# COMPETITION LAW AND FOREIGN-GOVERNMENT CONTROLLED INVESTORS

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**Executive Summary**

At the ninth "Freedom of Investment" Roundtable, which was held under the auspices of the OECD Investment Committee on December 17, 2008, the Secretariat of the Competition Committee described its perspective on investments by foreign government-controlled investors. The presentation began with the observation that, for competition authorities, "government ownership can matter": it might strengthen a company's capacity to act anti-competitively because direct or indirect government control may weaken market pressures or may shield it from the full force of competition law enforcement (either because domestic law provides such a shield or because, if the government controlled entity is foreign, it benefits from foreign sovereign immunity).

On the other hand, whether a company is foreign or domestic matters little to competition authorities, except inasmuch as it raises issues of jurisdiction. Most OECD countries require, when asserting anti-trust jurisdiction, that illegal conduct has some anti-competitive effect within the country (the "effects doctrine"). Furthermore, international cooperation among competition authorities is helping them to deal with situations where transactions have competition effects on multiple jurisdictions. This is becoming increasingly common as markets and companies become global, but competition authorities' enforcement powers are generally limited to their respective jurisdictions. Competition authorities deal with this in two ways: through parallel enforcement of competition rules and by enhanced comity through bilateral and multilateral agreements aimed at facilitating mutual legal assistance.

Direct investments, by domestic or foreign actors, that take the form of mergers and acquisitions are the transactions most likely to be subject to review by competition authorities. Concerns could arise if the transactions change the nature of competition in such a way that firms will be significantly more likely to raise prices after the merger, to lower product quality or to stifle innovation. Mergers and acquisitions by foreign government-controlled investors are, like their domestic counterparts, routinely subject to anti-trust review. Should concerns be identified, the competition authority can block transactions unless the parties can offer sufficient remedies to address the concerns.

Foreign government investors can assume a variety of legal forms: state-owned enterprises, pension funds or other government controlled entities such as sovereign wealth funds. The exact nature of a foreign government controlled investors, it public policy mission and its links with its government are matters of interest to competition officials, both for their impact on competition and for determining their status with respect to enforcement actions. These characteristics will interact with recipient countries' laws in complex ways to determine which competition enforcement actions, if any, should be taken. These questions – how competition law principles and the legal status of different types of government controlled investors interact – are complex issues which could benefit from further analysis.

The presentation ended by noting that the competition community, in this period of crisis, faces political pressure to soften enforcement of anti-trust rules. This mirrors protectionist pressures from domestic constituencies that may influence investment policy decisions. The OECD Competition Committee has recognised the benefits of foreign investments, including foreign investments by government controlled entities. A favourable environment for foreign investments, regardless of their ownership, has beneficial effects on the entire economy and on consumers. Thus, the competition and investment policy communities share the same policy objective – to resist protectionist and anti-competitive pressures and to safeguard the interest of key constituencies such as consumers and citizens. Likewise, when the investment policy measures, based on such considerations as national security, call for restricting investment, competition authorities could usefully participate in deliberations so as to help assess and highlight the costs of such policies for competition and to help design restrictions that have the least impact on competition.

## COMPETITION LAW AND FOREIGN-GOVERNMENT CONTROLLED INVESTORS

**(Presentation by Antonio Capobianco, OECD Competition Division)**

1. Thank you very much for the invitation to participate to today's discussion and for offering me the opportunity to spend a few minutes presenting how competition authorities deal with some of the concerns which may arise from foreign government-controlled investments. In particular, I have been asked to identify situations where the competition agency can play a role to adequately address the recipient countries' concerns while avoiding unnecessarily restrictive investment policy actions.

### I. Competition perspectives on government and foreign ownership

2. Before addressing today's topic, I would like to make some preliminary remarks on the competition perspective on government ownership and foreign ownership.

3. In competition policy, **government ownership can matter**. It matters because ties between market operators and governments can weaken the usual inferences about how rational economic actors are likely to behave in the marketplace. Indeed, a link to government might strengthen the capacity to act anti-competitively because entities that are subject to direct or indirect government control may not be fully subject to market pressures or to competition law enforcement. Anticompetitive conduct might be shielded from enforcement by sovereign immunity, and in some jurisdictions, competition law treats state-controlled enterprises differently than private entities. This could occur, for example, when government-controlled entities have public policy mandates such as public service obligations or management of a country's natural resource.

4. For competition authorities, the question is whether such activities, which can entail serious price or output restrictions, should be subject to antitrust scrutiny although they are compelled or authorised by law. In various ways, courts have concluded that no antitrust liability can be found if the challenged private conduct is determined by lawful public measures. This is the so-called **"state action defence"**. Although the scope of the state action doctrine has consistently been interpreted narrowly by courts and antitrust enforcement agencies, these limitations may still be of particular note in industry sectors, where there are many state-owned enterprises (energy, telecoms and postal services being just a few examples). This situation poses complex issues for international competition law, which are being explored in many jurisdictions.

5. The **foreign nature of a company matters less** to competition authorities. A number of criteria can be used to establish antitrust jurisdiction over foreign companies or individuals. The requirement that the illegal conduct has some anti-competitive effect within the jurisdiction (the "effects doctrine") is the jurisdictional criterion used in most OECD countries. The fact that a company is a foreign company does not matter to the extent that the company in question performs an economic activity within the jurisdiction concerned.

## II. Competition approach to direct investments by foreign government-controlled entities

6. When we think of government intervention in the market – be it by a foreign or a domestic government -- we generally refer to two things:

- **Direct or indirect subsidies**, including any privileged treatment in the home jurisdiction which gives companies advantages on home and/or international markets. Here the range of possible channels for government intervention is vast: direct subsidies, tax breaks, conferral of privileged positions in particular markets, advantageous contracting terms in public procurement and so forth. All of these can distort market competition, in both product and capital markets. Recent events have raised the profile of this issue for competition authorities: see, for example, the business press on state aids to banks, financial institutions and now to the car industry.

  I will not spend too much time on the issues of subsidies by foreign governments today, but I would like to note that this is an area where competition authorities may find themselves ineffective or with limited enforcement tools. Some jurisdictions (such as the EU) have state aids rules which are enforced by the competition agency (DG COMP), but this is unusual. Generally, remedies against foreign subsidies are available under statutes other than competition laws, such as international trade rules which in most cases are not administered by competition agencies.

- **Direct investments.** Direct investments in the form of mergers and acquisitions are most likely to fall within those situations which are subject to antitrust review competition authorities. This is also the case for green-field investments which are subject to notification to competition agencies (subject to the fulfilment of merger filing requirements) even if they raise no competition issue. The status of the foreign government-controlled investors engaging in these foreign investments could be of several types: state-owned enterprises (SOEs), pension funds or other government-controlled entities such Sovereign Wealth Funds (SWFs). The exact nature of a foreign government-controlled investor, its public policy mission and the links with its government are matters of interest to competition officials, both for their impact on competition and for determining their status with respect to enforcement actions. These characteristics will interact with recipient country competition laws in complex ways to determine whether and which actions might be taken by competition authorities. These questions – the market effects and of legal status of different types of government controlled investors – are complex issues in competition policy and could benefit from further analysis.

7. As summarised in the background material prepared by the Secretariat for this discussion, foreign government-controlled investments can raise a number of concerns in the recipient country: some concerns are competition related, some are related to national security considerations, some are related to foreign governments' immunity from domestic law enforcement; others finally are more political in nature. My remarks will focus on the competition-related concerns that may arise from direct investments by foreign government-controlled entities.

8. When it comes to the **direct investments** of foreign government-controlled companies, **merger control** rules place competition agencies at the centre of the review of the antirust impact of M&A activities, including investments by foreign government-controlled entities. Here, many countries make a distinction between (i) the acquisition of **controlling interests** and (ii) the acquisition of **non-controlling interests** (or minority shareholdings).

### *II.1 Acquisitions of controlling interests*

9. In all OECD member countries, large investments which allow the investor to acquire a controlling share in a company must be approved by the competition authority *ex-ante*, so that a successful approval process becomes a condition for the deal. Without going into the details of how merger control works, I would only like to note that:

- In most OECD countries merger control rules are ownership neutral and equally apply to private as well as state-controlled investors. When states or state-controlled entities operate in the marketplace as commercial operators, their activities are not immune from merger enforcement. Acquisitions by foreign government-controlled entities are routinely subject to merger review.

- The purpose of merger control is to identify and investigate competition-related concerns arising from M&A activities. Competition concerns may arise if a transaction is expected to increase market power resulting in higher prices (or in lower quality or less choice) for consumers (**unilateral effects**); or if the transaction changes the nature of competition in such a way that firms will be significantly more likely to coordinate and raise prices or otherwise harm effective competition after the merger in terms of lower product quality or less innovation (**coordinated effects**).

- Should any of these concerns be identified, the competition authority can block the transaction unless the parties can offer sufficient remedies to the competition concerns.

10. An interesting question is how the competition enforcement community deals with multi-jurisdictional effects of these transactions, since review processes remain largely national. This is a general issue raised by globalisation: markets and companies are going global but competition agencies' enforcement powers are generally limited to their respective jurisdictions. The antitrust enforcement community addresses this issue in two ways: parallel enforcement of competition rules and international cooperation. It is common nowadays to see the same deal investigated by a number of competition agencies at the same time, each reviewing the effects on competition in their own country. The major antitrust agencies have entered into bilateral cooperation and assistance agreements, which allow them to coordinate their enforcement actions across-jurisdictions. In addition, in 1995 the OECD has adopted a Recommendation on international antitrust cooperation, which offers a platform for comity considerations where no specific bilateral or multilateral agreement is in place. The system is not perfect or the most efficient one, as there may still be risks of duplication, inconsistencies and over regulation. However, it has proved effective and competition officials are making efforts to enhance international cooperation.

### *II.2. Acquisitions of non-controlling interests*

11. **Acquisitions of non-controlling interests** raise interesting issues as they may raise competition concerns, which in some OECD jurisdictions competition authorities are not in a position to address effectively.

12. One might find it hard to understand, at first glance, why non-controlling equity investments should be controversial, even if the investor is a foreign government-controlled entity. However, there is extensive literature on the effects of minority shareholdings between competing companies which shows that, in some circumstances,[1] minority shareholdings can have negative effects on competition, either by

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[1] In practice, anticompetitive unilateral or coordinated effects will depend on a number of factors which significantly influence firms' incentives to compete and which require careful analysis. Such factors may be

reducing the minority shareholder's incentives to compete (**unilateral effects**), or by facilitating collusion (**coordinated effects**). By acquiring a share in a competitor the **incentives to compete may be reduced**. If a firm owns equity in a competitor, the financial losses incurred by the competitor will affect the value of the firm's investment. In this scenario, the firm may have less incentive to compete against the company it has invested in. In addition, if the minority stake gives rise to representation rights (e.g. the right to appoint a member of the board) then the investor may be given **access to sensitive information** about the target company that could be used to collude.

13. As in the case of acquisitions of controlling stakes, merger rules are the most frequently used tool to examine the competitive effects of acquisitions of minority shareholdings. However, the system is not without **loopholes**. In merger regimes that use the concept of "control" to define a reviewable transaction (for example the EU and most European countries), acquisitions of non-controlling stakes can be reviewed only if they result in a “change of control”. This may create an **enforcement gap** with respect to minority shareholdings that do not affect control but may nevertheless have negative effects on competition. Other jurisdictions (such as the United States, the United Kingdom and, to some extent, Germany) have a wider jurisdictional net and can review acquisitions of non-controlling stakes under a “material influence” or similar standard, or can review all acquisitions of an interest in another company under their merger review regimes.

14. Does this mean that potential anti-competitive effects of acquisitions by foreign government-controlled entities of non-controlling stakes can in some OECD jurisdictions fall short of any antitrust review? The short answer is no, although reviewing the effects on competition of these transactions can be more complex and ultimately remedies less effective. Competition law provisions concerning restrictive agreements and unilateral conduct can also be applied to review the competitive effects of minority shareholdings. However, there are important differences in so far as:

- Merger control allows antitrust review and intervention *ex-ante*, preventing anti-competitive effects from arising in the first place, while rules on anti-competitive agreements and abuse of dominance can only be applied *ex-post*; and

- The application of cartels and dominance rules may not be straightforward in these cases. The application of rules on restrictive agreements has limited reach because they apply only if an "agreement" and anticompetitive effects can be established. In a similar way, rules on unilateral conduct require the agency to show substantial market power and unlawful conduct.

For these reasons, some countries have considered or are considering (e.g. EU and Ireland) amending their merger statutes to provide more effective enforcement in all circumstances.

## III. Conclusions – Shared interests for competition and investment policy

15. In closing, I would like to highlight several matters of interest that are shared by the investment and competition policy communities.

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structural (e.g., the degree of market concentration, entry conditions, the homogeneous or differentiated nature of the products concerned, the substitutability of the products concerned, their respective diversion ratios and the number of companies in the market which are linked to each other) or transaction specific (e.g., the companies’ respective costs and margins, their market shares, the size of the minority interest and the reciprocal nature of the structural links). See the Report of the Competition Committee on “Antitrust Issues Involving Minority Shareholdings and Interlocking Directorates” (DAF/COMP(2008)30).

### *III.1 Protecting competition and resisting protectionism during a crisis*

16. The question with which the competition community is now struggling is whether in a time of **systemic crisis**, such as the one we are living in, competition agencies should soften their enforcement standards of antitrust rules in general and merger rules in particular. In many countries there are strong pressures towards **protectionist policies**. In competition terms, this might translate into a more benign approach to **national champions** (i.e. allowing otherwise anti-competitive mergers between domestic entities) and into sponsoring **national ownership** (i.e. prohibiting otherwise pro-competitive acquisitions of domestic entities by foreign entities). I understand that the investment policy community may also be subject to protectionist pressures from domestic political constituencies.

17. The OECD Competition Committee has recognised the benefits of foreign investments, including foreign investments by government controlled entities. A favourable environment for foreign investments, regardless of their ownership, has beneficial effects on the entire economy and on consumers. Empirical evidence confirms that foreign takeovers have beneficial effects: they increase the level of competitiveness of national markets; they inject new human and financial resources in the system; they encourage greater investments in the domestic companies, and contribute to the overall growth and prosperity of the domestic economy.

18. Will the attitude of competition agencies change in the future *vis-à-vis* foreign investments? It is difficult to say, but antitrust agencies are truly committed the long-term benefits of competition both for consumers (who will benefit of more and better products at lower prices) and for the economy as a whole, since competition has a positive impact on growth and long-term productivity. Recent public statements of head of agencies have emphasised the determination to keep competition at the centre of the agency's policy objectives and not to loosen the competition standards that they apply. Only that will ensure long-term benefits for consumers and for the economy. If competition is put aside, there may well be short-term returns, but one can also be certain of the long-term damages to consumers and to the economy.

19. In this respect, it seems to me that the competition community and the investment policy community share the same policy objective, i.e. to resist protectionist and anti-competitive pressures.

### *III.2 Coordinating the work of competition and investment policy officials*

20. The Competition Committee has also always supported a centralised antitrust enforcement in one agency. When it comes to the antitrust review of foreign investments a proliferation of regulatory review could have a detrimental effect (in terms of risk of inconsistent approaches and over-regulation) and could ultimately discourage foreign investments. For this reason, I was happy to see in the OECD Investment Committee's guidance on security-related investment policies, that governments, if they have such policies, should adopt them only as a last resort, when other policy communities – like competition – cannot address the concerns. Clearly the competition community is the best placed to deal with competition issues.

21. There may, however, be other circumstances in which several policy communities, including investment and competition, can usefully work together. For example, competition authorities can sometimes include in their assessments considerations other than competition (such as national security or security of supply). However, such considerations would only be incidental to competition concerns. For example, competition policy assessment of mergers cannot normally deal with issues such as energy security only, unless these concerns translate into competition concerns. A competition agency cannot block a merger only on public interest grounds. In several countries, a body other than the competition agency may review and authorise or prohibit a transaction where interests and policies other than competition are at stake.

22. Similarly, if the investment policy community feels that it needs to block investments or impose remedies on grounds other than competition (e.g. national security), which may however have consequences on competition, then it would make sense to think of institutional frameworks or procedures allowing the competition community to participate in deliberations for such decisions so as to help to assess and highlight the costs of such policies for competition. The degree to which, in principle or in practice, the two policy communities should coordinate their actions to address these concerns might provide a fruitful area of future work.

Thank you for your attention.