WP3 Discussion on corporate governance, SOEs and competitive neutrality

20 October 2009

Contribution from Sweden

1 Summary

Public intervention in markets can often result in distortion of competition and act as a barrier to market entry and expansion. In order to address the competition issues that arise when the public sector competes with private undertakings on the open market, the Swedish Government recently proposed an amendment to the Swedish Competition Act (the "Competition Act").

The Swedish Government issued a Bill (2008/09:231) on public commercial activity (the "Bill") which proposes new rules stipulating that the Stockholm District Court (the "District Court") may prohibit:

- certain *conduct*, in the context of *offering goods or services*, by a municipality, county council, state or companies controlled by either of these bodies; or
- an *activity*, consisting of *offering goods or services*, from being carried out by municipalities, county councils or companies controlled by either of these bodies;
- ...if that conduct or activity
    i. *distorts*, by object or effect, the conditions for effective competition on the market; or
    ii. *impedes*, by object or effect, such competition from occurring or developing.

The above prohibitions can be issued by the District Court, through an injunction, further to an application by the *Swedish Competition Authority* (the "SCA").

Conduct that is found to be justifiable on public interest grounds; and activities which are compatible with law, may *not* be prohibited.

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Should the SCA decide not to bring a case before the District Court, an *undertaking* affected by a certain conduct will have standing before the District Court to apply for a Court order, as per above.

If adopted by the Swedish Parliament later this autumn, the new rules will be included in the Competition Act and come into force on 1 January 2010.

2 Introduction

The SCA highlighted some of the main competition issues that often arise as a result of public intervention in competition with the private sector in its submission to the OECD Competition Committee policy roundtable in 2004.[1]

When public players in central, regional or local government level act in competitive markets there is a risk that market entry by private undertakings is impeded and those active in the market may be driven out, particularly SMEs. Smaller companies generally have a weaker market position, which amplifies the competition issues that arise from public intervention.

The significance of these issues are further illustrated by the extent of the public sector in Sweden and its engagement in commercial activities. In 2007, approximately 35% of the employed population were employed by the public and in terms of size in relation to GDP, Sweden had the largest public sector in the EU[2].

3 Corporate governance

The public sector in Sweden does not only encompass the state but also county councils and municipalities, which enjoy a very high degree of independence.

It is also common in Sweden for municipalities and county councils to engage in commercial activity in competition with the private sector. The municipalities and county councils, as well as companies they operate, are regulated by the Local Government Act ("LGA"); and the Act on Certain Municipal Powers, which sets out the conditions for municipalities to engage in commercial activity within certain sectors, e.g. employment of disabled and tourism.

Municipalities must adhere to certain key principles set out in the LGA, and shall also ensure that companies they control adhere to the same principles. From an antitrust perspective, the most important of these principles that have given rise to competition issues, are the following:

- **The location principle (LGA §2:1); and municipalities' powers**: Municipalities and county councils may themselves attend to *matters of general concern* which are connected with the *area* of the municipality or

county council or with their *"members"*[3] and which are *not to be attended to solely by the state, another municipality, another county council* or some *other body*. "Matters of general concern", however, has never been further defined in law and the municipalities' powers have thus been significantly widened over the years through case law.[4]

- **The Prime Cost principle (LGA §8:3c[5])**: Municipalities and county councils may levy charges for services and utilities which they provide but such may not exceed the cost of the services or utilities provided (the prime cost). However, it also follows that this provision does *not prohibit* pricing *below* cost.[6]

Furthermore, the scope for appealing decisions by municipalities and county councils, on the basis that they are exceeding their authority, is rather restricted under the LGA.[7]

4 The Bill on public commercial activity

4.1 Background and key issues

A key difference between private and public entities is that the latter cannot be declared bankrupt and public entities also benefit from being financed through tax funding. Consequently, they operate on the market under different conditions and their mere *presence* on the market give rise to inevitable market distortions; e.g. it acts as a disincentive to private undertakings to expand or establish themselves. This increases barriers to market expansion and entry.

Examples of areas in which public entities in Sweden have been or become active in competition with the private sector and where such an activity does not appear to be justified include cleaning services, vehicle rental, architecture services and building maintenance.

The SCA receives many complaints regarding public intervention and, as stressed in the Bill, these complaints often concern cases where a public body's pricing practice is being questioned, either for being allegedly below cost or for being considered excessive. Other typical cases that give rise to competition issues are those that, *e.g.*, involve one or more of the following factors:

- cases where one and the same public entity carries out both activities of a legal state monopoly and activities that are subject to competition, particularly where the former constitute tasks of a public authority;

- sole access to an essential facility and/or refused or selective access to such facilities where access shall be provided on fair, reasonable and non-discriminatory terms;

- sales of excess capacity; and

- support of the public entity's own commercial activity and/or own bids in public procurement[8].

4.2 The difficulties of applying general antitrust rules in the public sector

The SCA has enforced, and will continue to enforce, the general antitrust rules contained in the Competition Act and the EC Treaty *vis-à-vis* public entities but has faced certain difficulties in the past when applying these rules in the public sector, including the following:

- **Is the entity an undertaking?**: Despite extensive case law on how the notion of an '*undertaking*' under certain circumstances can cover also public bodies for the purpose of competition law, it may in some instances be difficult to ascertain whether a public entity constitutes an 'undertaking' (e.g. certain areas and aspects of health care).

- **Outside rules on anti-competitive agreements**: The anti-competitive effect of public intervention in the market is rarely the result of public bodies having concluded an anti-competitive *agreement* with other undertakings, thus bringing it outside the scope of §2:1 of the Competition Act and/or Article 81 of the EC Treaty ("Article 81").

- **Is there dominance?**: It might be argued that the unique position that a public entity holds on a market (i.e. tax funding, not having to consider the threat of bankruptcy, etc.; cf. Section 4.1 above) suggests the very independence described in the definition of 'dominance'.[9] Moreover, public undertakings that are granted special/exclusive rights by the state can become dominant through such rights. However, it may still be difficult to demonstrate '*dominance*' as defined in case law under Article 82 of the EC Treaty ("Article 82") and/or §2:7 of the Competition Act, particularly before national Courts, who may be reluctant to accept an interpretation of dominance, which is broader than expressly stated in case law.[10]

- **Is there an abuse?**: In the event that dominance *can* be demonstrated, it may be difficult to establish whether that position has actually been *abused*:

    - An abusive intention may be hard to establish in the case of conduct by a public entity which does not have a profit motive.[11]

    - In cases concerning either excessive pricing or predatory pricing, it may be very challenging to calculate the relevant capital cost incurred by the entity in question.

4.3 The proposed legislation and scope

Given the above background and the difficulties in applying the general antitrust rules to public entities' distortions of competition, the Swedish Government has in its Bill, issued on 19 August 2009, proposed that specific rules are adopted to ensure competitive neutrality between the public and private sector.

The key provisions, proposed to be incorporated into the Competition Act and to come into force on 1 January 2010, state the following:

> *[Ch.3 §27] The state, a municipality or a county council may be prohibited from carrying out a certain conduct, in the context of offering goods or services, if this*
>
> 1. *distorts, by object or effect, the conditions for effective competition on the market; or*
>
> 2. *impedes, by object or effect, such competition from occurring or developing.*
>
> *A prohibition may not be imposed in relation to conduct that is justifiable on public interest grounds.*
>
> *A municipality or a county council may be prohibited from carrying out a certain activity, in the context of offering goods or services, in cases considered in the first paragraph. However, such an activity may not be prohibited if it is compatible with law.*
>
> *A prohibition is immediately enforceable, unless otherwise decided.*
>
> *[Ch.3 §32] Cases concerning prohibitions […] are tried by the Stockholm District Court on application by the Swedish Competition Authority. Pleadings concerning a re-examination of an issued prohibition may also be brought by the entity against whom the prohibition has been imposed.*
>
> *If the Swedish Competition Authority as regards a certain case decides not to apply for a prohibition [...], the undertaking affected by the conduct or activity in question may apply for a prohibition to be imposed.*[12]

This prohibition is a *complement* to the two general antitrust prohibitions, i.e. on anti-competitive agreements and abuse of a dominant position, which of course both remain applicable *vis-à-vis* public entities (see also below, Section 5). In the event a certain conduct or activity which distorts or impedes competition affects the trade between EU Member states and, hence, falls within the scope of Article 81 and/or Article 82, those provisions will be applied in accordance with EC Regulation 1/2003.[13]

For this proposed "third prohibition" to be applicable, a number of criteria need to be met. At the same time, there are some important differences to the criteria in Articles 81 and 82 and their national equivalents in the Competition Act:

Group of criteria	The proposed provision	Article 81 / Competition Act §2:1	Article 82 / Competition Act §2:7
Possibility to prohibit future conduct ('cease and desist')	Yes	Yes	Yes
Possibility of imposing penalties (fines, etc.)	**No**	Yes	Yes
Entity	**Public** entity (state, municipality or county council) **offering goods or services**	Undertakings (public *or* private)	Dominant undertaking (public *or* private)
Type of action	**Conduct** (state, municipality or county council) or **activity** (municipality or county council, i.e. *not* state)	*Agreement* or concerted practice	*Abusive conduct*
Effect on competition	**Distorts** *or* ***impedes*** competition, by object or effect	*Prevents, restricts* or *distorts* competition, by object or effect	Effect on structure of competition; or no effect[14]
Market impact	Conduct/Activity of some **'significance'**	De minimis (10/15% market share), unless hardcore	
Exception	Compatible with **law** or justifiable on **public interest** grounds	Individual or block exemption (Art. 81.3)[15]	(Objective justification)

4.3.1 Sanctions

The proposed new legislation will apply to **future** conduct in the sense that no penalties can be imposed for *past* conduct or activities. The prohibition will instead apply to the future, similar to the 'cease and desist' obligation in cases

concerning Articles 81 and 82, and a violation of such a prohibition decision can be made subject to a fine.

4.3.2 Entity

As mentioned above, when applying §§2:1 and 2:7 of the Competition Act, which mirror Articles 81 and 82, vis-à-vis public entities, it may be difficult to ascertain whether a public entity constitutes an 'undertaking' for the purpose of these rules. This can, e.g., be due to the social aspects and the entity's mix of commercial activities and tasks of a public authority. EC case law has confirmed that one and the same entity can constitute an undertaking for the purpose of the antitrust rules insofar as an activity is economic in nature, whilst as regards tasks typical of state authorities, the entity would be considered as a public authority. However, the process of ascertaining which activity of a public entity's operations that is commercial and which one that is not can be onerous and raises challenges to applying the general antitrust rules effectively vis-à-vis public entities.

The current proposal will apply to **public *undertakings*** and the notion of undertaking still follows the established definition in competition law, i.e. the key criterion is the economic *activity*, not the legal status of the entity or the way in which it is financed. However, the wording of the provision further *clarifies* that it applies to the *state, county councils and municipalities* when engaging in the *offering of goods or services*, as well as companies controlled by the state, county councils and municipalities. Thus, although *purchasing* activity is not covered[16], it removes any doubts as to whether the rule applies to a *public* entity, which in some cases may exist when applying the main antitrust rules. Moreover, there is *no* requirement to demonstrate that the entity in question holds a dominant position, as in Article 82 cases.

4.3.3 Type of action

The type of actions covered by the proposed rules will concern "*conduct*" and "*activities*".

'**Conduct'** for the purpose of the proposed rule covers both actual *actions* and a *failure* to act. The conduct can be ongoing; have ceased; or be planned and likely to occur. Examples of conduct that may be covered are listed above in Section 4.1 (see also below, Section 4.3.4).

Municipalities or county councils may also be prohibited from carrying out an **activity**, consisting of offering goods or services, if that activity (i) distorts, by object or effect, the conditions for effective competition on the market; or (ii) impedes, by object or effect, such competition from occurring or developing. However, it follows from the wording that, although state *conduct* when offering goods or services can be prohibited (as explained above), state *activities* cannot.

In order for conduct/activities by a public entity to be prohibited under the proposed rule, there is *no* requirement to establish an *agreement* or concerted practice, as in Article 81 cases.[17]

4.3.4 Effect on competition

In each case, the SCA will assess whether the conduct/activity is harmful to the conditions for competition or alters the structure of competition. The substantive test of the new rule is proposed to cover certain conduct or an activity that:

- **distorts**, by object or effect, **conditions** for effective competition on the market (§27, para. 1(1)); *or*

- **impedes**, by object or effect, such competition from **occurring** or **developing** (§27, para. 1(2)).

As regards **distortion** of conditions for effective competition in the first tier of the test, this takes aim at situations where *existing* competition is not on as equal terms as possible; e.g., a public entity benefiting from unjustified advantages as a result of having a role as an authority parallel to its commercial role in the market. Typical instances of distortion include below-cost selling, discrimination and refusal of access to certain infrastructure.

As is clear from the above, **impeding** the occurrence or development of effective competition is potentially wider than the scope of e.g. Article 81 (i.e. "*...prevention, restriction or distortion of competition...*") and takes aim at situations where the private alternative exits the market, or does not even enter the market, as a result of the conduct. It also covers instances where the expansion or development of private undertakings is hampered by the conduct. Examples could include situations where the mere presence of a public entity makes it more difficult for a private undertaking to expand or creates a barrier to entry; so-called foreclosure effects.

It should be noted that the Bill does not contain any list of conduct or activities that would be considered as distorting or impeding competition *per se*, such as in Article 81. Each case will therefore need to be assessed individually on its merits.

4.3.5 Market impact

According to the Bill, the competition distortion/impediment resulting from the conduct/activity in question must be of some significance. However, the preparatory works to the proposed legislation do not provide any further guidance on the level of market impact required to meet the 'significance' test (e.g. a particular market share below which the conduct/activity would be regarded as falling outside the scope of the provision similar to the "*de minimis*" test under Article 81).[18] Hence, it is expected that this will be developed through case law.

4.3.6 Exception

The following conduct/activities may not be prohibited:

- *Conduct* that is found to be justifiable on **public interest** grounds; and
- *Activities* carried out by county councils or municipalities which are compatible with **law**.

The scope of this justification is somewhat wider than the exception set out in Article 81(3) of the EC Treaty in that there is (a) no explicit requirement to demonstrate a fair share of the benefit for consumers (although that may be considered as covered by "public interest" as regards certain conduct); and (b) no requirement to demonstrate that competition is not eliminated as a result of the conduct/activity.

However, when assessing whether certain *conduct* is justifiable on public interest grounds or not, it should be considered whether the public interest objective can be attained by other less restrictive means. If they can, the conduct cannot be considered justifiable on public interest grounds. Moreover, if the conduct harms competition, the alleged reasons for a justification must have certain weight and importance. This means that the principle of proportionality applies, i.e. in order to justify conduct with more severe anti-competitive effects, the reasoning to support the alleged public interest must be all the more substantiated.

The justification assessment should in particular take into account whether the conduct is in breach of other laws or regulations, e.g. the LGA. When a conduct is a direct and intended effect of specific regulations, or is an inevitable result of such regulations, it will be considered justifiable on public interest grounds. E.g. as regards conduct covered by Article 82 but considered compatible with Article 86, the conduct in question would generally be considered justified on public interest grounds. A justification assessment shall also take into account whether the motives of the conduct were external, i.e. the public need for the public offering of goods/services; or internal, i.e. concerning the entity's own interests, e.g. to keep employees. External motives may be considered as justifiable on public interest grounds, whilst internal may not.

If an *activity* carried out by a municipality or a company owned by a municipality is compatible with the LGA it shall be considered as justified on public interest grounds and, hence, cannot be prohibited. However, it should be noted that there is nothing preventing a prohibition being imposed on an activity carried out by a municipality, which is *outside* the scope of the powers allocated to municipalities in the LGA or related case law.

4.4 Monitoring and enforcement

The monitoring and enforcement of the proposed rules, if adopted, will be the responsibility of the **SCA**, who decides whether to apply to the **District Court** for an injunction to prohibit the conduct/activity in question. The prohibition decision can be made subject to a fine.

The SCA can make the above application either at its own initiative or further to a complaint having been lodged. The District Court may, where there are special reasons, also adopt an interim decision to prohibit certain conduct/activity.

However, should the SCA choose not to bring a case before the District Court, an **undertaking affected** by a certain conduct or activity will have standing before the District Court to apply for a Court order prohibiting the conduct/activity in question.

This means that a prerequisite for undertakings affected by the conduct/activity in question to have *locus standi* is that an SCA decision *not* to investigate the complaint has been issued.

A judgment by the District Court can be appealed to the Market Court in accordance with the Competition Act, §7:2.

5 Competition law enforcement and public entities

In addition to applying the proposed new rules, the SCA will continue to enforce the following legislation *vis-à-vis* public entities, as and when applicable:

- the general antitrust provisions in the Competition Act, i.e. §2:1 and §2:7; and Articles 81 and 82;
- the rules on public procurement, as contained in the Public Procurement Act, which is based on EC legislation; and
- the Transparency Act, which is based on the so-called EC Transparency Directive.[19]

However, as explained above (see Section 4.2), the SCA has faced some difficulties in applying the general antitrust rules in the public sector. The SCA therefore welcomes the new legislative initiative described above, which will provide the SCA with further tools to tackle these competition issues that often arise between public and private entities. It is the SCA's expectation that the new rules will have a preventive effect and disencourage public entities from engaging in commercial activities. Practice will show how extensive the rules will prove to be and, e.g., how the "public interest defence" will be interpreted by the Courts.

NOTES

[1] See DAF/COMP(2004)36, p. 227 et seq.
[2] Statistiska Centralbyrån (Statistics Sweden): "*Offentlig Ekonomi 2009*" ("*Public Finances in Sweden 2009*"), p. 31-35, available at:
http://www.scb.se/statistik/_publikationer/OE0903_2009A01_BR_OE06BR0901.pdf
[3] This is wider than the geographic borders of the municipality, as it has been considered that an activity outside the municipality still can concern its "members", which are defined as *persons resident in the municipality* or who *own estates* in the municipality. For *legal persons* it is not sufficient to be based in the municipality; these must therefore *own an estate* registered in the municipality to be considered a "member".
[4] The Swedish Administrative Courts have, e.g., considered energy supply, providing housing and public transport, as well as erecting sports and parking facilities to fall within the municipalities' remit. Moreover, certain activities that, taken alone, would have fallen outside the scope of a municipality's powers, have been allowed by the Courts when the activity has been neighbouring to an activity which fell within the municipal competence (e.g. selling gravel from public gravel pits).
[5] A similar principle is contained in the Regulation on Fees that applies to state agencies but this generally works as a recommendation, unlike the principle in the LGA, which is compulsory.
[6] Public entities active in the sectors of district heating, electricity, networks and gas industries are exempted from this principle but it does apply to public entities that sell/provide goods/services in other business areas subject to competition. As regards activities where competition issues arise as a result of the Prime Cost principle, it should also be noted that the Government is keeping under review as to whether a general exemption from the Prime Cost principle should be adopted in the case of activities on open markets subject to competition.
[7] Only "members" (see above) of the municipality can launch an appeal. An appeal must be made within three weeks of a decision being taken by the municipality and if no appeal is made within this period, the decision takes legal effect even if it was illegal. Decisions by companies owned by municipalities, e.g. to start offering a product/service, cannot be appealed (however, the municipality's decisions concerning the scope of the company's articles of association or its activities can be appealed, as long as such appeals are brought within the above-mentioned three-week time period).
[8] In Sweden, a state authority may submit its own bid in a public procurement that it has initiated itself.
[9] I.e. "*...the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers*"; see e.g. Case 27/76 *United Brands v Commission* [1978] ECR 207, para. 65; Case 85/76 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, para. 38.
[10] E.g. the European Commission is trying not to apply a too rigid view of dominance that would focus solely on market shares (see e.g. Guidance on the Commission's enforcement priorities in applying Article 82 to abusive exclusionary conduct by dominant undertakings) but it may still prove difficult to demonstrate dominance in cases where the undertaking in question holds a market share well below 40-50%.
[11] E.g., the Prime Cost principle (see above) often results in prices being charged at such a low level that private undertakings find it difficult to compete. Thus, although the prices may not necessarily be below cost and the intention of the public entity may not be to eliminate competition, the anti-competitive effect may in some cases be similar to that of predatory pricing by a dominant undertaking. However, because the price is not set below cost and/or the intention of the entity in question is not "predatory", as defined in case law, these provisions would not be applicable on the conduct in question.
[12] This is not an official translation of the proposed legislation.

[13] See Article 3, Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ 2003 L1/1.
[14] Cf. European Commission decision of 20 July 1999, Case IV/36.888, *1998 Football World Cup*, OJ 2000 L5/55, para. 100, i.e. "Article 82 can (...) be applied (...) to situations in which a dominant undertaking's behaviour direct prejudices the interests of consumers, notwithstanding the absence of any effect on the structure of competition". Although "the application of Article 82 often requires an assessment of the effect of an undertaking's behaviour on the structure of competition (...), its application in the absence of such an effect cannot be excluded."
[15] I.e. economic or other benefit; fair share of benefits for consumers; indispensability of restriction; and no elimination of competition.
[16] The scope is therefore somewhat narrower in that respect than the definition of 'undertaking' in EC case law, which may cover *some* purchasing activity; cf. Case C-205/03P *FENIN v Commission* ECR [2006] I-6295; Case T-319/99 *FENIN v Commission* ECR [2003] II-357.
[17] Indeed, further to Article 3 of Regulation 1/2003, the proposed rule would not be applicable in a case concerning an anti-competitive agreement that affects trade between Member states.
[18] Cf. European Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) (de minimis), OJ 2001 C368/13.
[19] Commission Directive 2006/111/EC on the transparency of financial relations between Member states and public undertakings as well as on financial transparency within certain undertakings, OJ 2006 L318/17.