminology here is intended to reflect the definition under the EC Treaty of the "*operation of a service of general economic interest*" under Article 106.

<sup>64</sup> Concerted practices may be excluded from the application of the Act under section 3(1)(e) that refers to "concerted conduct designed to achieve a non-commercial socio-economic objective or similar purpose." Nevertheless exceptions under this provision would likely not apply to SOEs as it would be difficult to characterise their activities as non-commercial and as such will continue to be subject to the provisions contained in the Act.

<sup>65</sup> *Venter v The Law Society of the Cape of Good Hope and others*, [2013] 2 CPLR 477 (CT), at para. 46.

<sup>66</sup> The Tribunal held that Telkom's universal service obligation was imposed on a *quid pro quo* basis for the exclusivity it enjoyed over the public switched telephone service and facility provision. The universal service obligation was not imposed on the competitive value added network services market and therefore the state action defence was not sustainable. See *Competition Commission v. Telkom SA Ltd, Case No. Case 11/CR/Feb04*, at para. 170-171.

which can be contrary to profit maximisation. This combination of objectives in conjunction with state support can increase the incentives and ability of SOEs to act anti-competitively. However internationally (including the US and EU jurisdictions) specific provisions are made under which anti-competitive behaviour by SOEs can be justified and exempted from competition policy. These exemptions are known as the public interest mandate and state action defence. The South African Competition Act however does not appear to contain an explicit provision for an SOE to raise either a public interest mandate or state action defence. This raises three policy questions, which could potentially be addressed in further research.

The first policy question is whether the Act should be amended to include explicit provisions for either a public interest or state action defence by SOEs. Uncertainty surrounding the potential approach and outcomes of the two defences under the current structure of the Act might be addressed with the inclusion of such provisions. However one would have to consider whether there is a sufficient justification or need for such an amendment, and whether additional defences for SOEs are in the best interests of South Africa economic policy. Furthermore, SOEs (SAA and Telkom) have already been subjected to competition law in South Africa, and it is not been apparent in these processes that such provisions are necessary. These potential value and need for such provisions would have to be carefully analysed.

The second policy question is whether the Commission should play a greater role in *ex ante* regulation in terms of competitive effects of State policies and legislation, such as the Mexican example. While the Commission has shown a willingness to impose remedies on SOEs traditionally falling under sector regulators (i.e. Telkom), there may be a case for extending the powers of the Commission to address policies and regulations in these and other sectors on an *ex ante* basis, potentially preventing behaviour that would otherwise only be dealt with on *ex post* basis. A greater regulatory role for the Commission would have to be carefully assessed, in particular where a sector regulator is already active.

The third policy question is whether there may be room for the Competition Tribunal to have broader remedial powers to address issues of legislation or regulation where anti-competitive behaviour of SOEs can be fairly characterised as the result of state action. The potential benefits and costs of such powers and the precise ambit of these powers would need careful assessment by policy makers.